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Know Your Customer Regulations and the International Banking System: Towards a General Self-Regulatory Regime

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Daniel Mulligan

Abstract

This Comment discusses the implementation of “Know Your Customer” (KYC) regulation and its effect on the international banking system. Part I of this Comment explains general legal concepts and trends in international money laundering including background of the drug trade, money laundering process and techniques, and U.S. and international regulatory efforts to combat the money laundering problem. Part II examines the history and the purpose of KYC principles and the proposed regulations. Part III maintains that the rejection of the proposed regulations is appropriate. This Comment concludes that the U.S. government should permit U.S. banks to self-regulate and that a less specific self-regulatory scheme should be adopted internationally.

COMMENTS

KNOW YOUR CUSTOMER REGULATIONS AND THE INTERNATIONAL BANKING SYSTEM: TOWARDS A GENERAL SELF-REGULATORY REGIME

*Daniel Mulligan**

INTRODUCTION

In an effort to fight the War on drugs, the U.S. government has recruited U.S. banks as agents to track down illicit funds.¹ In 1970, the U.S. government enacted legislation that effectively imposed an immense burden on U.S. bankers to know their customers and to track suspicious transactions.² In an already highly regulated industry, these regulatory requirements may in fact become a hindrance, rather than an aid, in the fight against international money laundering³ because of the immense administrative and financial burden that these requirements im-

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1. See Thomas D. Grant, *Toward a Swiss Solution for an American Problem: An Alternative Approach for Banks in the War on Drugs*, 14 ANN. REV. BANKING L. 225, 227 (1995) (discussing variety of methods used by wealthy nations to curb effects of money laundering).

2. Currency and Foreign Transactions Reporting Act, Pub. L. No. 91-508, 84 Stat. 114 (1970) (codified as amended at 31 U.S.C. §§ 5311-5314, 5316-5325 (1994)). The Currency and Foreign Transactions Reporting Act ("BSA") gave the U.S. Secretary of the Treasury the authority to prescribe reporting limits for currency transactions. *Id.* § 5313(a). Pursuant to that authority, the Secretary of the Treasury requires banks to report transactions in amounts exceeding US\$10,000 via a currency transaction report ("CTR"). 31 C.F.R. § 103.22(b)(1) (1998). The BSA also grants the Secretary of the Treasury power to require reporting of suspicious transactions and power to impose anti-money laundering programs on U.S. banks that can include requirements that banks take measures to know their customers. 31 U.S.C. § 5318 (1994).

3. See Peter E. Meltzer, *Keeping Drug Money from Reaching the Wash Cycle: A Guide to the Bank Secrecy Act*, 108 BANKING L.J. 230, 231 (1991) (describing laundering process consisting of three distinct components: placement—deposit of cash into financial institution; layering—creating series of transactions through various accounts to disguise true origin of funds; integration—shifting funds to legitimate organizations with no apparent link to organized crime).

pose on financial institutions.⁴

A large portion of illicitly derived money is generated by the Latin American drug trade, and Latin American countries are well-known for the extent of money laundering activity within their borders.⁵ The use of devices such as payable through accounts⁶ (or "PTAs") by Latin American clients of U.S. banks render know your customer ("KYC") principles,⁷ imposed by U.S. regulation, virtually useless, as circumvention of these guidelines is nearly impossible to detect.⁸

On December 7, 1998, under direction of the U.S. Department of Treasury, the Federal Reserve⁹ ("Fed"), the Office of

4. See generally Duncan E. Alford, *Anti-Money Laundering Regulations: A Burden on Financial Institutions*, 19 N.C. J. INT'L L. & COM. REG. 437 (1994) (discussing immense financial burden imposed on U.S. financial industry by government regulation, regulatory inefficiency, and regulatory ineffectiveness).

5. See Berta Esperanza Hernandez, *Money Laundering and Drug Trafficking Controls Score a Knockout Victory over Bank Secrecy*, 18 N.C. J. INT'L & COM. REG. 235, 238 (1993) (noting that large portion of laundered money originates in Latin America but significant amount of money laundering occurs within borders of United States); see also H.R. REP. NO. 101-446, at 23 (1990) (explaining that border states such as Texas and New Mexico are subject to large scale money laundering). In 1989, the Federal Reserve of San Antonio reported in testimony before the Federal Reserve Board of Governors that a great deal of money laundering activity is occurring along the border with Mexico. *Id.* Much of this activity is conducted in unregulated cash exchange houses commonly known as "Casas De Cambios," which provide foreign exchange services but are traditionally not subject to banking laws in Latin America and are not closely scrutinized to prevent illicit funds from entering legitimate financial institutions. *Id.*

6. See *Warning, Guidelines Issued to Protect Against Improper or Illegal Use of "Payable Through" Accounts*, Apr. 7, 1995, available in 1995 WL 480501 (F.D.I.C.) [hereinafter *PTA Guidelines*] (noting that payable through accounts ("PTAs") are most commonly in form of checking accounts marketed by U.S. banks to foreign banks that would not under other circumstances be able to offer their customers access to U.S. banking system).

7. See *Guidelines for Monitoring Bank Secrecy Act Compliance*, available in 1996 WL 271924, at *9 (F.D.I.C.) (Financial Institution Letter) (providing detailed list of know your customer ("KYC") principles). KYC principles (also known as "guidelines" or "policies and procedures") require that U.S. banks perform due diligence in obtaining and maintaining appropriate information on each customer. *Id.* This type of information can include the type of business, the length of time that business has been in existence, and the type of relationships the customer maintains in their business affairs. *Id.*

8. See Scott Sultzer, Note, *Money Laundering: The Scope of the Problem and Attempts to Combat It*, 63 TENN. L. REV. 143, 189-92 (1995) (discussing use of non-bank financial institutions, front companies, and PTAs as potent tools to circumvent KYC guidelines and other money laundering regulation).

9. See CARL FELSENFELD, *BANKING REGULATION IN THE UNITED STATES* 6 (1998). The Federal Reserve ("Fed") was created by the U.S. Congress in 1913 and acts as the central bank for the United States. *Id.* It consists of 12 Federal Reserve banks throughout the United States and a Board of Governors in Washington, D.C. *Id.* It is responsi-

Comptroller of the Currency¹⁰ ("OCC"), the Office of Thrift Supervision¹¹ ("OTS"), and the Federal Deposit Insurance Company¹² ("FDIC") released proposed regulations that would codify specific KYC principles.¹³ On March 23, 1999, in response to overwhelmingly negative comments, the agencies issued a joint press release withdrawing the proposal.¹⁴ The concerns raised by the proposed regulations, however, remain, as KYC principles are imbedded in the U.S. anti-money laundering regime.¹⁵ KYC

ble for monetary policy, controlling interest rates, and regulating banks that choose to be members and use the services of the Federal Reserve System. *Id.*

10. *See id.* at 5. The Office of Comptroller of the Currency ("OCC"), established in 1862 as part of the U.S. Department of Treasury, regulates nationally chartered U.S. banks. *Id.*

11. *See id.* at 12. The Office of Thrift Supervision ("OTS") charters and regulates federal savings and loan associations, which mainly serve the function of providing deposit services, and providing loan services for home buyers. *Id.*

12. *See id.* at 7-8. The Federal Deposit Insurance Company ("FDIC") regulates state banks that choose not to be members of the Federal Reserve System. *Id.*

13. *See* Amy G. Rudnick & Linda Noonan, *Proposed Know Your Customer Regs Are Finally Issued*, 9 NO. 5 MONEY LAUNDERING L. REP. 1, 5 (1998) (discussing implication of proposed KYC regulation and financial industry's negative response to recent proposals); *see also* John E. Shockey, *Bank Regulatory Examination and Enforcement After Barings and Daiwa*, 935 PRAC. L. INST.: CORP. L. & PRAC. COURSE HANDBOOK SERIES 681, 692 (1996) (discussing formation of multi-agency task force to write specific KYC regulation after years of agency discussion of need for such KYC regulation).

14. *See Joint Statement, Proposed "Know Your Customer" Rule* (visited Mar. 29, 1999) <<http://www.fdic.gov/publish/newprs/1999/pr101-9914.html>> (on file with the *Fordham International Law Journal*) (stating that agencies' received unprecedented number of comments reflecting privacy and financial burden concerns).

15. *See, e.g.*, 12 C.F.R. § 21.21 (1999) (requiring that all banks under OCC supervision to establish procedures for compliance with BSA, necessarily including establishment of KYC principles needed to address, for example, reporting of suspicious transactions which require knowledge of customers banking habits and typical transactions). The provision states:

- (a) Purpose. This subpart is issued to assure that all national banks establish and maintain procedures reasonably designed to assure and monitor their compliance with the requirements of subchapter II of chapter 53 of title 31, United States Code, and the implementing regulations promulgated thereunder by the Department of Treasury at 31 CFR part 103.
- (b) Compliance procedures. On or before April 27, 1987, each bank shall develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with the recordkeeping and reporting requirements set forth in subchapter II of chapter 53 of title 31, United States Code, and the implementing regulations promulgated thereunder by the Department of Treasury at 31 CFR Part 103. The compliance program shall be reduced to writing, approved by the board of directors and noted in the minutes.
- (c) Contents of compliance program. The compliance program shall, at a minimum:

principles, furthermore, have infiltrated the international anti-money laundering framework.¹⁶ It is a prudent time, therefore, to suggest more appropriate measures to stem the tide of money laundering, as these principles are both too burdensome on financial institutions and are in many ways ineffective.¹⁷

This Comment discusses the implementation of KYC regulation and its effect on the international banking system. Part I of this Comment explains general legal concepts and trends in international money laundering including background of the drug trade, money laundering process and techniques, and U.S. and international regulatory efforts to combat the money laundering problem. Part II examines the history and the purpose of KYC principles and the proposed regulations. Part III maintains that the rejection of the proposed regulations is appropriate. This Comment concludes that the U.S. government should permit U.S. banks to self-regulate and that a less specific self-regulatory scheme should be adopted internationally.

I. GENERAL CONCEPTS AND TRENDS IN MONEY LAUNDERING

Most money laundering today is fueled by the international

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- (1) Provide for a system of internal controls to assure ongoing compliance;
 - (2) Provide for independent testing for compliance to be conducted by bank personnel or by an outside party;
 - (3) Designate an individual or individuals responsible for coordinating and monitoring day-to-day compliance; and
 - (4) Provide training for appropriate personnel.

Id.

16. See Initiative by the Organization of American States to Prepare Model Regulations on the Laundering of Property and Proceeds Related to Drug Trafficking: Articles Considered by the Inter-American Group of Experts, Dec. 9-13, 1991, OEA/Ser. L/XIV, 4.4, CIDAD/GT. Lavex/doc. 20/19, reprinted in INTERNATIONAL EFFORTS TO COMBAT MONEY LAUNDERING 4 (Dr. W.C. Gilmore ed., 1992) [hereinafter Model Regulations]; see also United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, U.N. Doc. E/Conf.82/16, reprinted in 28 I.L.M. 493 (1989) [hereinafter 1988 Convention]; Financial Action Task Force on Money Laundering (FATF): The Forty Recommendations of the Financial Task Force on Money Laundering, with Interpretive Notes, June 28, 1996, 35 I.L.M. 1291, 1293 [hereinafter 1996 FATF Report].

17. See John J. Byrne, *The Bank Secrecy Act: Do Reporting Requirements Really Assist the Government?*, 44 ALA. L. REV. 801, 837 (1993) (arguing that prevention of money laundering through existing regulation does not justify immense financial burden on U.S. banks and that some BSA reporting requirements have not had effect on money laundering).

drug trade.¹⁸ U.S. legislative efforts to combat money laundering not only are centered on reporting requirements found under the regulations authorized by the Bank Secrecy Act¹⁹ (or "BSA"), but also recognize the drug trade as the source of the problem.²⁰ Internationally, the measures taken to combat money laundering have embraced many of the principles found in U.S. legislation²¹ and acknowledged that regulation should focus on the drug trade.²²

A. Money Laundering and the Drug Trade

Although the production, sale, and consumption of illicit drugs and the need to launder profits from the trade is a relatively recent epidemic, drugs have been used for centuries through ancient rituals and traditions.²³ In the Andean countries of Bolivia, Peru, and Colombia, these cultural traditions still exist, but in addition, the production and export of coca leaf and processed cocaine is a major source of national income.²⁴ Thus, the governments of these countries have been reluctant to restrain the coca production and export industries.²⁵ Even if

18. See Jimmy Gurulé, *The 1988 U.N. Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances—A Ten Year Perspective: Is International Cooperation Merely Illusory?*, 22 FORDHAM INT'L L.J. 74, 75-76 (1998) (examining connection between drug trafficking and money laundering).

19. See 31 U.S.C. § 5313(a) (1994) (authorizing Department of Treasury to create transaction reporting requirements that they implemented under 31 C.F.R. § 103.22 (b)(1) (1998)).

20. See Comprehensive Drug Abuse Prevention and Control Act of 1970, 21 U.S.C.A. § 841(a)(1) (1994) (strengthening BSA by creating willful blindness culpability standard, making bankers liable for not seeking appropriate detailed information regarding customer transactions).

21. See, e.g., 1988 Convention, *supra* note 16, art. 3(1)(b), at 502 (using language similar to that found in U.S. money laundering legislation).

22. See Model Regulations, *supra* note 16, art. 2 (noting that drug epidemic is major issue throughout Latin America and related money laundering problems must keep drug issue at forefront).

23. See Melanie R. Hallums, Note, *Bolivia and Coca: Law, Policy, and Drug Control*, 30 VAND. J. TRANSNAT'L L. 817, 823-26 (1997) (describing evolution of coca use and misuse by examining history of cocaine producing country of Bolivia as example of more widespread problem of drug production in Latin America).

24. See *id.* (describing importance of coca industry to economic stability of Andean region).

25. See H.R. REP. NO. 101-991, at 5 (1990) (noting that report concerning U.S. government's supply side Andean initiative to eradicate drug production in these countries found that reduction of coca production and processing is of low priority for Andean countries). Dependence on the coca economy is so great that governmental intervention to reduce the drug trade would result in such great disruption as to create

these governments had the desire to impede the drug trade and money laundering, techniques used to circumvent regulation such as use of PTAs would make any such intervention difficult to effectuate.²⁶

1. Recent History of the Latin American Drug Trade

Economic hardships in Latin American countries, rather than cultural tradition, now fuel coca production and processing.²⁷ Without economic relief, the peasant farmers of these countries lack the incentive to abandon the production of these products.²⁸ Because the U.S. demand for processed drug products remains consistent despite the so-called War on Drugs,²⁹ instead of abandoning this lucrative business, producers in Latin America have become expert businessmen, with economic benefit accruing to some governments.³⁰ In Colombia, for example, large and powerful drug cartels are responsible for some of the

social unrest and severe economic dislocation. *Id.* The socioeconomic and political climate in the Andean countries is a significant barrier to Andean governments' confrontation of the drug trade. *Id.*

26. See generally Alford, *supra* note 4, at 439 (discussing variety of techniques used to circumvent money laundering regulation and costs that such techniques eventually impose on banks required to detect their use).

