WILMER, CUTLER & PICKERING

Financial Institutions Group Newsletter

AUGUST 13, 2001

ANTI-MONEY LAUNDERING HIGH ON THE RADAR SCREEN

One of the hottest current topics in the financial community is anti-money laundering. Indeed, regulators, legislators, and law enforcement agencies – both in the United States and internationally – have served notice that they will make anti-money laundering a priority this year and in years to come. In addition, the focus of attention, which has traditionally been directed principally at banks, is now broadening to include securities firms and insurance companies. In this environment, it is increasingly important for all types of financial institutions to ensure that they have in place robust anti-money laundering controls and procedures.

Enforcement Actions Highlight the Need for Money Laundering Controls. Two recent enforcement actions brought against U.S. banking institutions highlight the significant regulatory and reputational risks for firms lacking sufficient counter-money laundering controls. The first action involved a record fine levied against the U.S. Trust Corporation, a subsidiary of Charles Schwab & Company, and its state-chartered bank, the United States Trust Company of New York (together, "U.S. Trust").

On July 12, 2001, the Federal Reserve and the New York Superintendent of Banks issued a highly publicized cease and desist order against U.S. Trust. Without admitting any of the allegations presented against it, U.S. Trust consented to the issuance of the order and agreed to pay to a *$10 million* fine – one of the largest ever against a domestic banking firm, and the largest ever levied by the New York banking department – to the Federal Reserve and the State of New York.

The regulators' order cited several failures on the part of U.S. Trust to comply with the anti-money laundering procedures of the Bank Secrecy Act, as well as other statutory violations. For example, U.S. Trust apparently did not comply with the record-keeping and reporting requirements for currency transactions over $10,000 and lacked adequate systems to catch transactions that were structured to avoid the $10,000 reporting threshold.

U.S. Trust committed to take numerous detailed actions to fix the problems, including (1) hiring new personnel for the sole purpose of ensuring compliance with anti-money laundering laws, (2) developing and submitting to regulators new policies and procedures to comply with anti-money laundering laws, and (3) providing for rigorous and on-going independent auditing and testing of those enhanced procedures. The regulators' order establishes rigorous and tight timeframes by which U.S. Trust must accomplish each of the prescribed tasks.

On the same day that the U.S. Trust order was issued, the Federal Reserve also issued a cease and desist order against the Bank of Rogers in Arkansas, which was similarly cited for failure to comply with the anti-money laundering procedures of the Bank Secrecy Act. Although apparently not subject to a civil money penalty, the Bank of Rogers – like U.S. Trust – agreed to implement various new internal controls, policies and procedures to comply with anti-money laundering laws and to have these new measures reviewed by independent auditors and the Federal Reserve.

Anti-Money Laundering on the Horizon in the Securities Industry. The bank regulators have by no means been alone in their focus on anti-money laundering compliance. The Securities and Exchange Commission ("SEC") and its staff have indicated that anti-money laundering will be one of their chief regulatory priorities in the fall.

The SEC's focus on anti-money laundering was made clear in a speech given earlier this year by Lori Richards, the SEC's Director of the Office of Compliance Inspections and Examinations. In her remarks, Ms. Richards explained that securities firms are "subject to significant compliance obligations" under anti-money laundering laws and face "grave risks" if they fail to take appropriate measures to prevent money laundering.

Ms. Richards announced that SEC examiners would join counterparts from the New York Stock Exchange ("NYSE") and National Association of Securities Dealers ("NASD") to conduct a "sweep" that will assess the counter-money laundering policies, procedures, and internal controls of broker-dealers. (News reports suggest that investment advisers may be subject to similar SEC examinations at a future date.)

Ms. Richards noted that, in preparing for upcoming exams, broker-dealers can and should take several steps, including the following:

- designating a compliance officer or committee to take responsibility for the firm's money laundering program;
- developing *written* policies that are part of the firm's compliance manual and that clearly set forth the firm's anti-money laundering procedures;
- training employees to recognize signs of money laundering and what to do once a risk is identified;
- ensuring money laundering detection goes on in all relevant business units; and
- having an audit program that reviews and tests the anti-money laundering program to ensure that it is working as intended.

