

Avoiding the Money Laundering Trap

By Steven Andersen

Any money laundering expert will tell you it's virtually impossible to produce a reliable estimate of the amount of money that's laundered each year on a global basis. In 1996, for instance, the International Monetary Fund estimated the aggregate scope of money laundering could be anywhere from 2 percent to 5 percent of the world's gross domestic product, or between 590 billion and 1.5 trillion U.S. dollars.

One thing, however, is indisputable: criminal and terrorist organizations continue to develop increasingly sophisticated ways to launder the proceeds of illegal activities. Further, their attempts can sometimes involve unsuspecting corporations that become entangled in domestic or foreign money laundering scandals—or both.

How can a corporate general counsel work with senior management to keep the company from becoming an unwitting victim of money laundering? Develop a good understanding of the company's lines of business, where it does business, the nature of its transactions, who its customers are and how its products and services could be used for money laundering purposes. Conducting activities or servicing customers, especially

those in countries with less than stellar anti-money laundering (AML) enforcement records, may heighten risks.

"In terms of AML vigilance and enforcement, the United States is the global leader," explains Carol R. Van Cleef, a partner at Patton Boggs LLP who focuses on AML compliance. "The rest of the world is improving, especially post-9/11. But many regions are still playing catch-up."

"With recent AML advances in Western Europe, you can assume the level of compliance by the banks and supervision by the regulators there are as high as it is in the U.S.," adds Stephen J. McHale, a Patton Boggs partner whose practice includes anti-money laundering and counter terrorist financing programs. "But in other parts of the world you're dealing with a huge range of AML compliance systems, each with a varying quality of oversight."

Close Contact

In the United States, Van Cleef says banks play a major role in identifying and reporting potential money laundering activities.

To comply with U.S. regulatory expectations and take proactive steps to prevent being used for money laundering activities, banks

must conduct due diligence on new (and sometimes existing) customers to learn as much as possible about the customer, its business and its customers. This information is then used to monitor customer account and transactional activity for indications of unusual or potentially suspicious activity. That's why commercial customers must provide what some consider proprietary company information.

"We get all sorts of questions from corporate clients, such as, 'Can a bank really ask for information about our business activities?'"—especially when the client is not applying for credit." Van Cleef says. "Without question, such inquiries can be invasive, but if you want to retain your banking relationship you may have little choice but to work with the bank. Banks have been under extraordinary regulatory pressure to demonstrate that these questions have been asked and the answers reviewed in their decisions to continue relationships. For the company, it is a business decision as to whether it wants to work with the bank and provide that information."

Compliance with the law also requires the financial institution to monitor a company's banking behavior using software-based tools

that search for and identify any changes that don't seem to fit that particular company.

"If the bank is used to seeing activity in a business' account that is \$20,000 per week and that activity suddenly jumps to \$30,000 or \$40,000, and there doesn't appear to be a legitimate business reason, it could decide to file a Suspicious Activity Report (SAR) with FinCEN [the Financial Crimes Enforcement Network, an agency of the Treasury Department]," Van Cleef explains.

Before filing a SAR, the bank may try to find out more information as to why there was such a change in the customer's level of activity. A friendly client-service call to ask the customer if there has been a change in the business plan and whether it requires any new services given the evident increase in its activity could be beneficial for both the bank and the customer. The change in customer activity may be legitimate and the customer may welcome the opportunity to avail itself of more or different bank services; the bank avoids making a needless filing. Neither suffers potential repercussions of a filing that was not necessary.

By law the bank cannot inform the company that a SAR has been filed—once created, the report can take on a life of its own. The SAR goes into the master database and is available to federal, state and local law enforcement agencies throughout the country. From the SARs, law enforcement may decide to initiate a new investigation, supplement an investigation already underway and in some cases resurrect a cold case. The SAR is effectively fair game and brings unwanted scrutiny upon the subject of the filing.

"That's why it's so important to understand your AML risk exposure, put controls in place to address it and maintain close contact with your bank or other financial services provider to ensure they are aware of unusual changes in your business activity," Van Cleef says. "Otherwise, if the bank picks up on something, files a SAR and an investigation is ultimately launched, the results can be incredibly costly with respect to both human and fiscal resources and the company's reputation."

Know Your Customer

Not only do banks need to understand their customers but the company needs to understand its customers and business partners, both in the United States and elsewhere in the world. Understanding the customer's business sufficiently allows the company to ask questions if, for instance, a customer wants to buy expensive industrial

equipment when it has no apparent use for it.

"That's the cardinal rule. You have to make sure the customer is a legitimate business partner," McHale says. "If it's a new customer, you have to evaluate the potential transaction by examining the customer's business. Is it legitimate? How will he make a profit on this transaction? If it looks suspicious, perhaps he's more than just a bad businessman."

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Consider, for example, a real estate transaction. A company is looking to develop a vacation resort. A businessman offers to invest \$50 million in the project. "Sometimes the developer needs that investor and doesn't conduct the necessary due diligence," McHale says. "But you have to ask, 'Is this the type of person to have \$50 million to invest in a resort project? Is he a real estate investor who started out small but built his fortune over decades on real estate development?'" Van Cleef adds, "Understanding the investor's source of funds is critical in this type of situation."

Again, check out what bank a business partner uses. If the partner is legitimate, it will deal with local banks that have comparable, certifiable AML processes in place.

The stakes are even higher for a U.S. company looking to enter an emerging, international market where both the customers and financial institutions have much weaker AML controls

"If you're looking to branch out internationally and move into new, expanding markets, the risks become higher and the banks look more closely at your transactions with that customer and the customer's bank," McHale says. "That will certainly change your company's profile with

its bank." And, as Van Cleef notes, this could heighten the risk of a SAR filing.

According to Van Cleef, banks have become increasingly proactive and try to avoid taking on more AML risk than they feel they can tolerate. Thus, the company's U.S. bank will evaluate the strength of the AML supervision by the new market's banking institutions and potential customers. If the supervisory regime is considered weak, the bank could be reluctant to help the company consummate business transactions in that part of the world.

"Problems often arise when you try to move funds or goods from a weak AML supervisory regime to one that demands a higher degree of documentation. How can the U.S. bank be assured you're not being used to move bad funds?" McHale points out. "If a company is looking to move into a new market, it has to ask, 'Who are the financial institutions we'll be working with?'"

The company's existing bank may be able to help, either directly or by providing references. It may, for example, recommend establishing an account with a Western European bank, one with strong AML controls in place that's already doing business with local banks in that market.

"I often tell clients to make sure their bank is sophisticated enough to evaluate those risks," McHale concludes. "Sometimes a company will expand to international markets but stay with the local institution. I'm not saying they should change banks, but they may want to add a bank for the international business, one that's familiar with that market." ●

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