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THE US PATRIOT ACT – IS IT ALL BAD?

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In recent times there has been much discussion on the effect that the US Patriot Act (“the Act”) could have on Caribbean jurisdictions, especially those with offshore financial centers. This topic also seems to generate a significant amount of emotion. At a seminar in 2002, the presenter, an American lawyer, responding to questions stated that, relative to the Act, it is the geo-political power of the United States of America at work. To paraphrase his statement: the US is large enough and has the political influence to make demands on countries like the Bahamas. This response led to a few participants walking out. Unfortunately he could have not been any more accurate.

Jump back to a Bahamas Association of Compliance Officers (BACO) conference held in 2004. The discussion centered on the implications of the Patriot Act for the financial services industry. Sitting at that panel were some very distinguished professionals. The general conclusions were that the Act should essentially be rejected on the basis of its apparent implications for sovereignty and because it appears to, along with other international initiatives, impose a moving target for compliance on jurisdictions within the region. The argument was also made that a coordinated and considered effort has to be made to “lobby” strategic individuals within in the US who could then represent our interest or at the very least explain how the existence of the offshore financial centers in the region impacts the US capital market and financial services industry. This we assume would temper any negative consequences for the region.

Considering the two scenarios it is clear that the Act conjures up certain fears and is generally not thought of as having too many benefits for the Caribbean. But is the Act all bad or are there aspects of its objectives and its application which are not fully considered during these discussions? Our intent is not to sway the reader one way or the other. We will therefore present some information relevant to section 311 of the Act and leave the reader to take their own position. In another article we will analyze some other sections of the Act and their potential implications. The information is presented with one important caveat. We are not lawyers and this therefore is not intended to be a legal analysis.

Generally it is title III of the Act which is usually under the spotlight when discussions arise relative to financial services. Title III contains many pronouncements which have implications for every jurisdiction outside of the US, not just those within the Caribbean. Under section 311 of the Act the Secretary of the Treasury has the power to require US domestic banks to impose special requirements where “*a jurisdiction outside of the United States, financial institution operating outside of the United States, class of*



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transaction within, or involving, a jurisdiction outside of the United States, or one or more types of accounts has been declared as a primary money laundering concern". These special requirements may include prohibiting domestic banks from providing, for example, correspondent or payable through accounts. This power conferred upon the secretary has the potential to significantly disrupt a country's economy especially in instances where the provision of financial services forms a large portion of national income. In our opinion, it is this combination which unearths the most dreaded aspect of the Act. There is the ability to put some countries out of business, at least as it relates to the provision of financial services. It should be noted that several other international initiatives could potentially have the same effect.

Consider these two similar situations (but different in terms of impact) which play out during the practical application of the Act. The US authorities imposed special measures under section 311 against Myanmar (Burma). This restricted U.S. financial institutions from entering into direct as well as indirect transactions with Burmese banking organizations. With regard to indirect transactions, U.S. financial institutions are required, for example, to ensure that the correspondent or payable-through accounts they maintain in the United States for any foreign bank are not used by the foreign bank to provide banking services to Burmese banking organizations. This gives a fair idea of the wide ranging implications such a ruling can have on a jurisdiction. In addition to the country as a whole, two institutions were singled out as being a threat for money laundering. As a result the "special measures against these two banking organizations were more restrictive".

The release from the authorities declared "Without exception, U.S. financial institutions are broadly prohibited from establishing, maintaining or administering correspondent accounts or payable-through accounts with Myanmar Mayflower Bank and Asia Wealth Bank". Being familiar with the operations of an offshore financial institution it would [be] recognize that this action would have dealt a significant blow to their operations. The inability to create correspondent accounts, even on an indirect basis, will significantly restrict the level of service a bank is able to provide its clients especially where they are desirous of participating in the US capital market. In Burma's case the impact was largely limited to the financial sectors given other "viable" means of national income.

Nauru provides us with the second but more dramatic evidence of the impact the Act can have on a country. Based on information gleaned from the US Federal Reserves website, Nauru is a small island, ten square miles with a population approximately twelve thousand. It had developed a reputation for the establishment of offshore shell banks without physical presence. To raise income, having seen its previously impressive wealth from the mining of phosphates depleted, the country resorted to the selling of passports (or "economic citizenships"), to nonresident foreigners and offshore banking licenses. Nauru's banking licenses are only subject to cursory supervision, and maintain no



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banking records which would facilitate review by a bank regulator. It was noted in the report that “the limited information available indicates that there is a strong likelihood that they [were] shell banks that [were] not subject to effective banking supervision”. The country was declared a money laundering threat.

Subsequent to the declaration and discussions between the US and the country the offshore sector of the country essentially folded or as was reported the leadership agreed to “terminate certain types of business”. The country is currently on the doorsteps of total bankruptcy. The big question now is how this country, struggling for survival, will ever be able to find viable, legitimate replacement for the income lost as a result of the significant erosion of its “offshore” activities. Nauru has clearly shown that the application of the Act can and does create significant economic hardship for a country. We would not wish, given the facts involved for one to conclude that the Act was applied unjustifiably or with prejudice. There are however different perspectives on what constitute proper supervision or the level of risk posed by a certain types of institutions and financial services products. Consequently some may draw such a conclusion.

Considering the facts in the case of Nauru, there were aspects of the operations of their “offshore sector” which was obviously flawed. The lack of supervision and regulation would cause any objective observer to be concerned. The absence of physical presence together with inadequate paper trail (or paper support) definitely had negative implications for the financial systems of other countries and possibly certain prominent world financial centers. In this case therefore, one would have to conclude that, prima facie, the Act was beneficial not only to the US but to other jurisdictions given that there was the potential for unwelcome activities to be carried out through these non-domiciled, unregulated institutions. Here, in our opinion, is the manifestation of the geopolitical clout of the US. Consider whether any other major financial center, “singularly” imposing a similar “sanction” would have had the same effect.

