The US Patriot Act: Increased regulatory challenges for international banks

John J Maalouf
The writer is the Chairman of Maalouf Law Firm, New York. He was ranked No. 5 in the area of 'International Trade and Finance Lawyers' by the United States Lawyer Rankings, 2006 and can be reached at john.maalouf@maalouf.us.

INTERNATIONAL BANKS HAVE long been accustomed to extensive legal scrutiny by banking regulators in the USA. For years, international banks seeking to establish offices in the US have been required to abide by various approval, notice and licensing requirements, as well as by numerous restrictions on their activities. However, in the wake of the events of 11 September 2001, international banks have become subject to even greater regulatory scrutiny. The USA Patriot Act, Public Law 107-56, ('Patriot Act') signed by President George W. Bush on 26 October 2001, stands for "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism" (*Introduction to the Patriot Act of 2001)*. Deterring terrorist financing has, understandably, become one of the foremost priorities for the United States government today. Unfortunately, as an unforeseen consequence of the Patriot Act, international banks have been put in the untenable position of having to discern, solely from seemingly routine deposits, withdrawals or fund transfers, which of these transactions are innocent and which may be used to fund terrorist activities.

As numerous US banks conduct business around the world, there would appear to be little or no logical reason to draw regulatory distinctions between those banks and international banks with US operations. It is an unfortunate reality that terrorist groups could just as easily utilise US banks with international operations to finance their activities as they could use an international bank operating in the US. However, in some instances, the Patriot Act puts an international bank, which statistically maintains accounts for and conduct transactions with more non-US citizens, under greater scrutiny and more arduous restrictions than a similarly situated US bank. Moreover, in numerous instances, an international bank may find that it faces greater regulatory hurdles in complying with the Patriot Act provisions than do its US counterparts.

ENHANCED DUE DILIGENCE

One example of these stricter regulatory requirements is in the area of due diligence reviews a bank must perform when opening an account for a new client. All banks, whether US or international, which conduct banking operations in the USA must obtain, verify and maintain certain identifying information about their customers upon the opening of an account. In addition to basic client information requirements, enhanced due diligence must be applied when an account is opened for a non-US person who establishes a 'private banking account' – defined in the Patriot Act as an account, or any combination of accounts:

- requiring a one million dollar minimum aggregate deposit of funds or other assets;
- established on behalf of one or more individuals who have a direct or beneficial ownership interest in the account; and
- assigned to, or administered or managed by an assigned officer, employee or agent of the bank who acts as a liaison between the owner of the account and the bank.

The statute offers no specific guidance on what comprises such enhanced due diligence beyond noting that the procedures should be reasonably designed to (1) 'detect and report instances of money laundering' through the account, and (2) at a minimum, the institution must take 'reasonable steps' to ascertain both the nominal and beneficial owners of the account and the source of funds designated for the account. In addition, if the nominal or beneficial owner is a senior non-US political figure or an immediate family member or close associate of the political figure, enhanced due diligence must be carried out that is reasonably designed to detect and report transactions that may involve the proceeds of 'foreign corruption'.

Regulations providing additional guidance on the nature and specifics of this enhanced due diligence requirement are pending. An interim rule issued in 2002 referred banks to various letters including a 1997 letter issued by the Federal Reserve Board on private banking activities and a 2001 letter issued jointly by bank regulators and the Treasury and State departments providing guidance on enhanced scrutiny of transactions that might be linked to political corruption.

COMPLIANCE ISSUES

In seeking to comply with this enhanced due diligence requirement a bank may not have the same ability to research a potential non-US private banking customer as easily as it can a US private banking client (such as the ability to order a credit report) due to a lack of informational resources.

A possible additional twist the US offices of international banks face in complying with the Patriot Act requirements is dealing with bank management in the international bank's home country. Management may not fully understand why its bank's US office would refuse to open an account for a valued bank customer, even though there may be no way to verify where the potential customer works or obtained the funds to establish the account. As a result, management of an international bank's US office must have the requisite diplomatic skills to deftly handle these types of head office demands.

With customer identification, both the U.S. bank international bank are likely to have many of the same issues verifying the identity of a new non-US customer when complying with the regulation; however, in other instances, an international bank is treated differently in the relevant statute or regulation itself.

