Extraterritorial Application of the USA PATRIOT Act

Presented to
BUNDESVERBAND ÖFFENTLICHER BANKEN DEUTSCHLANDS
USA PATRIOT Act: Overview

• The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001
• Passed in Response to 9/11
• Received little debate, limited comment and mark-up from committee
• Expansive legislation, encompassing border security, surveillance procedures, criminal laws against terrorism, and financial regulations
• Foreign banks should be concerned with Title III, the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001
• After review in 2005, Congress chose not to rescind Title III
Anti-Money Laundering and Economic Sanctions Outside of the USA PATRIOT Act: OFAC

- The Office of Foreign Asset Compliance (OFAC) is an office within the Treasury Department. Authority for its actions lies in a number of sources, including IEEPA and various executive orders.

- Primary function is to maintain the list of Specially Designated Nationals (SDN), which contains countries, entities and individuals that are the targets of U.S. sanctions.

- Financial institutions have broad discretion to fashion their own compliance programs.

- OFAC does not attempt to exercise extraterritorial jurisdiction.
Current Issues: OFAC and SWIFT

• Although OFAC is generally passive, the newly created Terrorist Financing Tracking Program (TFTP) pursued an aggressive surveillance program.

• Congress has formally expressed support, but the program has been controversial.

• TFTP was established unilaterally by the executive branch, and some members of Congress have questioned the legality of the program on this and other bases.

• The Treasury Department has made a series of unilateral “Representations” related to the program to alleviate European concerns about data privacy.

• European officials will name an “eminent European” to conduct annual oversight of the program.
Current Issues: OFAC and Iran

• The State Department designated the Islamic Revolutionary Guard Corps (IRGC) and several other banks, entities and individuals as entities of proliferation concern.

• The Treasury Department designated the Qods branch of the IRGC and state-owned Bank Saderat as supporters of terror.

• Pursuant to these designations, OFAC imposed economic sanctions against these entities and individuals.
USA PATRIOT Act: Title III Overview

Title III provides for:

• Due diligence requirements for U.S. financial institutions that provide correspondent accounts for foreign banks

• Enhanced due diligence requirements for U.S. financial institutions that provide correspondent accounts for institutions or in jurisdictions of concern

• Prohibition on U.S. bank correspondent accounts with foreign shell banks

• Subpoena and seizure powers over information held at foreign banks and funds held in U.S. interbank accounts

• “Special Measures” for jurisdictions and institutions of concern
USA PATRIOT Act Title III Focus: Correspondent Accounts

- Majority of regulation affecting foreign banks is focused on correspondent accounts held with U.S. banks
- “Correspondent Account” defined very broadly to encompass most formal relationships between foreign and U.S. banks.

Issues facing correspondent accounts include:

- Due diligence/Enhanced due diligence
- “Special Measures”
- Exposure to the exercise of jurisdiction of U.S. courts
- Subpoenas
Due Diligence for Correspondent Accounts

- Risk-based approach allows U.S. bank to determine the nature of necessary diligence
- Periodic reviews

U.S. bank assessment of money-laundering risk must consider:

- Nature of the foreign institution and its market
- Type, purpose, and activity of the account
- Nature and duration of the relationship of the foreign institution to the U.S. financial institution
- Anti-money laundering regulations and supervision in the foreign jurisdiction
- Obtainable information about the institution’s anti-money-laundering record
Correspondent Accounts: Key Considerations

- Does the home jurisdiction have stringent anti-money-laundering laws and regulations?
- Does the institution have anti-money-laundering programs?
- Does the institution monitor its own customers?
- Affirmative answers to these questions will likely lead to less burdensome due diligence.
Enhanced Due Diligence

Required for:

• Foreign bank operating under an offshore banking license

• Foreign bank operating under license from a country deemed non-cooperative with international anti-money-laundering principles

• Foreign bank designated by U.S. Secretary of Treasury as warranting special measures due to money laundering concerns
Enhanced Due Diligence

- Designation of “non-cooperative country” made by Financial Action Task Force, an intergovernmental body.
- Currently, no countries are designated as non-cooperative.

Examples of previous non-cooperative countries:
- Russia
- Hungary
- Nigeria
- Philippines
- Israel
- Egypt
- Myanmar
Requirements for Enhanced Due Diligence

• U.S. banks must ascertain the identity and interest of each owner of non-publicly traded banks.

• U.S. bank must conduct risk-based “enhanced scrutiny” of the correspondent account and report suspicious activity.

• U.S. bank must ascertain whether such foreign banks provide correspondent accounts to other foreign banks. If so, banks must “mitigate” possibility of harm as risk requires.

• U.S. regulatory authorities make the effectiveness of and compliance with USA PATRIOT Act and anti-money-laundering (AML) measures a focus of examinations.

