

**DEPARTMENT OF THE TREASURY**

**31 CFR Part 103**

**RIN 1506-AA32**

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 240**

**[Release No. 34-46192, File No. S7-25-02]**

**Customer Identification Programs For Broker-Dealers**

**AGENCIES:** Financial Crimes Enforcement Network, Treasury; Securities and Exchange Commission.

**ACTION:** Joint notice of proposed rulemaking.

**SUMMARY:** The Department of the Treasury, through the Financial Crimes Enforcement Network (FinCEN), and the Securities and Exchange Commission are jointly issuing a proposed regulation to implement section 326 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (the Act). Section 326 requires the Secretary of the Treasury to jointly prescribe with the Securities and Exchange Commission a regulation that, at a minimum, requires broker-dealers to implement reasonable procedures to verify the identity of any person seeking to open an account, to the extent reasonable and practicable; maintain records of the information used to verify the person's identity; and determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the broker-dealer by any government agency.

**DATES:** Written comments on the proposed rule may be submitted to the Treasury Department and the Securities and Exchange Commission on or before [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** Because paper mail in the Washington area may be subject to delay, commenters are encouraged to e-mail comments. Comments should be sent by one method only.

Treasury: Comments may be mailed to FinCEN, Section 326 Broker-Dealer Rule Comments, P.O. Box 39, Vienna, VA 22183, or sent to Internet address [regcomments@fincen.treas.gov](mailto:regcomments@fincen.treas.gov) with the caption “Attention: Section 326 Broker-Dealer Rule Comments” in the body of the text. Comments may be inspected at FinCEN between 10 a.m. and 4 p.m. in the FinCEN Reading Room in Washington, D.C. Persons wishing to inspect the comments submitted must request an appointment by telephoning (202) 354-6400 (not a toll-free number).

Securities and Exchange Commission: Comments also should be submitted in triplicate to Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments also may be submitted electronically at the following e-mail address: [rulecomments@sec.gov](mailto:rulecomments@sec.gov). Comment letters should refer to File No. S7-25-02; this file number should be included on the subject line if e-mail is used. All comments received will be available for public inspection and copying at the Commission’s Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549-0102. Electronically submitted comment letters will be posted on the Commission’s Internet web site (<http://www.sec.gov>). Personal identifying

information, such as names or e-mail addresses, will not be edited from electronic submissions. Submit only information you wish to make publicly available.

**FOR FURTHER INFORMATION CONTACT:**

Treasury: Office of the Chief Counsel (FinCEN), 703/905-3590; Office of the Assistant General Counsel for Enforcement (Treasury), 202/622-1927; or the Office of the Assistant General Counsel for Banking & Finance (Treasury), 202/622-0480.

Securities and Exchange Commission: Division of Market Regulation, 202/942-0177 or [marketreg@sec.gov](mailto:marketreg@sec.gov).

**SUPPLEMENTARY INFORMATION:**

**I. Background**

**A. Section 326 of the USA PATRIOT Act**

On October 26, 2001, President Bush signed into law the USA PATRIOT Act.<sup>1</sup> Title III of the Act, captioned "International Money Laundering Abatement and Anti-terrorist Financing Act of 2001," adds several new provisions to the Bank Secrecy Act (BSA). See 31 U.S.C. 5311 et seq. These provisions are intended to facilitate the prevention, detection, and prosecution of international money laundering and the financing of terrorism.

Section 326 of the Act adds a new subsection (l) to 31 U.S.C. 5318 that requires the Secretary of the Treasury (Secretary) to prescribe regulations setting forth minimum standards for financial institutions and their customers regarding the identity of the customer that shall apply in connection with the opening of an account at the financial institution.

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<sup>1</sup> Pub. L. 107-56.

Section 326 applies to all "financial institutions." This term is defined very broadly in the BSA to encompass a variety of entities including banks, agencies and branches of foreign banks in the United States, investment companies, thrifts, credit unions, brokers and dealers in securities or commodities, insurance companies, travel agents, pawnbrokers, dealers in precious metals, check-cashers, casinos, and telegraph companies, among many others. See 31 U.S.C. 5312(a)(2).

For any financial institution engaged in financial activities described in section 4(k) of the Bank Holding Company Act of 1956 (section 4(k) institutions), the Secretary is required to prescribe the regulations issued under section 326 jointly with each Federal functional regulator appropriate for such financial institution. The Federal functional regulators include the Securities and Exchange Commission (Commission), the Commodity Futures Trading Commission (CFTC), and the banking agencies (banking agencies), namely, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration. Final regulations implementing section 326 must be effective before October 25, 2002.

Section 326 provides that the regulations, at a minimum, must require financial institutions to implement reasonable procedures for (1) verifying the identity of any person seeking to open an account, to the extent reasonable and practicable; (2) maintaining records of the information used to verify the person's identity, including name, address, and other identifying information; and (3) determining whether the person appears on any lists of known

or suspected terrorists or terrorist organizations provided to the financial institution by any government agency.

In prescribing these regulations, the Secretary is directed to take into consideration the various types of accounts maintained by various types of financial institutions, the various methods of opening accounts, and the various types of identifying information available.

The following proposal is being issued jointly by Treasury and the Commission. It applies only to persons registered, or required to be registered, with the Commission as brokers or dealers under the Securities Exchange Act of 1934 (Exchange Act), except persons who register pursuant to paragraph (b)(11) of section 15 of the Exchange Act (15 U.S.C. 78o(b)(11)) solely because they effect transactions in security futures products. This class of brokers and dealers will be subject to regulations issued by Treasury and the CFTC separately. Regulations governing the applicability of section 326 to other financial institutions, such as those regulated by the banking agencies, will be issued separately as well.

Treasury, the Commission, the CFTC and the banking agencies consulted extensively in the development of all rules implementing section 326 of the Act. All of the participating agencies intend the effect of the rules to be uniform throughout the financial services industry.

The Secretary has determined that the records required to be kept by section 326 of the Act have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, to protect against international terrorism.

In addition, Treasury under its own authority is proposing conforming amendments to 31 CFR 103.35, which currently imposes requirements concerning the identification of bank customers.

### **B. Codification of the Joint Proposed Rule**

The substantive requirements of the joint proposed rule will be codified with other BSA regulations as part of Treasury's regulations in 31 CFR Part 103. To minimize potential confusion by affected entities regarding the scope of the joint proposed rule, the Commission is also proposing to add a provision in its own regulations in 17 CFR 240 that will cross-reference the regulations in 31 CFR Part 103. Although no specific text is being proposed at this time, the cross-reference will be included in a final rule published by the Commission concurrently with the joint final rule issued by Treasury and the Commission implementing section 326 of the Act.

## **II. Section-by-Section Analysis**

### **A. § 103.122(a) Definitions**

§ 103.122(a)(1) Account. The proposed rule's definition of "account" is intended to include all types of securities accounts maintained by brokers or dealers. These include accounts to purchase, sell, lend or otherwise hold securities or other assets, cash accounts, margin accounts, prime brokerage accounts that consolidate trading done at a number of firms, and accounts for repurchase and stock loan transactions.

§ 103.122(a)(2) Broker-dealer. The proposed rule defines “broker-dealer” to include any person registered, or required to be registered, with the Commission as a broker or dealer under the Exchange Act, except persons who register, or are required to be registered, solely because they effect transactions in security futures products. These latter brokers or dealers, which register with the Commission pursuant to section 15(b)(11) of the Exchange Act, will be subject to a separate regulation issued jointly by Treasury and the CFTC implementing section 326.

§ 103.122(a)(3) Commission. The proposed rule defines “Commission” to mean the United States Securities and Exchange Commission.

§ 103.122(a)(4) Customer. The proposed rule defines “customer” as any person who opens a new account at a broker-dealer or is granted trading authority with respect to an account at a broker-dealer. Under this definition, a person who has an account at a broker-dealer prior to the effective date of the regulation would not be a “customer.” However, such a person becomes a “customer” if the person opens a different account. Moreover, a person becomes a “customer” each time the person opens a different type of account at a broker-dealer. Thus, if a person opens a cash account and subsequently opens a margin account, the person would be a “customer” for verification purposes on both occasions.

Similarly, a person with trading authority prior to the effective date of the regulation is not a “customer.” However, any person being granted trading authority after the effective date is a customer. This is true even if the person is granted trading authority with respect to

an account that existed prior to the effective date or the person had been granted trading authority for another account prior to the effective date.

The requirements of section 326 apply to “customers” (i.e., persons opening new accounts or being granted trading authority), but do not apply to persons seeking information about an account such as a schedule of transaction fees, if an account is not opened. In addition, transfers of accounts from one broker-dealer to another that are not initiated by the customer, for example as a result of a merger, acquisition, or purchase of assets or assumption of liabilities, fall outside of the scope of section 326, and are not covered by the proposed regulation.<sup>2</sup>

§ 103.122(a)(5) Person. The proposed rule defines “person” as having the same meaning as that term is defined in section 103.11(z). Thus, the term includes natural persons, corporations, partnerships, trusts or estates, joint stock companies, associations, syndicates, joint ventures, any unincorporated organizations or groups, Indian Tribes, and all entities cognizable as legal entities.