In addition to getting ready for examinations, broker-dealers should prepare for new regulations. The Treasury Department's Financial Crimes Enforcement Network ("FinCEN") long ago announced that it would promulgate a Suspicious Activity Reporting ("SAR") regulation applicable to all broker-dealers (current SAR regulations are applicable to banks and the subsidiaries of bank and financial holding companies, including broker-dealer subsidiaries). Our conversations with Treasury officials indicate that this year, the long-delayed Treasury regulations could finally be issued.

Insurance Firms also Need to Devote Attention to Money Laundering. Insurance regulators also are telling firms that they supervise to be watchful of money laundering and to install policies and procedures. Currently, insurance companies are generally exempt from the formal reporting requirements that apply to other segments of the financial services industry. Press reports indicate that this may soon be changing; indeed, the National Association of Insurance Commissioners ("NAIC"), among others, has advised insurers to get ready for increased regulatory attention to this issue. In addition, the NAIC and others have noted the serious consequences to insurers if they are involved in money laundering.

New Anti-Money Laundering Legislation Introduced. Congress also has turned its attention to money laundering problems. Most notably, on August 3, 2001, Sen. Carl Levin – joined by the Chairman of the Senate Banking Committee, Sen. Paul Sarbanes (D-Maryland), and several other Democratic and Republican Senators – introduced new anti-money laundering legislation. The legislation, titled the "Money Laundering Abatement Act" (S. 1371), is designed chiefly to address perceived vulnerabilities of the U.S. private and correspondent banking systems to international money laundering activities.

Among other things, the Levin bill would require U.S. depository institutions (and the U.S. branches and agencies of foreign banks) that open bank accounts for foreign entities to maintain records on each person having a "direct or beneficial ownership interest" in such accounts. The only exception to this requirement would be for corporations that issue publicly traded securities. Accordingly, this require-

ment could have far-reaching implications for various offshore entities, including private funds.

S. 1371 also would require U.S. banks that maintain correspondent accounts for foreign banks, the shares of which are not publicly traded, to "identify each of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner." In addition, the bill generally would prohibit U.S. depository institutions from maintaining correspondent banking relationships with foreign "shell" banks – that is, banks that lack a physical presence in any country.

S. 1371 also would mandate certain "enhanced due diligence" procedures to detect and report on possible instances of money laundering through private and correspondent banking accounts maintained in the United States by foreign persons or banks. Such enhanced due diligence would apply, in particular, to private bank accounts maintained by senior foreign political figures and to correspondent bank accounts maintained by foreign banks operating in certain high-risk countries. The enhanced due diligence would require U.S. banks, among other things, to determine whether a foreign correspondent bank itself offers correspondent services to other foreign banks and, if so, to identify and perform due diligence on the foreign bank's correspondents.

The Levin bill has numerous other important provisions. For example, the bill would authorize U.S. law enforcement officials to subpoena a foreign bank with U.S. correspondent accounts and to request records related to such correspondent accounts. If a U.S. law enforcement official notified a U.S. bank that its foreign correspondent either refused to comply with a subpoena or failed to initiate U.S. court proceedings to contest a subpoena, the U.S. bank would have to terminate its correspondent relationship with that foreign bank. In addition, the Levin bill would require U.S. financial institutions to respond to requests for anti-money laundering information from their U.S. bank regulator within 48 hours. Within that time, an institution would need to make available information and account documentation for "any account opened, maintained, administered or managed in the United States."

Bush Administration Policies to Be Announced. The Bush Administration has not yet taken a public position on the Levin bill. The Administration has, however, clashed in the past with Sen. Levin on how best to achieve the nation's anti-money laundering objectives. In particular, Treasury Secretary Paul O'Neill has been critical of anti-money laundering efforts that pay inadequate attention to compliance costs and burdens.

The Bush Administration's revised approach to money laundering – which focuses on not only the benefits of anti-money laundering regulations, but also their costs – is expected to be revealed within weeks in its "national money laundering strategy." Under the Money Laundering and Financial Crimes Strategy Act of 1998, the Administration is required to deliver to Congress, in each year from 1999-2003, a "national strategy" for combating money laundering. In 1999 and 2000, the strategy developed under the Clinton Administration comprised more than sixty discrete "action items."

Treasury Department staff members with whom we have spoken have indicated that the Bush Administration may pare down the number of "action items" in the last strategy and otherwise seek to make its strategy less "cumbersome" than that of the Clinton Administration. Staff members also have stated, at least privately, that a dramatic change in the direction of the strategy is highly unlikely.