CORRESPONDENT ACCOUNTS

An example of this arises in the situation where a large US bank wishes to establish a bank account (called a correspondent account) with another US bank. Doing so is usually a fairly straightforward matter under the Patriot Act. By contrast, if an international bank wishes to establish a correspondent account at a US bank or the US office of an international bank, the international bank must certify to the US bank that it is indeed a genuine bank with a physical presence and real banking operations, as opposed to a 'shell bank' that does not maintain a physical presence in any country. It also must certify that it will not use that correspondent account to indirectly provide banking services to a shell bank.

A US bank or US office of an international bank maintaining a correspondent account for an international bank must have policies and procedures that are similar to private banking customer account policies and procedures, including enhanced due diligence 'reasonably designed to detect and report instances of money laundering'. In addition, if the international bank is considered high risk (e.g. the international bank establishing the correspondent account has its charter from a country that might be of additional money laundering concern), then additional measures are to be taken including:

- determining the identity of the owners of a non-publicly traded bank;
- conducting more intense scrutiny of the account for suspicious transactions;
- ascertaining whether correspondent services for other international banks will be conducted through that account; and if so
- to obtain additional information on those international banks.

As with private banking accounts, more detailed regulations are expected to be issued that will provide additional guidance on these enhanced due diligence procedures.

The Treasury Department noted in an interim rule issued in 2002 that banks should make good faith efforts to develop the required policies and procedures and suggested using, as a guide, existing best practices such as those issued by the New York Clearing House. In March 2002, the New York Clearing House Association issued a 22-page paper entitled 'Guidelines for Counter Money Laundering Policies and Procedures in Correspondent Banking' – an extremely useful guide on establishing and maintaining correspondent banking relationships with international banks. The guidelines set out various risk factors and unusual activities that may signal a need for further investigation into the international bank's correspondent account, its ownership and its relationship with its home regulators. The guidelines are available on the Clearing House website at http://www.theclearinghouse.org [1]

1. On 30 June 2005, the Federal Financial Institutions Examination Council, an interagency group of federal banking regulators, issued a Bank Secrecy Act/Anti-Money Laundering Examination Manual that, while not purporting to be offering any new substantive guidance on this subject, was intended to collect in one spot all the current regulatory requirements, supervisory issuances and practices in this area.

In addition, when the international bank establishes the correspondent account, it must appoint a US agent for service of process and is subject to subpoena for documents regarding that account, even if the documents sought are located outside the United States. The secretary of the Treasury or the attorney general can require an account to be closed if the international bank does not either comply with or contest a summons or subpoena to produce documents, within 10 business days after receipt of said summons or subpoena. If the US bank does not comply with the disclosure order, it can face a civil penalty of up to US$10,000 a day until the correspondent account is finally closed.

FORFEITURE AUTHORITY

Another important provision applicable only to international bank correspondent accounts is the fact that §319(a) of the Patriot Act enables prosecutors to seize and forfeit assets in that international bank's correspondent account if a criminal against whom the US government has a forfeiture order deposits funds in the international bank outside of the United States. No connection between the funds in the US correspondent account and the criminal's deposited funds is necessary. Only the owner of the account can contest the seizure of the funds and, in this context, 'owner' does not include the international bank unless the basis for the seizure/forfeiture is alleged wrongdoing by the international bank, or the international bank can show by a preponderance of the evidence that it repaid the money to the depositor. There is also no requirement that the criminal sought be, in any way, related to terrorism. For example, in early 2001 a couple was indicted for conspiracy to commit money laundering, mail and wire fraud; they fled the US and deposited some of the proceeds of their crimes into banks outside the United States.

Efforts by the United States to recover those funds failed. However, after the Patriot Act was passed, prosecutors used §319(a) to recover what funds remained.

CONCLUSION

These are just a few examples of the unique issues international banks face conducting business in the United States. Fortunately, these new regulatory requirements, which in some instances appear to favour US banks by creating an uneven playing field, have not yet deterred international banks from establishing and maintaining offices in the United States. A sound international banking community is essential not only for purposes of maintaining global economic stability, but also as an indispensable element in combating terrorism.