§ 103.122(a)(6) U.S. person. The proposed rule defines “U.S. person” because U.S. citizens and persons incorporated under U.S. laws will be required to provide U.S. tax identification numbers whereas other persons, who may not have a U.S. tax identification number, will be required to provide other similar numbers. Thus, the rule defines “U.S.

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<sup>2</sup> However, there may be situations involving the transfer of accounts where it would be appropriate for a broker-dealer to verify the identity of customers associated with the accounts it is acquiring. Therefore, Treasury and the Commission expect procedures for transfers of accounts to be part of a broker-dealer's overall anti-money laundering program required under section 352 of the Patriot Act. See Footnote 5 infra for a discussion of the requirements of section 352.



person” to mean a U.S. citizen or, for persons other than natural persons, an entity established or organized under the laws of a State or the United States.<sup>3</sup>

§ 103.122(a)(7) Non-U.S. person. The proposed rule defines a “Non-U.S. person” as a person that is not a “U.S. person” as that term is defined in the rule.

§ 103.122(a)(8) Taxpayer identification number. The proposed rule defines “taxpayer identification number” to have the same meaning as determined under the provisions of section 6109 of the Internal Revenue Code and the regulations of the Internal Revenue Service thereunder.

**B. § 103.122(b) Customer Identification Program**

Section 326 of the Act requires the Secretary and the Commission to prescribe regulations requiring broker-dealers to implement and comply with “reasonable procedures” for: verifying the identity of customers “to the extent reasonable and practicable;” maintaining records associated with such verification; and consulting lists of known terrorists.

Paragraph (b) of the proposed rule sets forth the requirement that a broker-dealer must develop and operate a customer identification program (“CIP”) and sets forth relevant factors for the design of CIP procedures. The degree to which a CIP is effective will be a function of a broker-dealer’s assessment of these factors and the nature of its response to them (as manifested in the CIP’s procedures and guidelines). In addition, as section 326 and the proposed rule provide, the reasonableness of the CIP also will be a function of what is practicable for the broker-dealer.

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<sup>3</sup> The terms “State” and “United States” are defined in section 103.11.

In developing and updating CIPs, broker-dealers should consider the type of identifying information available for customers and the methods available to verify that information.

While certain minimum identifying information is required in paragraph (c) of this proposed rule and certain suitable verification methods are described in paragraph (d), broker-dealers should consider on an ongoing basis whether other information or methods are appropriate, particularly as they become available in the future.

Broker-dealers must also base their CIPs on the risks associated with their business operations. Some relevant risk factors to be considered are set forth in paragraph (b) and discussed below in general terms.<sup>4</sup>

The first risk factor to consider is the broker-dealer's size. For example, a large firm that opens a substantial number of accounts on any given day will have different risks than one that opens a new account no more than once or twice a month. The same is true with respect to a firm that has many branches as compared to a firm with one office.

The second risk factor is the location of the broker-dealer. Firms should assess whether they are located in areas where money laundering activities have been known to exist or that otherwise raise the risk that attempts will be made to open accounts for money laundering purposes.

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<sup>4</sup> This discussion of the risk factors is included in the release because it may be helpful in providing some meaning and context with respect to the factors. However, it is not meant to provide comprehensive definitions of these risk factors or an exhaustive description of the considerations involved in assessing them. Instead, it should serve as a starting point for defining and assessing them.

The third risk factor is the method by which customers open accounts at the broker-dealer. Accounts opened exclusively on-line present different, and perhaps greater, risks than those opened in person on the firm's premises.

The fourth and fifth risk factors are the types of accounts and transactions offered by the broker-dealer. Broker-dealers should assess whether there are different risks (and degrees of risk) associated with the various types of accounts they provide to customers (e.g., cash, margin, prime-brokerage) and transactions they execute in those accounts (e.g., short sales, over-the-counter derivatives, repurchase and reverse repurchase agreements, block trades).

The sixth risk factor is the customer base. Broker-dealers should assess the risks associated with different types of customers. For example, a firm should examine whether it is opening accounts for customers located in countries the Secretary determines to be of "primary money laundering concern" pursuant to section 311 of the Act. Verification procedures should account for the concerns raised by such customers. In addition, certain legal entities may pose greater risks (e.g., a closely held corporation as opposed to one that is publicly traded).

The seventh risk factor requires an assessment of whether the broker-dealer can rely on another broker-dealer, with which it shares an account relationship, to undertake any of the steps required by this proposed rule with respect to the shared account. A shared account means an account subject to a carrying or clearing agreement governed by New York Stock Exchange (NYSE) Rule 382 or National Association of Securities Dealers, Inc. (NASD) Rule 3230 (i.e., a customer account introduced by a correspondent broker-dealer to a clearing and carrying broker-dealer). Rules 382 and 3230 allow correspondents and clearing firms to set

forth in written agreements a division of responsibilities with respect to the accounts they share.

We anticipate broker-dealers sharing accounts may realize efficiencies by dividing up the requirements in this proposed rule pursuant to their clearing agreements. For example, the correspondent may undertake to obtain the identifying information from customers as required in paragraph (c), and the clearing firm may undertake the verification procedures as required in paragraph (d). Nonetheless, both firms would still be responsible for ensuring that each requirement in the rule is met with respect to each customer. Accordingly, a broker-dealer must continually assess whether the other firm can be relied on to perform its responsibilities. This would include communicating and coordinating with the other firm on an on-going basis. Moreover, a broker-dealer is expected to cease such reliance if it is no longer reasonable.

Paragraph (b) also requires that the identity verification procedures must enable the broker-dealer to form a reasonable belief that it knows the true identity of the customer. This provision makes clear that, while there is flexibility in establishing these procedures, the broker-dealer is responsible for exercising reasonable efforts to ascertain the identity of each customer.

Finally, paragraph (b) requires that broker-dealers make their CIPs part of their overall anti-money laundering programs required under section 352 of the Act (31 U.S.C. 5318(h)).<sup>5</sup>

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<sup>5</sup> Section 352 requires brokers and dealers to establish anti-money laundering programs that, at a minimum, include (1) the development of internal policies, procedures, and controls; (2) the designation of a compliance officer; (3) an ongoing employee training program; and (4) an independent audit function to test programs. On April 22, 2002, the Commission approved rule changes submitted by the NASD and the NYSE.

This requirement is intended to make it clear that the CIP is not a separate program, but rather should be integrated into a broker-dealer's overall anti-money laundering procedures and policies. However, this should not be read to create any negative inference about a broker-dealer's need to establish and maintain an overall money laundering program that is designed to ensure compliance with all other applicable regulations promulgated under the Act.

**C. § 103.122(c) Required Information**

The first step in verifying identity is obtaining identifying information from customers. Paragraph (c) of the proposed rule provides that a broker-dealer's CIP must require customers to provide, at a minimum, certain identifying information before an account is opened for the customer or the customer is granted trading authority over an account. Specifically, the broker-dealer must obtain each customer's: (1) name; (2) date of birth, if applicable; (3) addresses;<sup>6</sup> and (4) documentary number.<sup>7</sup>

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Exchange Act Release No. 45798 (April 22, 2002), 67 FR 20854 (April 26, 2002). These rules (NASD Rule 3011 and NYSE Rule 445) set forth minimum requirements for these programs.

<sup>6</sup> With respect to the address requirement, each customer must provide a mailing address, and, if different, the address of the customer's residence (if a natural person) or principal place of business (if not a natural person).

<sup>7</sup> Each customer that is a U.S. person must provide a U.S. taxpayer identification number (e.g., social security number or employer identification number). Customers that are Non-U.S. persons must provide either a U.S. taxpayer identification number, an alien identification card number, or the number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard. The term "similar safeguard" is included to permit the use of any biometric identifiers that may be used in addition to, or instead of, photographs.

The rule requires only that the minimum identifying information be obtained from each customer. Broker-dealers, in assessing the risk factors in paragraph (b), should determine whether other identifying information is necessary to form a reasonable belief as to the true identity of each customer. There may be certain types of customers from whom it is reasonable to obtain other identifying information in addition to the minimum required information. There also may be circumstances that make it appropriate to obtain additional information. If a broker-dealer, in examining the nature of its business and operations, determines that additional information should be obtained in certain cases, it should set forth guidelines in its CIP indicating the types of additional information and the circumstances when it shall be obtained.