27. See H.R. REP. 101-991 at 6 (stating that "[t]he Andean Initiative reflects a . . . response to deep-rooted and diverse economic problems" and noting that Andean Initiative Committee found that economic crises in Peru and Bolivia were at root of continued coca production and processing).

28. *Id.* There is not even a minimum of incentive for peasant farmers in Andean countries to abandon coca production absent genuine economic alternatives. *Id.* Economic assistance, therefore, is an important complement to enforcement and interdiction efforts in the Andean countries. *Id.* In the first year of the Andean initiative, there was no significant economic assistance to the three Andean countries, and any future assistance is predicated on meeting counter-narcotics objectives through government enforcement. *Id.*

29. See *id.* at 5 (providing that efforts to eradicate drug production, distribution, and sale, otherwise known as "War on Drugs," has been ongoing U.S. priority); see also Gregory Wilson, Note, *The Changing Game: The United States Evolving Supply-Side Approach to Narcotics Trafficking*, 26 VAND. J. TRANSNAT'L L. 1163, 1164-65 (1994) (noting that war has been in existence for over twenty-five years, was declared by President Nixon, was escalated by Presidents Reagan and Bush, and continued by President Clinton); H.R. REP. 101-991, at 5-7 (noting "war on drugs" has been attempt to eradicate drug epidemic from supply side through primarily military and law enforcement solutions).

30. See Sharon A. Gardner, *A Global Initiative to Deter Drug Trafficking: Will Internationalizing the Drug War Work?*, 7 TEMP. INT'L & COMP. L.J. 287, 291 (1993) (noting that leaders of drug trafficking industry have made shrewd business decisions and that Colombia has benefitted from economically stabilizing effect of increased national income).

country's economic success.³¹ In the 1980s, the infamous Medellín Cartel³² ("Cartel") attained so much financial clout that it became a significant economic power.³³ In 1987, the Cartel met with Colombian government officials and offered to pay off Colombia's national debt and to terminate their involvement in the drug trade in exchange for the government's refusal to extradite certain members to the United States.³⁴ The disruptive nature of the Cartel on the financial stability of Colombia is evident from its economic crisis endured throughout the 1980s.³⁵ Due to the tremendous revenue generated by the drug trade, the inability of supply side measures to stop production,³⁶ and no apparent end to the demand for product, laundering of profits from the drug trade remains a significant international problem.³⁷

2. The Money Laundering Process

Legitimizing illicit profits is a problem faced by every drug trafficker.³⁸ To facilitate the legitimization of illicit profits, money launderers commonly use a three step process: placement, layering, and integration.³⁹ Description of this process, and the techniques used, however, can suffer from over generalization as the criminal mind has few limits to its creativity when faced with law enforcement obstacles.⁴⁰

31. *See id.* (discussing rise and power of drug cartels in Colombia and their effect on politics and economy of Colombia).

32. *See* Wilson, *supra* note 29, at 1168-76 (detailing history and activity of Medellín Cartel (or "Cartel"), which is conglomerate of drug traffickers brought together in concerted effort to dominate cocaine market and considered at one time to be most powerful and notorious international criminal drug operation).

33. *See id.* at 289 (discussing economic power gained by Medellín Cartel from drug trade and consequent ability to influence business and politics in Colombia).

34. *See id.* at 290 (noting that offer also demanded that Colombian government allow Cartel to invest in Colombian enterprises, but that offer was rejected by Colombian government).

35. *See* H.R. REP. 101-991, at 6 (1990) (describing economic depression felt by citizens of Colombia, which was in part brought on by various countries' dependence on illicit drug trade).

36. *See id.* (finding that Andean region supply reduction programs were ineffective in reducing production and export of coca products).

37. *See* Hallums, *supra* note 23, at 818-19 (commenting on continued demand for cocaine in United States).

38. Sultzer, *supra* note 8, at 148.

39. *Id.*

40. *See* Timothy H. Ehrlich, Note, *To Regulate or Not? Managing the Risks of E-Money and Its Potential Application in Money Laundering Schemes*, 11 *HARV. J.L. & TECH.* 833, 835

Placement is the physical deposit of cash into a financial institution.⁴¹ Although the money laundering process has three steps, it is generally agreed by law enforcement and regulatory officials that the point at which criminals are most vulnerable to detection is the placement stage.⁴² Cash accumulated at the initial point of sale is delivered to intermediary sites controlled by the criminal organization known as safe houses, then to brokers who often distribute the cash to import/export businesses.⁴³ Brokers then use wire transfers and structure the transaction to avoid threshold reporting requirements.⁴⁴ Next, the businesses deposit the money into a financial institution under an apparently legitimate business name.⁴⁵ Conversion of illicit proceeds to a medium that is either more convenient or less suspicious for purposes of exchange, such as property, cashier's checks, or money orders, completes the placement stage.⁴⁶

The next step in the money laundering process is layering, which is the movement of funds from one financial institution to a series of others through a variety of complex transactions intended to disguise the original source.⁴⁷ For example, layering can be achieved by wire transferring funds through offshore banking havens.⁴⁸ Adding more complex layers in this stage can

(1998) (discussing three step money laundering process in context of electronic financial transactions).

41. See Meltzer, *supra* note 3, at 232 (noting that drug trade is cash and carry business with profits from street sales in bills of small denominations, usually twenties or less, and that since drug trade is estimated to gross over US\$100 billion dollars per year, it would be difficult to have such deposits go undetected).

42. See Lawrence L.C. Lee, Note, *Combating Illicit Narcotics Traffic in Taiwan: The Proposed Money Laundering Control Act*, 4 TUL. J. INT'L & COMP. L. 189, 210 (1996) (discussing consensus among law enforcement officials that placement is most susceptible stage of process to detection because it is where funds are most easily linked to original source); see also Meltzer, *supra* note 3, at 232 (noting that because placement is most vulnerable stage in process, this is where force of legislation in United States, and internationally, has been directed).

43. Ehrlich, *supra* note 40, at 836.

44. *Id.* Under federal regulation, financial institutions are required to file a Currency Transaction Report ("CTR") for any transaction of US\$10,000 or more. 31 C.F.R. § 103.22 (b)(1) (1998). Additionally, individuals must file a Report of International Transportation of Currency or Monetary Instruments if more than US\$10,000 enters or leaves the United States in any manner. 31 U.S.C. § 5316 (1994).

45. Ehrlich, *supra* note 40, at 836.

46. See Lee, *supra* note 42, at 210 (discussing instruments that make illicit funds appear legitimate as they leave placement stage of money laundering process).

47. See *id.* (commenting on integration stage of money laundering process).

48. See Sultzter, *supra* note 8, at 150 (noting that off-shore banking havens include

be achieved through use of an off-shore bank.⁴⁹ Once the money is deposited into off-shore bank accounts in countries with strict bank secrecy laws, its source becomes increasingly difficult to trace.⁵⁰

Finally, integration occurs when the funds are transmitted to legitimate operations with no link to their illicit origin.⁵¹ The variety of legitimate and illegitimate instruments used in this phase include traditional monetary instruments, such as letters of credit, bank notes, and debt and equity securities.⁵²

3. Money Laundering Techniques

Money laundering techniques range from simply exchanging small bills for larger bills in day-to-day commerce for the purpose of easier transport, to the establishment by launderers of small boutique banks to accept illicit funds.⁵³ These boutique banks in turn deal with larger correspondent banks at the placement stage.⁵⁴ To avoid currency reporting requirements, launderers wire funds internationally into U.S. banks, which have historically been ill-equipped to distinguish clean wired money from money illicitly derived.⁵⁵ Still other launderers have moved

countries with traditional customer secrecy laws such as Cayman Islands, Panama, Bahamas, and to lesser extent today, Switzerland and Pakistan).

49. See David D. Beazer, *The Mystique of "Going Offshore,"* 9 UTAH BUS. J. 19 (1996) (explaining variety of financial transactions conducted through off-shore banking operations in effort to avoid tax and regulatory scrutiny). Broadly defined, an off-shore bank conducts banking and financial transactions in a foreign jurisdiction with favorable tax and regulatory conditions. *Id.* at 19.

50. See H.R. REP. NO. 98-907 (1984) (describing difficulty of obtaining records from banks in highly unregulated countries and increasing difficulty when more than one foreign jurisdiction is involved).

51. See Sultzter, *supra* note 8, at 151 (noting that integration can be achieved through variety of avenues including use of wire transfers from one financial institution to series of others).

52. *Id.*

53. *Id.*

54. *Id.*

55. See Bill McConnell, *In Focus: Technology, Cooperation Needed to Stem Growth of Financial Crimes*, AM. BANKER, Mar. 4, 1996, vol. 161, no. 42, at 1 (reporting that simple record keeping procedures are inadequate when faced with "criminals' sophistication and technical prowess"); see also CARL FELSENFELD, LEGAL ASPECTS OF ELECTRONIC FUNDS TRANSFER 173 (1988) (stating that "[t]he rapidly evolving techniques of electronic communication creates a constant series of new risks with consequent opportunities for tampering of all sorts"). *But see* Gilda I. Mariani, *New Federal Regulations Assist Money Laundering Prosecutions*, 1997 FIN. CRIMES REP. 10, 10-11 (1997) (commenting on rules that will make wire transfers subject to stricter reporting requirements).

into the non-bank financial institution⁵⁶ marketplace to launder funds.⁵⁷ For example, other popular and effective techniques include payable through accounts,⁵⁸ front companies,⁵⁹ and loan back agreements.⁶⁰

One of the more recent, effective, and troublesome developments in money laundering is the use of the payable through account.⁶¹ A PTA is an account established in a U.S. bank, usually by a foreign bank, through which the foreign bank's customers conduct banking transactions.⁶² The customers of the foreign bank can generally transfer funds by writing checks at their own bank that are payable through the U.S. bank,⁶³ wire funds, and carry on most banking activities as if they were a direct customer of the U.S. bank.⁶⁴ These accounts gained favor with international banks as it became more difficult for foreign banks to gain approval to operate in the United States in the wake of the Bank of Credit and Commerce International money launder-

56. See *Money Laundering Trends Highlight FATF Report*, 7 No. 7 MONEY LAUNDERING L. REP. 1, 7 (1997) [hereinafter *Money Laundering Trends*] (noting recent trend of money launderers moving away from banking to non-banking sector, most notably to currency-exchange businesses, which provide financial services but have less stringent regulatory controls than banks and less KYC emphasis).

57. Sultzer, *supra* note 8, at 155.

58. See *PTA Guidelines*, *supra* note 6, at 2 (explaining that PTAs, in general, are checking accounts marketed to foreign banks that otherwise would not be able to offer customers with access to the U.S. banking system); see also *Money Laundering Trends*, *supra* note 56, at 7 (noting that PTAs provide foreign banks customers with access to U.S. banking system without being subject to KYC guidelines).

59. See Sultzer, *supra* note 8, at 156 (noting that money launderers set up fictitious import/export companies that use services of U.S. banks to conduct business).

60. See *Money Laundering Trends*, *supra* note 56, at 7 (describing loan back agreement as vehicle whereby money launderer deposits illicit funds in foreign bank and uses deposit as collateral for loan from U.S. bank, both cleansing funds and receiving tax benefits).

61. See Christine M. Taylor, *Finding Laundering Perils, Fed Cracks Down on 'PTAs'*, 3/1/95 MONEY LAUNDERING ALERT, available in 1995 WL 8353434 (describing Federal Reserve Board's instructions on how banks should handle "latent money laundering menace" of PTAs).

62. *Id.*

63. See *Swiss Style Banking in Montana*, 6 No. 7 MONEY LAUNDERING L. REP. 3 (1996) (noting that check writing facility at U.S. bank allows foreign customers to maintain anonymity by circumvention of KYC requirements).

64. See *FDIC Launches First Crackdown on Payable-Through Accounts*, 1/1/96 MONEY LAUNDERING ALERT, available in 1996 WL 8687165 [hereinafter *Crackdown on PTAs*] (describing elements of PTAs, noting that Fed believes that risk of illegal conduct through use of PTAs is great and that banks should create system that will enable it to identify ultimate end users).

ing case.⁶⁵ U.S. regulators have become concerned that PTAs will be used by money launderers to circumvent the KYC programs of U.S. banks.⁶⁶ The U.S. government is aware and concerned with this problem, and in March 1995 the FDIC presented guidelines for banks to follow concerning the use of PTAs by their foreign clients.⁶⁷

B. *U.S. Money Laundering Regulatory Scheme*

Current regulatory efforts addressing issues such as PTAs find roots in the BSA, passed by Congress in 1970 under the title, the Currency and Foreign Transactions Reporting Act.⁶⁸ The financial community labeled this act, and commonly refers

65. *See* *United States v. Awan*, 966 F.2d 1415, 1417 (11th Cir. 1992) (providing extensive factual background of Bank of Credit and Commerce International money laundering investigation). The Bank of Credit and Commerce International ("BCCI") case involved an undercover sting operation where government agents presented themselves as legitimate businessmen and began conducting transactions through the Tampa, Florida branch of BCCI. *Id.* at 1417-19. After conducting seemingly legitimate transactions for a period of time, the agents informed bank personnel that the money was derived through illegal activity. *Id.* at 1420. The central focus of the government's case was that the bank had failed to report that the client had come forward with this information and continued to conduct the banking relationship. *Id.* at 1422. The bank and the bankers were charged with knowingly participating in a conspiracy to distribute cocaine, money laundering, and conspiracy to defraud the government. *Id.* at 1422-23. The bank plead guilty instead of facing trial and agreed to forfeiture of assets derived from their criminal activity. *See* *United States v. BCCI Holdings*, 1992 WL 100334 (D.D.C. 1992).

66. *See Crackdown on PTAs*, *supra* note 64, at 1 (noting that because of concern over improper uses of PTAs, regulators have issued instructions to banks as to handling of such accounts and Fed issued "guidelines" for operation of PTAs).

67. *See PTA Guidelines*, *supra* note 6, at 4 (commenting that PTAs have been used for some time in United States by credit unions, e.g., for checking account services, and investment companies, e.g., for checking account services associated with money market management accounts, to provide their customers with all of banking services that would be offered by commercial banks). The problems with foreign PTAs are unrelated to these traditional uses. *Id.* The PTA guidelines state:

In those situations where (1) adequate information about the ultimate users of the payable through accounts cannot be obtained; (2) the U.S. banking entity cannot adequately rely on the home country supervisor to require the foreign bank to identify and monitor the transactions of its own customers; or (3) the U.S. banking entity is unable to ensure that its payable through accounts are not being used for money laundering or other illicit purposes, it is recommended that the U.S. banking entity terminate the payable through arrangement with the foreign bank as expeditiously as possible.

