

STEP Bahamas Branch and the AIBT

USA PATRIOT ACT

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USA Patriot Act

How does it effect you in the Bahamas?

USA Patriot Act of 2001

Uniting and Strengthening America by Providing Appropriate
Tools Required to Intercept and Obstruct Terrorism

What Are the Motivating Factors?

Terrorism: September 11th, 2001

Money Laundering

International Monetary Fund estimates:

\$500 Million - \$1.5 Billion Laundered Throughout
the World Each Year (2% - 5% of World GDP)

Up to \$750 Million Laundered in United States
Each Year

Tax Evasion:

\$70 Billion in Lost Taxes to U.S. Government Due to U.S. Citizens Hiding Money Offshore

A History Lesson is Worth a pound of Logic!

Prior to the Patriot Act

- No level playing field
- No common KYC standards
- Different Regulators with different Standards
 - Federal Reserve
 - SEC
 - FDIC
 - NYSE
 - OCC
 - NASD
 - OTS
 - Individual State Insurance Commissioners
- Administration was Openly Questioning the Benefit and Utility of Existing AML Requirements
- Respect for Privacy Concerns
 - Right to Financial Privacy Act of 1978
 - Gramm Leach Bliley Act of 1999
 - QI Provisions
 - NYSE Rules

After September 11th, 2001

- October 24, 2001 - House passes bill 357-66
- October 25, 2001 - Senate passes bill 98-1
- October 26, 2001 - President Bush signs bill into law

Prior Unsuccessful Attempts to Pass New Money-Laundering Legislation

- International Counter Money Laundering Act of 2000
- Integrity in Banking and Money Laundering Prevention Act of 1999
- Money Laundering Prevention Act of 1999
- Money Laundering Abatement Act of 1999

Act Incorporates both text and titles of
Draft Legislation:

Title III of Act is entitled:

“International Money Laundering Abatement and
Anti-terrorist Financing Act of 2001”

Why does the Patriot Act apply to you in the Bahamas?

- Accounts in U.S.
- Clearing U.S. Dollars
- Long Arm of U.S. Law enforcement extended further.

Simply put all financial institutions Worldwide are effected!

Know Your Customer

- KYC is Really a Prism Through Which You Look at Your Customers, It Can Mean “Know Your Customers” for:
 - Suitability
 - Credit Risk
 - AML Risk

Successful AML Program

- Good Customer Identification
- Good Knowledge of the Source and Use of Customer Funds
- Well -Trained Employees
- Information Sharing
- Good Partners to Help you Get Needed Data to Detect Patterns and Identify Problem Accounts

Gatekeeper

Insurance & Money Laundering

Types of Products: Susceptible to Laundering

- Life
- Variable Annuities
- Any product with Lending or Surrender Value

Existing Regulatory Framework

Department of Treasury Proposed Rule issued September 18th, 2002

Is the Act in Force?

Certain Provisions immediate effect

- Shell banks (Dec. 25th, 2001) → Final Rule Issued on September 18th, 2002
- Correspondent accounts (December 28th, 2002) Final Rule issued on September 18th, 2002
- SAR's (Banks already in force B/D's July 1st, 2002)

Other Provisions are dependent on Regulations or Orders:

Customer Verification rules must be in force by Oct. 24th, 2002.

Regulatory Agencies (NASD) Have Implemented new Rules re: Compliance programs as of April 24th, 2002.

Compliance program for mutual funds, credit card operators and money service business. (July 24th, 2002)

Note back offices are introducing procedures anticipating what is to come!

Summary- What has changed?

U.S. Patriot Act requires ALL Financial Institutions to:

- Establish Anti-Money Laundering Programs
 - Development of Internal Policies, Procedures and Controls
 - Designation of Compliance Officer
 - Ongoing employee training programs
 - Independent audit function to test programs
- File Currency Transaction Reports
- File suspicious Activity Reports with FINCEN
(Financial Crime Enforcement Network)
- Comply with Regulations regarding Account Documentation and ID Verification
- Extends Money Laundering Offenses and Reach of U.S. Law Enforcement

What is a Financial Institution?

