THE IMPLICATIONS OF THE USA PATRIOT ACT ON FOREIGN BANKING INSTITUTIONS

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Delivered at the National Anti Money Laundering Training Seminar
May 24, 2002 Kingstown, St. Vincent and the Grenadines

US newscaster Dan Rather has recently made some quite controversial statements in an interview with the BBC where he indicated that American journalists were afraid to ask tough questions of the Administration regarding the events surrounding the attack of September 11th. He suggested that it was deemed unpatriotic to ask tough questions. Indeed the relative silence surrounding the passage of the USA Patriot Act was indicative of this phenomenon. Neither Americans nor persons from around the world were very vocal in reacting to the very drastic measures that were effected by this Act. Indeed one may even question the purpose of the naming of the USA PATRIOT Act as one that was intended to induce a sense of patriotism and so to silence its critics.

In addition to the extraterritorial financial sanctions that it places on foreign banking institutions the Act seriously erodes many of the personal privacy and civil liberties previously enjoyed by Americans. Just to give you a few examples:

- the Act allows for the detention and deportation of non-citizens who provide lawful assistance to groups that the government claims is a terrorist organization, even if at the time when the assistance was given these groups were not yet identified as terrorist groups. It then requires that the immigrant prove a negative: that he did not know, and should not have known, that his assistance would further terrorist activity. (There is also new power under the Act for the Secretary of State to determine a group to be a terrorist group)
- The Act creates a new definition of terrorist activity so that it now covers the use of a 'weapon or other dangerous device .. to cause substantial damage to property" even if such damage created no danger of injury. Under the new definition of terrorism groups such as World Trade Organization protestors who engage in minor vandalism, abortion foes who engage in civil disobedience or protestors at Vieques, Puerto Rico who damage a fence would be deemed terrorist organizations. Likewise, purely humanitarian assistance to Hamas could be seen as assistance to a terrorist organization.

The definition of terrorism is:

"an activity that (i) involves a violent act or an act dangerous to human life, property, or infrastructure: and (ii) appears to be intended either to intimidate or coerce a civilian population' or to influence the policy of a government by intimidation or coercion or to affect the conduct of government by mass destruction, assassination, kidnapping or hostage taking". As you see this is much wider than the definition in Article 3 of the UN Convention that we saw yesterday.

- another area where there is restriction on a civil liberty, this time the right to privacy is in the area of **online activities and communication**. The USA Patriot Act introduces expanded surveillance of online activities with reduced checks and balances. One must now be careful what one puts in a google search as the government may now spy on web surfing of innocent Americans, including terms entered into search engines.

So those are some of the examples of the wide reach of this Act, which are unrelated to foreign banking institutions and jurisdictions.

The US law has from time to time been critized for passing extra-territorial laws, that is laws which, contrary to the principles of international law and territorial sovereignty, have exercised powers in the territory of another state. The US has justified the extra-territorial reach of its laws by what is known as the 'effects doctrine', which states that if something occurs in another state and has a negative effect on this United States, then the US has a right to legislate against it.

The Patriot Act is by far the strongest expression of extra-territorial powers over the international dollar payments system. Indeed what the USA Patriot Act says is that if you desire to use the US banking system in any way, then your anti –money laundering laws must conform with US standards. If you want to do business with us, then you must do it our way, or face immediate sanctions or penalties.

There has been little international criticism of the strong-arm tactics of the Patriot Act. The threat of non-compliance, which in this case meant jeopardizing our financial freedom is simply too awesome to ignore or to challenge.

Compare to OECD/FATF

Much has been said of the threats of sanctions and counter-measures that could result from the negative listing on the OECD and FATF lists. However fortunately those organizations have rarely applied such sanctions, at least never to St. Vincent. However the USA Patriot Act has now indirectly imposed sanctions on countries on the FATF black list. So where the FATF failed to take counter measures against black listed countries, the US government has stepped in to do so.

So what are these sanctions and threats of which I have been speaking? I will now speak of the substance of the USA PATRIOT Act as it affects foreign banks.

USA PATRIOT ACT – The object and reasons

The USA PATRIOT ACT – is an abbreviation of the words – *Uniting and Strengthening of America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism.*

The Act is based on the premise that money laundering and the weaknesses in financial transparency on which money launderers rely, are critical to the **financing of global terrorism**. There was the shocking revelation of how the hijackers of the planes used as weapons in the September 11th attack just hours before the attack were seen to be withdrawing money from ATM machines. The Act is thus intended to strip the terrorist of the ability to use the US financial system to finance his criminal activities.

