

# RESCINDED

Office of Thrift Supervision  
Department of the Treasury

December 07, 1998

**Transmittal**

**TR-214**

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Federal Register, Vol. 63, No. 234. , pp. 67536-67542

**Number: TR-214**

Savings associations would be required to establish and maintain “Know Your Customer” programs under the attached regulation proposed by the Office of Thrift Supervision (OTS). OTS and the other federal banking agencies were directed by statute to require programs that determine the identities of customers and monitor their transactions. The programs are intended to help thrifts and banks understand customer relationships and determine when customers’ conduct is suspicious or involves illegal activities such as money laundering. The proposed rule is similar to rules other federal banking agencies have or will shortly propose.

Rather than spelling out detailed procedures, the OTS proposed minimum requirements. Each savings association would have to determine the identity of its customers, their sources of funds such as direct deposit of pay checks, and their normal and expected transactions. Institutions would report suspicious transactions under existing reporting requirements.

Every savings association could adapt its own “Know Your Customer” program to reflect its size, the nature and complexity of its operations, and its risk of illicit activity. Such a program could include customer profiles for classifying customers in risk-based categories and a monitoring procedure appropriate to each.

Small savings institutions should direct their attention to the section headed “Regulatory Flexibility Act.” OTS purposely designed the proposed rule so that each savings association could design a “Know Your Customer” program appropriate for its circumstances. This flexibility, however, prevents OTS at this time from determining how much economic impact the proposed rule would have on small institutions. Therefore, OTS has included an initial regulatory analysis of potential impact and specifically invites comment on the proposed rule’s economic impact on small institutions.

The rule defines customers as not only individuals or other entities having accounts with the thrift, but also those on whose behalf such accounts are maintained. It applies to both individual and business customers.

Key identifying information may include the customer’s name, home address, place of business and telephone number, all of which may be verified. For business customers, additional identifying information may be required, such as evidence of the business’ legal status.

Thrifts should identify customers who use the mail, the Internet or other electronic means to establish accounts, identify private banking customers, and verify the information.

OTS does not intend that thrifts would not have to check each and every account or buy expensive software in order to comply. Rather, each thrift should design an effective monitoring

## ***Transmittal 214***

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program tailored to the institution and the risk of illegal activities by its customers.

A savings association may choose to monitor only those transactions that meet established parameters, such as dollar size, frequency, or source of funds, in order to focus their monitoring on areas with the greatest risk. The important thing is that each institution adopt a plan and follow it. Thrifts would be required to use either outside parties or independent employees to test their compliance.

The notice of proposed rulemaking was published in the December 07, 1998, edition of the Federal Register, Vol. 63, No. 234, pp. 536-542. Written comments must be received on or before March 8, 1999, and should be addressed to: Manager, Dissemination Branch, Records Management and Information Policy Division, Office of Thrift Supervision, 1700 G Street, N.W., Washington, DC 20552. Comments may be mailed, hand-delivered, faxed to 202/906-7755 or e-mailed to: [public.info@ots.treas.gov](mailto:public.info@ots.treas.gov). All comments should include their name and telephone number.

*For further information contact:*

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— Ellen Seidman  
Director  
Office of Thrift Supervision

Attachment

(1) Provide for and document a system of internal controls;

(2) Provide for and document independent testing for compliance to be conducted by bank personnel or by an outside party on a regular basis;

(3) Designate an individual or individuals as responsible for coordinating and monitoring day-to-day compliance; and

(4) Provide for and document training to all appropriate personnel, on at least an annual basis, of the content and required procedures of the Know Your Customer program.

(f) *Availability of documentation.* For all accounts opened or maintained in the United States, each insured nonmember bank must ensure that all information and documentation sufficient to comply with the requirements of this section are available for examination and inspection, at a location specified by an FDIC representative, within 48 hours of an FDIC representative's request for such information and documentation. In instances where the information and documentation is maintained at a location other than where the customer's account is maintained or the financial services are rendered, the insured nonmember bank must include, as part of its Know Your Customer program, specific procedures designed to ensure that the information and documentation is reviewed on an ongoing basis by appropriate bank personnel in order to comply with this subpart.

By order of the Board of Directors.

Dated at Washington, D.C. this 27th day of October, 1998.

Federal Deposit Insurance Corporation.