Id.

68. 31 U.S.C. §§ 5311-14, 5316-25 (1994).

to it as, the Bank Secrecy Act.⁶⁹ Amendments to, and supplements of, the BSA throughout 1980s and 1990s changed the focus of the act in some respects, but it remains the centerpiece of U.S. money laundering regulation.⁷⁰

1. Bank Secrecy Act

The BSA, as originally enacted, required banks to maintain certain records and reports, thus creating a paper trail useful to law enforcement agencies investigating criminal, regulatory, and tax evasion schemes in which monies were being hidden from government scrutiny.⁷¹ The BSA sought to regulate foreign transactions of U.S. citizens attempting to avoid tax and regulatory authority by sheltering funds in offshore bank secrecy havens.⁷² Subsequent to the BSA, legislation was developed to prevent the laundering of proceeds from the international drug trade by imposing civil penalties for violation of the BSA and imposing record keeping on U.S. banks for certain international funds transfers.⁷³ Congressional findings revealed the belief that by making the laundering process more difficult, it would inhibit organized crime operations that rely on the cleansing of illicit profits.⁷⁴ Today, however, the routine record keeping and reporting requirements of numerous legitimate transactions can

69. See Byrne, *supra* note 17, at 801 (noting that BSA was not originally designed to combat money laundering).

70. See John J. Byrne et al., *Examining the Increase in Federal Regulatory Requirements and Penalties: Is Banking Facing Another Troubled Decade?*, 24 CAP. U. L. REV. 1, 40-41 (1997) (examining detrimental effects and confusion in banking industry as result of BSA amendments and explaining that some amendments are inconsistent with original goals of BSA established in 1970).

71. See H.R. REP. NO. 91-975, at 2 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4394 (discussing need for adequate record keeping to aid law enforcement efforts to combat financial crimes).

72. See Byrne et al., *supra* note 70, at 40-41 (commenting that when originally enacted portion of legislation relating to foreign transactions essentially revolved around sheltering of monies subject to taxes in Swiss banks); *see also* H.R. REP. NO. 91-975, at 3 (discussing testimony by U.S. Department of Justice, U.S. Attorney's Office for Southern District of New York, U.S. Department of Treasury, Internal Revenue Service, Securities and Exchange Commission, U.S. Department of Defense, and Agency for International Development indicating widespread use of foreign financial facilities located in secrecy jurisdictions to circumvent U.S. law).

73. See H.R. REP. NO. 101-446, at 29-35 (1990) (noting that proposed amendments to Depository Institution Money Laundering Act of 1990 would enhance enforcement of BSA by making banks liable for negligent conduct in adhering to record keeping requirements).

74. See 144 CONG. REC. H9474-01, H9477 (daily ed. Oct. 5, 1998) (noting that

take bankers away from more serious attempts to address money laundering in their institutions.⁷⁵ Subsequent legislation, aimed at the prevention and detection of money laundering, particularly resulting from the drug trade, has widely expanded the BSA.⁷⁶

a. Legislative History of the Bank Secrecy Act

Prior to enactment of the BSA, law enforcement officials realized that the large sums of cash deposited into the U.S. banking system were becoming increasingly difficult to trace, and brought this problem to the attention of legislators.⁷⁷ Law enforcement officials made the inability to trace the source of such large deposits a public issue when they identified a need to create a structure that would enable them to track these funds, which they believed had criminal origin.⁷⁸ The U.S. Department of Treasury, the Securities and Exchange Commission, and the U.S. Department of Justice lobbied Congress to draft legislation that would provide bank record keeping requirements to aid the fight against organized and white collar crime.⁷⁹ In response to this need, legislation was proposed in both the U.S. House of Representatives⁸⁰ and the U.S. Senate.⁸¹

money laundering is lifeblood of drug traffickers and that efforts to eliminate drug problem must address flows of illegal funds).

75. See Byrne et al., *supra* note 70, at 65 (examining ineffectiveness of some burdensome reporting requirements put on banks and explaining that banking industry has been forced to bear financial costs to address social problem of drug money at expense of addressing issues in their own institutions).

76. See, e.g., 31 U.S.C. § 5324 (1994) (criminalizing structuring of transactions in attempt to avoid threshold reporting requirements of US\$10,000 under BSA); see also Meltzer, *supra* note 3, at 255 (commenting on changing nature of money laundering and consequent need for legislation to be fluid).

77. See Sultzer, *supra* note 8, at 152 (discussing law enforcement officials' realization that organized crime and growth of drug trade were generating large deposits of cash into U.S. banks, which subsequently were laundered, prompting need for legislation).

78. Charles W. Blau, *The U.S. Bank Secrecy Act: A Federal Tool in the Prosecution of Federal Crimes*, in SEMINAR ON "BANK SECRECY ACT AND BANK FRAUD STATUTES" 20 (1989).

79. See H.R. REP. NO. 91-975, at 3 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4394 (noting that regulatory agencies are often frustrated in attempts to investigate international financial crime due to use of financial secrecy laws applicable to foreign banking institutions operating in United States).

80. See *id.* at 16 (noting that Rep. J. William Stanton and Rep. Wright Patman opposed BSA legislation that came out of House Committee on Banking and Currency). The committee, however, reported favorably on the bill and recommended that it pass. *Id.* at 1.

After the House of Representatives agreed on a bill, Sen. William Proxmire proposed a similar bill, with subtle alterations, which were further debated in the Senate Committee on Banking and Currency.⁸² Many advocates representing the law enforcement community came before the Senate committee as witnesses in full support of the proposed legislation.⁸³ Advocates for the law enforcement community were aware of concerns that the banking industry would have with the bill, but, from the law enforcement perspective, the legislation directly addressed the problem and needed no alterations to serve their purposes.⁸⁴

The hearings and debates, however, revealed several problems that implementation of this legislation would present to the banking community.⁸⁵ The most prominent of these

81. See *Hearings Before the Senate Comm. on Banking and Currency, Subcomm. on Financial Institutions*, 91st Cong., 2d Sess. (1990) [hereinafter *Hearings of June 8, 1970*] (noting that Sen. William Proxmire, member of Senate Committee on Banking and Currency, sponsored BSA legislation in Senate). In Senator Proxmire's opening remarks to the Senate subcommittee, he spoke volumes about the mood of the more conservative establishment of the United States when he stated that "[w]e are concerned, and properly so, about maintaining order in our cities and on our campuses." *Id.* "The problem of affluent, adult hypocrisy, delinquency, and crime is no less important." *Id.* Little debate as to whether there should be legislation can be found in the legislative history of the BSA, although some particulars were debated. See H.R. REP. 91-975, at 16 (stating views of Representative Patman, who felt photocopying provision of bill should be changed).

82. *Hearings of June 8, 1970, supra* note 81, at 1-35.

83. See *id.* at 57 (statement of Will Wilson, Assistant Attorney General, U.S. Department of Justice, before Subcomm. on Financial Institutions) (stating that "[m]y concern and my responsibility is the enforcement of the Federal Criminal laws. Regarding S.3678 entirely from that position I can state unequivocally that the legislation before us would provide additional ammunition in the fight on organized crime and white collar criminals").

84. See *id.* at 73 (statement of Carl W. Desch, former Senior Vice President, First National City Bank) (commenting that Mr. Wilson "urged that we not burden legitimate business with unnecessary redtape. Our purpose . . . should be to detect and prosecute crime, not build a mountain of paper."). This concern would later become one of the central issues in the debate concerning to what extent the banking industry should be responsible not only for record keeping, but also for knowing their customers. See generally Alford, *supra* note 4, at 437-39 (discussing immense financial burden that BSA puts on banks).

85. *Hearings of June 8, 1970, supra* note 81, at 73 (statement of Carl W. Desch). Advocating for the banking industry, Carl W. Desch, former Senior Vice President, First National City Bank, identified five problem areas:

1. The unmistakable potential for invasion of privacy.
2. The existence of provisions which we believe could adversely affect the strength of the dollar.
3. The almost unprecedented breadth of the regulatory discretion entrusted to the Secretary of the Treasury.

problems were concerns over the invasion of clients' financial privacy⁸⁶ and a severe burden that the legislation would impose upon banks to maintain voluminous records.⁸⁷ Workable solutions to these problems were suggested and alternative statutory language was proposed for legislative consideration.⁸⁸ Law enforcement concerns, however, finally outweighed the burden to financial institutions because Congressional leaders felt that the cost to banks was not significant.⁸⁹ In addition, some Congressional leaders believed that it was the civic duty of banks to bear these costs and that in the end this approach would be in the banking industry's best interest.⁹⁰

The House bill on bank secrecy included a laundry list of requirements.⁹¹ The Senate Committee on Banking and Currency hoped to avoid this laundry list, but the alternative was to give more authority to the Department of Treasury.⁹² The policy that the Senate adopted did in fact give the U.S. Secretary of the Treasury broad and sweeping powers to promulgate regulation.⁹³ Although no precedent for this power existed at the

4. The operational difficulties, and even impossibilities, which could be created by some of the bills provisions.

5. The possible adverse effects of the bill on the trading in, and the market for, American securities.

Id.

86. See generally Hernandez, *supra* note 5, at 245 (discussing lack of privacy rights under BSA, which unlike secrecy law in other countries, is invasive rather than supportive of privacy).

87. See Grant, *supra* note 1, at 266-67 (examining ineffectiveness of BSA requirements, which cost U.S. bankers estimated US\$10.7 billion in 1991).

88. *Hearings of June 8, 1970, supra* note 81, at 73 (statement of Carl W. Desch, former Senior Vice President, First National City Bank). On behalf a consortium of banks known as the New York Clearinghouse Association, Mr. Desch attached a paper to his statement before the subcommittee that included suggested changes to the language of the bill. *Id.* Although considered, the final version of the bill did not include these suggestions. *Id.*

89. See H.R. REP. NO. 91-975, at 11 (1970) *reprinted in* 1970 U.S.C.C.A.N. 4394 (noting that Rep. Wright Patman's view on microfilming of checks was that it was not significant cost factor).

90. See *id.* (reporting that Representative Patman believed that banks should bear costs imposed by BSA legislation as part of their civic duty to combat crime and in addition, that effectiveness of bill in reducing expense of battling criminal activity could result in savings to insured banks).

91. See *id.* at 12-14 (noting that list included reports for domestic and foreign currency transactions, margin requirements for extension of credit under federal securities laws, and persons required to file reports).

92. *Hearings of June 8, 1970, supra* note 81, at 73 statement of Carl W. Desch.

93. See, e.g., 31 U.S.C. § 5313(a) (1994). The statute states:

time, Congress felt that the problem warranted the granting of such power.⁹⁴ Congress granted this power to the Treasury Department because the intricacies of regulation in this area required certain expertise and resources that the Treasury Department was uniquely suited to deliver.⁹⁵

b. Implications of Bank Secrecy Act

To promulgate regulations pursuant to the power granted under the BSA, the Secretary of the Treasury created a task force that consulted with both private and public sector representatives in the financial community to determine exactly what types of records should be retained.⁹⁶ The Secretary of the Treasury granted authority to the task force to create the details of the regulations, and the task force determined specific criteria such as the photo-copying of checks.⁹⁷ The task force completed its study, finding, for example, that only "on us"⁹⁸ checks in excess of US\$100 were needed to serve the purpose of law enforce-

When a domestic financial institution is involved in a transaction for the payment, receipt, or transfer of United States coins or currency (or other monetary instruments the Secretary of the Treasury prescribes), in an amount, denomination, or amount and denomination, or under circumstances the Secretary prescribes by regulation, the institution and any other participant in the transaction the Secretary may prescribe shall file a report on the transaction at the time and in the way the Secretary prescribes. A participant acting for another person shall make the report as the agent or bailee of the person and identify the person for whom the transaction is being made.

Id.; see *California Bankers Assoc. v. Shultz*, 416 U.S. 21, 30 (1974) (examining legislative history of BSA and stating that "there is no denying the impressive sweep of the authority conferred upon the Secretary by the Bank Secrecy Act").

94. See *Hearings of June 8, 1970*, *supra* note 81, at 73 (statement of Carl W. Desch) (noting that intricacies of problem demanded attention from centralized source and that U.S. Department of Treasury was best equipped to achieve this goal).

95. See *id.* (explaining that because Department of Treasury had significant resources and expertise in banking affairs, it was granted authority to determine what records would be useful and how much information they should contain, and to what extent that information must be maintained); see also 31 U.S.C. § 5314(a)(1)-(4) (providing details of record keeping requirements that were determined necessary by U.S. Department of Treasury).

96. See *Hearings to Amend the Bank Secrecy Act Before the Subcomm. on Banking, Housing and Urban Affairs*, 92d Cong., 2d Sess. 60-64 (1972) (noting input from private sector provided government with important insight into practical issues in implementing BSA requirements).

97. *Id.*

98. See L. RICHARD FISCHER, *THE LAW OF FINANCIAL PRIVACY: A COMPLIANCE GUIDE* § 4 (2d ed. 1991) (noting that these are checks drawn on or payable by bank).

ment.⁹⁹ The Secretary of the Treasury then implemented the specific suggestions determined by the task force.¹⁰⁰

The banking industry's compliance with the record keeping and other requirements under the BSA was inconsistent; thus, the BSA had minimal impact throughout the 1970s and 1980s.¹⁰¹ Additionally, as feared by the banking industry, the BSA Currency Transaction Report¹⁰² (or "CTR") requirement imposed a substantial administrative as well as financial burden upon U.S. financial institutions.¹⁰³ The hardship imposed on banks and the subsequent ineffectiveness of the legislation largely resulted from the sheer number of CTRs filed each year.¹⁰⁴ In addition, the effectiveness of the reporting requirement is questionable as evidenced by the ratio of criminal prosecutions to the number of CTRs filed, which is poor at best.¹⁰⁵

2. Additional U.S. Money Laundering Legislation

Congress has consistently addressed the ineffectiveness of the BSA and responded to the changing nature and capabilities

99. See *California Bankers Assoc. v. Shultz*, 416 U.S. 21, 34 n.5, 6 & 7 (1974) (describing, in detail, specifics suggested by task force and implemented by Secretary of the Treasury).

100. *Id.*

101. See Sultzzer, *supra* note 8, at 154 (commenting that adherence to reporting requirements was so poor during 1970s and 1980s that most cost effective way to place large sums of cash into banking system was simply to walk into bank and to dump it onto bankers counter).