Indeed, any views that the Bush Administration takes money laundering less seriously than past Administrations was dispelled by Attorney General John Ashcroft. On August 7, Mr. Ashcroft said that he considers money laundering "a serious threat" to American communities, financial institutions, and national security. Without commenting on the Levin bill, Mr. Ashcroft said that U.S. anti-money laundering laws should be tightened.

International Anti-Money Laundering Efforts Proceed. On the international front, in June, the Financial Action Task Force ("FATF") revised its list of countries deemed non-cooperative in international anti-money laundering efforts. Last year, the FATF "blacklisted" fifteen countries: Bahamas, Cayman Islands, Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, Marshall Islands, Nauru, Niue,

Panama, Philippines, Russia, St. Kitts and Nevis, St. Vincent and the Grenadines. This year, FATF removed four nations from the blacklist (Bahamas, Cayman Islands, Liechtenstein, and Panama) but added six new countries (Egypt, Guatemala, Hungary, Indonesia, Myanmar, and Nigeria).

Financial institutions should take special anti-money laundering precautions with respect to transactions involving any FATF-blacklisted country, or persons or entities in those blacklisted countries. Domestic regulatory and law enforcement agencies take these warnings into account when determining whether a financial institution should file a SAR. Last year, FinCEN issued formal "advisories" to that effect regarding each of the fifteen blacklisted countries. After the June 2001 FATF announcement, FinCEN withdrew the advisories with respect to the four countries de-listed by FATF. We understand that FinCEN will soon issue advisories with respect to the newly blacklisted countries.

Another development in the international anti-money laundering arena was the statement issued on July 7 by the Finance Ministers of the "G7" countries — Canada, France, Germany, Great Britain, Japan, Italy, and the United States — committing these countries to including "originator identification" in all international wire transfers. The United States has pushed for such a requirement in previous years to facilitate the detection of international money laundering, but other G7 countries raised technical or mechanical concerns regarding any requirement that banks identify the originators of international wire transfers. According to the G7 statement, those concerns have been resolved, and the G7 will now urge the inclusion of an originator identification requirement when FATF revises its so-called "Forty Recommendations" that function as the international standard for anti-money laundering procedures.

Conclusion. The unmistakable message from both domestic and international policymakers is that money laundering is high on their "radar screen." Accordingly, U.S. and international financial institutions ignore money-laundering issues at their own significant peril. At a minimum, firms should develop (or strengthen existing) written anti-money laundering policies and procedures, convey the importance of complying with those procedures to all employees, and conduct periodic audits and tests of those procedures to determine their effectiveness. Wilmer, Cutler & Pickering's Financial Institutions Group can assist in these efforts.

This letter is for general informational purposes only and does not represent our legal advice as to any particular set of facts, nor does this letter represent any undertaking to keep recipients advised as to all relevant legal developments. For further information on these or other financial institutions matters, please contact one of the lawyers:

James E. Anderson	(202) 663-6180	Michael D. Leffel	(202) 663-6874
Philip D. Anker	(202) 663-6613	Christopher R. Lipsett	(212) 230-8880
Robert G. Bagnall	(202) 663-6974	David A. Luigs	(202) 663-6451
Ursula C. Bass	(202) 663-6133	James H. Mann	(212) 230-8843
Brandon Becker	(202) 663-6979	Francisco A. Medina	(202) 663-6191
Russell J. Bruemmer	(202) 663-6804	Eric Mogilnicki	(202) 663-6410
J. Beckwith Burr	(202) 663-6695	Lester Nurick	(202) 663-6419
Matthew A. Chambers	(202) 663-6591	Matthew P. Previn	(212) 230-8878
Ricardo R. Delfin	(202) 663-6912	Victoria E. Schonfeld	(212) 230-8874
Susan Franck	(202) 663-6791	Marianne K. Smythe	(202) 663-6711
Ronald J. Greene	(202) 663-6285	Daniel H. Squire	(202) 663-6060
Franca Harris Gutierrez	(202) 663-6557	Natacha D. Steimer	(202) 663-6534
Stephen R. Heifetz	(202) 663-6558	Todd Stern	(202) 663-6940
Satish M. Kini	(202) 663-6804	Manley Williams	(202) 663-6595
Michael Klein	(202) 663-6620	Soo J. Yim	(202) 663-6958