**Robert E. Feldman,**

*Executive Secretary.*

[FR Doc. 98-32334 Filed 12-4-98; 8:45 am]

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## DEPARTMENT OF THE TREASURY

### Office of Thrift Supervision

#### 12 CFR Part 563

[No. 98-114]

RIN 1550-AB15

#### Know Your Customer

**AGENCY:** Office of Thrift Supervision, Treasury.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Office of Thrift Supervision (OTS) is proposing to issue a regulation requiring savings associations to develop and maintain

Know Your Customer programs to deter and detect financial crimes. The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency are proposing substantially similar rules in separately published notices. The proposed regulation would reduce the likelihood that savings associations will become unwitting participants in any customer's illicit activities by requiring savings associations to determine the true identities and legitimate activities of their customers. The proposal would require each savings association to determine the identity of its customers, to determine normal and expected transactions for its customers, to determine its customers' sources of funds, to identify transactions that are not normal or expected transactions for the customer, and to report suspicious transactions under existing suspicious activity reporting requirements. The proposal's flexible approach would allow each savings association to design a Know Your Customer program suitable for its own circumstances.

**DATES:** Comments must be received by March 8, 1999.

**ADDRESSES:** Send comments to Manager, Dissemination Branch, Information Management and Services Division, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention Docket No. 98-114. Hand deliver comments to Public Reference Room, 1700 G Street, NW., lower level, from 9:00 A.M. to 5:00 P.M. on business days. Send facsimile transmissions to FAX Number (202) 906-7755 or (202) 906-6956 (if the comment is over 25 pages). Send e-mails to public.info@ots.treas.gov and include your name and telephone number. Interested persons may inspect comments at 1700 G Street, NW., from 9:00 A.M. until 4:00 P.M. on business days.

#### FOR FURTHER INFORMATION CONTACT:

Larry A. Clark, Senior Manager, Compliance and Trust Programs, Compliance Policy, (202) 906-5628, Gary C. Jackson, Analyst, Compliance Policy, (202) 906-5653, Christine Harrington, Counsel (Banking and Finance), (202) 906-7957, or Karen Osterloh, Assistant Chief Counsel, (202) 906-6639, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

#### SUPPLEMENTARY INFORMATION:

##### I. Background

The financial sector's integrity depends on depository institutions' ability to attract and retain legitimate

funds from law abiding customers. Depository institutions' ability to do so rests on the quality and the reliability of their services and on their sound reputation within the financial sector. Illicit financial activities, such as money laundering and fraud, pose a serious threat to financial institutions' integrity. Illicit funds transactions can damage the reputations of the involved financial institution, may subject the institution to criminal liability,<sup>1</sup> and may ultimately damage the reputation of the entire financial sector. While it is impossible to identify every transaction that is illegal or that assists criminals in moving illegally derived funds, financial institutions must take every reasonable step to detect such activity. When institutions identify their customers and determine what transactions are normal and expected for these customers, they are able to monitor transactions to identify unusual or suspicious transactions. By identifying and reporting unusual or suspicious transactions, financial institutions protect their integrity and assist the Federal banking agencies and law enforcement authorities in thwarting illicit activities.

The proposed regulation would implement 12 U.S.C. 1818(s). This statute requires the Federal banking agencies to prescribe regulations requiring depository institutions to establish and maintain procedures reasonably designed to ensure and monitor compliance with the Currency and Foreign Transaction Reporting Act (31 U.S.C. 5311 *et seq.*) Effective Know Your Customer programs should facilitate compliance with the Currency and Foreign Transaction Reporting Act and the regulations issued thereunder (31 CFR 103.11 *et seq.*) (collectively referred to as the Bank Secrecy Act).

Accordingly, OTS is proposing to issue rules requiring savings associations to develop and maintain Know Your Customer programs to detect and deter financial crimes. The Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation are also proposing similar Know Your Customer regulations. OTS believes that similar rules applicable to different types of financial institutions will prevent competitive disparities between industries. OTS's proposal uses the plain language drafting techniques described in President Clinton's Memorandum on Plain Language in Government Writing (June 1, 1998), Vice President Gore's Memorandum Implementing the Presidential

<sup>1</sup> See 18 U.S.C. 1956 and 1957.

Memorandum on Plain Language (July 20, 1998), and the **Federal Register** Document Drafting Handbook.

The Federal banking agencies' position regarding the importance of a Know Your Customer program is consistent with that of other countries, as evidenced by the pronouncements of several international organizations.<sup>2</sup> Numerous countries have supported Know Your Customer programs and mandatory suspicious transaction reporting as the best means of protecting the financial sector. Criminal elements tend to gravitate towards financial institutions that operate within poorly regulated and poorly supervised jurisdictions. Know Your Customer programs work to stifle transactions involving illegally derived funds.