- The Act is based on a series of findings. First, that **offshore banking** and related facilities provide the anonymity that is abused by criminal to hide the origins of their tainted funds. Second, that the **correspondent banking** facilities provided by US banks to foreign banks are susceptible to manipulation by foreign banks to permit the laundering of funds. It also points to the abuse of **private banking services** by corrupt foreign officials.

The Act therefore targets these three particular areas (1) offshore banks (2) correspondent accounts and (3) private banking services, these are the areas identified as vulnerable to money laundering and in particular terrorist financing.

PROHIBITION ON DOING BUSINESS WITH SHELL BANKS

The Patriot Act (section 313) specifically prohibits US banks from allowing foreign shell banks to open corresponding accounts with them. So US financial institutions are cannot do business with foreign shell banks.

PROHIBITION ON DOING BUSINESS *INDIRECTLY* WITH SHELL BANKS

The Act goes further to say that US financial institutions cannot *indirectly* do business with shell banks. In other words if a foreign bank (such as the National Commercial Bank of St. Vincent and the Grenadines) is doing business with offshore shell banks in St. Vincent then it (the NCB) will not be permitted to open or maintain a correspondent account in the United States.

In fact every foreign bank seeing to maintain a correspondent account with a US bank must issue a certification to the US authorities that it does not do business with shell banks. By this certification (copy attached) the foreign bank must provide

(1) a declaration that it does not do business with shell banks
(2) the name and address of its agent in the US (for serving legal process) – (US banks can now deem funds deposited in foreign banks with US interbank accounts as funds deposited in the US institution for the purposes of asset forfeiture – hence the importance of this requirement)
(3) the identity of the beneficial owner
(4) the fixed address

All foreign banks that have correspondent accounts in the US must fill out this certification.

Well you may ask if the National Commercial Bank (a foreign bank) does business for example with an offshore bank in St. Vincent and the Grenadines, does that mean that it is doing business with a shell bank. Well not necessarily. An offshore bank, if properly structured in accordance with the laws and regulations of this country should not be a shell bank.

The definition of a shell bank as defined by the USA Patriot Act is as follows:

A **shell bank** is a bank that does **not have a physical presence** in any country.

Physical presence is defined as

- a place of business that is located at a fixed address;
- employs one or more individuals on a full time basis; and
- maintains operating records related to its banking activities and
- is subject to inspection by the banking authority which gave it its license

As most of you may be aware in the past many of the offshore banks in St. Vincent operated here only in theory – while the mind and the management of the bank took place in France, Brazil or some other foreign country. Well it is now the case that shell banks can no longer operate in St. Vincent – this is as a result not only of the Patriot Act but of the strict application of St. Vincent offshore legislation as well as the new anti money laundering laws and regulations.

This specific prohibition against foreign banks that do business with shell banks from enjoying correspondent banking relationships in the US as well as the direct prohibition against shell banks came into force on December 25, 2001. However it was even before the Patriot Act that US financial institutions of their own accord started terminating and threatening to terminate the correspondent relationships of foreign banks that they suspected to have sub-standard anti money laundering policy.

It is now no longer a matter of the discretion of the US financial institution whether it wishes to do business directly or indirectly with a shell bank, but it proscribed by law.

Another term that I have been using is that of a '**corresponding account'** – well this is defined very broadly in the Act to include 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.

SPECIAL MEASURES FOR PRIMARY MONEY LAUNDERING CONCERNS

In addition to the express prohibitions placed on US financial institutions as to who they can do business with, there are also restrictions imposed on them as to the levels of due diligence that they must apply in relation to certain flagged institutions or jurisdictions.

Essentially where the Secretary of the Treasury determines that a jurisdiction, a financial institution or an international transaction is of 'prime money laundering concern' then US financial institutions will be required to take certain measures against that entity or jurisdiction. The first of the measures that may be imposed is a special record keeping requirement where the institution will be required to ascertain (i) the identity and address of the participants to a transaction (ii) the legal capacity of the participants and (iii) the identity of the beneficial owner of the funds.

