The USA Patriot Act Has Broad Implications for Financial Institutions

The Act imposes new and wide-ranging obligations on financial institutions (including non-bank financial institutions such as broker-dealers, insurance companies, and the like), financial institutions of all types must be aware of and prepared to satisfy the heightened obligations imposed by the statute.

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In the wake of the 9-11 terrorist attacks, Congress acted quickly to pass the most comprehensive and sweeping anti-terrorism legislation in U.S. history. Entitled the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("the Act"), the Act provides U.S. law enforcement with substantially broadened powers to wage war on terrorism on various fronts, including domestic security, wiretapping and electronic surveillance, border patrol and immigration, and intelligence.

Almost unnoticed in the press coverage of the Act was Title III, entitled the “International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001” (“IMLAFAT”). IMLAFAT makes unprecedented changes to the money laundering law and permits this country, if it so desires, to act as the world’s policeman. In particular, the Act amends money laundering and bank secrecy law and recruits financial institutions as "partners" with law enforcement in detecting and reporting not only terrorist but also a wide variety of non-terrorist illegal activities. Because the Act imposes new and wide-ranging obligations on financial institutions (including non-bank financial institutions such as broker-dealers, insurance companies, and the like), financial institutions of all types must be aware of and prepared to satisfy the heightened obligations imposed by the statute. While a detailed understanding of IMLAFAT is beyond the scope of this article, we focus on those IMLAFAT provisions most applicable, and critical to, financial institutions.

BANK SECRECY ACT AMENDMENTS

The Bank Secrecy Act (“BSA”) was originally enacted in the 1990’s to deter money-laundering. The BSA, which is principally a reporting and record-keeping law, currently requires that financial institutions assist law enforcement by filing currency transaction reports (“CTRs”) for cash transactions exceeding $10,000 and, in certain circumstances, “whistle-blowing” by the filing of what are known as suspicious activity reports (“SARs”).

Expansion of Covered Financial Institutions. Title III of the Act incorporates and amends the definition of “financial institution” contained in the BSA. In addition to entities traditionally regarded as financial institutions, such as commercial banks, thrifts, broker-dealers, and insurance companies, the definition also includes an agency or branch of a foreign bank in the U.S.; an investment banker or investment company; a wide variety of entities that process cash, such as a currency exchanger or an issuer, redeemer,
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Increased Suspicious Activity Reporting. Section 356 of the Act substantially broadens the SAR requirements by directing that Treasury, in consultation with the Federal Reserve Board and the Securities and Exchange Commission, issue regulations requiring, for the first time, that registered securities brokers and dealers file SARs. Proposed regulations were published on December 31, 2001.4 The proposed regulations describe particular categories of transactions that require reporting. One category requires brokers to report any known or suspected criminal violation committed through the broker-dealer. Another category requires brokers-dealers to report three specific types of transactions when the dealer knows, suspects, “or has reason to suspect,” that certain events have occurred and incorporates a due diligence reporting requirement. The first class includes transactions involving funds derived from illegal activity; the second class involves transactions that are used as a means to evade the BSA reporting requirements, whether through structuring or otherwise; and the third class involves transactions that appear to serve no business or apparent lawful purpose and which the broker-dealer “knows of no reasonable explanation after examining the available facts relevant to the transaction and the parties.”5

The proposed regulations provide examples such as the use of large-scale wire transfer facilities with nominal or nonexistent securities purchases that may be indicative of suspicious activities. Another example provided is where an individual seeks to cancel a transaction after the person is informed of the currency transaction reporting requirements.

It should be noted that insurance companies that sell variable annuities are subject to the reporting obligations. In addition, Treasury may promulgate regulations requiring futures commissions merchants, commodity trading advisors, and commodity pool operators registered under the Commodity Exchange Act to submit SARs.

To streamline BSA reporting, section 366 of the Act directs Treasury to establish, through its Financial Crimes Enforcement Network (“FinCEN”), a highly secure electronic network through which reports (including SARs) may be filed and information regarding suspicious activities warranting immediate and enhanced scrutiny may be provided to financial institutions. On March 4, 2002, FinCEN issued proposed information-sharing regulations under Section 314 of the Act.6 Under the proposed regulations, bank and non-bank financial institutions will be subject to information requests and, among other things, will be able to respond by e-mail to FinCEN. The proposal allows sharing of information between financial institutions subject to SAR reporting and an operator of a card system that is not a money services business.

Streamlining Currency Transaction Reporting. Due to the increased volume of the cash transaction report-

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2 Despite opposition from civil liberties organizations, the legislation passed overwhelmingly in Congress, with a vote of 357-66 in the House and 98-1 in the Senate.
5 Id. at 67,673.
ing system, section 366 of the Act directs Treasury to review, by October 25, 2002, that system to make it more efficient, possibly by expanding the use of exemptions to reduce the volume of CTRs filed.