OTS recognizes that the proposed Know Your Customer requirements would impose additional burdens on some institutions. Consequently, OTS has proposed only the minimal requirements necessary to ensure that savings associations have adequate programs. Moreover, the proposed regulation is designed to be flexible so that savings associations can create Know Your Customer programs appropriate for their circumstances. In addition, the Federal banking agencies intend to publish interpretive guidance on Know Your Customer issues at the same time as the regulations become final. This guidance, coupled with a flexible regulation, will aid savings associations in complying with the regulations.

### Section-by-Section Analysis

OTS proposes to add a new regulation at 12 CFR 563.178 that would require every savings association to develop and implement a Know Your Customer program. The proposed rule describes the basic requirements of a Know Your Customer program, but does not set forth specific mandates in a checklist style. Rather, the proposal would give each savings association the flexibility to design a Know Your Customer program that is appropriate for its size, the nature and complexity of its operations, and its risk of illicit activity. The proposed rule is summarized below.

<sup>2</sup> See the Basle Committee on Banking Regulations and Supervisory Practices' December 1988 "Statement on the Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering," as well as the Committee's April 1997 "Core Principles for Effective Banking Supervision;" the 1988 United Nations Vienna Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances; the 1990 Council of Europe Convention; and the Financial Action Task Force Forty Recommendations, issued in 1989 and amended in 1996.

### *Section 563.178(a) Who Must Establish a Know Your Customer Program?*

Proposed paragraph (a) would require each savings association to establish and comply with a written Know Your Customer program. The savings association's board of directors or a committee of the board would be required to approve the program and record the approval in the official board minutes. These requirements would ensure that the same standards are applied throughout the savings association and would inform auditors and examiners of the program's requirements.

OTS intends to allow savings associations a sufficient time after publication of a final rule to establish Know Your Customer programs. OTS proposes to make the final Know Your Customer rule effective on April 1, 2000. In this way, savings associations will have a sufficient period to establish and implement their Know Your Customer programs.

### *Section 563.178(b) Why Must I Establish a Know Your Customer Program?*

Paragraph (b) of the proposed rule would explain why a savings association must establish a Know Your Customer program. Such programs serve several purposes: protecting the savings association's reputation; facilitating its compliance with the Bank Secrecy Act, the OTS's suspicious activity reporting regulations, and safe and sound practices; and protecting the savings association from becoming a vehicle for, or a victim of, illegal activities by its customers.

### *Section 563.178(c) Who Is My Customer?*

The proposed rule defines "customer" to include any person or entity who has an account with a savings association that involves the receipt or disbursement of funds, and any person or entity on behalf of whom an account is maintained. The term includes direct and indirect beneficiaries of the account when the activity in the account involves the receipt or disbursement of funds. A "customer" would include an account holder, a beneficial owner of an account, or a borrower. A "customer" could include the beneficiary of a trust, an investment fund, a pension fund or a company whose assets are managed by an asset manager; a controlling shareholder of a closely held corporation; or the grantor of a trust established in an off-shore jurisdiction. The term "customer" does not include recipients of services for which the

receipt or disbursement of customer funds is incidental, such as rental of safe deposit boxes.

The proposed definition would include both existing and new customers. The effectiveness of a Know Your Customer program would be greatly reduced if all customer accounts in existence prior to the effective date of the regulations were excluded from its scope. However, the OTS does not believe that it is practicable for a savings association to conduct a large-scale information request from all its existing customers. Rather, a savings association could comply with the proposed regulation by determining its current customers' normal and expected transactions using available account data, and monitoring their transactions for suspicious activities. However, if existing customers and their transactions present unusual risk of illegal activity (for instance, transactions involving private banking customers), it may be necessary to fulfill all of the requirements of this regulation as if they were new customers.

### *Section 563.178(d) What Transactions Are Covered Under This Section?*

The regulation would define "transaction" to include any transaction by a customer that is conducted at a savings association's facilities or that involves the savings association, regardless of where the transaction is conducted.

### *Section 563.178(e) What Must My Know Your Customer Program Contain?*

Proposed paragraph (e) sets forth the basic requirements for Know Your Customer programs. Savings associations vary considerably in how they conduct their day-to-day business. OTS believes that requiring each savings association to follow a standard checklist would be of little value. Accordingly, the proposed regulation would allow each savings association to develop an individualized Know Your Customer program. Such individualized programs would more appropriately reflect the size and complexity of the savings association, the types of customers it serves, the nature and extent of its customers' activities, and its risks of illicit activity. In particular, proposed paragraph (e) would allow a savings association to develop "customer profiles" for classifying customers into risk-based categories to determine the information and monitoring that is appropriate for those customers and to determine when customers' transactions may be suspicious.