• Failure to comply effectively with the Act and AML requirements often results in regulatory enforcement actions against banks, including civil money penalties, and possible criminal actions, and is likely to delay or prevent expansion activities by the bank.
The Problem of “nesting” accounts

- Regulators fear that unsafe accounts can utilize U.S. accounts by establishing accounts with foreign banks that have their own U.S. correspondent account
- Enhanced due diligence and prohibitions on foreign shell banks directly confront this issue
- Remains implicit in risk-based assessment for normal diligence
Special Measures for Jurisdictions and Institutions of Concern

• Considers Jurisdictional and Institutional Factors

Jurisdictional Factors:
• Presence of high-risk groups
• Extent of bank secrecy offered to nonresidents
• Volume of transactions in proportion to the size of the economy
• Ability of U.S. law enforcement to obtain information in the jurisdiction
• Institutional corruption in the jurisdiction

Institutional Factors
• Extent to which institution is used to promote money laundering
• Extent of legitimate use of institution
Special Measures for Jurisdictions and Institutions of Concern

One or more of the following measures may be imposed:

• Recordkeeping and reporting of certain financial transactions, including, but not limited to, the identities of parties and the nature of the transaction

• Maintenance of information related to beneficial ownership

• Maintenance of information relating to the parties and nature of certain payable-through accounts

• Maintenance of information relating to the parties and nature of certain correspondent accounts

• Prohibitions or conditions on opening or maintaining certain correspondent or payable through accounts
Special Measures for Jurisdictions and Institutions of Concern

Jurisdictions that are of, or contain institutions of, concern:

- Burma
- Syria
- Belarus (proposal pending)
- “Turkish Republic of Northern Cyprus” (proposal pending)
- Latvia (only one institution remains listed)
- China (Banco Delta Asia)
Current Issues: Section 311 Sanctions and Banco Delta Asia

- Of the available “special measures,” only the most severe, prohibitions on correspondent or payable-through accounts, has ever been used.

- These prohibitions were threatened against, and ultimately imposed upon, Banco Delta Asia (BDA), a small bank in Macau, China suspected of substantial business relationships with North Korea.

- The threat of sanctions against BDA caused other banks in the region to curtail business with North Korea.

- Economic pressure created by the sanctions played a substantial role in continuing negotiations with North Korea and resulted in significant diplomatic progress.
Prohibition on Correspondent Accounts with Foreign Shell Banks

- U.S. banks cannot maintain correspondent accounts with foreign shell banks
- U.S. banks must assure that correspondent accounts are not used indirectly to provide services to a foreign shell bank (avoid nesting accounts)
- Certification requirements, with recertification every three years
- Definition of correspondent account is still very broad
- Foreign branches of U.S. banks need not comply
- Exception for accounts held by foreign banks that are affiliates of a regulated institution
Expanded Subpoena Powers

- USA PATRIOT Act authorizes government to subpoena records from a foreign bank that maintains a correspondent account with a U.S. bank
- Records need not be held in the U.S.
- Information requested may include information regarding deposits into the foreign bank
- Subpoenas may be challenged in U.S. court, but under the Act, status of historical balancing-of-interest test is uncertain. Also, the need to address security concerns may be an overwhelming interest in U.S. courts.
Asset Forfeiture

- Proceeds of illegal activities deposited in foreign accounts of foreign banks deemed to have been deposited in interbank accounts held in the U.S.
- Government may seize funds in interbank accounts up to the amount of illegal proceeds deposited in foreign account
- Funds need not be traceable to illegal proceeds
- Attorney General can suspend seizure where justice is served and conflicts of laws exist
- Foreign bank can challenge seizure, argue “innocent owner”
Long-Arm Jurisdiction

Jurisdiction is now proper where:

• Foreign person commits a money-laundering offense that involves a financial transaction in the United States
• Foreign person converts property that has been subject to a forfeiture by court order
• Foreign bank maintains a correspondent bank account at a U.S. financial institution

Additionally:

• Court may enter a preliminary order to take custody of assets pending outcome of litigation
• Assets need not be located in the United States
Financial Data Privacy in the U.S.

- The U.S. has no general law of financial privacy.
- Consumers are protected from government intrusion into their financial records held by financial institutions.
- Transfers of financial data among private entities are more lightly regulated.
- Generally, statutes rely on notice to consumers and the ability to opt out of data sharing programs.
- Nationality does not play a role in the various statutory schemes. Statutes distinguish only between affiliated and unaffiliated entities.
Financial Privacy Statutes

- Right to Financial Privacy Act – limits federal government access to financial records without due process.
- Fair Credit Reporting Act – provides limited circumstances in which financial data may be shared with unaffiliated companies without notice. Sharing among affiliated companies is more broadly permitted.
- Electronic Funds Transfer Act – users of electronic fund transfer systems may require financial institutions to provide information about data sharing.
- Fair and Accurate Credit Transactions Act – prohibits the sharing of customer information without clear notice and the opportunity to opt out.
- Gramm-Leach-Bliley Act – most comprehensive; establishes standards for confidentiality of customer records, prohibits disclosure for use in marketing programs, requires notice and opt-out policies for information shared with unaffiliated third parties, requires annual disclosure of privacy policies.
Current Issues: SEC Web Tool for Companies Conducting Business in State Sponsors of Terror

• The SEC introduced a web tool in June 2007 that linked users to references in companies’ annual statements to business conducted in state sponsors of terror.

• Although companies are required to report activities in state sponsors of terror, the web tool was not required by any statute or regulation.

• Companies complained that the web tool was indiscriminate and did not give users access to the most current information. One influential legislator suggested a $20 million threshold for search results.

• In July 2007, the SEC removed the web tool, but resolved to reinstate it in the future. The agency suggested that the web tool might be subject to a notice and comment period before being reintroduced.