Treasury and the Commission recognize that a new business may need to open a brokerage account before it has received an employer identification number (EIN) from the Internal Revenue Service. For this reason, the proposed rule contains a limited exception to the requirement that a taxpayer identification number must be provided prior to the opening of an account or the granting of trading authority. Accordingly, a CIP may permit an account to be opened or trading authority to be granted for a person, other than an individual (such as a corporation, partnership or trust), that has applied for, but has not received, an EIN. However, in such a case, the CIP must require that the broker-dealer obtain a copy of the application for the EIN prior to the time the account is opened or trading authority granted. Currently, the IRS indicates that the issuance of an EIN can take up to five weeks. This length of time, coupled with when the person applied for the EIN, should be considered by the

broker-dealer in determining the reasonable period of time within which the person should provide its EIN to the broker-dealer.

**D. § 103.122(d) Required Verification Procedures**

After obtaining identifying information from a customer, the broker-dealer must take steps to verify the accuracy of that information in order to reach a point where it can form a reasonable belief that it knows the true identity of the customer. Accordingly, paragraph (d) of the proposed rule requires a broker-dealer's CIP to have procedures for verifying the accuracy of the identifying information provided by the customer. The extent of the verification for each customer will depend on the steps necessary for a broker-dealer to reach a reasonable belief that it knows the true identity of the customer.

Paragraph (d) requires that the verification procedures must be undertaken within a reasonable time before or after a customer's account is opened or a customer is granted authority to effect transactions with respect to an account. This flexibility must be exercised in a reasonable manner, given that verifications too far in advance may become stale and verifications too long after the fact may provide opportunities to launder money while verification is pending. The amount of time it will take a broker-dealer to verify the identity of a customer may depend on the type of account opened, whether the customer opens the account in person, and on the type of identifying information available. In addition, although an account is opened, a broker-dealer may choose to place limits on the account, such as restricting the number of transactions or the dollar value of transactions, until a customer's identity is verified. Therefore, the proposed rule provides broker-dealers with the flexibility to

use a risk-based approach to determine when the identity of a customer must be verified relative to the opening of an account or the granting of trading authority.<sup>8</sup>

A person becomes a customer each time the person opens a new account at a broker-dealer or is granted trading authority with respect to an account. Therefore, upon the opening of each account or the granting of new authority, the verification requirements of this rule would apply. However, if a customer whose identification has been verified previously opens a new account or is granted new authority, the broker-dealer would not need to verify the customer's identity a second time, provided the broker-dealer (1) previously verified the customer's identity in accordance with procedures consistent with the proposed rule, and (2) continues to have a reasonable belief that it knows the true identity of the customer.

The rule provides for two methods of verifying identifying information: verification through documents and verification through non-documentary means. For example, using documents would include obtaining a driver's license or passport from a natural person or articles of incorporation from a company. Non-documentary methods would include cross-checking the information provided by a customer against that supplied by a credit bureau.

The proposed rule requires that a broker-dealer's CIP address both methods of verification. Depending on the type of customer and the method of opening an account, it may be more appropriate to use either documentary or non-documentary methods. In some cases, it may be appropriate to use both methods. The CIP should set forth guidelines

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<sup>8</sup> We note that it is possible a broker-dealer could violate other laws by permitting a customer to transact business prior to verifying the customer's identity. See, e.g., 31 CFR part 500, prohibiting transactions involving designated foreign countries or their nationals.



describing when documents, non-documentary methods, or a combination of both will be used. These guidelines should be based on the broker-dealer's assessment of the factors described in paragraph (b) of the proposed rule.

The risk a broker-dealer will not know a customer's true identity will be heightened for certain types of accounts, such as accounts opened in the name of a corporation, partnership, or trust that is created or conducts substantial business in a jurisdiction the Secretary determines is a primary money laundering concern or an international body, such as the Financial Action Task Force on Money Laundering, designates as non-cooperative. Obtaining sufficient information to verify a given customer's true identity can reduce the risk a broker-dealer will be used as a conduit for money laundering and terrorist financing. A broker-dealer's identity verification procedures must be based on its assessments of the factors in paragraph (b). Accordingly, when those assessments suggest a heightened risk, the broker-dealer should prescribe additional verification measures.

#### **1. Verification through documents**

Paragraph (d)(1) provides that the CIP must describe when a broker-dealer will verify identity through documents and set forth the documents that will be used for this purpose. The rule also lists certain documents that are suitable for verification. For natural persons, these documents may include: unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard. For other persons, suitable documents would be ones showing the existence of the entity, such as registered articles of incorporation, a government-issued business license, a partnership agreement, or a trust instrument.

## **2. Verification through non-documentary methods**

Paragraph (d)(2) provides that the CIP must describe non-documentary verification methods and when such methods will be employed in addition to, or instead of, using documents. The rule allows for the exclusive use of non-documentary methods because frequently accounts are opened by telephone, mail, or over the Internet. However, even if the customer presents documents, it may be appropriate to use non-documentary methods as well. Ultimately, the broker-dealer is responsible for employing sufficient verification methods to be able to form a reasonable belief that it knows the true identity of the customer.

The proposed rule sets forth certain non-documentary methods that would be suitable for verifying identity. These methods include contacting a customer after the account is opened;<sup>9</sup> obtaining a financial statement; comparing the identifying information provided by the customer against fraud and bad check databases to determine whether any of the information is associated with known incidents of fraudulent behavior (negative verification); comparing the identifying information with information available from a trusted third party source, such as a credit report from a consumer reporting agency (positive verification); and checking references with other financial institutions. The broker-dealer also may wish to analyze whether there is logical consistency between the identifying information provided, such as the customer's name, street address, ZIP code, telephone number (if provided), date of birth, and social security number (logical verification).

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<sup>9</sup> The purpose of engaging in verification is to check identifying information about a customer against an independent source. Contacting a customer may be a useful part of the verification process when an account is opened on-line or by mail. However, a broker-dealer should not rely solely on this method as a means of verification.

Paragraph (d)(2) also provides that the CIP must require the use of non-documentary methods in certain cases; specifically, when a natural person is unable to present an unexpired government issued identification document that bears a photograph or similar safeguard and when the broker-dealer is presented with unfamiliar documents to verify the identity of a customer, does not obtain documents to verify the identity of a customer, does not meet face-to-face a customer who is a natural person, or is otherwise presented with circumstances that increase the risk the broker-dealer will be unable to verify the true identity of a customer through documents.

Thus, non-documentary methods should be used when a broker-dealer cannot examine original documents. In addition, Treasury and the Commission recognize that identification documents, including those issued by a government entity, may be obtained illegally and may be fraudulent. In light of the recent increase in identity fraud, broker-dealers are encouraged to use non-documentary methods, even when a customer has provided identification documents.

**E. § 103.122(e) Government Lists**

Section 326 of the Act also requires reasonable procedures for determining whether a customer appears on any list of known or suspected terrorists or terrorist organizations provided by any government agency. The proposed rule implements this requirement and clarifies that the requirement applies only with respect to lists circulated by the Federal government. In addition, the proposed rule states that broker-dealers must follow all Federal directives issued in connection with such lists. This provision makes clear that a broker-

dealer must have procedures for responding to circumstances when a customer is named on a list.

**F. § 103.122(f) Customer Notice**

Section 326 provides that financial institutions must give their customers notice of their identity verification procedures. Therefore, a broker-dealer's CIP must include procedures for providing customers with adequate notice that the broker-dealer is requesting information to verify their identity. A broker-dealer may satisfy the notice requirement by generally notifying its customers about the procedures the broker-dealer must comply with to verify their identities. For example, the broker-dealer may post a sign in its lobby or provide customers with any other form of written or oral notice. If an account is to be opened electronically, such as through an Internet website, the broker-dealer may provide notice electronically. Notice must be given before an account is opened or trading authority is granted.

**G. §103.122(g) Lack of Verification**

Paragraph (g) of the proposed rule states that a broker-dealer's CIP must include procedures for responding to circumstances in which it cannot form a reasonable belief that it knows the true identity of a customer. Generally, a broker-dealer should maintain an account for a customer only when it can form a reasonable belief that it knows the customer's true identity.<sup>10</sup> Thus, a broker-dealer's CIP should specify the actions to be taken when it cannot form a reasonable belief. There also should be guidelines for when an account will not be

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<sup>10</sup> There are some exceptions to this basic rule. For example, a broker-dealer may maintain an account, at the direction of law enforcement, notwithstanding that the broker-dealer does not know the true identity of a customer.

opened. In addition, the CIP should address the terms under which a customer may conduct transactions while a customer's identity is being verified. The CIP should specify at what point, after attempts to verify a customer's identity have failed, an account that has been opened will be closed. Finally, the procedures should include a process for determining whether a Suspicious Activity Report should be filed in accordance with applicable laws and regulations.