While the proposed regulation would provide savings associations with substantial flexibility to devise individualized Know Your Customer programs, all Know Your Customer programs must contain certain critical features. First, proposed § 563.178(e)(1) would require each savings association to determine the identities of its prospective customers. For existing customers, a savings association also would be required to determine their identity if it has reason to believe that it lacks adequate information to know their identity.

Each savings association would need to establish, to its own satisfaction, that it is dealing with a legitimate person or entity, and must verify its customer's identity. The nature and extent of the identification process should be commensurate with the anticipated transactions and the risks of illegal activity associated with such transactions.

If a prospective customer refuses to provide any requested information, sound practices would require that the savings association not establish the customer relationship. Similarly, if an established customer refuses to provide requested information, sound practices would require the savings association to consider terminating the relationship.

The best documents for verifying the identity of a prospective customer are the ones that are the most difficult to obtain illicitly and the most difficult to counterfeit. Because no single form of identification can be guaranteed to be genuine, a savings association should use a cumulative identification process and should obtain enough information and documentation to ensure that it has properly identified its customer. In addition to the customer's name, key identifying information may include the customer's address, place of business, and telephone number. A savings association may find it appropriate to verify addresses by physically observing the locations, and to verify telephone numbers by calling the numbers. Extra steps may be appropriate for customers outside a savings association's normal service area.

If a customer is a natural person, acceptable forms of identification would include a document with a photograph, a description of the person, the person's signature, and an easily recognizable identification issued by a government entity. While not an exhaustive list, examples of acceptable identification issued by a government entity include a driver's license or an identification card with a photograph issued by the State where the savings association is located, or a United States passport or alien

registration card. Other forms of identification, while not sufficient without corroboration, can serve as helpful cumulative information. Examples of such information include an employer or student identification card, an out-of-State driver's license, a credit card, or a customer's current home utility bills.

For corporate or business customers, a savings association should verify that the corporation or business entity exists and engages in its stated business. A savings association should obtain evidence of a business's legal status, such as an incorporation document, a partnership agreement, association documents, or a business license. In some instances, it may also be appropriate to obtain information on the business's controlling owners. Additionally, a savings association should obtain a business customer's financial statements, a description of the business, and a description of its primary areas of trade. To verify information, a savings association may also obtain information related to a business's customers and suppliers.

At a minimum, for both natural persons and corporate or business customers, the savings association's records should indicate the type of identification obtained. If no legal impediment exists, the savings association should duplicate and maintain a copy of the documentation.

Establishing a customer relationship without face to face contact (e.g., by mail, Internet, or other electronic operations) poses difficulties in identifying customers. Even though photographic identification may be impractical, other acceptable means of identifying the customer are available. In such circumstances, a savings association should carefully verify a customer's address and telephone number. The savings association may use other commercially available data, such as credit reports and traditional information sources, to compare items such as a customer's name with his or her date of birth and social security number.

Introductions or referrals of prospective customers by established customers can provide extremely valuable background information about a prospective customer. The savings association should, of course, document details regarding the introduction or referral to assist in verifying the prospective customer's identity. Introductions and referrals cannot, however, take the place of the identification required under the proposed regulation.

Private banking accounts pose unique risks because customers may use them to protect or conceal their identities by using such account vehicles as personal investment companies, trusts, personal mutual investment funds, or a financial advisor's account. However, OTS and other Federal banking agencies believe that properly identifying private banking customers is necessary to depository institutions' safe and sound operation. Procedures for identifying private banking customers should be no different than the procedures for identifying other customers. A savings association can address private banking customers' confidentiality needs by developing special protections that limit access to information that could reveal the beneficial owners of these accounts.<sup>3</sup>

A savings association must also identify beneficial owners of assets bought, sold or managed through the savings association. Such transactions often occur at the behest of intermediaries, such as asset managers. The "customer" in these situations would include the beneficiaries of the transactions, not just the intermediaries. The amount of information necessary to fulfill Know Your Customer obligations would depend on the risk of illicit activity. Risk depends on matters such as the type, duration, and size of the transactions that a customer will conduct. Savings associations should address the type and amount of information necessary as a part of their Know Your Customer programs.