The second measure that can be taken is that the institution must obtain information on the beneficial owner of any account operated in the US by a foreign person.

The third measure is that the institution must obtain information on each customer who is permitted to use a payable through account.

The fourth special measure is a specific prohibition or the imposing of conditions on the opening or maintaining of correspondent or payable through account by a foreign banking institution.

These measures are only applicable to institutions or jurisdictions or transactions that are deemed to be a prime money laundering concern.

DETERMINATION OF A PRIME MONEY LAUNDERING CONCERN

The USA Patriot Act gives sole power to the Secretary of the Treasury to determine whether a jurisdiction, institution or a transaction is a prime money laundering concern. The Secretary must consider the following in making this determination:

- evidence that criminals, terrorists do business in that jurisdi ction
- extent to which the jurisdiction offers bank secrecy or regulatory advantages to non-residents
- the quality of the bank supervision and anti money laundering laws
- the relationship between the volume of financial transactions and the size of the economy
- **the characterization of the jurisdiction as an offshore bank or secrecy haven by credible international organizations or multilateral group**
- extent of cooperation with US law enforcement officials
- characterization by high levels of institutional or official corruption

As far as I am aware the Secretary has not yet exercised his powers and made a determination under this section.

SPECIAL DUE DILIGENCE FOR CORRESPONDENT BANKING AND PRIVATE ACCOUNTS

These are provisions that do not rely on the designation or decision of the Secretary of the Treasury but which automatically come into force on July 23, of this year.

These provisions – which place restrictions on correspondent accounts – apply to such correspondent accounts that are requested or maintained by a foreign banking operation operating:

(a) under an offshore banking licence or
(b) under a banking licence issued by a country designated as non-cooperative with international money laundering principles by organizations which the US is a member **or** by the Secretary of the Treasury as a prime money laundering concern.

So here we have an almost direct reference to the FATF listing and we begin to see the first signs of a direct sanction that will be placed on St. Vincent's financial institutions for being on the FATF black list.

So what exactly are these enhanced due diligence requirements that would come into play –

The relevant US financial institutions when dealing with such entities listed above must ascertain

(a) the owners of the foreign bank
(b) conduct enhanced scrutiny of such accounts to guard against money laundering
(c) where such foreign banks provides correspondent accounts to other foreign banks, then they must ascertain the beneficial owners of those other banks.

Finally there are minimum standards that are set for dealing with private bank accounts –

The financial institutions must ascertain the beneficial owners of such accounts and the source of the funds deposited. A private bank account is one that has an initial deposit of US$ one million. Also where the account is requested by a senior political figure or any member of his family, the institution must conduct enhanced scrutiny of such account to be on the look out for detecting the proceeds of foreign corruption.

This provision ensures that senior foreign political figures are automatically regarded as suspect. This is not a provision that is being applied to senior US officials but to foreign ones. So in other words, we may have expected that when our Ministers travels to the United States and conducts certain personal business there that they may enjoy certain privileges, well in fact this law will ensure that the exact opposite happens. They will be regarded as political exposed persons who may be vulnerable to foreign corruption and their transactions will be highly scrutinized. The same concept will apply to any of their children.

This is one of the provisions of the USA Patriot Act that is potentially highly discriminatory but perhaps the reason why there has not been an international outcry is that we are all painfully aware that foreign corrupt officials have in the past been known to ferret away the monies of their third world states into bank accounts in Europe and America – names like Idi Amin and Ferdinand Marcos readily come to mind.

Know Your Customer Regulations

By October 26, 2002 the Act requires the Secretary of the Treasury to issue regulations that require financial institutions to implement procedures to verify the identity of customers. At minimum they will be required to

- (i) verify the identity of anyone seeking to open an account
- (ii) maintain records of the information used to verify the identity of the person and
- (iii) consult lists of known or suspected terrorists to see if such persons appear on the list.

CONCLUSION

There are many other aspects of this law that I have not covered but I think I have covered most of the essential areas.

In conclusion I will restate the obvious – that this Act is the tolling of the bell for shell banks.

It single-handedly casts the anti money laundering standards of the US government on all institutions across the world seeking to benefit from the US banking system. It is potentially more far reaching than any black list. Like the President George W Bush said – you are either with us or against us. There is always a choice – you can comply or not comply but if you don't comply do not expect to do business with the US.