

### Keeping Step with the USA Patriot Act

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On October 26, 2001, the President signed into law the USA PATRIOT Act ("Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001") (the "Act"). While many of its provisions were designed to bolster domestic security, enhance surveillance procedures, etc., Title III of the Act, "International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001," contains many new provisions and amendments to the Bank Secrecy Act and the Money Laundering Control Act of 1986. These will affect both financial and non-financial institutions in how they do business.

In many instances, the Act requires the Department of the Treasury ("Treasury") or other departments or agencies to enact certain rules and regulations to implement the Act's various requirements. As of May 1, 2002, many of the rules required by the Act have already been proposed. Some of the rules are currently in effect or will be in effect soon. The Act is constantly evolving, with new requirements and compliance procedures being added periodically.

#### **Entities Covered by The Act**

The Act promulgates new requirements for both financial institutions and non-financial institutions. Many entities are of a mistaken belief that only banks fall under the definition of "financial institution." Under the Act, a "financial institution," whether domestic or foreign, is defined very broadly.

According to the Act, financial institutions include: an insured bank; a commercial bank or a trust company; private bankers; an agency or branch of a foreign bank in the United States; any credit union; a thrift institution; a broker or dealer registered with the SEC under the Securities Exchange Act of 1934; a broker or dealer in securities or commodities (whether registered with the SEC or not); an investment banker or investment company; a currency exchange; an issuer, redeemer, or cashier of traveler's checks, checks, money orders, or similar instruments; an operator of a credit card system; an insurance company; a dealer in precious metals, stones, or jewels; a pawnbroker; a loan or finance company; a travel agency; a licensed sender of money or any other person who engages as a business in the transmission of funds, formally or informally; a telegraph company; a business engaged in vehicle sales, including automobile, airplane and boat sales; persons involved in real state closings and settlements; the United States Postal Service; an agency of the federal or any state or local government carrying out a duty or power of a business described in the definition of a "financial institution"; a state-licensed or Indian casino with annual gaming revenue of more than \$1,000,000; and certain other businesses designated by Treasury (collectively "Financial Institutions"). A non-financial institution is simply any institution that does not fall under the Financial Institution category ("Non-Financial Institution").

## Reporting Requirements

Currency Transactions Reports. The Act requires **Non-Financial Institutions** to report certain cash and currency transactions ("CTRs") to the Financial Crimes Enforcement Network ("FinCEN"), a part of the Department of Treasury. However, it does not repeal a similar provision under the Internal Revenue Code (26 U.S.C. § 6050I). CTRs require entities or persons who receive \$10,000 or more in coins or currency (which includes monetary instruments typically in bearer form, such as travelers' checks, bearer negotiable instruments, etc.) to report the transaction. It is a crime to "structure" payment of coins or currency to avoid the \$10,000 reporting requirement. Non-Financial Institutions previously were required to report to I.R.S. They are now required to report to FinCEN as well.

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Treasury's proposed regulation and interim rule implementing the Currency Transactions Reports provision are similar to the current cash reporting requirements already applicable to trades and businesses under the Internal Revenue Code, 26 U.S.C. § 6050I, and its corresponding regulation, 26 C.F.R. § 1.6050I-1 (*i.e.*, Form 8300). Annual statements will continue to be required under the Internal Revenue Code, but are not required under the FinCEN rule. Under FinCEN's rule, the filing of a Form 8300 will satisfy both I.R.S. and FinCEN.

**Suspicious Activity Reports for Brokers, Dealers and Commodities Merchants.** After consultation with the SEC and the Federal Reserve, Treasury published proposed regulations which will go in to effect on July 1, 2002, requiring Suspicious Activity Reports ("SARs") by securities broker/dealers. After consulting with the CFTC, the Secretary may enact (but has not yet enacted) regulations requiring SARs by futures commission merchants, commodity trading advisors and commodity pool operators registered under the Commodity Exchange Act.

**Sharing of Information on Terrorism and Money Laundering.** The Act requires Treasury to improve sharing of law enforcement and regulatory information to assist Financial Institutions to identify and report suspicions of terrorism and money laundering. Financial Institutions are required to designate someone to receive the information and monitor accounts of persons or entities identified by the government. If prior "notice" is given to Treasury, two or more Financial Institutions (or an association of Financial Institutions) may share information with each other about money laundering or suspected terrorist activities.

## Internal Regulations

Anti-Money Laundering Compliance Programs. Financial Institutions are required to adopt anti-money laundering programs. These programs must be in effect as of April 24, 2002. The programs must include the development of internal policies, procedures and controls, designation of a compliance officer, ongoing training, and an independent audit system. Regulations have been announced which cover mutual funds, operators of credit card systems and money services businesses (such as money transfer companies and check cashers). Banks, savings associations, credit unions, registered brokers and dealers in securities, futures commission merchants and casinos can comply by establishing anti-money laundering programs in compliance with

existing FinCEN regulations or with those of their respective regulating agencies. All other Financial Institutions are (for now) exempt. The National Association of Securities Dealers ("NASD") has implemented rules governing its members, and even offers on-line training courses for the education component of the compliance program.