Where there is little risk of illegal activities by customers, savings associations would not be required to identify those indirect customers or monitor their transactions. For example, if the customer is a widely-held mutual fund or asset management fund whose shares are traded on a public exchange, there is little risk that the customer's shareholders would conduct illegal acts at the savings association. Similarly, if a savings association's customer is a regulated financial institution for whom the savings association is an intermediary in check clearing or funds transfer processing, there is little risk that the financial institution's customers would conduct illegal acts at the savings association. On the other hand, if the savings association's customer is a mutual fund established in an off-shore

<sup>3</sup> For an in-depth discussion of private banking and sound practices associated with the administration of private banking activities, see the July 1997 Guidance on Sound Risk Management Practices Governing Private Banking Activities, prepared by the Federal Reserve Bank of New York and issued by the Federal Reserve Board. It is available on the Federal Reserve Board's public Internet website ([www.federalreserve.gov/](http://www.federalreserve.gov/)).

jurisdiction that has a limited number of shareholders, the risk of illegal activity is higher. In that case, the savings association would be required to identify and monitor the customers of the mutual fund.

In addition to identifying each customer as a part of the Know Your Customer program, proposed § 563.178(e)(2) would require a savings association to identify its customer's sources of funds for transactions at the savings association. For purposes of determining and documenting the sources of funds, the amount of information necessary will depend on the type of customer. A savings association may categorize customers and obtain more or less information depending on the risks of illicit activities in the category. For example, many customers with demand deposit accounts obtain their funds from payroll deposits. Thus, a savings association may identify and document these customers' sources of funds relatively easily. On the other hand, a savings association would be required to obtain more documentation for customers with multiple deposits from a variety of sources. The proposed regulation would allow, and OTS would encourage, savings associations to categorize customers that share common characteristics in order to collect pertinent information with the least burden.

Proposed § 563.178(e)(3) would require a savings association to determine its customers' normal and expected transactions. This determination forms the basis for identifying transactions that are out of the ordinary, unexpected, and possibly suspicious. A savings association cannot completely determine a customer's normal and expected transactions when it first establishes a customer relationship. Accordingly, an effective Know Your Customer program should include procedures for periodically reviewing a savings association's original determination to determine whether the same transactions are still normal and expected.

OTS encourages savings associations to design flexible Know Your Customer programs. This proposed rule would allow savings associations to determine normal and expected transactions for categories or classes of customers that share common characteristics.

Associations may use this flexibility to focus their efforts on areas with the greatest risk of illicit activity. For example, customers with demand deposit accounts funded by payroll deposits will, most likely, use the accounts for depositing salaries and for

ordinary living expenses. Such accounts would require little analysis. Conversely, business accounts or private banking customers' accounts may require more in-depth analysis of the customers' intended use of the accounts.

Proposed § 563.178(e)(4) would require a savings association to monitor customers' transactions to determine if transactions are normal and expected for individual customers or for categories or classes of customers. While monitoring is critical, a savings association would not be required to monitor every transaction of every customer. Similarly, OTS does not suggest that savings associations must purchase expensive, sophisticated computer hardware or software to comply with the proposed rule. Rather, OTS encourages each savings association to design an effective monitoring program that is appropriate for that institution and that corresponds to the risk of illegal activities by its customers. For example, a savings association may categorize, for monitoring purposes, by account type, transaction type, account size, or number and size of transactions in accounts. A savings association may choose to monitor only those transactions that meet established parameters, such as dollar size, frequency, or source of funds, for a particular category of account. Whatever the method, savings associations should focus their monitoring on areas with the greatest risk of illegal activity. The Federal banking agencies are working on interpretive guidance to help institutions in this area. OTS will give deference to a savings association's monitoring program.

For some categories or classes of accounts, a savings association may have to monitor each transaction. For example, a savings association should understand the nature of and monitor each significant private banking transaction. Because one of the goals of private banking is to offer highly individualized service through the use of relationship managers, OTS does not believe that the burden of monitoring each transaction of private banking customers is significant.

In many instances, savings associations already monitor their customers' transactions. For example, savings associations monitor transactions in order to comply with suspicious activity reporting requirements. Similarly, savings associations monitor for large cash transactions, check kiting and attempted withdrawals from accounts with insufficient funds or from closed accounts. Savings associations'

experience in monitoring these transactions should ease the impact of Know Your Customer monitoring requirements.

Proposed § 563.178(e)(4) would require savings associations to identify customer transactions that are not normal and expected. Under this proposed rule, a savings association would not be required to detect every abnormal or unexpected transaction. Rather, a savings association would be required to identify those monitored transactions that were not consistent with its determination of what is normal and expected for a particular customer.

Under proposed § 563.178(e)(5), the savings association would be required to determine whether each identified transaction is unusual or suspicious. If the transaction is suspicious, the association would be required to report the transaction under OTS's existing suspicious activities reporting requirements at 12 CFR 563.180. The proposed Know Your Customer regulation would impose no additional reporting requirements.