The right to create a means which ensure survival and prosperity is an explicit right of every country. Against this background isn't it very curious that a sovereign could take certain actions against another, unilaterally, which places it at a significant disadvantage. Careful analysis of the procedures for application of section 311 of the Act shows that the US may not, in fact, necessarily be acting singularly or as unilateral as it first appears but is relying on signals from other jurisdictions and institutions. Institutions such as FATF, FSF and the IMF play a significant role in this regard. This is why there needs to be careful consideration of other international initiatives and their impact in any discussion on the implications and effects of the Patriot Act. This is also why the actions and pronouncements of these multilateral bodies should never be disregarded especially where they have negative connotations towards the region.

The Patriot Act, in our opinion, has been carefully crafted to ensure that sufficient and careful consideration is given before an entity, country or class of accounts is declared as



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a primary money laundering concern. Section 311 requires consultation with, amongst others, the Board of Governors of the Federal Reserves system, the Securities and Exchange Commission, the Secretary of State. *Consideration must be given to whether similar actions are being taken by other countries or multilateral groups.* This is where the importance of groups such as the FATF and FSF becomes pronounced. The impact on competitiveness and compliance burden on US financial institutions is also considered together with whether the timing of the action would have any adverse systemic impact on the global financial system and the effect of the action on the US national security and foreign policy.

Essentially the process is designed to carefully consider and protect the interest of the US. Therefore, all things being equal, with these checks and balances, there should be very little anxiety that undue and undeserved sanctions would be imposed on any entity or country. Given the collective financial importance of Caribbean financial centers and the obvious impact that the imposition of “special measures” could have on the US financial system together with the potential impact on the competitiveness of US financial institutions, it is difficult to envision any type of ill-considered declaration directed at the region.

An examination of the conclusions drawn in the case of Nauru is useful in gauging how Caribbean jurisdictions would be assessed in the unlikely event of any coming up for such consideration. The following delineates the thought process leading to the decision to declare Nauru a money laundering concern. The authorities considered the following:

- Whether similar actions have been or are being taken by other nations or multilateral groups. *The FATF had **called** on its member countries for the imposition of counter-measures against Nauru.*
- Whether the imposition of any particular special measure would create a significant competitive disadvantage, including any undue cost or burden associated with compliance, for financial institutions organized or licensed in the United States. *It was concluded that the imposition of sanctions against Nauru should not create such a situation. This was taken against the background that FATF members and G-7 countries had already responded to the FATF’s call for the imposition of counter-measures and that there was already a restriction on the provision of certain services to Nauruan financial institutions by institutions in the US.*
- The extent to which the action or the timing of the action would have a significant adverse systemic impact on the international payment, clearance, and settlement system, or on legitimate business activities involving the particular jurisdiction, institution, or class of transactions. *The conclusion was that action against Nauru should have no significant adverse systemic impact on the international payment*



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system or on legitimate business activities due to the small size of the economy and the absence of any meaningful, legitimate international business.

- Finally, the Effect of the action on United States national security and foreign policy. *It was concluded that the action is expected to have virtually no effect on United States national security or foreign policy.*

Based on the foregoing, the declaration was made. The reader can determine for himself how Caribbean jurisdictions or any specific jurisdiction would fare in a similar circumstance taking into account the points enumerated above. It is clear that while the factors considered mainly focus on the US's position there is also allowance for assessing the impact within the targeted country. One other element which is interesting is the extent to which the "importance" of a jurisdiction to the national security and foreign policy of the US would influence the decision.

It appears that the process for implementing the force of the Act is very deliberate and structured to ensure that the "right" decision is made. Further it would appear that by including factors such as competitiveness and foreign policy there is unlikely to be any overwhelming adverse action against the Caribbean given relatively good relationships between the US and the region and the extent to which a few, for example the Bahamas, has serious implications for the US national security. The competitiveness aspect, while an important factor, which would play to the advantage of the Caribbean, does raise the possibility of actions from other countries, regions or multilateral institutions being used to influence sanctions under the Act, given that such actions would reduce the adverse impact on US interest by eroding the competitiveness argument. In this regard, it therefore appears that there lies more veiled danger in other quarters which could render the region susceptible to the might of the Patriot Act

One point that can be raised, especially in the aftermath of certain Caribbean jurisdiction being blacklisted, is that there is a need to correct what appears not only to be a clear misunderstanding, on the part of US policy makers, of the products and what is done in Caribbean offshore jurisdictions but also the clear underestimation on how much these activities contribute to the US capital markets and financial services industry. From this perspective the call for a lobbyist approach, as noted above, certainly has significant value. Clearly, without educating those with ability to "hurt" our economies that there is an intrinsic connection in the viability of the offshore institutions, subject to proper management of money laundering issues, and the onshore institutions the misunderstandings will continue and the implication for us is not favourable. If the Caribbean can show that actions against it by the US, through the Patriot Act or other measures for that matter would hurt, at least sections, the US financial services industry in a noticeable way then the region would be well on the way to ensuring that the factors, when considered, are skewed in its favour.



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Finally, we must again ask the question - should the Patriot Act be summarily rejected? Analysis of the facts, some of which are discussed above, suggests that at this point in time, that approach does not appear to represent a viable solution. Obviously there are others who are able to argue otherwise and we welcome such discussions. A useful approach, however, is not to agonize over the geo-political clout of the US (or any other region), nor seek to disregard the Act but to consistently guard against the need for the provisions of the Act to be even considered much less applied with regards to the Caribbean.

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