102. See 31 C.F.R. § 103.22 (b)(1) (1998) (describing CTR, also known as IRS Form 4789, as primary document required under BSA to be filed by banks whereby disclosure of customers' identity, source of funds, and other pertinent information is recorded for transactions made for benefit of one account on single day in aggregate amount of US\$10,000).

103. See Alford, *supra* note 4, at 461 (noting that in 1989, cost of such reporting was estimated to be US\$129 million and that these costs are significant burden to financial institutions, but they are not end of regulatory costs imposed on banks); see also Byrne, *supra* note 17, at 817-18 (reporting that estimates of costs of record keeping for funds transfers under BSA run as high as US\$200 million per year, but that this figure may not accurately reflect true costs incurred as many bankers simply did not know how to estimate costs and others calculated estimate excluding such categories as fixed costs).

104. See Alford, *supra* note 4, at 457 (noting that from 1970 through 1994 over thirty million CTRs had been filed and that financial institutions estimate that each CTR takes approximately twenty minutes to complete with cost of filing ranging from \$3 to \$15 per filing).

105. See Byrne, *supra* note 17, at 820 (noting that in one five-year period, IRS agent in Greater Northwest region reported only one criminal prosecution had been initiated by review of CTR).

of organized crime and the burdens imposed on banks.¹⁰⁶ To address BSA noncompliance and the ineffectiveness of CTR filings, Congress enacted the Money Laundering Control Act of 1986¹⁰⁷ ("MLCA"), which imposed criminal liability upon individuals who structured transactions¹⁰⁸ or attempted to structure transactions for the purpose of avoiding the filing requirement of the BSA.¹⁰⁹ The MLCA sets fines and prison terms for those

106. See Alford, *supra* note 4, at 456-62 (discussing variety of U.S. legislation aimed at enhancement and complement to BSA).

107. Money Laundering Control Act of 1986, Pub. L. No. 99-570, 100 Stat. 3207-18 (codified as amended at 18 U.S.C. §§ 1956-1957 (1994), 31 U.S.C. §§ 5324-26 (1994)).

108. See 31 C.F.R. § 103.22 (c)(2)(1998) (defining structured transactions to include multiple transactions made by one person, or on behalf of any individual person, in excess of US\$10,000 on one day).

109. 31 U.S.C. § 5324 (1994). This section of the BSA, which address the structuring of transactions, states:

- (a) Domestic coin and currency transactions.—No person shall for the purpose of evading the reporting requirements of section 5313(a) or 5325 or any regulation prescribed under any such section—
 - (1) cause or attempt to cause a domestic financial institution to fail to file a report required under section 5313(a) or 5325 or any regulation prescribed under any such section;
 - (2) cause or attempt to cause a domestic financial institution to file a report required under section 5313(a) or 5325 or any regulation prescribed under any such section that contains a material omission or misstatement of fact; or
 - (3) structure or assist in structuring, or attempt to structure or assist in structuring, any transaction with one or more domestic financial institutions.
- (b) International monetary instrument transactions.—No person shall, for the purpose of evading the reporting requirements of section 5316—
 - (1) fail to file a report required by section 5316, or cause or attempt to cause a person to fail to file such a report;
 - (2) file or cause or attempt to cause a person to file a report required under section 5316 that contains a material omission or misstatement of fact; or
 - (3) structure or assist in structuring, or attempt to structure or assist in structuring, any importation or exportation of monetary instruments.
- (c) Criminal penalty.—
 - (1) In general.—Whoever violates this section shall be fined in accordance with title 18, U.S. Code, imprisoned for not more than 5 years, or both.
 - (2) Enhanced penalty for aggravated cases.—Whoever violates this section while violating another law of the United States or as part of a pattern of any illegal activity involving more than \$100,000 in a 12-month period shall be fined twice the amount provided in subsection (b)(3) or (c)(3) (as the case may be) of section 3571 of title 18, U.S. Code, imprisoned for not more than 10 years, or both.

Id.

directly involved or aid in the structuring process.¹¹⁰ In addition, this act prohibits financial transactions involving the proceeds of specified unlawful activities, the international transportation of criminal proceeds, and monetary transactions in property constituting or deriving from proceeds obtained from criminal offenses.¹¹¹ It also requires reporting of suspicious transactions¹¹² to government officials.¹¹³

To buttress the BSA and MLCA, Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act of 1989¹¹⁴ ("FIRREA"), and the Comprehensive Drug Abuse Prevention and Control Act of 1970 has also been used for this purpose.¹¹⁵ FIRREA provides for imprisonment of up to twenty years per count for specified violations, sets forth stringent sentencing guidelines, and calls for severe civil penalties.¹¹⁶ The

110. *Id.*

111. *Id.*

112. See Shockey, *supra* note 13, at 717 (characterizing suspicious transactions as transactions that may be irregular or abnormal for particular customer). *But see* Byrne et al., *supra* note 70, at 61 (discussing lack of uniformity and clarity as to what defines suspicious transaction).

113. 31 U.S.C. § 5318(g) (1994). This section also provides an exemption from liability from any U.S. law or regulation for directors, employees, officers, or agents of financial institutions for disclosure of such transactions. *Id.* § 5318(g)(3).

114. Pub. L. No. 101-73, 103 Stat. 183 (1989) (codified as amended at 12 U.S.C. 1811-1835 (1994)). The statute in pertinent part states:

(j) Criminal Penalty.—

Whoever, being subject to an order in effect under subsection (e) or (g), without the prior written approval of the appropriate Federal financial institutions regulatory agency, knowingly participates, directly or indirectly, in any manner (including by engaging in an activity specifically prohibited in such an order or in subsection (e)(6)) in the conduct of the affairs of—

- (1) any insured depository institution;
- (2) any institution treated as an insured bank under subsection (b)(3) or (b)(4), or as a savings association under subsection (b)(8);
- (3) any insured credit union (as defined in section 101(7) of the Federal Credit Union Act);
- (4) any institution chartered under the Farm Credit Act of 1971; or
- (5) the Resolution Trust Corporation,

shall be fined not more than \$1,000,000, imprisoned for not more than 5 years, or both.

Id.

115. Comprehensive Drug Abuse Prevention and Control Act of 1970, Pub. L. No. 91-513, Title II, § 401, Oct. 27, 1970, 84 Stat. 1260, 21 U.S.C. § 841 (1994).

116. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73 (1989); see Robert S. Bennett et al., *Taking It to the Banks: The Use of the Criminal Process to Regulate Financial Institutions*, 109 BANKING L.J. 28, 30 (1992) (commenting on comprehensive enhancements to BSA through related banking legislation

Comprehensive Drug Abuse Prevention and Control Act¹¹⁷ has been interpreted to subject drug-related criminal activity to a strict culpability standard of willful blindness.¹¹⁸

Under the MLCA and Comprehensive Drug Abuse Prevention and Control Act, financial institutions could conceivably be liable for any dealings that they have with criminal entities if they do not conduct a detailed investigation into their clients criminal history.¹¹⁹ The increased number of CTRs filed in the wake of the MLCA and the prosecutions that followed indicate that the noncompliance issue has lessened.¹²⁰

Money laundering offenses are also covered under the Anti-Drug Abuse Act of 1988.¹²¹ The Anti-Drug Abuse Act increased the reach of the U.S. anti-money laundering efforts beyond its own borders in two ways.¹²² It orders the U.S. Secretary of the Treasury to negotiate with finance ministers of foreign countries to establish an international currency control agency, which will serve as central source of information, collect and analyze CTRs filed by its members, and encourage the adoption of uniform money laundering acts.¹²³ Further, this act directs the Secretary of the Treasury to negotiate with foreign financial supervisory agencies that conduct business in U.S. currency to reach agreements that will ensure that they keep records and provide accessibility to these records by U.S. law enforcement officials.¹²⁴ The

and noting civil penalties for violation of FIRREA are up to US\$1,000,000 per day per violation).

117. 21 U.S.C. § 841(a)(1) (1994).

118. *See, e.g.*, *United States v. Jewell*, 532 F.2d 697, 700-03 (9th Cir.), *cert. denied*, 426 U.S. 951 (1976) (holding that where defendant is aware of facts indicating high probability of illegality but purposely fails to investigate on account of desire to stay ignorant, there is knowledge of illegality).

119. *See Alford*, *supra* note 4, at 457 (noting that banks face dilemma of either investigating each customer's transactions or facing liability under 18 U.S.C. § 1957).

120. *See United States v. Penagaricano-Soler*, 911 F.2d 833, 836 (1st Cir. 1990) (upholding conviction in District Court for District of Puerto Rico of bank president for felony offenses stemming from failure of bank to file required currency transaction reports); *see also Byrne*, *supra* note 17, at 818-19 (noting that in 1991, 7.4 million CTRs were filed and in 1992, 9.2 million were filed).

121. *See Anti-Drug Abuse Act of 1988*, Pub. L. No. 100-690, 102 Stat. 4181 (codified as amended at 21 U.S.C. §§ 1501-1509 (1994 & Supp. 1997)) (supporting multilateral efforts to control money laundering including establishment of international organizations to monitor currency movements).

122. *Hernandez*, *supra* note 5 at 273-74.

123. 31 U.S.C. § 5315 (1994).

124. *Id.*

United States has reached agreements that include the US \$10,000 reporting threshold of the BSA with a number of countries based on the Anti-Drug Abuse Act.¹²⁵ Additional amendments give the President of the United States the authority to terminate banking relations with any country that refuses to negotiate.¹²⁶ All of this additional legislation, however, has not reduced the costs to the financial industry in any way, and its effectiveness is questionable.¹²⁷

C. International Regulation of Money Laundering

Since the early 1980s, the global concern regarding drug trafficking and money laundering has become a prominent issue on the international landscape.¹²⁸ The monetary costs attributed to international money laundering are staggering,¹²⁹ and the social costs of money laundering are immense.¹³⁰ International banking and monetary regulation, an evolving and dynamic area of international law,¹³¹ remains hotly debated and is

125. See Hernandez, *supra* note 5, at 274 (noting that these countries include United Kingdom, Switzerland, Cayman Islands, Bahamas, Belgium, Canada, Mexico, Thailand, and Netherlands).

126. 31 U.S.C. § 5315.

127. See Laura M.L. Maroldy, Note, *Record Keeping and Reporting in an Attempt to Stop the Money Cycle: Why Blanket Recording and Reporting of Wire and Electronic Transfers Is Not the Answer*, 66 NOTRE DAME L. REV. 863, 864-65 (1991) (arguing that specifically tailored reporting requirements are ineffective).

128. See Hernandez, *supra* note 5, at 235-36 (remarking that as of 1993, drug profits estimated at US\$300 billion are laundered through international banking system each year, that illegal drug proceeds from U.S. drug sales generate about US\$110 billion, and that because these figures are so alarming, international cooperation has grown in effort to curb drug trafficking).

129. See 144 CONG. REC. H9474-01 (daily ed. Oct. 5, 1998) (noting that U.S. Congress's findings concerning Money Laundering Deterrence Act of 1998 included estimate of US\$500 million laundered internationally every year); see also Ricardo A. Pellerano & Eduardo Jorge, *Money Laundering Rules in the Dominican Republic*, 114 BANKING L.J. 136 (1997) (claiming that estimates suggest that international money laundering may be in tens of billions of dollars per year); Morgan, *supra* note 30, at 25 (asserting that between US\$100 billion and US\$300 billion in U.S. currency is involved in money laundering each year).

130. See Morgan, *supra* note 30, at 25 (noting that as of 1991, U.S. Drug Enforcement Agency found U.S. citizens spent less money on national defense than on drugs, drug prevention, drug rehabilitation, and drug education).

131. See William M. Berenson, *Current Legal Issues Affecting Central Banking*, 29 GEO. WASH. J. INT'L L. & ECON. 337, 338-39 (1996) (discussing prominent nature of international banking and continuing need to address issues in field both practically and academically).

the focus of many international regulatory efforts.¹³²

1. The International Response to U.S. Money Laundering Regulation

Detractors of the BSA and its progeny claim that U.S. money laundering regulation is too intrusive and violates the customers right to financial privacy.¹³³ Some countries explicitly reject U.S. money laundering regulation because the requirements are not practical, effective, or cost efficient.¹³⁴ For instance, the Canadian government came to the conclusion that the U.S. reporting system generates too much paper, results in excessive delay in providing the information to law enforcement, provides insufficient evidence of its value, and is too costly and highly intrusive.¹³⁵

On the other hand, an increasing number of foreign governments have enacted laws making money laundering a crime

132. See *id.* at 339 (commenting that money laundering is one of many unresolved issues of significant importance to international banking community). Among the other relevant issues that are directly related to money laundering are bank secrecy, regulation versus competition, and electronic bank transfers. *Id.*

133. See Hernandez, *supra* note 5, at 245 (discussing intrusion into financial privacy of U.S. citizens in wake of BSA enactment). Clients' privacy rights in this country are recognized and protected by the Right to Financial Privacy Act ("RFPA"). 12 U.S.C. §§ 3401-22 (1994). The RFPA was passed in an attempt to halt the erosion of privacy rights and to re-institute privacy protections. Hernandez, *supra* note 5, at 245. Contradictory to those goals, the RFPA simply sets out the procedures whereby the government can obtain personnel financial records. 12 U.S.C. § 3403. It allows the government to obtain financial records by written consent of the customer, with a search warrant, by administrative subpoena, by formal written request, by judicial subpoena, or by grand jury subpoena. *Id.* § 3404-06.

134. See Byrne et al., *supra* note 70, at 41 (noting that countries rejecting some portion of U.S. reporting system include United Kingdom, Australia, and Japan).

135. See *id.* at 42 (discussing Canada's view of record keeping requirements). The Canadian government later decided to adopt record keeping requirements for transactions in excess of US\$10,000. *Id.* In 1990, a U.S. Senate report named Canada, Switzerland, the Bahamas, Luxembourg, Hong Kong, and Panama as the most frequently used jurisdictions for the laundering of drug trade proceeds originating in the United States. See *Drug Money Laundering, Banks and Foreign Policy, A Report on Anti-Money Laundering Law Enforcement and Policy Before the Subcomm. on Narcotics, Terrorism and International Operations*, 101st Cong., 2d Sess. 20 (1990) (commenting that proximity and interchanging of currencies at Canadian border are prime reasons for large volume of money laundering activity); see also John L. Evens, *International Money Laundering: Enforcement Challenges and Opportunities*, 3 Sw. J.L. & TRADE AM. 195, 200-01 (1996) (commenting that Canada's inclusion with other money laundering countries is not because they share traditional bank secrecy laws that others employ; rather, they are subject to large scale money laundering largely because of shared border with United States as well as being largest trading partner of United States).

and have required their financial institutions to retain and to review transactions in a similar fashion as in the United States.¹³⁶ The Dominican Republic, like the United States, has enlisted the help of its financial institutions in the war on money laundering by recently adopting anti-money laundering laws.¹³⁷ This development was particularly important because most illicitly derived money generated today emanates from the drug trade occurring in Central and Latin America.¹³⁸ The Dominican Republic, along with other Caribbean nations, has entered into agreements with the United States to assist in the drug war.¹³⁹ Indeed, the Dominican Republic was one of the first countries in the Latin American region to make money laundering a crime and has recently enhanced its money laundering rules.¹⁴⁰

In addition, many tenets of U.S. money laundering legislation are incorporated in international agreements such as the Inter-American Commission Against Drug Abuse's¹⁴¹ ("CICAD") Model Regulations ("Model Regulations").¹⁴² CICAD took into

136. See Mariani, *supra* note 55, at 12 (discussing increase in foreign financial institutions' compliance with standards comparable to those under U.S. money laundering regulation).