#### *Section 563.178(f) How Do I Ensure Compliance With My Know Your Customer Program?*

Under proposed § 563.178(f), a savings association must follow its Know Your Customer program. To do so, a savings association would have to establish internal controls to ensure ongoing compliance. In addition, the savings association would be required to use either outside parties or independent employees to test its compliance. The proposed rule would also require each savings association to designate at least one individual to be responsible for coordinating and monitoring day-to-day compliance. Finally, a savings association would be required to train the appropriate personnel in the Know Your Customer program at least annually.

These requirements are very similar to OTS's procedures for monitoring Bank Secrecy Act compliance.<sup>4</sup> Savings associations are familiar with, and regularly use, the Bank Secrecy Act procedures. Where appropriate, a savings association may charge its Bank Secrecy Act compliance officer with the responsibility for its Know Your Customer program. This should ease the burdens associated with complying with the new Know Your Customer regulation.

<sup>4</sup> 12 CFR 563.177(c) (1998).

*Section 563.178(g) How Do I Document My Compliance With My Know Your Customer Program?*

Proposed section 563.178(g) would require a savings association to maintain information and documents demonstrating that it has complied with all of the requirements of the Know Your Customer regulation, including the internal control, independent testing, and training requirements listed under the compliance requirements. The proposed rule would further require a savings association to make all Know Your Customer documents available to OTS within 48 hours of a request, unless OTS specifies a different time period.

In addition, if a savings association maintains information or documents at a location other than where it maintains a customer's account or where it renders financial services, it must also establish and follow procedures designed to ensure that its employees review, on an ongoing basis, information and documents to ensure that it has complied with the Know Your Customer requirements.

**Comments Sought**

OTS specifically seeks comments on the following questions:

1. Is the proposed definition of "customer" sufficient to include all persons who benefit from an account opened at a savings association, such as persons who establish off-shore shell companies, or entities that otherwise conduct their business through intermediaries?

2. Is the proposed definition of "customer" too broad, unnecessarily reaching persons who pose a minimal risk of illicit activities at savings associations?

3. Should "customer" include savings associations' counterparties in wholesale financial transactions? Should "customer" include correspondent banking relationships? Would a different standard be more appropriate for those transactions or relationships?

4. Would the benefits of implementing Know Your Customer requirements outweigh the costs involved? Are there alternatives that would better balance these costs and benefits?

5. Would the proposed regulation place savings associations at a competitive disadvantage with respect to other financial entities offering similar services that are not subject to similar requirements? Please cite specific examples.

6. Would the added compliance benefits of this proposal outweigh the

actual or perceived invasion of personal privacy interests?

7. Should OTS waive Know Your Customer requirements for accounts below a minimum size threshold? If so, where should OTS set the threshold?

**Executive Order 12866**

The Director of OTS has determined that this proposed rule does not constitute a "significant regulatory action" for the purposes of Executive Order 12866.

**Regulatory Flexibility Act**

Under the Regulatory Flexibility Act, OTS must either provide an Initial Regulatory Flexibility Analysis (IRFA) with this proposed rule, or certify that the proposed rule would not have a significant economic impact on a substantial number of small entities. This proposed rule is designed to be flexible so that each savings association could design a Know Your Customer program appropriate for its circumstances. While advantageous to savings associations, this flexibility makes it difficult to predict the economic impact of the proposed rule. OTS cannot, at this time, determine whether the proposed rule would have a significant economic impact on a substantial number of small institutions. OTS, therefore, includes this IRFA.

*A. Reasons for and Objectives of the Proposed Rule*

The proposed Know Your Customer rule is designed to deter and detect financial crimes, such as money laundering, tax evasion, and fraud. Financial crimes conducted at or through savings associations, even where savings associations are not parties to the transactions, can damage the reputations of the institutions involved, and possibly of the entire thrift industry. Under current law, savings associations are required to report suspicious activities to law enforcement authorities, but are not required to specifically search for suspicious activities. As a result, suspicious activities may go unreported, and illegal activity may go undetected. Know Your Customer programs would better enable savings associations to alert law enforcement authorities to potential criminal conduct and help deter criminal conduct in the thrift industry.

OTS has two primary objectives for this proposed rulemaking: (1) increasing savings associations' detection and reporting of suspicious customer activities; and (2) deterring financial crimes at savings associations.

The proposed rule would apply to large and small savings associations. Small savings associations are generally defined, for Regulatory Flexibility Act purposes, as those with assets under \$100 million.<sup>5</sup> This proposed rule would apply to approximately 600 small savings associations.