#### **H. §103.122(h) Recordkeeping**

Section 326 of the Act requires procedures for maintaining records of the information used to verify a person's identity, including name, address, and other identifying information. Paragraph (h) of the proposed rule sets forth recordkeeping procedures that must be included in a broker-dealer's CIP. These procedures must provide for the maintenance of all information obtained pursuant to the CIP. Information that must be maintained includes all identifying information provided by a customer pursuant to paragraph (c). Thus, the broker-dealer must make a record of each customer's name, date of birth (if applicable), addresses, and tax identification number or other number. Broker-dealers also must maintain copies of any documents that were relied on pursuant to paragraph (d)(1) evidencing the type of document and any identification number it may contain. For example, if a customer produces a driver's license, the broker-dealer must make a copy of the driver's license that clearly indicates it is a driver's license and legibly depicts any identification number on the license.

Broker-dealers also must make and maintain records of the methods and results of measures undertaken to verify the identity of a customer pursuant to paragraph (d)(2). For

example, if a broker-dealer obtains a report from a credit bureau concerning a customer, the report must be maintained. Broker-dealers also must make and maintain records of the resolution of any discrepancy in the identifying information obtained. To continue with the previous example, if the customer provides a residence address that is different than the address shown on the credit report, the broker-dealer must document how it resolves this discrepancy or, if the discrepancy is not resolved, how it forms a reasonable belief notwithstanding the discrepancy.

The broker-dealer must retain all of these records for five years after the date the account is closed or the grant of authority to effect transactions with respect to an account is revoked. In all other respects, the records should be maintained in accordance with the requirements of Rule 17a-4.<sup>11</sup>

Nothing in this proposed regulation modifies, limits or supersedes section 101 of the Electronic Records in Global and National Commerce Act, Pub. L. 106-229, 114 Stat. 464 (15 U.S.C. 7001) (E-Sign Act). Thus, a broker-dealer may use electronic records to satisfy the requirements of this regulation, as long as the records are maintained in accordance with Rule 17a-4(f), which the Commission has interpreted as being consistent with the requirements in the E-Sign Act.<sup>12</sup>

Treasury and the Commission emphasize that the collection and retention of information about a customer, as an ancillary part of collecting identifying information, do not

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<sup>11</sup> 17 CFR 240.17a-4.

<sup>12</sup> See Exchange Act Release No. 44238 (May 1, 2001), 66 FR 22916 (May 7, 2001).

relieve a broker-dealer from its obligations to comply with anti-discrimination laws and regulations.

**I. §103.122(i) Approval of Program**

Paragraph (i) of the proposed rule requires that the broker-dealer's CIP be approved by the most senior level of the firm (e.g., the board of directors, managing partners, board of managers, or other governing body performing similar functions) or by persons specifically authorized by that body to approve such a program.

**J. § 103.122(j) Exemptions**

Section 326 states that the Secretary and the Federal functional regulator jointly issuing a rule under that section may by order or regulation exempt any financial institution or type of account from the regulation in accordance with such standards and procedures as the Secretary may prescribe. The proposed rule provides that the Commission, with the concurrence of the Secretary, may exempt any broker-dealer that registers with the Commission pursuant to 15 U.S.C. 78o and 78o-4. However, it excludes from this exemptive authority broker-dealers that register pursuant to 15 U.S.C. 78o(b)(11). These are firms that register as broker-dealers solely because they deal in securities futures products. The exemptive authority with respect to these firms will be in the rule issued jointly by Treasury and the CFTC. The proposed rule provides that the Secretary, with the concurrence of the Commission, may exempt any broker-dealer that registers pursuant to 15 U.S.C 78o-5 (i.e., government securities dealers).

In issuing exemptions under the proposed rule, the Secretary and the Commission shall consider whether the exemption is consistent with the purposes of the BSA, and in the public interest, and may consider other necessary and appropriate factors.

### **III. Conforming Amendments to 31 CFR 103.35**

Current section 103.35(a) sets forth customer identification requirements when certain brokerage accounts are opened. Generally, sections 103.35(a)(1) and (2) require a broker-dealer, within 30 days after an account is opened, to secure and maintain a record of the taxpayer identification number of the customer involved. If the broker-dealer is unable to obtain the taxpayer identification number within 30 days (or a longer time if the person has applied for a taxpayer identification number), it need take no further action under section 103.35 concerning the account if it maintains a list of the names, addresses, and account numbers of the persons for which it was unable to secure taxpayer identification numbers, and provides that information to the Secretary upon request. In the case of a non-resident alien, the broker-dealer is required to record the person's passport number or a description of some other government document used to determine identification.

Section 103.35(a)(3) currently provides that a broker-dealer need not obtain a taxpayer identification number with respect to specified categories of persons<sup>13</sup> opening accounts. The

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<sup>13</sup> The exemption applies to (i) agencies and instrumentalities of Federal, State, local, or foreign governments; (ii) aliens who are ambassadors; ministers; career diplomatic or consular officers; naval, military, or other attaches of foreign embassies and legations; and members of their immediate families; (iii) aliens who are accredited representatives of certain international organizations, and their immediate families; (iv) aliens temporarily residing in the United States for a period not to exceed 180 days; (v) aliens not engaged in a trade or business in the United States who are attending a recognized college or university, or any training program supervised or conducted by an agency of



proposed rule does not contain any exemptions from the CIP requirements. Treasury believes that the requirements of section 103.35(a)(1) and (2) are inconsistent with the intent and purpose of section 326 of the Act and incompatible with the proposed rule. For these reasons, Treasury, under its own authority, is proposing to repeal section 103.35(a).

In addition, Treasury and the Commission are requesting comments on whether any of the exemptions in Section 103.35(a)(3) should apply in the context of the proposed CIP requirements in light of the intent and purpose of section 326 of the Act.

#### **IV. Request for Comments**

Treasury and the Commission invite comment on all aspects of the proposed regulation, and specifically seek comment on the following issues:

1. Whether the proposed definition of "account" is appropriate and whether other examples of accounts should be added to the rule text.

2. How broker-dealers can comply with the requirement to obtain both the address of a person's residence, and, if different, the person's mailing address in situations involving natural persons who lack a permanent address.

3. Whether non-U.S. persons that are not natural persons will be able to provide a broker-dealer with the identifying information required in § 103.122(c)(4), or whether other categories of identifying information should be added to this section. Commenters on this issue should suggest other means of identification that broker-dealers currently use or should

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the Federal Government; and (vi) unincorporated subordinate units of a tax exempt central organization that are covered by a group exemption letter.

use in this circumstance that would allow a broker-dealer to form a reasonable belief that it knows the true identity of the entity.

4. The extent to which the verification procedures required by the proposed rule make use of information that broker-dealers currently obtain in the account opening process. We note that the legislative history of section 326 indicates that Congress intended "the verification procedures prescribed by Treasury [to] make use of information currently obtained by most financial institutions in the account opening process." See H.R. Rep. No. 107-250, pt. 1, at 63 (2001).

5. Whether any of the exemptions from the customer identification requirements contained in current section 103.35(a)(3) should be continued in the proposed rule. In this regard, Treasury and the Commission request that commenters address the standards set forth in paragraph (j) of the proposed rule (as well as any other appropriate factors).

## **V. Paperwork Reduction Act**

Certain provisions of the proposed rule contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.<sup>14</sup> Treasury has submitted the proposed rule to the Office of Management and Budget (OMB) for review in accordance with 44 U.S.C 3507(d). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

### **A. Collection of Information Under the Proposed Rule**

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<sup>14</sup> 44 U.S.C. 3502 et seq.

The proposed rule contains recordkeeping and disclosure requirements that are subject to the Paperwork Reduction Act of 1995. In summary, the proposed rule requires broker-dealers to implement reasonable procedures to (1) maintain records of the information used to verify the person's identity and (2) provide notice of the CIPs procedures to customers. These recordkeeping and notice requirements are required under section 326 of the Act.

**B. Proposed Use of the Information**

Section 326 of the Act requires Treasury and the Commission jointly to issue a regulation setting forth minimum standards for broker-dealers and their customers regarding the identity of the customer that shall apply in connection with opening of an account at the broker-dealer. Furthermore, section 326 provides that the regulations, at a minimum, must require broker-dealers to implement reasonable procedures for (1) verifying the identity of any person seeking to open an account, to the extent reasonable and practicable; (2) maintaining records of the information used to verify the person's identity, including name, address, and other identifying information; and (3) determining whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency.

The purpose of section 326, and the regulations promulgated thereunder, is to make it easier to prevent, detect and prosecute money laundering and the financing of terrorism. In issuing the proposed rule, Treasury and the Commission are seeking to fulfill their statutorily mandated responsibilities under section 326 and to achieve its important purpose.

The proposed rule requires each broker-dealer to establish a written CIP that must include recordkeeping procedures and procedures for providing customers with notice that the broker-dealer is requesting information to verify their identity. The proposed rule requires a broker-dealer to maintain a record of (1) the identifying information provided by the customer, the type of identification document(s) reviewed, if any, the identification number of the document(s), and a copy of the identification document(s); (2) the means and results of any additional measures undertaken to verify the identity of the customer; and (3) the resolution of any discrepancy in the identifying information obtained.

