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THE EXPORT OF US COMPLIANCE OBLIGATIONS

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September 11th was a seismic event, the effects of which are now being felt by UK banks and investment businesses caught in the aftershock of US foreign policy.

Since 9/11, the US authorities have deliberately expanded their reach, imposing so-called 'know your customer' obligations on non-US banks. Each bank must be able to provide assurances that its customers are not terrorists, drug traffickers, money launderers or anyone who is *persona non grata* in the international financial markets. For these banks, the price of non-compliance is high – being barred from doing business in US dollars. The risk is posed not only to banks but any financial institution, including investment businesses.

Sanctions are nothing new. To further its national security objectives, the United States has, for many years, systematically restricted transactions with various countries, through sanctions which are policed by OFAC. By and large, US financial institutions, well aware of the draconian powers of OFAC and the Financial Crimes Enforcement Network (FinCEN), have toed the line. But, in a global economy in which the US dollar remains the currency of choice, the US government has tired of its 'enemies' circumventing existing sanctions by transacting their US dollar business through non-US financial institutions. These financial institutions process such transactions through their own accounts at US banks (so-called 'correspondent accounts'). Thus, the wrongdoer hides behind the good credit and unimpeachable reputation of his or her foreign bank.

The USA PATRIOT Act enacted in October 2001 imposed an obligation on US banks operating correspondent accounts to force their foreign bank customers to comply with US regulations. But, in a number of instances, foreign banks are said to have implemented 'special procedures' for certain fund transfers on behalf of Iranian customers, thus undermining the dual objectives of the PATRIOT Act and OFAC sanctions against Iran. ABN AMRO suffered the ignominy of an investigation into similar alleged practices through its Dubai branch and was fined $80 million as a result.

In the ABN AMRO case, the US authorities were able to exercise jurisdiction by claiming that the Dutch bank was a US person by virtue of its US branch. The fear in Washington is that the same stick cannot be wielded against foreign banks operating US correspondent accounts with no branch or subsidiary on American soil.

The response has been to apply direct pressure to foreign banks to force them to comply with US sanctions, at the risk of losing the privilege of doing business in dollars through the New York financial markets. This has resulted in a comprehensive 'export' of US compliance obligations. The thinking goes that, if the US authorities have foreign banks by their correspondent accounts, their hearts and minds will follow. An international bank without a US correspondent account is effectively shut out of the global financial markets.

The US has loaded its enforcement arsenal with a number of effective weapons to force compliance with its sanctions and anti-money laundering programmes and has marshalled the US banks to act as its front line troops in the enforcement battle. If they are not assured of the foreign banks' compliance with US regulatory standards, then they are obligated to close their vital correspondent accounts.

Further ammunition is provided under Section 319 of the PATRIOT Act, which permits US authorities to hold foreign banks responsible for the financial misdeeds of their customers and gives them the power to forfeit funds from a foreign bank's US correspondent accounts for infractions of US law. This is a particularly effective disincentive for two reasons: firstly, as the action is brought against a bank's property not against the bank itself, no wrongdoing needs be proven against the bank for the provision to bite; and secondly, the civil and not the more onerous criminal standard of proof applies.

Of even greater concern are the anti-terrorism laws enacted in 1992 and 1996 which permit victims of terrorist attacks to bring civil actions against financial institutions that are alleged to have provided material support or resources, including financial services, to a foreign terrorist organisation in breach of the US Anti-Terrorism Act. The US civil plaintiff bar that waged the tobacco class litigation wars of the 1980s and 90s now have foreign banks firmly in their sights on behalf of the victims of terrorist attacks. Contingency fee arrangements in the US permit lawyers to recruit potential plaintiffs who pay no legal fees unless they win and bear no risk of costs if they lose. These lawyers are presumably well aware of the reputational cost to banks of defending claims brought by the victims of terrorism.

NatWest is currently defending a series of claims by US citizens and the heirs of foreign citizens injured or killed in ten terrorist attacks in Israel in 2002 and 2003. It is claimed that, by having maintained accounts and processed transfers in the UK for Interpal (a Palestinian charity registered with the UK Charities Commission), NatWest provided material support to terrorist organisations such as Hamas.

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At the time the accounts were maintained by NatWest in the UK, Interpal was designated as a terrorist organisation only by the authorities in Israel. It was only later in 2003 that Interpal was sanctioned by OFAC. At all material times NatWest acted lawfully in the UK where the accounts were operated. Nevertheless, the bank now finds itself defending, at considerable expense, a claim that, whether it succeeds or not, will have done nothing to enhance its reputation. If the claims succeed, the US Anti-Terrorism Act's 'treble damages' provisions are likely to guarantee that the sums in damages will be very substantial.

The position in which UK banks and companies have been placed has not gone unnoticed at parliamentary level. The House of Lords Economic Affairs Committee in their report into the impact of economic sanctions expressed extreme concern at the US approach, noting that whilst they recognised the need to take vigorous action in response to terrorist threats facing the EU and US they condemned the extra-territorial application of US sanctions as a violation of international law.

It is difficult to conceive of more powerful disincentives for non-US banks to act contrary to US foreign policy objectives wherever they conduct their business, whether they maintain a banking presence in the US or not. Consequently, it has become imperative that non-US banks understand the expanded reach of US law in designing their own compliance regimes. With no prospect of a change in policy on extra territoriality by President Obama the costs of compliance to the non-US banking sector look set to continue to soar.

What are the lessons? Critically banks must recognise that the nature of criminal, regulatory and civil liability risk has 'gone global'. Too many institutions encourage a jurisdiction specific 'silo mentality' to risk management and express surprise when a risk manifests from outside of their limited field of vision. The devastating effects of the US housing collapse on UK banks is a symptom of this mentality. Clouds are gathering for financial services businesses in the UK – many of them are ill equipped to withstand the consequences of a hurricane that has at its epicentre an OFAC sanctions breach or an anti terror act claim.

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