*B. Requirements of the Proposed Rule*

The proposed rule would require savings associations to identify their customers, determine their customers' normal and expected transactions, determine their customers' sources of funds, monitor transactions to find those that are not normal and expected, and, for transactions that are not normal and expected, identify which are suspicious. Savings associations are required to report any suspicious transactions under current law, and this proposed rule would have no additional reporting requirements.

The impact of the proposed regulation on an institution's resources, and the skills necessary to comply with it, will vary from one institution to another because the proposed regulation is designed to take into account each institution's size and resources. Because each institution would be able to design an individualized Know Your Customer program, it is difficult to specify the type of professional skills necessary for preparing any required records or reports. Large institutions may be more likely to use computerized Know Your Customer programs, and in that event would be more likely to need professional computer skills. Small institutions that choose to automate their Know Your Customer programs would need professional computer skills.

Know Your Customer monitoring would be similar to monitoring that savings associations already do. For example, savings associations monitor customer transactions to ensure that cash transactions exceeding \$10,000 are reported under the Bank Secrecy Act, to ensure that customers do not overdraw their accounts, and to ensure that loan payments are accurate and timely. Thus, Know Your Customer monitoring would rely, at least in part, on computer and other skills that savings association personnel already have and regularly use.

*C. Significant Alternatives*

1. No Know Your Customer Requirements

OTS considered recommending rather than requiring Know Your Customer

<sup>5</sup> 13 CFR 121.201, Division H (1998).

procedures. OTS decided to propose this rulemaking, however, because of the risks that savings associations face from customers who attempt illegal activities. Illegal activities would harm an association's reputation and that of the entire thrift industry. Requiring Know Your Customer programs significantly reduces the likelihood that some savings associations would not establish or adhere to such programs. In addition, because other Federal banking agencies are proposing Know Your Customer rules, OTS believes that criminals would quickly move their illegal funds transfers into savings associations without Know Your Customer programs, thus increasing those savings associations' exposure to illegal activity.

For these reasons, merely recommending Know Your Customer programs would interfere with OTS's goals of increasing savings associations' detection and reporting of suspicious customer activities, and deterring financial crimes at savings associations.

## 2. Exemption for Small Savings Associations

OTS considered exempting small institutions from Know Your Customer requirements. However, this alternative has the disadvantage of possibly creating a haven for criminal activity. It is likely that criminals would concentrate their activity at those institutions not subject to any Know Your Customer requirements. An exemption for small savings associations would conflict with OTS's goals of increasing savings associations' detection and reporting of suspicious customer activities and deterring financial crimes at savings associations.

## 3. Flexible Know Your Customer Requirements

OTS proposes requiring all savings associations to establish and follow Know Your Customer programs, but proposes allowing each institution to develop a program appropriate for its circumstances, including but not limited to its size and resources. This approach is preferable to the first two alternatives because it does not allow criminals to choose a savings association without Know Your Customer requirements to conduct illegal activities. A flexible alternative also avoids requirements beyond the means of small institutions. Small institutions could use simpler, less costly, and less burdensome programs than larger institutions.

## D. Other Matters

OTS has statutory authority to promulgate these proposed regulations.<sup>6</sup> There are no federal rules that duplicate, overlap, or conflict with this proposed rule. The proposed rule complements OTS rules implementing the Bank Secrecy Act at 12 CFR 563.178 and the suspicious activity reporting requirements at 12 CFR 563.180.

OTS encourages comments on all aspects of this initial regulatory flexibility analysis, including comments on any significant economic impacts the proposed rule would have on small entities.

### Unfunded Mandates Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4 (Unfunded Mandates Act), requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a federal mandate that may result in expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. OTS has determined that the proposed rule will not result in expenditures by state, local, or tribal governments or by the private sector of \$100 million or more. Accordingly, this rulemaking is not subject to section 202 of the Unfunded Mandates Act.

### Paperwork Reduction Act

OTS invites comment on: Whether the proposed information collection contained in this proposal is necessary for the proper performance of OTS's functions, including whether the information has practical utility;

The accuracy of OTS's estimate of the burden of the proposed information collection;

(1) Ways to enhance the quality, utility, and clarity of the information to be collected; Ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and

Estimates of capital and start-up costs of operation, maintenance and purchases of services to provide information.

Respondents/recordkeepers are not required to respond to this collection of

information unless it displays a currently valid OMB control number.