The proposed rule also requires each broker-dealer to give customers “adequate notice” of the identity verification procedures. A broker-dealer may satisfy this disclosure requirement by posting a sign in the lobby or providing customers with any other form of written or oral notice. If the account is opened electronically, the broker-dealer may provide the notice electronically. Accordingly, a broker-dealer may choose among a variety of methods of providing adequate notice and may select the least burdensome method, given the circumstances under which customers seek to open new accounts.

### **C. Respondents**

The proposed rule would apply to approximately 5,568 broker-dealers, which is the approximate number of firms that conduct business with the general public.

### **D. Total Annual Reporting and Recordkeeping Burden**

#### **1. Providing Notice to Customers**

The requirement to provide notice to customers generally will be a one-time burden in terms of drafting and posting or implementing the notices. The Commission estimates that broker-dealers will take two hours each to draft and post the required notices. There are approximately 5,568 broker-dealers that will have to undertake this task. Therefore, in complying with this requirement, the Commission estimates that the industry as a whole will spend approximately 11,136 hours.

## **2. Recordkeeping**

The requirement to make and maintain records related to the CIP will be an annual time burden. The total burden to the industry will depend on the number of new accounts added each year. The Commission estimates that broker-dealers, on average, will spend two minutes per account making and maintaining the required records.<sup>15</sup> Therefore, in complying with this

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<sup>15</sup> The Commission estimates that the number of new accounts in the upcoming years will be: 15,400,000 in 2002, 16,900,000 in 2003, and 18,600,000 in 2004. The Commission arrived at this estimate by considering: (1) the total number of accounts at the 2001 year-end (102,700,000) as reported by broker-dealers on Form X-17a-5 - Financial and Operational Combined Uniform Single (FOCUS) Reports they file pursuant to section 17 of the Exchange Act and rule 17a-5 (17 CFR 240.17a-5) thereunder; and (2) the annualized growth rate in total accounts for the years 1990 through 2001 (ten percent). The Commission also estimates that the number of accounts that are closed each year equals five percent of the total number of accounts. Accordingly, the Commission estimates that the total annualized growth rate for new accounts each year is fifteen percent. Therefore, starting with the 2001 total of 102,700,000 and using an annualized growth rate of fifteen percent, the Commission estimates that 15,400,000 new accounts will be added in 2002, 16,900,000 in 2003 and 18,600,000 in 2004.

requirement, the Commission estimates that the industry as a whole will spend approximately 513,333 hours in 2002, 563,333 hours in 2003, and 620,000 hours in 2004.<sup>16</sup>

**E. Collection of Information is Mandatory**

These recordkeeping and disclosure (notice) requirements are mandatory.

**F. Confidentiality**

The collection of information pursuant to the proposed rule would be provided by customers and other sources to broker-dealers and maintained by broker-dealers. In addition, the information may be used by federal regulators, self-regulatory organizations, and authorities in the course of examinations, investigations, and judicial proceedings. No governmental agency regularly would receive any of the information described above.

**G. Record Retention Period**

The proposed rule will require that the records with respect to a given customer be retained until five years after the date the account of a customer is closed or the grant of authority to effect transactions with respect to an account is revoked.

**H. Request for Comment**

Pursuant to 44 U.S.C. 3506(c)(2)(B), Treasury and the Commission solicit comments to:

(1) Evaluate whether the proposed collections of information are necessary, and whether they would have practical utility,

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<sup>16</sup> The Commission derived these estimates by taking the number of new accounts projected for each upcoming year and multiplying the number by two minutes and then dividing that number by 60 to convert minute totals into hour totals.

(2) Evaluate the accuracy of the estimates of the burden of the proposed collection of information,

(3) Enhance the quality, utility, and clarity of the information to be collected, and

(4) Minimize the burden of the collection of information on those required to respond, including through the use of automated collection techniques or other forms of information technology.

Comments concerning the recordkeeping and disclosure requirements in the proposed rule should be sent (preferably by fax (202-395-6974)) to Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Paperwork Reduction Project (1506), Washington, DC 20503 (or by the Internet to [jlackeyj@omb.eop.gov](mailto:jlackeyj@omb.eop.gov)), with a copy to FinCEN by mail or the Internet at the addresses previously specified.

## **VI. Commission's Analysis of the Costs and Benefits Associated with the Proposed Rule**

The Commission is considering the costs and benefits associated with the proposal and requesting comment on all aspects of this cost-benefit analysis, including identification and assessment of any other costs and benefits not discussed in the analysis. Commenters are encouraged to identify, discuss, analyze, and supply relevant data concerning the costs and benefits associated with the proposed rule.

Section 326 of the Act requires Treasury and the Commission to prescribe regulations setting forth minimum standards for broker-dealers regarding the identities of customers that shall apply in connection with the opening of an account. The statute also provides that the

regulations issued by Treasury and the Commission must, at a minimum, require financial institutions to implement reasonable procedures for: (1) verification of customers' identities; (2) determination of whether a customer appears on a government list; and (3) maintenance of records related to customer verification. The proposed rule implements this statutory mandate by requiring broker-dealers to (1) establish a CIP; (2) obtain certain identifying information from customers; (3) verify identifying information of customers; (4) check customers against lists provided by federal agencies, (5) provide notice to customers that information may be requested in the process of verifying their identities; and (6) make and maintain records. The Commission believes that these requirements are reasonable and practicable, as required by the section 326 and, therefore, that the costs associated with them are attributable to the statute. Moreover, while the proposed rule specifies certain minimum requirements, broker-dealers will be able to design their CIPs in a manner most appropriate to their business models and customer bases. This flexibility should be beneficial to broker-dealers in helping them to tailor their CIPs appropriately, while still meeting the statutory requirements of section 326.

Even though the Commission believes the costs associated with the proposed rule are attributable to the statute, it nonetheless has undertaken an analysis of the costs and benefits of the requirements. The Commission seeks comment on all aspects of the proposed rule, including whether the proposed rule, by setting forth minimum requirements, creates a benefit or, conversely, imposes costs because broker-dealers will not be able to choose for themselves the minimum procedures they wish to use to meet the requirements of the statute. The Commission also seeks comment on whether the costs are attributable to the statute.



## **A. Benefits Associated with the Proposed Rule**

The anti-money laundering provisions in the Act are intended to make it easier to prevent, detect and prosecute money laundering and the financing of terrorism. The proposed rule is an important part of this effort. It fulfills the statutory mandate of section 326 by specifying how a broker-dealer is to establish a program that will assist it in determining the identities of customers. Verifying identities, in turn, will reduce the risk of broker-dealers unwittingly aiding criminals, including terrorists, in accessing U.S. financial markets to launder money or move funds for illicit purposes. Additionally, the implementation of such programs should make it more difficult for persons to successfully engage in fraudulent activities involving identity theft or the placing of fictitious orders to buy or sell securities.

## **B. Costs Associated with the Proposed Rule**

### **1. Writing Procedures**

Most broker-dealers, as a matter of prudent business practices, should already have procedures in place for verifying identities of customers. In addition, Exchange Act Rule 17a-3(a)(9) requires broker-dealers to obtain the name and address of each beneficial owner of a cash or margin account.<sup>17</sup> Similarly, the self-regulatory organizations have rules requiring broker-dealers to obtain identifying information from customers.<sup>18</sup> Accordingly, firms should already have written procedures for complying with these existing regulations.

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<sup>17</sup> 17 CFR 240.17a-3(a)(9).

<sup>18</sup> See, e.g., NYSE Rule 405, NASD Rule 3110.

Nonetheless, the Commission believes that some broker-dealers will have to update or establish a CIP. The proposed rule seeks to keep the costs low by allowing for great flexibility in establishing a CIP. For example, it is to be based on factors specific to each broker-dealer, such as size, customer base and location. Thus, the analysis and detail necessary for a CIP will depend on the complexity of the broker-dealer and its operations. Given the considerable differences among broker-dealers, it is difficult to quantify a cost per broker-dealer. Highly complex firms will have more risk factors to consider, given, for example, their size, multiple offices, variety of services and products offered, and range of customers. However, most large firms already have some procedures in place for verifying customer identities. Smaller and less complex firms will not have as many risk factors.