**Bulk Cash Reporting.** In an attempt to preempt excessive fines issues with respect to currency and monetary instrument forfeitures, Congress enacted a bulk cash smuggling provision in section 371 of the Act. The provision provides that whoever, with intent to evade a currency reporting requirement under 31 U.S.C. 5316, conceals more than $10,000 in currency or other monetary instruments in any conveyance, article of luggage, merchandise, or other container and transports or transfers or attempts to transport or transfer the currency or instruments from a place within the U.S. to a place outside the U.S., or from a place outside the U.S. to inside it, is guilty of a felony. Concealment may involve any article of clothing or any luggage, backpack, or container worn or carried by the individual. The penalty is up to five years incarceration and includes forfeiture provisions. The statute also provides that any article, container, or conveyance used or intended to be used to conceal or transport the currency is property involved in the offense for purpose of asset forfeiture.

**ANTI-MONEY LAUNDERING AMENDMENTS**

In passing the Act, Congress found that “money laundering, and the defects in financial transparency on which money launderers rely, are critical to the financing of global terrorism and the provision of funds for terrorist attacks.” The Act’s anti-money laundering amendments significantly broaden the reach of the money laundering laws in an effort to prosecute international money laundering and the financing of terrorist activity.

**Forfeiture of Funds in Interbank Accounts.** In a controversial provision, section 319 of the Act expands the circumstances under which funds in a U.S. “interbank account” may be subject to forfeiture. An “interbank account” is defined as “an account held by one financial institution at another financial institution primarily for the purpose of facilitating customer transactions.”

If a deposit of funds in a foreign bank outside of the U.S. is subject to forfeiture, and the foreign bank maintains an interbank account at a covered financial institution, U.S. law enforcement may seize the funds in the U.S. account as a substitute for the foreign deposit. Significantly, law enforcement is not required to trace the funds seized in the U.S to the deposit abroad.

The Act provides that for purposes of the “innocent owner” defense, 18 U.S.C. 983(d), the owner of the funds sought to be forfeited is the person who deposited the funds into the foreign bank, not the foreign bank or any intermediary institution involved in the transfer of the funds. Thus, only the foreign customer, and not the foreign bank, has standing to contest the forfeiture. Foreign banks will likely object to this provision on the ground that it deprives them of their property without due process of law.

**Development of Anti-Money Laundering Programs.** Section 352 of the Act requires that all financial institutions, within the meaning of 31 U.S.C. 5312(a)(2), as amended by the Act, implement an anti-money laundering program no later than April 24, 2002. At a minimum, such programs must include internal policies, procedures, and controls; the designation of a compliance officer; an ongoing employee training program; and an independent audit function. Treasury is directed to promulgate regulations to ensure that “the requirements imposed under this section are commensurate with the size, location, and activities of the financial institutions to which such regulations apply.” Due to the broad reach of the definition of “financial institution” (such as travel agencies and car dealers), many such institutions will now be required to implement formal anti-money laundering programs for the first time.

Further highlighting the importance of anti-money laundering programs, section 327 requires that the Federal Reserve Board and other federal banking regulators consider, when reviewing applications submitted pursuant to the Bank Holding Company Act and the Federal Deposit Insurance Act, the effectiveness of the applicants’ anti-money laundering activities, including in overseas branches. This provision applies to all applications submitted after December 31, 2001.

**ENHANCED DUE DILIGENCE**

The Act also imposes significantly increased due diligence require-
ments for financial institutions with respect to correspondent and private banking accounts. For purposes of the Act, a “correspondent account” is defined as an account “established to receive deposits from, make payment on behalf of, or handle other financial transactions related to such institution.”

A “private bank account” is defined as an account with a minimum aggregate deposit of $1 million that is assigned to or managed by a person who acts as a liaison between a financial institution and the beneficial owner(s).

The Act was passed amid speculation that the terrorists responsible for the 9-11 attacks may have received funds in the U.S. that were processed through correspondent accounts maintained for banks from countries that may harbor terrorists or condone terrorist activity. In addition, there has been concern that U.S. banks are establishing correspondent accounts without undertaking sufficient due diligence on the non-U.S. bank. The Act’s provisions relating to correspondent accounts are intended to prevent such use of correspondent accounts in the future.

The Act directs that Treasury, after consultation with appropriate federal agencies, must issue implementing regulations by April 24, 2002. This section of the Act is effective July 23, 2002, regardless of whether final regulations have been issued.

General Due Diligence Required.

The Act’s provisions strengthen existing “know your customer” requirements. Of particular importance to financial institutions is section 312 of the Act, which provides as follows:

Each financial institution that establishes, maintains, administers, or manages a private banking account or correspondent account in the United States for a non-United States person, including a foreign individual visiting the United States, or a representative of a non-United States person shall establish appropriate, specific, and, where necessary, enhanced, due diligence policies, procedures, and controls that are reasonably designed to detect and record instances of money laundering through those accounts.

All correspondent and private bank accounts are subject to these requirements, whether such accounts were opened before or after the enactment of the Act.

