

SCHWARTZ & BALLEN
1990 M STREET, N.W. · SUITE 500
WASHINGTON, DC 20036-3418
(202) 776-0700

FACSIMILE
(202) 776-0720

M E M O R A N D U M

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To Our Clients and Friends

Re: Proposed Rule Implementing USA Patriot Act:
Foreign Bank Correspondent Accounts

SUMMARY

The USA Patriot Act (the “Patriot Act”) amended the Bank Secrecy Act by adding new anti-money laundering provisions that:

- prohibit a covered financial institution from maintaining a correspondent account for a foreign bank that does not have a physical presence in any country (“shell bank”);
- require a covered financial institution to take reasonable steps to prevent a correspondent account provided to a foreign bank from being used indirectly by the foreign bank to provide banking services to a foreign shell bank; and
- require a covered financial institution that provides correspondent accounts to foreign banks to maintain the names and addresses of the foreign banks’ owners and U.S. agents designated to accept service of process on behalf of the foreign banks.

Last November the Treasury Department issued interim guidance for financial institutions in implementing these provisions. The Treasury Department is now proposing final rules for this implementation. Comments are due by February 11, 2002.

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The proposed rule differs from the interim guidance in the following respects:¹

- brokers-dealers are subject to the same obligations and reporting requirements as other covered financial institutions
- in addition to the certification process, a covered financial institution is responsible for verification every two years and when the institution has reason to believe information previously provided is no longer accurate
- a covered financial institution that does not obtain required information from a foreign bank must terminate its correspondent account relationship with that foreign bank
- covered financial institutions must terminate correspondent accounts of foreign banks that fail to turn over their account records within 10 days of being notified to do so by the Secretary of the Treasury or the Attorney General or be subject to a civil penalty of \$10,000 per day

REQUIREMENTS

The Patriot Act provides that a “covered financial institution” may not establish, maintain, administer, or manage a “correspondent account” in the U.S. for, or on behalf of, a “foreign shell bank.” A “covered financial institution” is:

- an “insured bank,” as defined in the Federal Deposit Insurance Act;
- a commercial bank, trust company or private banker;
- an agency or branch of a foreign bank in the United States;
- a thrift institution or credit union; or
- a broker-dealer registered with the Securities and Exchange Commission.

A “correspondent account” for banking institutions is an account established to receive deposits from, make payments on behalf of, or handle other financial transactions related to, a foreign financial institution. For brokers-dealers a “correspondent account” is an account that permits the foreign bank to engage in securities transactions, funds transfers, or other financial transactions through the account. These include accounts for trading foreign currency, custody accounts, OTC derivative accounts and accounts to purchase futures. Further, a correspondent account maintained in a foreign branch of a covered financial institution are considered to be maintained in the U.S. and are covered by the proposed rule.

A “foreign shell bank” is a foreign bank without a “physical presence” in any country. A “physical presence” is a foreign bank’s place of business that is located at a fixed address and at which the foreign bank:

¹ For a summary of the interim guidance, please see http://www.schwartzandballen.com/MemoDocs/foreign%20shell%20banks%20_12-11-01_.pdf

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- employs one or more individuals on a full-time basis;
- maintains operating records related to its banking activities; and
- is subject to inspection by the banking authority that licensed the foreign bank to conduct banking activities.

However, a covered financial institution may continue to provide correspondent services to a foreign shell bank that is an affiliate of a bank that maintains a physical presence in the United States or a foreign country and that is subject to supervision by a banking authority.

A covered financial institution is also required to take reasonable steps to ensure that a correspondent account it establishes, maintains, administers or manages in the United States for a foreign bank is not used by the foreign bank to provide banking services indirectly to a foreign shell bank that is not a regulated affiliate.

CERTIFICATION PROCESS

In order to satisfy the requirement that financial institutions maintain records in the U.S. identifying the owners of foreign banks, and the names and addresses of U.S. residents authorized to accept service of legal process for records regarding correspondent accounts, the Treasury Department has developed a certification form that financial institutions may provide to foreign banks.

The certification form requires a foreign bank that maintains a correspondent account with a covered financial institution to certify certain information, including:

- whether or not it is a shell bank;
- its (or its affiliate's) physical address and its regulator;
- that it does not provide banking services to any shell bank;
- the names and addresses of its owners;
- the name and address of its U.S. agent designated to accept service of legal process;
- that it will notify in writing each U.S. financial institution at which it maintains a correspondent account within 30 days of any change in facts or circumstances it has certified; and
- that it understands that a copy of the certification may be provided to the Secretary of the Treasury and the Attorney General.

The rule also provides that at least every two years a covered financial institution must verify that the information previously provided is accurate (biennial verification) and must also verify the accuracy of the information whenever it has reason to suspect that the information is no longer correct (interim verification). A covered financial institution may ask the foreign bank for a revised certification form or may use the

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recertification form developed by the Treasury Department to comply with biennial and interim certifications.

The Treasury guidelines provide considerable detail regarding what constitutes an “owner” of a foreign financial institution and what level of ownership interest will be required to be reported. A copy of the guidelines can be found at <http://www.schwartzandballen.com/WhatsNew.htm>

If you have any questions concerning the Treasury Department’s guidelines, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.