

FINANCIAL INSTITUTIONS DRAFTED INTO WAR ON TERRORISTS by James D. Harmon, Jr.

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On October 26, 2001, the President signed into law the International Money Laundering Abatement and Financial Antiterrorism Act of 2001 (hereinafter the Act) as part of the USA Patriot Act. This article focuses on those provisions of the Act having the most direct impact on United States financial institutions.

Among the Congressional findings and purposes behind the Act was that between 12 and 30 trillion dollars are laundered worldwide annually,¹ and that there is a need “to increase the strength of United States measures to prevent, detect, and prosecute international money laundering and the financing of terrorism.”² Though unstated, the real target of the legislation is the terrorist Al Qaeda network and its collaborators.

The Act, and its level of sophistication, is a product of the fact that Al Qaeda has successfully compromised international financial institutions worldwide at virtually every level of their businesses.

The entire financial system organized by bin Laden seems to be functioning quite effectively and efficiently. The most important proof is that virtually no terrorist money has been seized throughout the West.³

The Act enlists financial institutions as a

strategic partner in the war against terrorists. Mission: to deny terrorists access to international and local methods of financing their operations. Financial institutions now have the means and incentive to follow the President’s “stop payment” order.

Money is the lifeblood of terrorist operations. Today, we’re asking the world to stop payment.⁴

Principally, the Act imposes statutory obligations on private banks to determine the identity of their high net worth foreign customers and the source of their funds, demands that all banks investigate correspondent banks operating through laundering havens, prohibits dealings with foreign shell banks and mandates the adoption of customer identification procedures. Financial institutions are required to report suspect conduct, and freed from liability if they do so.

What is ‘Reasonable’?

In some instances, follow-up Treasury regulatory action is mandated. In others, further Treasury regulation is permissive. Implementation of all new measures is phased in over the next year. Violations carry stiff civil and criminal penalties. The law has an unusual sunset feature. All of its provisions terminate “on or after the first day of the fiscal year 2005,” but only after

Congress enacts a joint resolution to that effect.⁵

The Act sets certain minimum objective standards for investigation. Beyond these objective measures, the notion of “reasonableness” threads its way through all of the various duties to investigate. This “reasonableness” has objective and subjective aspects.

Objectively, the measures taken must be “reasonably designed to detect and report instances of money laundering through those accounts,” or “reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption,” for example.

This is not a mere matter of compliance. The exercise of some subjective judgment is required. To know what is reasonable requires financial institutions to gain access to and apply broad expertise in the money laundering process. Otherwise, their investigations and due diligence cannot be said to be reasonable. Reasonableness is not defined in terms of cost.

Reasonableness provides a defense to violations of these new obligations to investigate. On the other hand, cosmetic or careless anti-money laundering systems open the way to criminal liability premised upon looking the other way, i.e., willful blindness.⁶

Private Banks

Private banks manage the assets of the world’s wealthy. A rough idea of the size of the private bank market may be found in the J. P. Morgan Private Bank, a part of J. P. Morgan Chase, which alone reportedly oversees \$300 billion in assets.⁷

The Act imposes special obligations on private banks to engage in due diligence with regard to their foreign customer/clients.⁸ An

interesting feature of the due diligence requirement is that it applies to existing accounts, as well as to new accounts.⁹

Private banks are now required “to establish appropriate, specific, and, where necessary, enhanced, due diligence policies, procedures and controls that are reasonably designed to detect and report instances of money laundering through [private banking] accounts.”¹⁰

Private banking accounts are those 1) with minimum fund deposits or other assets of more than \$1 million, 2) established on behalf of one or more individuals who have direct or beneficial ownership¹¹ interest in the account, and 3) administered by a specific bank employee acting as liaison between the financial institution and the direct or beneficial owner of the account.¹²

The Act sets forth the following minimum standards for the conduct of due diligence for such high net worth foreign account holders, requiring private banks:

- 1) to ascertain the identity of nominal and beneficial owners of, and the source of funds deposited into, the private account; and
- 2) to conduct enhanced scrutiny of any such account connected to a senior foreign political figure, family member or close associate.¹³

The effective date for the establishment and commencement of customer due diligence procedures is 270 days from the date of enactment of the Act, i.e., no later than July 23, 2002.¹⁴ Within 180 days, Treasury is required to further delineate the customer due diligence policies, procedures, and controls required, i.e., no later than April 23, 2002.¹⁵

Shell Banks

Banks must now not only check out their

customers, but also the offshore banks with which they have relationships. Enhanced due diligence is required to be performed when certain foreign banks request or maintain a correspondent account¹⁶ with a United States financial institution on the foreign bank's behalf.¹⁷

The obligation to conduct this enhanced due diligence is triggered when the foreign bank, first, is operating under an offshore banking license which prohibits the licensed entity from conducting banking activities with the citizens of, or with the local currency of, the country which issued the license,¹⁸ or, second is operating under a banking license issued by a foreign country that has been designated as non-cooperative with international anti-money laundering principles or procedures.¹⁹

In either of these cases, the United States financial institution must take reasonable steps, first, to ascertain the ownership of the foreign bank, second to conduct enhanced scrutiny of such a correspondent account, and third, to identify other foreign banks having correspondent relationships with the questioned bank.²⁰

As if this were not enough, additional due diligence is also required on these other foreign banks having correspondent relationships with the questioned bank "reasonably designed to detect and report instances of money-laundering."²¹ Note that the plain language of the new statute requires that all of this due diligence on correspondent banks be done if the correspondent bank merely makes a "request" to establish a correspondent account.