137. See Pellerano & Jorge, *supra* note 129, at 136 (commenting on Dominican Republic's implementation of BSA-type laws, which while only addressing money laundering associated with proceeds of drug trafficking, are broadly defined under Dominican law and impose substantial deterrence to financial institutions that violate them). The penalties range from RD\$100,000 to RD\$250,000 and in some cases, a financial institutions license may be canceled. *Id.*

138. See *id.* at 136 (commenting that Caribbean and Latin American countries are ideally situated for drug trafficking and money laundering because of their proximity to drug source and U.S. banking system).

139. See *id.* at 137 (explaining that these agreements, known as "hot pursuit" agreements, have allowed U.S. Coast Guard to enter territorial waters when following suspect under certain circumstances).

140. See *id.* at 137-38 (remarking that these enhancements were influenced by Financial Action Task Force ("FATF"), formed by G-7 nations of Canada, France, Germany, Italy, Japan, United Kingdom, and United States in effort to affect governments' policies on variety of financially related issues).

141. See Inter-American Program of Action of Rio de Janeiro Against the Illicit Use and Production of Narcotic Drugs and Psychotropic Substances and Traffic Therein, Apr. 1986 (extracts), ch. IV (1), *reprinted in* INTERNATIONAL EFFORTS TO COMBAT MONEY LAUNDERING 4 (Dr. W.C. Gilmore ed., 1992 (recommending formation of Inter-American Commission Against Drug Abuse ("CICAD") and giving CICAD responsibility for developing, coordinating, evaluating, and monitoring measures prescribed by Program of Action and for submitting proposals for prevention of drug abuse and trafficking in region); see also Sultzer, *supra* note 8, at 212 (noting that CICAD is organization formed within Organization of American States ("OAS"), whose membership includes almost all nations in Western Hemisphere).

142. See Model Regulations, *supra* note 16.

consideration the Forty Recommendations¹⁴³ adopted by the twenty-six nation Financial Action Task Force¹⁴⁴ ("FATF"), an organization that attempts to influence governments on a range of financially related issues.¹⁴⁵ The Model Regulations adopted essentially incorporate KYC policies to prevent the opening of anonymous accounts and threshold reporting limits similar to those found under the BSA.¹⁴⁶

2. International Regulatory Efforts

Divergent legal, historical, and cultural norms present many barriers to efficient international regulation.¹⁴⁷ Unlike U.S. bank secrecy and money laundering legislation, which is an aid to government enforcement of drug policy, many other countries have implemented bank secrecy laws with the purpose of protecting client confidentiality.¹⁴⁸ Although the international community has continually responded to money laundering is-

143. See 1996 FATF report, *supra* note 16.

144. See *id.* (noting that FATF was formed in 1989 as intergovernmental body whose purpose is development and promotion of policies to combat money laundering).

145. See Sultzer, *supra* note 8, at 211 (commenting that FATF has been very active in developing and promoting anti-money laundering initiatives among its members and has been source for development of regional organization directed at similar purposes such Caribbean Financial Action Task Force).

146. See Model Regulations, *supra* note 16, art. 10, 12.

147. See Bruce Zagaris & Sheila M. Castilla, *Constructing an International Financial Enforcement Subregime: The Implementation of Anti-Money-Laundering Policy*, 19 BROOK. J. INT'L L. 871, 874-76 (1993) (examining problems such as divergent asset-forfeiture law, common law versus Napoleonic code, and cultural difference exemplified in contrast between Islamic law and Western law); see also *Protecting Business Assets from Fraud in Financial Dealings in Latin America*, LATIN AM. L. & BUS. REP., available in 1997 WL 9499057 [hereinafter *Dealings in Latin America*] (asserting that fact-gathering techniques used in United States are almost nonexistent or have limited use in many Latin American countries and that Latin American banking customers are not accustomed to regulations intruding on personal financial privacy).

148. See Hernandez, *supra* note 5, at 236 (discussing history of traditional bank secrecy law and inherent conflict with current money laundering legislative efforts); see also Geoffrey W. Smith, *Competition in the European Financial Services Industry: The Free Movement of Capital Versus the Regulation of Money Laundering*, 13 U. PA. J. INT'L BUS. L. 101, 124 (1992) (noting that countries with laws focusing on individuals' privacy rights tend to attract larger number of deposits from drug traffickers who wish to keep their financial affairs private). Countries such as Switzerland, Austria, Monaco, Hong Kong, the Cayman Islands, Uruguay, Gibraltar, and the Bahamas exemplify secrecy and tax havens that attract money launderers as well as legitimate business. *Id.* One of the three largest financial secrecy havens in the world is Luxembourg, which has roughly US\$160 million in foreign deposits in about 120 banks. *Id.*

sues through entities such as the United Nations and FATF, the problem persists.¹⁴⁹

a. The United Nations

In the fifty-four years since its inception, the United Nations has sought to be a facilitator for peace, cooperation, and resolution of conflicts within the international community.¹⁵⁰ The U.N. Charter clearly reveals this purpose.¹⁵¹ To this end generally, and to achieve the common international goal of eradicating the problems surrounding money laundering from the drug trade specifically, the United Nations has provided a forum for significant international cooperation concerning money laundering.¹⁵² In the early 1980s, as the power of the drug cartels became more pervasive and their methods became increasingly sophisticated, a need for more exact and stringent international measures arose.¹⁵³ In the late 1980s, the United Nations recognized the increasingly international scope of the drug trade with the 1987 International Conference on Drug Abuse and Illicit Traffic¹⁵⁴ ("1987 Conference") and the 1988 U.N. Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Sub-

149. See *Financial Action Task Force on Money Laundering Annual Report 1995-1996*, 11/1/96 *FIN. MARKET TRENDS* 39, available in 1996 WL 10360795 (examining continuing problems associated with international drug trade and money laundering).

150. See generally Jost Delbruck, *The Role of the United Nations in Dealing with Global Problems*, 4 *IND. J. GLOBAL LEGAL STUD.* 277 (1997) (commenting on expanding potential of United Nations to play significant role in effort towards globalization).

151. See U.N. CHARTER art. 1 (stating that "[t]he Purposes of the United Nations are: [t]o maintain international peace and security . . . ; [t]o achieve international cooperation in solving international problems of an economic, social, cultural, or humanitarian character . . . ; [and] [t]o be a center for harmonizing the actions of nations in the attainment of these common ends").

152. See Hallums, *supra* note 23, at 836-43 (recounting history of U.N. efforts to aid in eradication of drug trafficking and related international offenses); see also United Nations: International Law Commission Report on the Draft Articles Adopted at its Forty-Third Session, Sept. 11, 1991, ch. 2, art. 25, reprinted in 30 *I.L.M.* 1554, 1593 (noting that International Law Commission's draft articles of Draft Code of Crimes against Peace and Security of Mankind, Commission specifically lists illicit traffic of narcotic drugs and related financial crime as one of these offenses).

153. See David P. Stewart, *Internationalizing the War on Drugs: The U.N. Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances*, 18 *DENV. J. INT'L L. & POL'Y* 387, 390 (1990) (discussing historical background of U.N. efforts to regulate drug trafficking).

154. United Nations International Conference on Drug Abuse and Illicit Trafficking: Decisions of the Conference, U.N. Doc. A/CONF.133/12, U.N. Sales No. E87.I.18, reprinted in 26 *I.L.M.* 1637 (1987) [hereinafter 1987 Conference].

stances ("1988 Convention").¹⁵⁵

The 1987 Conference did not specifically focus on money laundering crimes related to the drug trade; rather, it focused on supply side interdiction¹⁵⁶ and called for attention to the illicit demand for drugs and drug treatment.¹⁵⁷ The 1987 Conference also acknowledged the financial incentives to poor farmers to cultivate illicit crops in drug producing counties.¹⁵⁸ In the end, the proposals from this conference were general in nature, but focused on a multifaceted approach to control the drug trade.¹⁵⁹

Two predecessors of the 1988 Convention, the 1961 Single Convention on Narcotic Drugs¹⁶⁰ and the 1971 Psychotropic Substances Convention,¹⁶¹ are used to regulate the legal production and distribution of controlled substances for medical and scientific purposes and made all other production illegal.¹⁶² These measures, however, did not provide the basis for the type of comprehensive action needed to curtail the illicit drug trade.¹⁶³ As a result, in 1987 the United Nations formed the Commission on Narcotic Drugs¹⁶⁴ (or "Commission") for the purpose of formulating a more comprehensive, long-range ap-

155. 1988 Convention, *supra* note 16; *see* Hallums, *supra* note 23, at 837-39 (examining history of U.N. narcotic control efforts including analysis of 1988 convention).

156. *See generally* Wilson, *supra* note 29, at 1163-1206 (surveying history and methods of combating drug trafficking at Latin American source including asset attachment, military interdiction, and anti-money laundering legislation such as BSA).

157. *See* 1987 Conference, *supra* note 154, at 1666-1706 (outlining variety of supply-side measures such as identifying narcotic plants and elimination of illicit planting, disruption of major trafficking networks, and strengthening border patrols).

158. *See id.* at 1647-65 (providing for preventative measures such as assessment of extent of drug use and misuse and drug abuse education).

159. *See id.* at 1644 (announcing that application of recommendations in 1987 Conference implies participation of many branches of national governmental machinery including legislatures, authorities concerned with education, public health, economics, and law enforcement).

160. Single Convention on Narcotic Drugs of 1961, Mar. 30, 1961, 18 U.S.T. 1407, 520 U.N.T.S. 204 (entered into force Dec. 13, 1964).

161. Convention on Psychotropic Substances, Feb. 2, 1971, 32 U.S.T. 543, 1019 U.N.T.S. 175 (entered into force Aug. 16, 1976).

162. *See* Stewart, *supra* note 153, at 390 (discussing details of 1961 and 1971 conventions and commenting that lack of attention to illicit drugs left gap in international regulatory efforts).

163. *Id.*

164. *See* 1987 Conference, *supra* note 154, at 1723 (recognizing important role of United Nations Commission on Narcotic Drugs as policy making entity within United Nations on drug control matters).

proach to the illegal drug problem at the international level.¹⁶⁵ The Commission soon recognized that these conventions were adequate in their regulation of licit production and distribution of controlled substances, but they lacked effective mechanisms for controlling international drug trafficking.¹⁶⁶ Accordingly, the U.N. General Assembly resolved that the U.N. Commission on Narcotic Drugs draft a new convention to supplement and reinforce the 1961 and 1971 conventions.¹⁶⁷

The resulting draft became the 1988 Convention,¹⁶⁸ which was a more comprehensive and concerted effort by the United Nations to establish international norms aimed to address the international drug trafficking issue.¹⁶⁹ The 1988 Convention calls for party states to take specific law enforcement measures designed to prevent and to punish international drug trafficking.¹⁷⁰ More specifically, it addressed financial crimes related to the trade.¹⁷¹ Through the use of language included in certain U.S. money laundering statutes,¹⁷² the 1988 Convention required the criminalization of money laundering in party

165. See Stewart, *supra* note 153, at 390 (commenting on U.N. focus on forward looking solutions to issues emanating from international drug trade).

166. *Id.*

167. U.N. GAOR No. 39/41 (1984).

168. See Gurulé, *supra* note 18 (detailing elements and effects of 1988 Convention).

169. Stewart, *supra* note 153, at 390-91.

170. See 1988 Convention, *supra* note 16, art. 3(1), at 500 (requiring party states to enact domestic money laundering legislation).

171. *Id.* art. 3(1)(a), at 501.

172. Compare 18 U.S.C. § 1956 (a)(1) (1994) (providing criminal liability for knowingly engaging in financial transaction with proceeds of some form of unlawful activity with intent to promote carrying on of specified unlawful activity or with design of concealing nature, location, source, ownership, or control of proceeds), with 1988 Convention, *supra* note 16, art. 3(1)(b), at 501 (providing that knowing conversion of property derived from illicit activity or disguise of illicit activity for purpose of avoiding legal ramification is criminal offence). The provision of the convention establishes criminal liability for the following offenses:

- (i) The conversion or transfer of property, knowing that such property is derived from any offence or offences established in accordance with subparagraph (a) of this paragraph, or from an act of participation in such offences or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of his actions;
- (ii) The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offence or offences established in

states.¹⁷³ The 1988 Convention was a significant and specific step aimed at the drug trafficking and money laundering activities that have had the greatest international impact.¹⁷⁴ For example, the 1988 Convention requires party states to enable their courts, or other competent authorities, to mandate the production of bank and financial records needed to trace and identify proceeds derived from illicit drug traffic, notwithstanding bank secrecy laws.¹⁷⁵

b. FATF

The 1988 Convention's specificity and comprehensiveness influenced the next step towards comprehensive and uniform international regulation, which came from FATF.¹⁷⁶ In the spirit of the U.N. initiatives, FATF adopted a multi-disciplinary approach to money laundering issues, bringing together the policy making power of legal, financial, and law enforcement experts.¹⁷⁷ FATF's membership consists of twenty-six countries and two international organizations.¹⁷⁸ Since its inception, FATF has

accordance with subparagraph (a) of this paragraph or from an act of participation in such an offence or offences.

1988 Convention, *supra* note 16, art. 3(1)(b), at 501.

173. 1988 Convention, *supra* note 16, art. 3(1)(b), at 501.

174. See Stewart, *supra* note 153, at 392-93 (noting that "core" offenses covered under Article 3(1) of 1988 Convention are thought to be "the cornerstone of the Convention"). These offenses include:

- (i) The acquisition, possession or use of property, knowing, at the time of receipt, that such property was derived from an offence or offences established in accordance with subparagraph (a) of this paragraph or from an act of participation in such offence or offences;
- (ii) The possession of equipment or materials or substances listed in Table I and Table II, knowing that they are being or are to be used in or for the illicit cultivation, production or manufacture of narcotic drugs or Psychotropic substances;
- (iii) Publicly inciting or inducing others, by any means, to commit any of the offences established in accordance with this article or to use narcotic drugs or Psychotropic substances illicitly;
- (iv) Participation in, association or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counseling the commission of any of the offences established in accordance with this article.