The Commission estimates that establishing a written CIP could result in additional costs for some broker-dealers to the extent they do not have verification procedures that meet the minimum requirements in the rule. This includes broker-dealers that would need to augment their procedures to make them compliant. On average, the Commission estimates the additional cost per broker-dealer to establish a compliant CIP to be approximately \$2,244, resulting in a one time overall cost to the industry of approximately \$12,494,592.<sup>19</sup>

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<sup>19</sup> The Commission estimates that it will take broker-dealers on average approximately 20 hours to establish a written CIP. This estimate seeks to account for the fact that many firms already have customer identification and verification procedures and that discrepancies in size and complexity will result in differing time burdens. The Commission believes that broker-dealers will have senior compliance personnel draft their CIPs and that this will take an average of 16 hours. The Commission anticipates that in-house counsel will spend on average 4 hours reviewing the CIP. According to the Securities Industry Association (“SIA”) Management and Professional Earnings 2000 report (“SIA Earnings Report”), Table 051, the hourly cost of a compliance manager plus 35% overhead is \$101.25. The hourly cost for an in-house counsel plus 35% overhead is

## 2. Obtaining Identifying Information

The Commission believes that broker-dealers already obtain from customers most, if not all, of the information required under the proposed rule.<sup>20</sup> Rule 17a-3(a)(9) requires broker-dealers to obtain, with respect to each margin and cash account, the name and address of each beneficial owner, provided that the broker-dealer need only obtain such information from the persons authorized to transact business for the account if it is a joint or corporation account.<sup>21</sup>

Further, broker-dealers are already required, pursuant to NASD Rule 3110, to obtain certain identifying information with respect to each account.<sup>22</sup> For example, if the customer is

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\$156.00 (SIA Earnings Report, Table 107 (Attorney)). Therefore, the Commission estimates that the total cost per broker-dealer to establish a CIP would be \$2,244 per broker-dealer [(16 x \$101.25) + (4 x \$156.00)]. As of the 2000 year-end, there were approximately 5,568 broker-dealers that engaged in some form of a public business. Therefore, the Commission estimates that the total cost to the industry would be \$2,244 multiplied by 5,568 or \$12,494,592.

<sup>20</sup> For example, the Anti-Money Laundering Committee of the SIA recommended in its Preliminary Guidance for Deterring Money Laundering Activity (February 2002) that broker-dealers obtain certain identifying information from customers at the commencement of the business relationship, including, for natural persons: name, address, date of birth, investment experience and objectives, social security number or taxpayer identification number, net worth, annual income, occupation, employer's address, and the names of any persons authorized to effect transactions in the account. For non-resident aliens, the SIA Committee recommended that the broker-dealer obtain, in addition to the information above, a passport number or other valid government identification number. The SIA Committee also made a number of recommendations with respect to customers that are not natural persons.

<sup>21</sup> 17 CFR 240.17a-3(a)(9).

<sup>22</sup> Section 15(b)(8) of the Exchange Act (15 U.S.C. 78o(b)(8)) requires each broker-dealer to become a member of a securities association registered pursuant to section 15A of the Exchange Act (15 U.S.C. 78o-3) unless the broker-dealer effects transactions solely on a national securities exchange of which it is a member. The NASD is the only securities

a natural person, the rule requires the broker-dealer to obtain the customer's name and address.<sup>23</sup> In addition, the broker-dealer must determine whether the customer is of legal age, and, if the customer purchases more than just open-end investment company shares or is solicited to purchase such shares, the broker-dealer must obtain the customer's tax identification or social security number.<sup>24</sup> If the customer is a corporation, partnership, or other legal entity, the broker-dealer must obtain its name, residence, and the names of any persons authorized to transact business on behalf of the entity.<sup>25</sup> If the account is a discretionary account, the broker-dealer must obtain the signature of each person authorized to exercise discretion over the account.<sup>26</sup> Finally, the broker-dealer must maintain all of this information as a record of the firm.

In addition, NYSE Rule 405 requires broker-dealers to “[u]se due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted

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association registered pursuant to section 15A. Exchange Act Rule 15b9-1 (17 CFR 240.15b9-1) exempts broker-dealers from this requirement to register with the NASD if they (1) are an exchange member, (2) carry no customer accounts, and (3) derive gross annual income from purchases and sales of securities other than on a national securities exchange of not greater than \$1,000. Generally then, most broker-dealers that carry customer accounts are members of the NASD and subject to Rule 3110.

<sup>23</sup> NASD Rule 3110(c)(1).

<sup>24</sup> NASD Rule 3110(c)(2).

<sup>25</sup> NASD Rule 3110(c)(1).

<sup>26</sup> NASD Rule 3110(c)(3).

or carried by such organization and every person holding power of attorney over any account accepted or carried by such organization.”<sup>27</sup>

While broker-dealers are required currently to obtain most of this information, the Commission estimates that there will be some new costs for broker-dealers because some may not be obtaining all the required information. The Commission estimates that the total cost to the industry to obtain the minimum identifying information will be \$5,826,333 in 2002, \$6,393,833 in 2003, and \$7,037,000 in 2004.<sup>28</sup> The Commission also estimates that some broker-dealers will have to update their account opening applications or account opening websites in order to insert line items requesting customers to provide the required information. The Commission estimates that this will result in a one-time cost to the industry of \$563,760.<sup>29</sup>

### **3. Verifying Identifying Information**

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<sup>27</sup> NYSE Rule 405(1).

<sup>28</sup> The Commission estimates that obtaining the required minimum identifying information will take broker-dealers approximately one minute per account. This takes into consideration the fact that approximately 97% of customer accounts are held at the 70 largest broker-dealers. These firms likely already obtain the required identifying information from their customers. Therefore, requiring that each piece of identifying information be obtained should not impose a significant additional burden. The average hourly cost of the person who would be obtaining this information is \$22.70 per hour (per the SIA Earnings Report, Table 082 (Retail Sales Assistant, Registered) and including 35% in overhead charges). Therefore, the costs to the industry would be: (number of new accounts per year) x (1/60 of an hour) x (\$22.70). As indicated previously, the Commission estimates that the number of new accounts in the upcoming years will be: 15,400,000 in 2002, 16,900,000 in 2003, and 18,600,000 in 2004.

<sup>29</sup> The Commission estimates that it will take each broker-dealer, on average, one hour to update account opening applications or electronic account opening systems. The Commission believes that broker-dealers will have a compliance manager implement the necessary changes. The hourly cost for a compliance manager is \$101.25 (SIA Earnings Report, Table 051 (Compliance manager)). Accordingly, the total cost to the industry

The proposed rule provides broker-dealers with substantial flexibility in establishing how they will independently verify the information provided by customers. For example, customers that open accounts on a broker-dealer's premises can simply provide a driver's license or passport, or if the customer is not a natural person, it can provide a copy of any documents showing its existence as a legal entity (e.g., articles of incorporation, business licenses, partnership agreements or trust instruments). There are also a number of options for customers that open accounts via the telephone or Internet. In these cases, broker-dealers may obtain a financial statement from the customer, check the customer's name against a credit bureau or database, or check the customer's references with other financial institutions.

The documentary and non-documentary verification methods set forth in the rule are not meant to be an exclusive list of the appropriate means of verification. Other reasonable methods may be available now or in the future. The purpose of making the rule flexible is to allow broker-dealers to select verification methods that are, as section 326 requires, reasonable and practicable. Methods that are appropriate for a smaller broker-dealer with a fairly localized customer base may not be sufficient for a larger firm with customers from many different countries. The proposed rule recognizes this fact and, therefore, allows broker-dealers to employ such verification methods as would be suitable to a given firm to form a reasonable belief that it knows the true identities of its customers.

The Commission estimates that verifying the identifying information could result in costs for broker-dealers because some firms currently may not use verification methods. The

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would be:  $(\$101.25) \times$  (the number of broker-dealers doing a public business or 5,568) or \$563,760.

Commission estimates that the total cost to the industry to verify the identifying information will be \$48,628,333 in 2002, \$53,375,833 in 2003, and \$58,745,000 in 2004.<sup>30</sup>

#### **4. Determining Whether Customers Appear on a Federal Government List**

The Commission believes that broker-dealers who receive federal government lists, chiefly clearing firms, already have procedures for checking customers against them. First, there are substantive legal requirements associated with the lists circulated by Treasury's Office of Foreign Asset Control of the U.S. Treasury (OFAC). The failure of a firm to comply with these requirements could result in criminal and civil penalties. The Commission believes that, given the events of September 11, 2001, most broker-dealers that receive lists from the federal government have implemented procedures for checking their customers against them.