Other major provisions include barring United States banks from establishing, maintaining, administering, or managing a correspondent account "for, or on behalf of" foreign "shell banks" that have no physical presence²² in any country, and are not part of a regulated banking system. This prohibition includes establishing, etc., a correspondent account of a foreign bank that is being used "indirectly" by a foreign shell bank.²³

There is a sole exception to the prohibition against foreign shell bank dealings. The Act permits correspondent accounts for shell banks, as long as they are an affiliate.²⁴

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Endnotes

1. The Act, § 302 (a) (1).
2. The Act, § 302 (b) (1).
3. Bodansky, Bin Laden: The Man Who Declared War On America (Random House 2001), p. 43. The author, Yossef Bodansky, is the director of the House Task Force on Terrorism and Unconventional Warfare.
4. Statement of the President (September 24, 2001).
<http://www.whitehouse.gov/news/releases/2001/09/20010924-4.html>
5. The Act, § 303(a).
6. Willful blindness is “a concept more akin to negligence than to knowledge,” United States v. Finkelstein, 229 F.3d 90, 95 (2d Cir. 2000), but is still the equivalent of actual knowledge nonetheless. United States v. Rodriguez, 53 F.3d 1439, 1447 (7th Cir. 1995).
7. The New York Times (October 7, 2001), sec. 3, p.1.
8. 31 U.S.C. § 5318(i)(1) The due diligence requirement applies to a private banking or a correspondence account “... for a non-United States person, including a foreign individual visiting the United States, or a representative of a non-United States person...”.
9. The Act, § 312(b)(2).
10. 31 U.S.C. § 5318(i)(1).
11. The concept of “beneficial ownership” runs through several of the Act’s provisions. 31 U.S.C § 5318A (B)(1)(B)(Records of Offshore Transactions); 31 U.S.C § 5318A(b)(2) (Information Relating to Beneficial Ownership); 31 U.S.C § 5318A(i)(I)(3)(Minimum Standards for Private Banking Accounts); 31 U.S.C § 5318(i)(4)(B)(Private Banking Account Defined); 31 U.S.C § 5318(h)(3)(Concentration Accounts); The Act, § 356(c)(4)(Treasury Report on Investment Companies & Beneficial Ownership of Personal Holding Companies). Its definition is left to future regulatory action by Treasury.

Such regulations shall address issues related to an individual's authority to fund, direct, or manage the account (including, without limitation, the power to direct payments into or out of the account), and an individual's material interest in the income or corpus of the account, and shall ensure that the identification of individuals under this section does not extend to

any individual whose beneficial interest in the income or corpus of the account is immaterial.

31 U.S.C § 5318A(e)(3). Beneficial ownership is crucial to deter and detect offshore money laundering. These regulations will attempt to deal with the many screens behind which launderers operate, i.e., trusts, attorneys, nominees, front businesses and shell banks.

12. 31 U.S.C. § 5318 (i) (2) (B).

13. 31 U.S.C. § 5318 (i) (3) (A, B) provides as follows:

MINIMUM STANDARDS FOR PRIVATE BANKING ACCOUNTS- If a private banking account is requested or maintained by, or on behalf of, a non-United States person, then the due diligence policies, procedures, and controls required under paragraph (1) shall, at a minimum, ensure that the financial institution takes reasonable steps—

(A) to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, such account as needed to guard against money laundering and report any suspicious transactions under subsection (g); and

(B) to conduct enhanced scrutiny of any such account that is requested or maintained by, or on behalf of, a senior foreign political figure, or any immediate family member or close associate of a senior foreign political figure that is *reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption.* (Emphasis added).

14. The Act, § 312(b).

15. The Act, § 312(a).

16. 31 U.S.C. § 5318A (i)(2)(A); 31 U.S.C. § 5381A(e)(1)(B) defines a correspondent account as follows:

(B) **CORRESPONDENT ACCOUNT-** The term ‘correspondent account’ means an account established to receive deposits from, make payments on behalf of a foreign financial institution, or handle other financial transactions related to such institution.

17. 31 U.S.C. § 5318 (i) (1).

18. 31 U.S.C. § 5318 (i)(2)(A)(i); 31 U.S.C. § 5318 (i)(4)(A).

19. 31 U.S.C. § 5318 (i)(1).

20. 31 U.S.C. § 5318 (i)(2)(B)(i- iii).

21. 31 U.S.C. § 5318 (i)(2)(B)(iii).

22. 31 U.S.C. § 5318(j) and (j)(4)(B). The term ‘physical presence’ means a place of business that–

(i) is maintained by a foreign bank;

(ii) is located at a fixed address (other than solely an electronic address) in a country in which the foreign bank is authorized to conduct banking activities, at which location the foreign bank–

(I) employs 1 or more individuals on a full-time basis; and

(II) maintains operating records related to its banking activities; and

(iii) is subject to inspection by the banking authority which licensed the foreign bank to conduct banking activities.

31 U.S.C. § 5318(j)(4)(B).

23. 31 U.S.C. § 5318 (j)(2).

24. “[T]he term ‘affiliate’ means a foreign bank that is controlled by or is under common control with a depository institution, credit union, or foreign bank...”. 31 U.S.C. § 5318(j)(4)(A).

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