**Due Diligence for Foreign Private Banking and Foreign Correspondent Accounts.** All Financial Institutions are required to implement certain due diligence procedures for foreign private banking clients and foreign correspondent accounts. While this provision ostensibly applies to brokers and dealers of securities, the broker/dealer equivalent of a correspondent account is not defined. So far, no final regulations have been issued. However, this section of the Act takes effect regardless of whether final regulations have been implemented. In general, the Act requires certain record keeping procedures, efforts to identify the owners of a foreign bank and beneficial owners of accounts, etc.

## Structural Changes

**Doing Business in Jurisdictions of "Primary Money Laundering Concern."** Treasury has been given discretion to require "domestic Financial Institutions," to take "special measures" if Treasury finds that a foreign jurisdiction, certain foreign Financial Institutions, or a class of foreign financial transactions or accounts, are of "primary money laundering concern." The "special measures" available under the Act generally affect record-keeping requirements and the identification of beneficial owners of accounts. So far, no countries or institutions have yet been named as being of "primary money laundering concern."

**No Foreign Shell Bank Accounts.** Banks and brokers/dealers may not maintain correspondent accounts with foreign "shell banks" having no "physical presence" in any country, unless (1) the shell bank is affiliated with a bank that maintains a physical presence in the United States or a foreign country and (2) the shell bank is subject to supervision by a banking authority in a jurisdiction that regulates the affiliated bank.

**Correspondent Accounts.** If a foreign bank maintaining a domestic correspondent bank account disobeys a summons or subpoena relating to the correspondent account, the U.S. bank must close the account within 10 days of notification from the government, unless the foreign bank commences court proceedings challenging the subpoena or summons.

## Law Enforcement Implications

**Additional Predicate Crimes for Money Laundering.** The legislation adds new crimes which are prerequisites to the crime of money laundering. These include terrorism, foreign corruption, certain export controls, certain foreign crimes and extraditable offenses.

Also, amendments to 18 U.S.C. § 1960 criminalize the operation of an "unlicensed" money transmitting business. An unlicensed money transmitting business is the "transportation or transmission of funds that are known to the defendant to have been derived from a criminal offense or are intended to be used to promote or support unlawful activity." The section could apply to "reverse" money laundering which apparently occurs in financing terrorist activities (e.g., legitimately-obtained funds laundered through various entities to finance illegal activity, rather than illegally-obtained funds made to look legitimate).

**"Interbank" Accounts and Forfeiture.** The government can seize funds of a foreign bank subject to drug or money laundering forfeiture from an "interbank" account of a U.S. bank without first tracing the funds at the foreign bank to or from the domestic account.

**Requests for Information by Regulators.** Within 120 hours (five days) of a request from a regulator, a bank must produce account information for any account maintained or managed (but not necessarily located) in the United States, or about the institution's money laundering compliance program. This provision is ambiguous as to whether it applies to a similar request to a broker/dealer.

**Suspicious Activity Reporting Safe Harbor.** Financial Institutions which file SARs are protected from civil liability for filing the reports, even under private contract theories, or even where the accounts at issue contain arbitration provisions in the account opening documents. Also, there is no liability for Financial Institutions issuing written employment references which contain references to a reported suspicious activity. Banks may, but are not required to, provide information about suspicious activity involving an "institution-related party" (e.g., a former employee) in response to a request from another bank.

### **Regulations on the Verge of Enactment**

**Concentration Accounts.** Treasury may issue (but has not yet issued) regulations covering "concentration accounts" at all Financial Institutions to help ensure that such accounts do not prevent discovery of the identity of an individual customer with the movement of funds. "Concentration Accounts" is not defined in the Act, but it is anticipated that Treasury will define the term when it promulgates regulations covering those accounts.

**Identity of Customers.** The Act requires Treasury to adopt regulations (which are to take effect no later than October 26, 2002), setting forth minimum standards for Financial Institutions regarding customer identification required at the opening of an account. So far, no regulations have been issued covering this provision.

**Foreign Nationals' Identification Upon Opening an Account.** Treasury is required to conduct a study, and then report to Congress its recommendations, as to the identification which should be required from foreign nationals who open accounts at Financial Institutions, and as to whether foreign nationals should be required to obtain an "identification number" (equivalent to a taxpayer identification number) as a prerequisite to opening an account at a Financial Institution. No regulations are yet in place on this point.

**FinCEN Highly Secure Network.** By July 26, 2002, FinCEN must create a "highly secure network" to allow Financial Institutions to file reports required under the Bank Secrecy Act or the FDIC Act and to allow FinCEN to alert Financial Institutions about certain suspicious activities.

The USA PATRIOT Act and its myriad of regulations are complex. More regulations implementing its various provisions are due or go into effect soon. Sheppard Mullin can provide advice and counsel regarding the Act and implementing regulations, and can develop tailored Anti-Money Laundering Programs for any business required to implement such a program.

If you would like copies of the USA PATRIOT Act or any of the rules or regulations in effect or proposed under the Act, please contact:

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