1988 Convention, *supra* note 16, art. 3(1)(c), at 501.

175. See 1988 Convention, *supra* note 16, art. 5(3), at 501.

176. See Zagaris & Castilla, *supra* note 147, at 888-89 (discussing influence of 1988 Convention on FATF's Forty Recommendations, most significantly, recommending criminalizing money laundering).

177. 1996 FATF Report, *supra* note 16, at 1293.

178. See *id.* at 1293, n.1, 2. (listing twenty-six FATF member countries and govern-

issued reports containing suggestions aimed at combating money laundering problems.¹⁷⁹

In 1990, FATF issued its Forty Recommendations on Money Laundering, which made broad suggestions, such as improving national legal systems,¹⁸⁰ enhancing the role of the financial system in reporting and monitoring suspicious activity,¹⁸¹ and strengthening international cooperation.¹⁸² FATF further recommended criminalizing the laundering of money derived from drug trafficking as proposed by the 1988 Convention.¹⁸³ The report also suggested international implementation of KYC policies and BSA reporting requirements in place in the United States.¹⁸⁴

In 1996, FATF issued a revision of its Forty Recommendations, taking into account the experience gained over the intervening six years and reflecting the changes that had occurred concerning money laundering.¹⁸⁵ These revised recommendations, however, acknowledge that the FATF countries have diverse legal and financial systems.¹⁸⁶ Blanket recommendations aimed at universal regulations applicable to all countries may prove more disruptive to some countries than others because not all banking and financial systems are of equal quality.¹⁸⁷ Furthermore, banking over-regulation is a drain on the domestic

ments, which are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, United Kingdom, and United States, and two organizations, which are European Commission and Gulf Cooperation Council).

179. *See id.* at 1291.

180. *See id.* at 1294-95 (stating Recommendations 4-6).

181. *See id.* at 1297 (stating Recommendations 14-19).

182. *See id.* at 1299-1300 (stating Recommendations 30-40); *see also* Zagaris & Castilla, *supra* note 147, at 876 (discussing cooperative international agreements based on Forty Recommendations).

183. *Compare* 1996 FATF Report, *supra* note 16, at 1294 (stating Recommendation 4, that each country should take measures to criminalize money laundering as set forth by 1988 U.N. Convention), *with* 1988 Convention, *supra* note 16, art. 3(1), at 500 (recommending that money laundering be criminalized).

184. 1996 FATF Report, *supra* note 16, at 1293.

185. *Id.*

186. *See id.* at 1294 (noting that FATF acknowledges that diversity of countries that it addresses will make it impossible for all countries to take identical measures).

187. *See* Lawrence L.C. Lee, *The Basle Accords as Soft Law: Strengthening International Banking Supervision*, 39 VA. J. INT'L L. 1, 2 (1998) (discussing risks associated with global economy, which may disrupt macroeconomic performance).

economies of some countries.¹⁸⁸ The recommendations, therefore, permit flexible implementation, allowing countries to apply the principles within their own political, legal, and financial framework.¹⁸⁹ Although the 1996 FATF report clarified the original Forty Recommendations by issuing interpretive notes along with this revision, it left them substantially unchanged and the suggestions included within the Forty Recommendations continue to provide a universally applicable legal framework for countries to combat international money laundering.¹⁹⁰

c. Basle Supervisory Committee

The Committee on Banking Regulations and Supervisory Practices¹⁹¹ ("Basle Committee") is an organization formed by the world's most influential capitalist countries to provide a forum for discussion of international banking issues and to help guide their respective banking regulatory systems.¹⁹² In 1988, the Basle Committee, in response to the growing risks associated with money laundering in the increasingly globalized banking industry, adopted a statement of principles aimed at the issues surrounding money laundering.¹⁹³ This statement established

188. See Darren McDermott, *Hints of a Recovery in Asia Stir Debate over Readiness - How Much Suffering Will Heal a Sick Economy?*, 10/22/98 ASIAN WALL ST. J. 1, available in 1998 WL-WSJA 12989003 (quoting Robert Zielinski, a Lehman Brothers banking analyst, who stated: "The crisis is finally starting to force the sort of changes the Japanese economy needs, *stripping away excessive regulation* and improving financial management") (emphasis added).

189. See 1996 FATF Report, *supra* note 16, at 1294 (explaining belief that flexibility of Forty Recommendations should neither infringe upon any countries constitutional framework nor limit freedom to engage in legitimate financial transactions).

190. *Id.* at 1293-94.

191. See Committee on Banking Regulations and Supervisory Practices: Revised Basle Concordat on Principles for the Supervision of Banks' Foreign Establishments, 22 I.L.M. 900, 901 (1983) (noting that Basle Committee on Banking Regulations and Supervisory Practices ("Basle Committee") has representatives from Belgium, Canada, Federal Republic of Germany, France, Italy, Japan, Luxembourg, Netherlands, Sweden, Switzerland, United Kingdom, and United States).

192. See *id.* at 900 (noting that in 1975, Bank for International Settlements, which later became known as Committee on Banking Regulations and Supervisory Practices, was created in recognition of growing interdependency of international banking system and operation of world economy). The Basle Committee was formed to promote coordination and cooperation among banking supervisors in the industrial countries to foster a sound international banking system. *Id.*

193. *Basle Committee on Banking Supervision: Prevention of Criminal Use of the Banking System for the Purpose of Money-Laundering*, reprinted in International Economic Law Documents, I.E.L. II-0018 (1988) [hereinafter *Statement of Principles*]; see Lee, *supra* note 187,

an ethical code of conduct for central bank supervisors aimed at the prevention of fraud and money laundering.¹⁹⁴ It outlined basic policies and procedures designed to help bank regulators prevent criminals from using the banking system to launder money and to preserve the integrity of the international banking community.¹⁹⁵ The Basle Committee explicitly suggested that banks should attempt to discover the true identity of their clients, i.e., adhere to KYC principles.¹⁹⁶

In 1992, the Basle Committee issued its Report on Minimum Standards for the Supervision of International Banking Groups and Their Cross-border Establishment¹⁹⁷ (“Minimum Standards”) to emphasize the need for more consolidated supervision.¹⁹⁸ The Minimum Standards set forth guidelines that provided to a host country’s banking regulators the right to obtain information from international banks.¹⁹⁹ Under the standards, if the host country determines that an international bank fails to meet the standards, then the host country’s regulators may impose sanctions against the bank.²⁰⁰

Although the Basle Committee’s Minimum Standards have improved the international regulatory landscape, they do not

at 1-13 (discussing background and history of international banking regulation and role of Basle Committee).

194. *Statement of Principles*, *supra* note 193, pmbl, cl. 4, at 2.

195. *Id.* at 3.

196. *Id.*; see Kavita Natarajan, Note, *Combating India’s Heroin Trade Through Anti-Money Laundering Legislation*, 21 FORDHAM INT’L L.J. 2014, 2029 (1998) (providing background discussion of Basle Committee recommendations).

197. *Basle Committee Report on Minimum Standards for the Supervision of International Banking Groups and Their Cross-border Establishment*, reprinted in International Economic Law Documents, I.E.L. II-I (1992) [hereinafter *Minimum Standards*].

198. See Lee, *supra* note 187, at 21 (noting that consolidated approach of Minimum Standards is rooted in Basle Committee’s revision of Basle Concordant on Principles for Supervision of Banks’ Foreign Establishments (“Concordant”), issued in 1983). The revised Concordant focused on ensuring that no bank could escape adequate supervision. *Id.* The Concordant developed responsibilities of the home and host countries aimed at a dual regime of supervision. *Id.* For a detailed summary of the Basle Committee’s Minimum Standards, see *id.* at 21-22.

199. See *Minimum Standards*, *supra* note 197, at 3 (establishing that supervisory authorities in host country should establish understanding with authority in home country providing that each may gather information needed for effective home-country supervision to be accomplished either by on-site examination or by other means satisfactory to host country).

200. See *id.* (explaining that host country may impose restrictive measures needed to comply with Minimum Standards, including prohibiting international banks from creating banking establishments).

have treaty force and have no binding effect on the participating countries.²⁰¹ The Minimum Standards rely solely on the moral authority and informal pressure of the regulators of the participating countries.²⁰² Reliance on countries to enforce the Minimum Standards unilaterally makes the goal of uniform international regulation difficult to realize.²⁰³

d. The Organization of American States

The Organization of American States²⁰⁴ ("OAS") is a multinational organization designed to develop peace in the Americas.²⁰⁵ The OAS established the Inter-American Drug Abuse Control Commission to draft model regulations concerning money laundering control and the problems associated with the illicit drug trade.²⁰⁶ In May 1992, the General Assembly of the OAS adopted the Model Regulations Concerning Laundering Offenses Connected to Illicit Drug Trafficking and Related Offenses ("Model Regulations").²⁰⁷ The Model Regulations have no binding effect on the internal legal systems of OAS member countries,²⁰⁸ but the General Assembly of the OAS urged member countries to adopt the Model Regulations in their domestic

201. See Duncan E. Alford, *Basle Committee Minimum Standards: International Regulatory Response to the Failure of BCCI*, 26 GEO. WASH. J. INT'L L. & ECON. 241, 271 (1992) (commenting that non-binding effect notwithstanding, Minimum Standards are significant improvement over existing international banking regulation).

202. See *id.* at 270-74 (noting shortcomings of Minimum Standards, which include varying degrees of regulatory scrutiny in different countries making information difficult to obtain, and lack of adequate resources to implement Minimum Standards on cross-country basis).

203. *Id.*

204. See Charter of the Organization of American States, Apr. 30, 1948, 2 U.S.T. 2394, 119 U.N.T.S. 3 [hereinafter OAS Charter]. The Organization of American States ("OAS") is the world's oldest regional organization, with its origin dating back to 1890 with the First International Conference of American States where the International Union of American Republics was established. *Id.* at 981. Adoption of the OAS charter followed the end of World War II, transformed the Union of American Republics into the OAS, and was adopted in 1948 in Bogota, Colombia. *Id.* It was entered into force on December 13, 1951, at the Ninth International Conference of American States. *Id.* Thirty-two Member States ratified the charter since adoption in Bogota. *Id.*

205. *Id.* art. 1, at 989.

206. See CHARLES INTRIAGO, *INTERNATIONAL MONEY LAUNDERING* 38-42 (1991) (explaining initiatives of OAS directed at eradication of money laundering and related crimes in Latin America).

207. Model Regulations, *supra* note 16; see Alford, *supra* note 4, at 453 (commenting on adoption of Model Regulations in order to implement previous regional resolutions, as well as 1988 U.N. Convention).

208. See OAS Charter, *supra* note 204, art. 1, at 989 (noting that OAS has only

legislation to create binding obligations.²⁰⁹ The OAS took into consideration the forty recommendations of FATF and some basic tenets of the BSA when drafting the Model Regulations.²¹⁰ For example, the Model Regulations require banks to file currency transaction reports much like those required under the BSA.²¹¹

One of the more prominent problems associated with international regulation of money laundering, particularly in Latin America, are lax banking standards regarding customer identification and record keeping.²¹² These lax standards may in part be due to the weak banking systems in Latin America²¹³ with limited resources available to combat money laundering.²¹⁴ The Model Regulations specifically address the need to strengthen standards universally by incorporating elements of the BSA into its provisions.²¹⁵ For example, Article 10 of the Model Regulations requires that financial institutions accurately identify clients and maintain records for at least five years.²¹⁶ Article 11 emphasizes that financial institutions must provide records to competent authorities and suspend all bank secrecy laws that may impede investigation.²¹⁷ Articles 12 and 13 incorporate

powers granted by charter and no power to intervene in internal matters of Member States).

209. Alford, *supra* note 4, at 454.

210. See Model Regulations, *supra* note 16, art. 12 (requiring records of cash transactions be recorded if they exceed limits set by competent authorities); see Alford, *supra* note 4, at 456 (noting that Model Regulations require financial institutions to provide information to law enforcement and require reporting of currency transactions).

211. Model Regulations, *supra* note 16, art. 12.

212. See *Dealings in Latin America*, *supra* note 147, at 1 (noting discretionary nature of record keeping and lack of uniform accounting procedure in Latin America); see also Zagaris & Castilla, *supra* note 147, at 920 (noting that Ecuadorian government enacted anti-money laundering laws that made money laundering criminal but failed to implement KYC policies or suspicious transaction reporting).

213. See Judith Evans, *Contenders, or Pretenders? (Latin American Equity Markets)*, 1/11/97 *LATINFINANCE* 20, available in 1997 WL 10930636 (commenting on weakness of banking systems as bar to expansion of capital markets and stating that "[i]n Latin America, generally speaking, banks are part of the problem, not part of the solution").

214. See Zagaris & Castilla, *supra* note 147, at 963 (discussing inability of some Latin American countries to implement effective anti-money laundering schemes due to limited resources).

215. Compare 31 C.F.R. § 103.22 (b)(1) (1998) (requiring CTR filings), with Model Regulations, *supra* note 16, art. 12 (requiring filings materially similar to CTR).

216. Model Regulations, *supra* note 16, art. 12; see Paulina L. Jerez, Note, *Proposed Brazilian Money Laundering Legislation: Analysis and Recommendations*, 12 *AM. U.J. INT'L L. & POL'Y* 329, 346-47 (1997) (providing detailed analysis of Model Regulations).

217. Model Regulations, *supra* note 16, art. 11.

threshold reporting requirements and encourage banks to focus attention on suspicious transactions.²¹⁸ Finally, Article 15 requires mandatory compliance programs aimed at employee honesty, KYC principles, and regular audit checks.²¹⁹

The Model Regulations are important to Latin American countries because the regulations complement Latin American civil and common law legal systems.²²⁰ While the Model Regulations are not binding, they serve as a suggested statutory framework designed to facilitate the adoption of anti-money laundering legislation in countries that do not have the resources to develop their own legislation.²²¹ The regulations provide a vehicle that allows Latin American countries to implement anti-money laundering regulations in their respective domestic law systems.²²²

e. International Treaties and Agreements

The principles articulated in the U.N. conventions, FATF's Forty Recommendations, the Minimum Standards, and the Model Regulations moved closer to becoming binding law when, in 1990, the United States, Bolivia, Colombia, and Peru entered into the Declaration of Cartagena,²²³ an agreement that would lay the framework for future binding agreements to combat drug trafficking and money laundering.²²⁴ The Declaration of Cartagena embraced the multi-faceted approach²²⁵ suggested by both

218. *Id.* arts. 12-13.