The Commission estimates that this requirement could result in some additional costs for broker-dealers because some may not already check such lists. The Commission estimates

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<sup>30</sup> The Commission estimates that the processing costs associated with verification methods will be approximately \$1.00 per account. The Commission further estimates that the average time spent verifying an account will be five minutes. The hourly cost of the person who would undertake the verification is \$25.90 per hour (per the SIA Earnings Report, Table 086 (Data Entry Clerk, Senior) and including 35% in overhead charges). Therefore, the costs to the industry reported above are: (number of new accounts per year) x (\$1.00) + (number of new accounts per year) x (1/12 of an hour) x (\$25.90). The Commission estimates that the number of new accounts in the upcoming years will be: 15,400,000 in 2002, 16,900,000 in 2003, and 18,600,000 in 2004.

that the total cost to the industry to check such lists will be \$3,323,833 in 2002, \$3,647,583 in 2003, and \$4,014,500 in 2004.<sup>31</sup>

## **5. Providing Notice to Customers**

A broker-dealer may satisfy the notice requirement by generally notifying its customers about the procedures the broker-dealer must comply with to verify their identities. For example, the broker-dealer may post a sign in its lobby or provide customers with any other form of written or oral notice. If an account is opened electronically, such as through an Internet website, the broker-dealer may provide notice electronically. The Commission estimates the total one-time cost to the industry to provide notice to customers to be \$1,432,368.<sup>32</sup>

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<sup>31</sup> The Commission believes that most of the firms that receive these lists already check their customers against them. Moreover, as indicated previously, 97% of customer accounts are held at the 70 largest firms. The Commission understands that most of these firms have automated processes for complying with many regulatory requirements. Accordingly, the Commission estimates that it will take broker-dealers on average thirty seconds to check whether a person appears on a government list. The hourly cost of the person who would check the list is \$25.90 per hour (per the SIA Earnings Report, Table 086 (Data Entry Clerk, Senior) and including 35% in overhead charges). Therefore, the costs to the industry reported above are: (number of new accounts per year) x (1/120 of an hour) x (\$25.90). The Commission estimates that the number of new accounts in the upcoming years will be: 15,400,000 in 2002, 16,900,000 in 2003, and 18,600,000 in 2004.

<sup>32</sup> The Commission estimates that it will take each broker-dealer, on average, two hours to create and implement the appropriate notice. This estimate takes into consideration the fact that many small firms will be able to provide adequate notice by hanging signs in their premises. Larger firms will be able to provide notice by updating account opening documentation or electronic account opening systems. The Commission believes that broker-dealers will have an attorney draft the appropriate notice, and that this will take approximately one hour. The hourly cost for an in-house counsel plus 35% overhead is \$156.00 (SIA Earnings Report, Table 107, (Attorney)). The Commission believes that broker-dealers will have a compliance manager implement the notice, and that



## 6. Recordkeeping

The Commission estimates that many of the records required by the rule are already made and maintained by broker-dealers. As discussed above, Commission and self-regulatory organization rules already require broker-dealers to obtain much of the minimum identifying information specified in the proposed rule. These regulations also require that records be made and kept of this information. The Commission estimates that the recordkeeping requirement could result in additional costs for some broker-dealers that currently do not maintain certain of the records for the prescribed time period. The Commission estimates that the total cost to the industry to make and maintain the required records in the upcoming years will be \$13,295,333 in 2002, \$14,590,333 in 2003, and \$16,058,000 in 2004.<sup>33</sup>

## VII. Regulatory Flexibility Act

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implementation will take approximately one hour. The hourly cost for a compliance manager is \$101.25 (SIA Earnings Report, Table 051 (Compliance manager)). Accordingly, the total cost to the industry would be:  $(\$156.00 + 101.25) \times$  (the number of broker-dealers doing a public business or 5,568) or \$1,432,368.

<sup>33</sup> The Commission estimates that it will take approximately two minutes per new account to make and maintain the required records. This estimate takes into account the fact that many broker-dealers already make and maintain many of the required records. In addition, for many new accounts, the recordkeeping will be fairly simple (e.g., making a photocopy of a driver's license or financial statement, or keeping a record of the results of a public database search or credit bureau query. The hourly cost of the person who would undertake the verification is \$25.90 per hour (per the SIA Earnings Report, Table 086 (Data Entry Clerk, Senior) and including 35% in overhead charges). Therefore, the costs to the industry reported above are: (number of new accounts per year)  $\times$  (1/30 of an hour)  $\times$  (\$25.90). The Commission estimates that the number of new accounts in the upcoming years will be: 15,400,000 in 2002, 16,900,000 in 2003, and 18,600,000 in 2004.

Treasury and the Commission are sensitive to the impact our rules may impose on small entities. Congress enacted the Regulatory Flexibility Act, 5 U.S.C. 601 et seq., to address concerns related to the effects of agency rules on small entities. In this case, Treasury and the Commission believe that the proposed rule likely would not have a “significant economic impact on a substantial number of small entities.” 5 U.S.C. 605(b). First, the economic impact on small entities should not be significant because most small entities are likely to have a relatively small number of accounts, and thus compliance should not impose a significant economic impact. Second, as discussed in Section VI (the Commission’s cost benefit analysis), the economic impact on broker-dealers, including small entities, is imposed by the statute itself, and not by the proposed rule. Treasury and the Commission seek comment on whether the proposed rule would have a significant economic impact on a substantial number of small entities and whether the costs are imposed by the statute itself, and not the proposed rule.

While Treasury and the Commission believe that the proposed rule likely would not have a significant economic impact on a substantial number of small entities, Treasury and the Commission do not have complete data at this time to make this determination. Therefore, an Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603.

**A. Reason for the Proposed Action**

Section 326 of the Act requires Treasury and the Commission jointly to issue a regulation setting forth minimum standards for broker-dealers and their customers regarding

the identity of the customer that shall apply in connection with the opening of an account at the broker-dealer. Furthermore, section 326 requires, at a minimum, that broker-dealers implement reasonable procedures for (1) verifying the identity of any person seeking to open an account, to the extent reasonable and practicable; (2) maintaining records of the information used to verify the person's identity, including name, address, and other identifying information; and (3) determining whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency.

The purpose of section 326, and the regulations promulgated thereunder, is to make it easier to prevent, detect and prosecute money laundering and the financing of terrorism. In issuing the proposed rule, Treasury and the Commission are seeking to fulfill their statutorily mandated responsibilities under section 326 and to achieve its important purpose.

#### **B. Objective**

The objective of the proposed regulation is to make it easier to prevent, detect and prosecute money laundering and the financing of terrorism. The proposed rule seeks to achieve this goal by specifying the information broker-dealers must obtain from or about customers that can be used to verify the identity of the customers. This will make it more difficult for persons to use false identities to establish customer relationships with broker-dealers for the purposes of laundering money or moving funds to effectuate illegal activities, such as financing terrorism.

### **C. Legal Basis**

The proposed rule is being promulgated pursuant to section 326 of the Act, which mandates that Treasury and the Commission issue a regulation setting forth minimum standards for financial institutions and their customers regarding the identity of customers that shall apply in connection with the opening of accounts at financial institutions.

### **D. Small Entities Subject to the Rule**

The proposed rule would affect broker-dealers that are small entities. Rule 0-10 under the Exchange Act<sup>34</sup> defines a broker-dealer to be small if it (1) had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to § 240.17a-5(d) or, if not required to file such statements, a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in the rule.

As of December 31, 2000, the Commission estimates there were approximately 873 broker-dealers that were “small” for purposes of Rule 0-10 that would be subject to this rule because they conduct business with the general public. The Commission bases its estimate on the information provided in broker-dealer FOCUS Reports.

### **E. Reporting, Recordkeeping and other Compliance Requirements**

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<sup>34</sup> 17 CFR 240.0-10(c).

The proposed rule would require broker-dealers to (1) establish a CIP; (2) obtain certain identifying information from customers; (3) verify identifying information of customers; (4) check customers against lists provided by federal agencies; (5) provide notice to customers that information may be requested in the process of verifying their identities; and (6) make and maintain records related to the CIP.

#### **F. Duplicative, Overlapping or Conflicting Federal Rules**

As discussed throughout this preamble, there are other federal rules that contain requirements for collecting certain information from customers. However, these other requirements do not provide sufficient information for broker-dealers to verify the identity of their customers. Congress has mandated that Treasury and the Commission issue a regulation that requires broker-dealers to undertake such verifications.

#### **G. Significant Alternatives**

If an agency does not certify that a rule will not have a significant economic impact on a substantial number of small entities, the Regulatory Flexibility Act directs Treasury and the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any adverse impact on small entities.

In connection with the proposed amendments, we considered the following alternatives: (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources of small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the proposed amendments, or any part thereof, for small entities.

The proposed rule provides for substantial flexibility in how each broker-dealer may meet its requirements. This flexibility is designed to account for differences between broker-dealers, including size. Nonetheless, Treasury and the Commission did consider alternatives such as exempting certain small entities from some or all of the requirements of the proposed rule. Treasury and the Commission do not believe that such an exemption is appropriate, given the flexibility built into the rule to account for, among other things, the differing sizes and resources of broker-dealers, as well as the importance of the statutory goals and mandate of section 326. Money laundering can occur in small firms as well as large firms.

#### **H. Solicitation of Comments**

Treasury and the Commission encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis, including comments regarding the number of small entities that may be affected by the proposed rule. Such comments will be considered by Treasury and the Commission in determining whether a Final Regulatory Flexibility Analysis is required, and will be placed in the same public file as comments on the proposed amendment itself. Comments should be submitted to Treasury or the Commission at the addresses previously indicated.

