FinCEN Final Patriot Act Regulations on Special Due Diligence Program

From the Investment Management Practice Group

OVERVIEW

The Financial Crimes Enforcement Network (“FinCEN”) of the Department of Treasury has issued a final rule (the “Final Rule”) implementing a key provision of Section 312 of the USA PATRIOT Act (the “Patriot Act”). The Final Rule clarifies the risk-based procedures that U.S. financial institutions should use in tailoring their enhanced due diligence to assess the risks of certain foreign banking relationships.

As we discussed in a previous client alert, Section 312 of the Patriot Act requires covered financial institutions (e.g., banks, U.S. branches or agencies of a foreign bank, registered broker-dealers, and mutual funds) that establish, maintain, administer or manage a “correspondent account” in the United States for a foreign financial institution to subject such account to certain due diligence measures. This general due diligence applies to all correspondent accounts for foreign financial institutions. Under certain circumstances, Section 312 requires covered financial institutions to adopt “enhanced due diligence procedures.”

Under the Final Rule, all covered financial institutions must adopt “enhanced due diligence programs” with respect to correspondent accounts for the following foreign banks:

- Foreign banks operating under an offshore license;
- Foreign banks operating under license issued by a country designated as being non-cooperative with international anti-money laundering principles or procedures by an intergovernmental organization of which the U.S. is a member and with which designation the U.S. concurs;
- Foreign banks operating under license issued by a country designated by the Secretary of the Treasury as being of special money laundering concern.

Under the Final Rule, covered financial institutions have some flexibility to apply the enhanced due diligence procedures according to the institution’s assessment of an account’s risk profile. However, all covered financial institutions must, at a minimum, include enhanced due diligence procedures in their anti-money laundering programs (“AML Programs”) designed to ensure that, for this subset of correspondent banks, a covered financial institution takes reasonable steps to:

First: Conduct appropriate enhanced scrutiny. The level and nature of this scrutiny will depend upon the covered financial institution’s risk assessment of the account’s risk profile. FinCEN states that it expects a covered financial institution to conduct, as appropriate, a review of the correspondent foreign bank’s written AML Program to determine whether the program appears to be reasonably designed to detect and prevent money laundering. However, this review is not mandatory. The requirement to obtain and consider information related to the AML Program of the correspondent bank is intended to be risk-based. Whether enhanced due diligence should include a reasonable inquiry into the AML Program of a correspondent bank will depend on the extent to which such a review would be appropriate based on the nature of the correspondent account. For example, if a covered financial institution has long maintained a correspondent account for a correspondent
bank, the institution could determine through experience and due diligence that the review of information related to the AML Program of the correspondent bank would not provide relevant information. A covered financial institution should have reasonable procedures to monitor overall activity through its correspondent account and to detect unusual and suspicious activity, including activity that is not in accord with the type, purpose, and anticipated activity of an account. It should also obtain information from the correspondent bank about any persons with authority to pass transactions through a correspondent account that is a “payable-through” account and the sources and beneficial owners of funds or other assets in payable-through accounts. (A payable-through account is an account opened at a covered financial institution by a foreign financial institution by means of which the foreign financial institution permits its customers to engage, either directly or through a subaccount, in banking activities that are typical for the business of banking in the United States.)

Second: Ascertain whether the foreign bank in turn maintains correspondent accounts for other foreign banks (“nested banks”) that use the foreign correspondent account to process transactions. If so, a covered financial institution must take reasonable steps to obtain information relevant to assess and mitigate money laundering risks associated with the foreign bank’s correspondent accounts for other foreign banks. In general, FinCEN does not expect covered financial institutions to obtain lists of foreign bank customers from the foreign correspondent banks. FinCEN does expect U.S. financial institutions, based on their risk assessment of a correspondent bank and as part of their enhanced due diligence efforts, to make appropriate inquiries about such factors as the nature of the foreign bank customers and, in the highest risk situations, to obtain the identity of the foreign bank customers.

Third: Obtain the identity of the owners of any foreign correspondent bank whose shares are not publicly traded and the nature and extent of each owner’s interest. For these purposes, an owner is any person who directly or indirectly owns or controls 10% or more of any class of securities (whether voting or nonvoting) of a correspondent bank.

The Final Rule will apply to correspondent accounts established on or after February 5, 2008. Correspondent accounts established before February 5, 2008 will be subject to the Final Rule effective May 5, 2008.

If you have any questions regarding the new regulations or need assistance in preparing new or amended anti-money laundering policies, please do not hesitate to contact any member of our Investment Management Practice Group.
Stay Current

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2 A “correspondent account” is an account established for a foreign financial institution to receive deposits from, or to make payments or other disbursements on behalf of, the foreign financial institution, or to handle other financial transactions relating to such foreign financial institution. Accounts include proprietary accounts and accounts opened for certain purposes other than transferring, holding, or investing a client’s money, such as custody or escrow accounts, even though these types of accounts represent a lower risk of money laundering.

For broker-dealers, correspondent accounts established on behalf of foreign financial institutions include any formal relationship established with a broker-dealer in securities to provide regular services to effect transactions in securities, including, but not limited to, the purchase and sale of securities and securities loaned and borrowed activity and to hold securities or other assets for safekeeping or as collateral.

For mutual funds, an account is any contractual relationship or other business relationship established between a person and a mutual fund to provide regular services to effect transactions in securities issues by the mutual fund, including the purchase and sale of securities.

3 “Foreign financial institution” is defined to include: a foreign bank; any branch or office located outside the U.S. of any domestic bank, broker-dealer, futures commission merchant, commodities introducing broker, or mutual fund; a non-U.S. entity that, if it was located in the U.S., would be securities broker-dealers, futures commission merchants or mutual funds; and a non-U.S. entity that is engaged in the business of, and is readily identifiable as, a currency dealer or exchange, or money transmitter. A foreign bank is a bank organized under foreign law or an agency, branch or office located outside the United States of a U.S. bank.

4 “Offshore banking license” means a license to conduct banking activities which, as a condition of the license, prohibits the licensed entity from conducting banking activities with the citizens of, or with the local currency of, the country which issued the license.

5 Presently, the Financial Action Task Force (FATF) is the only intergovernmental agency of which the United States is a member that has designated countries as non-cooperative with international anti-money laundering principles. However, no such countries are currently designated as non-cooperative by FATF.

6 The Secretary is authorized under Section 311 of the USA Patriot Act, after finding that reasonable grounds exist for concluding that a foreign jurisdiction, foreign financial institution, international class of transaction, or type of account is of “primary money laundering concern,” to require domestic financial institutions and domestic financial agencies to take certain statutorily defined “special measures” against the primary money laundering concern. Relevant designations and rulemakings are on FinCEN’s website at www.fincen.gov/reg_section311.html. The only country currently designated as warranting special measures is Nauru. The U.S. Treasury Secretary has also imposed special measures against Burma, making it illegal for a U.S. institution to maintain a correspondent account for a foreign bank from or licensed by that country.