219. Model Regulations, *supra* note 16, art. 15.

220. See Jerez, *supra* note 216, at 348 (commenting on importance of Model Regulations in Latin America because of lack of domestic legislation in most Latin American Countries).

221. *Id.*

222. *Id.*

223. The Declaration of Cartagena Concerning the Production of, Trafficking in and Demand for Illicit Drugs, Feb. 15, 1990, State Dept. No. 90-88 KAV No. 2908, available in 1990 WL 484467 (1990) [hereinafter Declaration of Cartagena].

224. See Lee, *supra* note 187, at 3-4 (discussing distinction between soft law, which includes recommendations or reports for purpose of influencing governments to take action, but are not binding, such as Basle Accords, and hard law, which is binding, most commonly in form of treaties).

225. Declaration of Cartagena, *supra* note 223, at 1. The parties to the declaration adopted a strategy aimed at implementing or strengthening a comprehensive program that addressed demand reduction, consumption, and supply. *Id.* The strategy also addresses economic cooperation, alternative development, and encouragement of trade and investment. *Id.* The parties acknowledged the interconnectedness of these areas and that progress or failure in any one would necessarily effect the others. *Id.*

the U.N. conventions and FATF and provided the groundwork for subsequent international cooperation.²²⁶ The United States has also entered into a variety of mutual cooperation agreements, understandings, and treaties with South American money laundering centers such as Colombia,²²⁷ Chile,²²⁸ and Paraguay.²²⁹ Some of the U.N. conventions' and FATF's suggestions, which include language very similar to that found in the BSA, have been incorporated into agreements between the United States and Colombia, as well as between the United States and Paraguay.²³⁰

II. *THE HISTORY, PURPOSE, AND EFFECT OF KYC GUIDELINES AND THE REJECTION OF THE NEWLY PROPOSED REGULATIONS*

KYC guidelines, from which the proposed KYC regulations emanate, have a long, hotly-debated history, which originated with language in a legislative report on the BSA.²³¹ The report and the BSA, however, do not define the term "know your customer" and do not give examples of what it means.²³² KYC prin-

226. See, e.g., Andean Trade Preference Act, 19 U.S.C. §§ 3201-06 (1994); see also Guy C. Smith, *The Andean Trade Preference Act*, 21 *DENV. J. INT'L L. & POL'Y* 149 (1992) (commenting on elements of Andean Trade Preference Act ("ATPA"), which encourages legitimate trade with Peru, Colombia, Bolivia, and Ecuador through economic incentives).

227. Memorandum of Understanding Between the Government of the United States of America and the Government of Colombia, July 24, 1990, T.I.A.S. No. 12417, available in 1990 WL 743729; Mutual Cooperation Agreement Between the Government of the United States of America and the Government of the Republic of Colombia to Combat, Prevent, and Control Money Laundering Arising from Illicit Activities, Feb. 27 1992, U.S.-Colum., T.I.A.S. No. 12450, available in 1992 WL 465994 [hereinafter Colombia Agreement].

228. Agreement of Cooperation Between the Government of the United States of America and the Government of Chile, Aug. 5, 1994, available in 1994 WL 560659 [hereinafter Chile Agreement].

229. Agreement Between the Government of the United States of America and the Government of the Republic of Paraguay to Cooperate in the Prevention and Control of Money Laundering Arising from Illegal Trafficking in Narcotics and Psychotropic Substances, Aug. 17, 1994, available in 1994 WL 560684 [hereinafter Paraguay Agreement].

230. See Colombia Agreement, *supra* note 227, art. I(3), at 1 (defining reporting of transactions similar to CTR reporting requirement); Paraguay Agreement, *supra* note 229, art. I(2), at 1 (same).

231. See H.R. REP. NO. 91-975, at 8 (1970) (mandating that insured banks keep records of identities of each account holder and individual authorized to sign checks, to make withdrawals, or to have any control over such accounts).

232. Lawrence S. Plave & Richard Fechter, *The Ride Bankers Got On and Can't Get*

principles, such as development of internal policies, procedures, and controls,²³³ designation of a compliance officer,²³⁴ ongoing employee training programs,²³⁵ and independent audit function,²³⁶ however, are embodied in provisions of, and amendments to, the BSA.²³⁷ The lack of definitively articulated standards has been one of the central criticisms of KYC policies since their inception.²³⁸

A. *The History of KYC Guidelines*

On several occasions codification of KYC guidelines appeared imminent.²³⁹ The authority to promulgate KYC regulation is vested in the U.S. Department of Treasury.²⁴⁰ Although KYC guidelines are not codified, the Treasury Department has delegated authority²⁴¹ to the federal banking agencies to require banks to establish and maintain adequate internal compliance programs to ensure conformity to the reporting requirements of the BSA.²⁴² Throughout the 1980s and 1990s, law enforcement

Off, MONEY LAUNDERING, CYBERPAYMENTS, CORPORATE AND BANK SECURITY, AND INTERNATIONAL FINANCIAL CRIMES CONFERENCE, 295 (Oceana Publications, Inc., Feb. 20-21, 1997) (on file with the *Fordham International Law Journal*) (arguing that proposed KYC regulations may not be solution to current money laundering problem because they remain too ambiguous for banking community to interpret reasonably).

233. 31 U.S.C. § 5318(h)(1)(a) (1994).

234. *Id.* § 5318(h)(1)(b).

235. *Id.* § 5318(h)(1)(c).

236. *Id.* § 5318(h)(1)(d).

237. *See Id.* § 5324 (prohibiting structuring of transactions); Comprehensive Drug Abuse Prevention and Control Act of 1970, 21 U.S.C. § 841(a)(1) (1994).

238. *See Plave & Fechter, supra* note 232, at 296 (commenting on lack of specificity concerning KYC principles and speculating that U.S. government keeps principles purposely vague).

239. *See, e.g.*, Bank Secrecy Act Regulatory Applications to the Problem of Money Laundering Through International Payments, 54 Fed. Reg. 45,769, 45,771 (1989) (to be codified at 31 C.F.R. pt. 103) (proposing that model KYC procedures be employed prior to origination of international wire transfers).

240. *See S. REP. NO. 101-460* (1990) (noting that Money Laundering Enforcement Amendments of 1990 authorized U.S. Department of Treasury to promulgate regulations to address money laundering through model KYC procedures); 136 CONG. REC. S14465-01, S14466 (daily ed. Oct. 3, 1990) (statement of Sen. D'Amato) (explaining that Department of Treasury should have authority to require financial institutions to have stronger KYC procedures); *In Brief, Know Your Customer*, 4 No. 20 DOJ ALERT 13 (1994) (Dept. of Justice) (reporting that top anti-money laundering officials previewed anticipated KYC regulations, which were expected but never issued by Department of Treasury, at 1994 money laundering conference).

241. 31 U.S.C. § 5318 (h)(1) (1994).

242. *See* 12 C.F.R. § 21.21 (1999) (requiring all banks under supervision of OCC

officials and the U.S. banking regulatory agencies promoted KYC policies and procedures as one of the most effective ways for banks to prevent money laundering²⁴³ and to avoid liability under money laundering laws.²⁴⁴

B. *The Purpose of KYC Guidelines*

KYC guidelines serve several purposes.²⁴⁵ First, they may deter criminals posing as legitimate customers who would use fi-

to establish procedures for compliance with BSA). This provision states in pertinent part:

- (a) Purpose. This subpart is issued to assure that all national banks establish and maintain procedures reasonably designed to assure and monitor their compliance with the requirements of subchapter II of chapter 53 of title 31, United States Code, and the implementing regulations promulgated thereunder by the Department of Treasury at 31 CFR part 103.
- (b) Compliance procedures. On or before April 27, 1987, each bank shall develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with the recordkeeping and reporting requirements set forth in subchapter II of chapter 53 of title 31, United States Code, and the implementing regulations promulgated thereunder by the Department of Treasury at 31 CFR Part 103. The compliance program shall be reduced to writing, approved by the board of directors and noted in the minutes.
- (c) Contents of compliance program. The compliance program shall, at a minimum:
 - (1) Provide for a system of internal controls to assure ongoing compliance;
 - (2) Provide for independent testing for compliance to be conducted by bank personnel or by an outside party;
 - (3) Designate an individual or individuals responsible for coordinating and monitoring day-to-day compliance; and
 - (4) Provide training for appropriate personnel.

Id.

243. See Proposed Rules, Department of the Treasury, 31 C.F.R. Part 103, Bank Secrecy Act Regulatory Applications to the Problem of Money Laundering Through International Payments, 54 Fed. Reg. 45,769, 45,771 (1989) (requesting that banks impose KYC procedures for suspicious wire transfers); see also An Examiner's Guide to Consumer Compliance, Bank Secrecy Act, available in 1993 WL 786985 (O.C.C.) [hereinafter OCC Examiner's Guide] (providing guidance to bank examiners for examination of internal compliance programs required for banks to adhere to BSA). In 1993, the OCC expanded application of this regulation by instructing its examiners to encourage banks to adopt KYC policies to assist in the reporting of suspicious transactions and included specifics as to what adequate KYC policies should contain. OCC Examiner's Guide, *supra*, at 6-7.

244. See Bennett et al., *supra* note 116, at 44 (commenting that government has repeatedly emphasized that strong commitment to KYC programs is key to avoiding problems associated with money laundering).

245. See Meltzer, *supra* note 3, at 239 (commenting on underlying reasons for KYC principles, noting that they are significant step in prevention of money laundering and

nancial institutions as tools to launder proceeds from their illicit activities.²⁴⁶ Second, strict adherence to KYC guidelines may reveal the illicit nature of a customer's business.²⁴⁷ Third, the information obtained from a customer will be transferred onto a database that will indicate when transactions are inconsistent with a customer's normal business transactions.²⁴⁸

The potential to generate immense profits is at the source of drug trafficking and money laundering.²⁴⁹ Many experts agree that the key stage to limit this potential is when the illicit cash first enters the financial system.²⁵⁰ The BSA, and the KYC guidelines established thereunder, were designed to prevent entry of illicit funds into the system²⁵¹ and to keep banks from becoming unwitting participants in money laundering schemes.²⁵² KYC guidelines do so by requiring banks to obtain adequate information to determine the identity and legitimacy of their clients.²⁵³ Many scholars and banking experts argue that a finan-

that they provide information needed for reporting requirement exemptions under BSA).

246. *See id.* (noting that investigation of client might reveal services that they desire are more consistent with needs of money laundering operation).

247. *See* 31 C.F.R. pt. 103, app. at 10 (1998) (suggesting that strong policies are only way to reveal transactions inconsistent with customer profile).

248. Meltzer, *supra* note 3, at 239. For example, if a customer has a business that requires a certain payroll disbursement on a bi-weekly basis and sudden withdrawals at inconsistent time intervals occur, this activity could indicate that money laundering is taking place. *Id.*

249. *See* H.R. REP. NO. 101-446 at 21-22 (1990) (noting that street sales in United States generate up to US\$110 billion per year).

250. *See id.* (reporting that Congressional Banking Committee recognized importance of monitoring flow of money entering financial system when enacting BSA); *see also* Statement by Edward W. Kelly, Jr., Member Board of Governors of the Federal Reserve System, Before the Committee on Banking and Financial Services, U.S. House of Representatives, Feb. 28, 1996, 82 Fed. Res. Bull. 322 [hereinafter *Statement by Edward W. Kelly, Jr.*] (noting that bank systems and bank employees are first and best line of defense against financial crimes); Elizabeth Kingma, *New Frontiers in the Regulation of International Money Movement in the Wake of BCCI*, 86 AM. SOC'Y INT'L L. PROC. 188, 199 (1992) (opining that placement is key stage in prevention of money laundering); Meltzer, *supra* note 3, at 231-32 (arguing that record keeping of cash transactions at point of entry into financial system is necessary to successful anti-money laundering system).

251. *See* H.R. REP. NO. 101-446, at 21-22 (discussing Congressional acknowledgment that monitoring and reporting cash flows, as well as identifying illegal source of funds, are important tools to thwart money launderers).

252. *See* Rudnick & Noonan, *supra* note 13, at 5 (reporting that banks are particularly susceptible to abuse by financial criminals).

253. *See id.* (noting that customer profiles should be kept that are appropriate to money laundering risks posed by particular customer or type of customer and their use of bank products).

cial institution with sound KYC guidelines in place will have the ability to prevent the opening of fictitious accounts and will provide the financial institution with a customer profile that will enable it to predict, with relative certainty, the types of transactions in which the customer is likely to engage.²⁵⁴

The ability of a financial institution, under a strong KYC policy, to detect suspicious transactions has become one of the most significant elements in the prevention of criminal activity.²⁵⁵ Capitalizing on the ability to detect suspicious transactions, the Fed and other federal supervisory agencies required banks to report suspected criminal activity,²⁵⁶ which has proven to be somewhat effective.²⁵⁷ Congress, however, has acknowledged that suspicious transaction reporting places a substantial burden on financial institutions,²⁵⁸ and the U.S. regulatory authorities have made attempts to ease the burden of the reporting requirements while maintaining the effectiveness of the reports.²⁵⁹

254. See *Guidelines for Monitoring Bank Secrecy Act Compliance*, *supra* note 7, at *2 (noting that bank employee education programs are essential for proper administration of KYC programs, particularly identification of suspicious transactions); see also Kingma, *supra* note 250, at 200-01 (arguing for full or partial adoption of OAS Model Regulations, which support both KYC programs and suspicious activity reporting); Shockey, *supra* note 13, at 16-17 (contending that KYC programs promote basic safety and soundness considerations and that identifying and reporting suspected criminal activity is one of more significant elements of KYC program).

255. See *Statement by Edward W. Kelly, Jr.*, *supra* note 250, at 323-24 (commenting that KYC policies are best way to prevent illicit funds from entering system and that suspicious transaction reporting is essential element).

256. 31 U.S.C. § 5318(g) (1994).

257. See *Statement by Edward W. Kelly, Jr.*, *supra* note 250, at 323-24 (noting that in 1995 more than 70,000 criminal referrals were filed).

258. See H.R. REP. NO. 101-446, at 24 (1990) (noting that compliance with BSA is difficult and costly, as staff must be trained to identify suspicious transactions and that financial community, and taxpayers, must be reassured by government that filing of over six million CTRs results in criminal liability for money launderers).

259. See *Statement by Edward W. Kelly, Jr.*, *supra* note 250, at 323-24 (commenting that Fed and other federal bank supervisory agencies, along with U.S. Department of Treasury, changed suspicious transaction criminal referral process, combining current supervisory agency rules with Department of Treasury's suspicious-activity reporting requirements). Additionally, a uniform inter-agency reporting form has reduced the need for repetitive reports. *Id.* Banks will now also have the ability to use computer software to help prepare magnetic filing of the reports. *Id.*; see *Lee v. Bankers Trust Company*, 1999 WL 64633 (2d Cir. 1999) (holding that safe harbor provision of 31 U.S.C. § 5318(g) provides unqualified privilege against liability for defamation or liable for filing Suspicious Activity Report).