OTS has submitted the collection of information requirements contained in this proposal to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Send comments on the collections of information to the Office of Management and Budget, Paperwork Reduction Project (1550), Washington, D.C. 20503, with copies to the Regulations and Legislation Division (1550), Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, N.W., Washington, D.C. 20552.

The collection of information requirements in this proposed rule are found in 12 CFR 563.178. OTS requires this information for the proper supervision of savings associations' compliance with the Bank Secrecy Act. The likely respondents/recordkeepers are savings associations.

*Estimated average annual burden hours per respondent/recordkeeper:* 8.  
*Estimated number of respondents:* 1191.

*Estimated total annual reporting and recordkeeping burden:* 9528.

*Start up costs to respondents:* None.

### List of Subjects in 12 CFR Part 563

Accounting, Advertising, Crime, Currency, Investments, Reporting and recordkeeping requirements, Savings associations, Securities, Surety bonds.

Accordingly, the Office of Thrift Supervision proposes to amend Title 12, Chapter V as set forth below:

### PART 563—[AMENDED]

1. The authority citation for part 563 is revised to read as follows:

**Authority:** 12 U.S.C. 375b, 1462, 1462a, 1463, 1464, 1467a, 1468, 1817, 1818, 1820, 1828, 1831p-1, 3806; 42 U.S.C. 4106.

2. Section 563.178 is added to read as follows:

#### § 563.178 Know your customer.

(a) *Who must establish a Know Your Customer program?* Each savings association ("you") must establish and comply with a written Know Your Customer program that describes your procedures for complying with this section. Your board of directors, or a committee of your board, must approve your Know Your Customer program and must record that approval in your official board minutes.

(b) *Why must I establish a Know Your Customer program?* These procedures: protect your reputation; facilitate your compliance with the Bank Secrecy Act, the suspicious activity reporting

<sup>6</sup> 12 U.S.C. 1464(a)(1), 1464(d)(6)(A), 1818(s)(1).



requirements of § 563.180, and safe and sound practices; and protect you from becoming a vehicle for, or a victim of, your customers' illegal activities.

(c) *Who is my customer?* Your customer is any person or entity who has an account with you involving the receipt or disbursement of funds, and any person or entity on behalf of whom such an account is maintained.

(d) *What transactions are covered under this section?* A transaction is any transaction by a customer that is conducted at your facilities or that involves you, regardless of where the transaction is conducted.

(e) *What must my Know Your Customer program contain?* Your Know Your Customer program may vary in scope and complexity according to categories or classes of customers that you establish, and the potential risk of illicit activities associated with your customers' accounts and transactions. Under your Know Your Customer program, you must do all of the following:

(1) Determine your prospective customers' identities. You must also determine the identities of your existing customers if you have reason to believe that you lack adequate information to know the identities of those customers.

(2) Identify the sources of funds for your customers' transactions. You may make this determination for a customer individually, or for categories or classes

of customers that share common characteristics.

(3) Determine the types of transactions that you expect your customers to normally conduct ("normal and expected transactions"). You may make this determination for a customer individually, or you may determine what types of transactions are normal and expected for categories or classes of customers that share common characteristics.

(4) Monitor your customers' transactions and identify transactions that are not consistent with your customers' normal or expected transactions as determined under paragraph (e) (2) and (3) of this section. You may monitor transactions for each customer individually, or you may monitor transactions for categories or classes of customers that share common characteristics.

(5) Determine whether transactions identified under paragraph (e)(4) of this section are unusual or suspicious. If any are suspicious, you must follow OTS's suspicious activity reporting regulations at 12 CFR 563.180.

(f) *How do I ensure compliance with my Know Your Customer program?* To ensure compliance, you must do all of the following:

(1) Establish internal controls to ensure your ongoing compliance.

(2) Independently test your compliance. Your employees or outside parties may conduct the testing.

(3) Designate an individual(s) responsible for coordinating and monitoring day-to-day compliance.

(4) Train all appropriate personnel on your program at least annually.

(g) *How do I document my compliance with my Know Your Customer program?* (1) You must maintain information and documents demonstrating that you have complied with all of the requirements of this section, including internal control, independent testing, and training requirements of paragraph (f) of this section.

(2) You must provide all information and documents demonstrating your compliance with this section to OTS for examination and inspection within 48 hours of an OTS request, unless OTS specifies a different time period.

(3) If you maintain information or documents at a location other than where you maintain a customer's account or where you render financial services, you must establish and follow procedures designed to ensure that your employees review, on an ongoing basis, information and documents to ensure that you comply with this section.

Dated: November 9, 1998.

By the Office of Thrift Supervision.

**Ellen Seidman,**

*Director.*

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