- Foreign Banks
- U.S. Financial Institutions
- Covered Financial Institutions

Foreign Bank

No definition in the Act

Final Rules Issued on September 18th, 2002, adopt the Bank Secrecy Act definition:

A foreign bank is “*a bank organized under foreign law or an agency, branch or office located outside the United States*”.

Note: Branches and agencies of foreign banks in U.S. are not included

U.S. Financial Institutions

Certain provisions of Patriot Act apply to all financial institutions.

Patriot Act defines 30 types of business. They include:

banks, brokerage firms, money service business, insurance companies, loan and finance companies.....

Covered Financial Institutions

Most important provisions apply to U.S. “Covered Financial Institutions” which are defined as:

- Insured Bank (FDIC)
- Commercial Bank
- Trust Company
- Private Banker
- Agency or Branch of Foreign Bank
- Credit Union
- Thrifts
- Broker or Dealer Registered with SEC

Main Provisions

- Sec. 313. Shell Banks
- Sec. 319. Ownership of Foreign Banks
- Sec. 312. Private Banking
- Sec. 326. Account Verification
- Sec. 311. Special Measures
- Sec. 325. Omnibus Account Rules
- Sec. 314. Information Sharing
- Sec. 319. 120 Hour Rule
- Sec. 319. Forfeiture of Funds

Note: There are many more!

SEC 313

Shell Banks

“A covered financial institution shall not establish, maintain, administer or manage a correspondent account in the U.S. for or on behalf of a foreign bank that does not have a physical presence in any country”

Department of Treasury rules provide that this includes “correspondent accounts” where beneficial owner of funds held in the account is a shell bank.

Failure to close account  Fine of \$10,000 per day!

(Final Rules Issued September 18th, 2002)

Physical Presence means a place of business:

1. maintained by a foreign bank; and
2. located at a fixed address in the country in which it is authorized to conduct banking activities; and
3. where it employs one or more individuals on a full time basis; and
4. maintains operating records; and
5. is subject to inspection by the Banking Authorities which licenses it.

Correspondent Accounts Ownership of Foreign Banks

Covered Financial Institutions must maintain records identifying owners of accounts held for a foreign bank

Dept. of Treasury Rule issued September 18th, 2002
(superceding Interim rule issued on December 28th, 2001)

- provides safe harbor certification:

U.S. Banks must maintain records of:

- Owners of foreign banks
- Agent in the U.S. designated to accept service of process for records regarding the correspondent account - covers all records within and outside the U.S.

Secretary of Treasury and Attorney General may issue summons or subpoenas on any foreign bank that maintains a correspondent account in the U.S. requesting records relating to such accounts and funds deposited within the account.

What is a Correspondent Account?

“a correspondent account is an account established by a covered financial institution for a foreign bank to receive deposits from, to make payments or other disbursements on behalf of a foreign bank or to handle other financial transactions related to the foreign bank.”

(Final Rule Issued September 18th, 2002)

U.S. Treasury Department Final Rule Issued
September 18th, 2002

This appears to effect every account held by a foreign bank.

SEC 312

Enhanced Due Diligence

Required for:

- Correspondent Accounts
- Private banking accounts
 - aggregate of \$1 million
 - managed by a client relationship officer
 - established by one or more direct or beneficial owners

Treasury Department Interim Final Rules issued May 23rd, 2002.- Enforces provisions for all Private banking accounts (including accounts at broker dealers) but only in force re: Correspondent Accounts at Banks

Correspondent Accounts: (Banks only) Pending Final Rules

U.S. Financial Institutions must establish due diligence policies, procedures and controls reasonably designed to detect and report money laundering through correspondent accounts established, maintained, administered or managed in the U.S. for a foreign financial institution:

Regulations  Target “high risk accounts”

Private Banking Accounts:

(Banks, Securities Brokers and Dealers, Introducing Brokers, Futures Commission Merchants)

- Must take reasonable steps to ascertain identity of:
 - Nominal and beneficial owners
 - Source of funds
 - Senior foreign political figures and their immediate family members or close associates