Additional Requirements for Correspondent Accounts.

The Act requires additional measures for correspondent accounts of foreign banks that either are licensed by particular jurisdictions or operate under off-shore banking licenses. The specific jurisdictions targeted by the Act are those (1) designated by intergovernmental groups (such as the Financial Action Task Force) as non-coopera-

14 Act section 313(a), 31 U.S.C. 5318(j).
supervision by the banking authority that regulates the affiliated entity. Covered financial institutions are directed to take “reasonable steps” to ensure that accounts for foreign banks are not used to indirectly provide banking services to shell banks.\(^\text{15}\)

On December 28, 2001, Treasury published notice of proposed rulemaking which seeks to codify prior interim guidance.\(^\text{16}\) In that notice, Treasury set forth its expectation that covered financial institutions will “immediately terminate all correspondent accounts with any foreign bank that it knows to be a shell bank ... [or] that it knows is being used to indirectly provide banking services to a foreign shell bank.” Treasury also formally proposed to extend the prohibition on correspondent accounts with shell banks to broker-dealers.

Due Diligence Requirements for Private Banking. The Act specifies minimum standards for private banking accounts at U.S. institutions. For all private banking accounts maintained by or on behalf of non-U.S. persons (including those opened prior to passage of the Act), the financial institution must report suspicious transactions and maintain records of (1) the names of all nominal and beneficial owners; and (2) the source of funds deposited in those accounts. If a private bank account is maintained by or on behalf of a senior political figure or his or her immediate family members or close associates, the financial institution must conduct enhanced scrutiny of the account to detect any transactions that may involve proceeds of foreign corruption.

**“SPECIAL MEASURES” FOR CERTAIN JURISDICTIONS, FINANCIAL INSTITUTIONS, AND INTERNATIONAL TRANSACTIONS**

Section 311 of the Act provides Treasury with the authority to impose additional record-keeping and reporting obligations on particular financial institutions operating outside the U.S.; institutions in particular jurisdictions; types of accounts; and types of transactions, if Treasury determines that such institutions, jurisdictions, accounts, or transactions are of “primary money laundering concern.” Treasury must consult with the Federal Reserve Board and other agencies as appropriate in determining whether to impose such “special measures.” The measures may be imposed by regulation or by order. However, any measure other than a regulation must expire within 120 days.

The types of “special measures” contemplated by section 311 are maintenance of records and filing of reports with information about transactions, participants in transactions, and beneficial owners of funds involved in transactions. “Special measures” could also require due diligence with respect to the ownership of “payable-through accounts” and maintenance of information about correspondent bank customers that have access to correspondent accounts.\(^\text{17}\)

**SUBPOENAS FOR FOREIGN BANK RECORDS**

The Act provides law enforcement with a powerful tool by authorizing the Attorney General or the Secretary of the Treasury to serve a summons or subpoena on any foreign bank that maintains a correspondent account in the U.S.\(^\text{18}\) The summons or subpoena may request records related to the correspondent account, “including records maintained outside of the U.S. relating to the deposit of funds into the foreign bank.” This provision, which became effective December 25, 2001, permits law enforcement to serve such a summons or subpoena on a designated agent for service of process, thus significantly simplifying the previously onerous process for obtaining foreign bank records. If a foreign bank fails to comply with a summons or subpoena, the U.S. bank may be forced to close the correspondent account or face harsh civil penalties of up to $10,000 per day. For foreign banks operating in jurisdictions...
with strict laws governing the privacy of bank records, this provision promises to be controversial.

VERIFICATION OF IDENTIFICATION FOR NEW ACCOUNTS
Section 326 of the Act requires Treasury to implement regulations “setting forth the minimum standards for financial institutions and their customers regarding the identity of the customer.” Those minimum standards will include verifying the identity of the person opening the account; maintaining records used to verify the person’s identity, including name, address, and other identifying information; and vetting the person’s name against lists of terrorists provided by law enforcement. Final regulations are due by October 25, 2002. The term “account” is not defined by this provision and, as a result, regulations could apply this provision broadly to include more than simply deposit accounts.

SUNSET PROVISION
Highlighting the controversial nature of many of the Act’s provisions, section 303 provides that on September 30, 2004, the provisions of the Title III of the Act shall expire, but only if Congress enacts a joint resolution to that effect. Significantly, the President’s signature is not required. Because the sunset provision requires affirmative Congressional action, termination of the Act’s provisions seems unlikely.

CONCLUSION
Title III of the Act makes unprecedented changes to the bank secrecy and money laundering laws and applies its provisions widely to cover both traditional financial institutions and non-bank financial institutions such as broker-dealers and insurance companies. Covered financial institutions must be aware of their new obligations under the Act’s broad provisions to assist U.S. law enforcement in combating international terrorism. Whether the Act’s provisions will achieve this noble goal or will simply impose additional regulatory burdens on financial institutions remains to be seen.