#### **VIII. Executive Order 12866**

The Department of the Treasury has determined that this rule is not a significant regulatory action for purposes of Executive Order 12866. As noted above, the proposed rule closely parallels the requirements of section 326 of the Act. Accordingly, a regulatory impact analysis is not required.

## **Lists of Subjects in 31 CFR Part 103**

Administrative practice and procedure, Authority delegations (Government agencies), Banks, banking, Brokers, Currency, Foreign banking, Foreign currencies, Gambling, Investigations, Law enforcement, Penalties, Reporting and recordkeeping requirements, Securities.

## **Authority and Issuance**

For the reasons set forth in the preamble, part 103 of title 31 of the Code of Federal Regulations is proposed to be amended as follows:

## **PART 103 - FINANCIAL RECORDKEEPING AND REPORTING OF CURRENCY AND FOREIGN TRANSACTIONS**

1. The authority citation for part 103 is revised to read as follows:

**Authority:** 12 U.S.C. 1829b and 1951-1959; 12 U.S.C. 1818, 12 U.S.C. 1786(q), 31 U.S.C. 5311-5331; title III, secs. 312, 313, 314, 319, 326, 352, and Pub L. 107-56, 115 Stat. 307.

2. Section 103.35 is amended as follows:

- a. By removing paragraph (a);
- b. By redesignating paragraph (b) introductory text and paragraphs (b)(1) through (b)(4) as paragraphs (a) through (d), respectively; and
- c. In newly redesignated introductory text, by removing “, in addition,” in the first sentence.

3. Subpart I of part 103 is amended by adding 103.122 to read as follows:

**§ 103.122 - Customer identification programs for broker-dealers.**

(a) Definitions. For the purposes of this section:

(1) Account means any formal business relationship with a broker-dealer established to effect financial transactions in securities, including, but not limited to, the purchase or sale of securities, securities loan and borrowed activity, or the holding of securities or other assets for safekeeping or as collateral. For example, a cash account, margin account, prime brokerage account that consolidates trading done at a number of firms, or an account for repurchase transactions would each constitute an account.

(2) Broker-dealer means any person registered or required to be registered as a broker or dealer with the Commission under the Securities Exchange Act of 1934 (15 U.S.C 77a et seq.), except persons who register pursuant to 15 U.S.C 78o(b)(11).

(3) Commission means the United States Securities and Exchange Commission.

(4) Customer means:

- (i) Any person who opens a new account with a broker-dealer; and
- (ii) Any person who is granted authority to effect transactions with respect to an account with a broker-dealer.

(5) Person has the same meaning as that term is defined in §103.11(z).

(6) U.S. person means:

- (i) Any U.S. citizen; and



(ii) Any corporation, partnership, trust, or person (other than a natural person) that is established or organized under the laws of a State or the United States.

(7) Non-U.S. person means a person that is not a U.S. person.

(8) Taxpayer identification number. The provisions of section 6109 of the Internal Revenue Code of 1986 (26 U.S.C. 6109) and the regulations of the Internal Revenue Service promulgated thereunder shall determine what constitutes a taxpayer identification number.

(b) Customer identification program. A broker-dealer shall establish, document, and maintain a written Customer Identification Program (“CIP”). A broker-dealer’s CIP procedures must enable it to form a reasonable belief that it knows the true identity of the customer. A broker-dealer’s CIP must be a part of its anti-money laundering program required under 31 U.S.C. 5318(h). A broker-dealer’s CIP procedures shall be based on the type of identifying information available and on an assessment of relevant risk factors including:

- (1) The broker-dealer’s size;
- (2) The broker-dealer’s location;
- (3) The broker-dealer’s methods for opening accounts;
- (4) The types of accounts the broker-dealer maintains for customers;
- (5) The types of transactions the broker-dealer executes for customers;
- (6) The broker-dealer’s customer base; and

(7) The broker-dealer's reliance on another broker-dealer with which it shares an account relationship.

(c) Required information. (1) General. Except as permitted by paragraph (c)(2) of this section, the CIP shall require the broker-dealer to obtain specified identifying information about each customer before an account is opened or a customer is granted authority to effect transactions with respect to an account. The specified information must include, at a minimum:

- (i) Name;
- (ii) Date of birth, for a natural person;
- (iii) Addresses:
  - (A) Residence and mailing (if different) for a natural person;or
  - (B) Principal place of business and mailing (if different) for a person other than a natural person; and
- (iv) Documentary record:
  - (A) U.S. person. A taxpayer identification number from each customer that is a U.S. person; or
  - (B) Non-U.S. person. A taxpayer identification number, passport number and country of issuance, an alien identification card number, or the number and country of issuance of any other government-issued document

evidencing nationality or residence and bearing a photograph or similar safeguard.

(2) Limited exception. In the case of a person other than a natural person that has applied for, but has not received, an employer identification number, the CIP may allow the employer identification number to be provided within a reasonable period of time after the account is established, if the broker-dealer obtains a copy of the application for the employer identification number prior to the opening of an account or the granting of trading authority.

(d) Required verification procedures. The CIP shall include procedures for verifying the identity of customers, to the extent reasonable and practicable, using identifying information obtained. Such verification must occur within a reasonable time before or after the customer's account is opened or the customer is granted authority to effect transactions with respect to an account.

(1) Verification through documents. The CIP must describe when the broker-dealer will verify customers' identities through documents and describe the documents that the broker-dealer will use for this purpose. Suitable documents for verification may include:

- (i) For natural persons, an unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard; and
- (ii) For persons other than natural persons, documents showing the existence of the entity, such as registered articles of incorporation, a government-issued business license, a partnership agreement, or

a trust instrument.

(2) Verification through non-documentary methods. The CIP must describe non-documentary methods the broker-dealer will use to verify customers' identities and when these methods will be used in addition to, or instead of, relying on documents. Non-documentary verification methods may include contacting a customer, obtaining a financial statement, independently verifying information through credit bureaus, public databases, or other sources, and checking references with other financial institutions. Non-documentary methods shall be used when a customer who is a natural person is unable to present an unexpired government-issued identification document that bears a photograph or similar safeguard, or the broker-dealer is presented with unfamiliar documents to verify the identity of a customer, the broker-dealer does not obtain documents to verify the identity of a customer, does not meet face-to-face a customer who is a natural person, or the broker-dealer is otherwise presented with circumstances that increase the risk that the broker-dealer will be unable to verify the true identity of a customer through documents.

(e) Government lists. The CIP shall include procedures for determining whether a customer appears on any list of known or suspected terrorists or terrorist organizations provided to the broker-dealer by any federal government agency. Broker-dealers shall follow all federal directives issued in connection with such lists.

(f) Customer notice. The CIP shall include procedures for providing customers with adequate notice that the broker-dealer is requesting information to verify their identities.

(g) Lack of verification. The CIP shall include procedures for responding to circumstances in which the broker-dealer cannot form a reasonable belief that it knows the true identity of a customer.

(h) Recordkeeping. The CIP shall include procedures for making and retaining a record of all information obtained pursuant to the CIP.

(1) Required records. At a minimum, the CIP shall require the broker-dealer to make the following records:

- (i) All identifying information provided by a customer pursuant to paragraph (c) of this section, and copies of any documents that were relied on pursuant to paragraph (d)(1) of this section that accurately depict the types of documents and any identification numbers they may contain;
- (ii) The methods and results of any measures undertaken to verify the identity of a customer pursuant to paragraph (d)(2) of this section; and
- (iii) The resolution of any discrepancy in the identifying information obtained.

(2) Retention of records. The broker-dealer must retain all records made or obtained when verifying the identity of a customer pursuant to its CIP until five years after the date the account of the customer is closed or the grant of authority to effect transactions with respect to an account is revoked. In all other respects, the records shall be maintained pursuant to the provisions of 17 CFR 240.17a-4.

(i) Approval of CIP. The CIP shall be approved by the broker-dealer's board of directors, managing partners, board of managers or other governing body performing similar functions or by a person or persons specifically authorized by such bodies to approve the CIP.

(j) Exemptions. The Commission, with the concurrence of the Secretary, may by order or regulation exempt any broker-dealer that registers with the Commission pursuant to 15 U.S.C. 78o (except broker-dealers that register under subsection (b)(11) of that section) or 15 U.S.C. 78o-4 or type of account from the requirements of this section. The Secretary, with the concurrence of the Commission, may exempt any broker-dealer that registers with the Commission pursuant to 15 U.S.C. 78o-5. In issuing such exemptions, the Commission and the Secretary shall consider whether the exemption is consistent with the purposes of the Bank Secrecy Act, and in the public interest, and may consider other necessary and appropriate factors.

DATED: July 15, 2002

James F. Sloan

Director, Financial Crimes Enforcement Network

By the Securities and Exchange Commission

Margaret H. McFarland

Deputy Secretary

Date: July 12, 2002