SEC 326

Account Verification Procedures

Act provides for regulations to be issued to cover:

- ID verification of foreign persons
- Maintenance of ID records
- Checking OFAC (Terrorist) lists

possible requirement for ID numbers to be issued to all foreign nationals opening an account!

regulations have been Issued for:

Banks: Joint proposed Regulations Issued by
FINCEN, OCC, FEDERAL RESERVE, OTS, NCUA,
FDIC.- July, 2002

Broker Dealers: SEC Rules July 15th, 2002

Regulations must be final by October 26th, 2002.

SEC 326

SEC Rules

7 Risk factors:

- Broker Dealer's Size
- Location
- Method by which customers open accounts
- Type of Accounts
- Types of Transactions
- Customer base
- Reliance on another broker dealer (ie. introducing broker-clearing agent)

Questions:

What is an Account?

Who is a Customer?

SEC 314

Information Sharing

Financial Institutions may share information with each other if they have suspicions of money laundering or terrorist financing.

Requires annual electronic filing with FINCEN
Erodes protections afforded under the Right to Financial Privacy Act and Gramm-Leach-Bliley Act

SEC 319

120 Hour Rule:

Federal Banking Agency
(OCC, Federal Reserve, FDIC and OTS)
may request a Covered Financial Institution
to provide information and account documentation for any account:
- opened, maintained, managed or administered in the U.S.

Effective December 25th, 2001

Enforcement: SEC 319

Forfeiture of Funds in a U.S. interbank Account

Illicit fund deposited in an account at foreign bank

Foreign bank

Foreign bank's own funds held in U.S. Bank
can be seized up to value of illicit funds in
foreign bank

Funds.- Do not need to be traceable

This provision is aimed at compelling foreign banks
to introduce money laundering programs.

Specified Unlawful Activities

Current U.S. law makes it an Offense to conduct a Financial Transaction or to make a transfer into or from the U.S. knowing that the funds or securities involved are the proceeds of a “Specified Unlawful Activity”.

Specified Unlawful Activities are:

- All Narcotics Offenses Foreign and Domestic
- Racketeering Offenses
- Fraud Offenses including:
 - Bank Fraud both foreign and domestic
 - Medicare Fraud
 - Food Stamp Fraud
- Export Violations and Customs Offenses
- Murder, Kidnapping, Robbery and Extortion
- Copyright violations and Trafficking in Counterfeit goods

Patriot Act adds three more foreign offenses to the list:

1. Bribery of a foreign public official or theft of public funds for benefit of public official
2. Smuggling or export control violations involving items on U.S. Munitions trust
3. Any Foreign Crime Covered by bilateral extradition treaty

Extraterritorial Application

- District Courts given Long-arm jurisdiction over foreign money launderers whether foreign Persons or Financial Institutions if:

Service of Process under Federal Civil Procedure Rules or local laws where the Person is Found; and

- Offense committed involving a financial transaction in the U.S., or
- Foreign person converts to his use property that U.S. owns by virtue of the entry of a forfeiture decree; or
- Foreign person is a financial institution that maintains a bank account at a financial institution in the U.S.

Future Developments Anticipated Under the Act

SEC 311

Special Measures re: Accounts of Primary Money Laundering Concern

Secretary of Treasury may issue orders to require financial institutions to take special measures regarding:

- Certain jurisdictions
- Financial Institutions
- Transactions
- Accounts

- Payable Through Accounts - Secretary of Treasury may prohibit or impose conditions

SEC 325

Omnibus Accounts:

Secretary of Treasury MAY prescribe regulations to ensure banks can identify individual customers and link each transaction to its owner.

Closing Thoughts:

- Patriot Act fundamentally changes U.S. Financial Industry:
- Beneficial Owners will no longer be able to hide their Identity
 - All Sectors in U.S. Finance Industry effected
 - Further Extension of long reach of U.S. Law Enforcement
 - All Banks worldwide are effected!
 - New Windows of Opportunity!!