C. Rejection of the Proposed KYC Regulations

On December 7, 1998, FDIC, OTS, the Fed, and OCC issued proposed KYC regulations.²⁶⁰ The shared goal of this inter-agency effort was to protect the integrity of the financial institutions that each agency regulates.²⁶¹ Each agency believed that the best way to effectuate this goal was to employ strong KYC regulations.²⁶² While the regulations issued by each agency were substantially identical,²⁶³ each agency promoted flexibility in their own regulations to accommodate the different types of financial institutions under their supervision.²⁶⁴

Differences in language and emphasis aside, all of the regulations included the same basic elements.²⁶⁵ For example, each proposal included the requirement that financial institutions determine the true identity of the customer through proper identi-

260. Minimum Security Devices and Procedures and Bank Secrecy Act Compliance, 63 Fed. Reg. 67,529 (1998) (to be codified at 12 C.F.R. pt. 326) (proposed Dec. 7, 1998); Know Your Customer, 63 Fed. Reg. 67,536 (1998) (to be codified at 12 C.F.R. pt. 563) (proposed Dec. 7, 1998); Membership of State Banking Institutions in the Federal Reserve System; International Banking Operations; Bank Holding Companies and Change in Bank Control, 63 Fed. Reg. 67,516 (1998) (to be codified at 12 C.F.R. pt. 208, 211, 225) (proposed Dec. 7, 1998); "Know Your Customer" Requirements, 63 Fed. Reg. 67,524 (1998) (to be codified at 12 C.F.R. pt. 21) (proposed Dec. 7, 1998).

261. See, e.g., 63 Fed. Reg. at 67,516 (noting that Fed believed illicit financial activities such as money laundering undermine public's trust by marring reputation of financial institutions); see also *id.* at 67,525 (OCC proposal); *id.* at 67,530 (FDIC proposal); *id.* at 67,536 (OTS proposal).

262. See 63 Fed. Reg. at 67,516 (stating that Fed has long advocated KYC policies as one of most effective ways to thwart money laundering); see also *id.* at 67,525 (OCC proposal); *id.* at 67,530 (FDIC proposal); *id.* at 67,536 (OTS proposal).

263. See 63 Fed. Reg. at 67,517; *id.* at 67,525; *id.* at 67,530; *id.* at 67,536 (noting that each of proposed rules, for instance, define customer in substantially following language: "any person or entity who has an account involving the receipt or disbursal of funds with an institution covered by this regulation and any person or entity on behalf of whom an account is maintained").

264. See, e.g., 63 Fed. Reg. at 67,537 (discussing OTS desire for individualized KYC programs aimed at reflecting size, and complexity of savings association, type of customer that OTS regulated savings associations serve, and risk of illicit activity); Steve Cocheo, *Bankers Slam Proposed Know Your Customer Rules*, 2/1/99 A.B.A. BANKING J., available in 1999 WL 10893036 (noting that regulators avoided checklist approach to KYC regulation because they did not believe "one size fits all").

265. See 63 Fed. Reg. at 67,516; *id.* at 67,524; *id.* at 67,534; see also Cocheo, *supra* note 264, at 1 (noting that recent American Bankers Association analysis of inter-agency proposed regulations include six basic elements: determining identity of customer; determining source of customer funds; determining normal and expected transactions; monitoring of customer transactions to determine whether transactions are normal or expected; identifying abnormal or unexpected transactions; and determining whether transaction is unusual or suspicious).

fication documents²⁶⁶ and identify the source of the customer's funds.²⁶⁷ Additionally, the failure of a financial institution to act with due care with respect to KYC obligations could result in both criminal and civil liability for the institution as well as its officers and directors.²⁶⁸ KYC requirements, if not strictly adhered to, could result in convictions similar to those imposed for violations of other provisions and amendments to the BSA.²⁶⁹

The burdens associated with criminal liability were only part of the overwhelming negative reaction to the proposed regulations.²⁷⁰ One bank vice-president believed that the complexity of the issues raised by the KYC regulations would take great efforts on the part of compliance officers and cause fundamental changes in the way banks operate.²⁷¹ The vast majority of com-

266. See, e.g., 63 Fed. Reg. at 67,519 (proposing that identification process be commensurate with types of transactions that customer is involved in and risks associated with such transactions); *id.* at 67,526 (noting that best identification is type most difficult to attain illegally and should include photograph and signature of customer); *id.* at 67,532 (stating that KYC compliance requirements for regulated, insured non-member bank include determining to its own satisfaction that it is dealing with legitimate customer and further identifying beneficial owners of private banking accounts such as trusts and personal investment companies); *id.* at 67,538 (requiring proof of identity that includes name, address, and place of business of customer and means of verifying that information).

267. See, e.g., 63 Fed. Reg. at 67,520 (proposing that understanding nature and source of customer funds is essential to KYC program and can minimize potential criminal prosecution for avoidance of obtaining such information); *id.* at 67,527 (noting that amount of information needed can depend on type of customer); *id.* at 67,532 (stating that it may be beneficial to categorize customers based on types of services used); *id.* at 67,539 (same).

268. See 63 Fed. Reg. at 67,520 (proposing that conforming to KYC program can minimize potential criminal prosecution for avoidance of obtaining such information).

269. See *United States v. Giraldi*, 86 F.3d 1368 (5th Cir. 1996) (affirming conviction of private banker based on KYC rules for accepting client on third party recommendation alone and for failing to investigate client's source of funds); *United States v. Bank of New England*, 821 F.2d 844 (1st Cir. 1987), *cert. denied*, 484 U.S. 943 (1989) (holding bank criminally liable for failure to file CTR under willful blindness standard).

270. FDIC - *Know Your Customer Stats and Issues* (visited Mar. 13, 1999) <<http://www.fdic.gov/banknews/customer.html>> (on file with the *Fordham International Law Journal*) [hereinafter *KYC Stats*]. The FDIC received over 160,869 comments as of March 5, 1999, only 45 in favor of the regulation with the remainder expressing vigorous opposition to the proposal. *Id.* Comments, and the number of them, address cost burden (4049), competitive disadvantage (2140), and ineffective crime measure (5658). *Id.* Included among those making comments were individuals (153,377), banks (6502), and law firms (139). *Id.*

271. See *Money Laundering: Know Your Customer Proposed Rules Provoke Criticism, Complaints from Banks*, BNA BANKING DAILY NEWS, Nov. 4, 1998 (reporting that Susan Tucillo, vice-president and Senior Compliance Officer, Citibank, N.A., jokingly referred to proposed KYC regulations as "Compliance Officers' Guaranteed Employment Act of

ments, however, both reflected the public's and the financial service industry's concern that these KYC regulations would allow the government to invade individual financial privacy.²⁷² The intrusiveness of U.S. money laundering legislation has been criticized in the past,²⁷³ and the overwhelming negative response to these regulations encouraged Congressional leaders to propose legislation that would either postpone codification or completely abandon it.²⁷⁴

The public at large and Congressional leaders were not alone in opposition to the proposed regulations.²⁷⁵ Leaders of the regulatory agencies themselves expressed strong opinions denouncing the regulations.²⁷⁶ The view of the FDIC, given the significant opposition to the regulations, was that if the proposal was to become final, then it would not be in its then current

1998"). Ms. Tucillo feels the regulations create problems with almost every product line that a bank provides. *Id.*; see Ali Sartipzadeh, *Money Laundering: Bankers Urge Regulators to Scrap 'Know Your Customer' Proposals*, BNA BANKING DAILY NEWS, Feb. 1, 1999 (reporting that increased costs will accompany compliance and hurt smaller banks).

272. See *KYC Stats*, *supra* note 270 (observing that 99,522 comments focused on privacy issues—97,568 from individuals, 1521 from banks); see also *Irate Customers Flood Agencies over Proposed Regs*, 9 No. 5 MONEYL AuNDERING L. REP. 1, Dec. 1998. [hereinafter *Irate Customers*] (noting that majority of comments reflect fear of invasion of privacy by government through proposed regulations that will legitimately intrude upon personal lives of bank customers and use provided information without discretion).

273. See Hernandez, *supra* note 5, at 236 (discussing BSA and other U.S. money laundering regulations lack of protection of individuals financial privacy).

274. See 145 CONG. REC. E133-05 (daily ed. Feb. 3, 1999) (statement of Sen. Barr) (introducing legislation that proposed KYC regulations should be delayed "until authorized by Congress"); 145 CONG. REC. E155-05, E156 (daily ed. Feb. 8, 1999) (statement of Rep. Van Hilleary) (proposing Know Your Customer Program Abolishment Act because KYC regulations invade privacy and intrude on individual liberties); 145 CONG. REC. S1961-01 (daily ed. Feb. 24, 1999) (statement of Sen. Brownback) (supporting introduction of bill that would prohibit implementation of KYC regulations).

275. See Scott Barancik, *ABA Urges Regulators to Strip Exams of Know-Your-Customer*, 3/9/99 AM. BANKER 2, vol. 164, no. 45, Mar. 9, 1999 (noting that FDIC Chairman and Comptroller of Currency, both oppose regulations).

276. See *Testimony of Christie Sciacca, Associate Director Division of Supervision FDIC on Proposed Regulation on "Know Your Customer" Before the Subcomm. on Commercial and Administrative Law, Comm. on the Judiciary U.S. House of Representatives*, Mar. 4, 1999 (visited Mar. 13, 1999) <<http://www.fdic.gov/publish/speechs/99spchs/sp4mar.html>> (on file with the *Fordham International Law Journal*) [hereinafter *Testimony of Christie Sciacca*] (remarking that proposed regulations were inadequate in proposed form); see also *Comptroller Says "Know Your Customer" Rule Should Be Rejected, Statement of John D. Hawke Jr.* (visited Mar. 13, 1999) <<http://www.occ.treas.gov/ftp/release/99-17.txt>> (on file with the *Fordham International Law Journal*) (remarking that any marginal advantage gained by law enforcement as result of regulations is far outweighed by potential for long-term damage to banking system).

form.²⁷⁷ Although KYC guidelines were an essential element of money laundering legislation in the past and have become *de facto* regulation today,²⁷⁸ sentiment has abruptly shifted, disfavoring of the KYC principles embodied in the proposed regulations.²⁷⁹ The banking agencies' withdrawal of the proposed regulations, with little justification other than the overwhelmingly negative comments, indicate that KYC guidelines fail to serve the intended purpose of inhibiting money laundering, but leave open the possibility that they may return in modified form.²⁸⁰

III. REJECTION OF THE PROPOSED REGULATIONS IS APPROPRIATE AND A LESS SPECIFIC SELF-REGULATORY REGIME SHOULD BE ADOPTED BOTH IN THE U.S. AND THE INTERNATIONAL BANKING SYSTEMS

The rejection of the proposed regulations is the proper move towards a generally-stated international regulatory scheme concerning money laundering. As regulators retreat, the future of the KYC regulations is unclear.²⁸¹ Whether revamped KYC regulations resurface or not, the issues that they have raised will

277. *Testimony of Christie Sciacca, supra* note 276.

278. *See* Barancik, *supra* note 275, at 1 (quoting American Bankers Association senior counsel John J. Byrne, who stated that "[t]oday each bank must produce a know your customer policy to the bank examiner even though there is no regulation mandating this"). John J. Byrne pointed out that most banks have already implemented voluntary KYC policies. *Irate Customers, supra* note 272, at 2. Mr. Byrne told the press, "John Q. Citizen needs to recognize that there's nothing for him or her to worry about," as the regulations are meant "simply to prevent fraud." *Id.*

279. *See* 145 CONG. REC. H314-02, H317 (daily ed. Feb. 2, 1999) (statement of Rep. Paul) (comparing KYC regulations with violation of Fourth Amendment protection against searches and seizures).

280. *See* Minimum Security Devices and Procedures and Bank Secrecy Act Compliance, 64 Fed. Reg. 14,845 (1999) (withdrawn Mar. 29, 1999) (noting that only 105 favorable comments out of 254,394 were received); *see also* Know Your Customer, 64 Fed. Reg. 14,845, 14,846 (1999) (withdrawn Mar. 29, 1999) (stating that proposed regulations do not strike proper balance between privacy and financial burden concerns and framework for banks to adhere to anti-money laundering statutes); Membership of State Banking Institutions in the Federal Reserve System; International Banking Operations; Bank Holding Companies and Change in Bank Control, 64 Fed. Reg. 15,310 (1999) (withdrawn Mar. 29, 1999) (enumerating specific concerns raised by comments including cost of implementation). *But see* "Know Your Customer" Requirements, 64 Fed. Reg. 15,137 (1999) (withdrawn Mar. 29, 1999) (supporting KYC principles and noting that national banks supervised by OCC already have programs in place that accomplish intended objectives of KYC principles).

281. *See supra* note 280 and accompanying text (discussing withdrawal of KYC regulations without extensive comment by banking agencies).

continue to plague the banking industry so long as the U.S. money laundering legislation from which they emanate remains intact.²⁸² The U.S. government's expansive anti-money laundering regulations²⁸³ put U.S. financial institutions at a significant competitive disadvantage in the international marketplace.²⁸⁴ These institutions are ill-equipped to handle the regulatory burdens that KYC regulations would impose.²⁸⁵ Government imposed KYC principles, whether codified or not, and their spread through the international regulatory system,²⁸⁶ create inequities between countries with weak banking systems and those with strong banking systems. KYC regulations, furthermore, would only increase burdens on U.S. financial institutions and create significant inequities in the international banking system.

A. KYC Regulations Would Impose Too Significant a Burden on U.S. Financial Institutions

A legitimate open market free of corruption brought on by criminal elements is essential to a healthy banking system.²⁸⁷ KYC regulations, by driving away legitimate international clients, and particularly legitimate Latin American clients,²⁸⁸ will artificially inhibit the flow of money to markets that adopt KYC principles.²⁸⁹ The ultimate result will be fewer resources to devote to more practical efforts at eliminating money laundering.²⁹⁰

While it would be difficult to estimate the costs involved in strict adherence to ambiguous KYC guidelines embodied in the

282. See *supra* notes 233-37 and accompanying text (noting statute sections of BSA that embody KYC principles).

283. See *supra* notes 68-127 and accompanying text (discussing details of BSA and additional U.S. money laundering legislation).

284. See *supra* note 103 and accompanying text (explaining costs imposed by U.S. anti-money laundering regulation).

285. See *supra* note 270 and accompanying text (noting that FDIC survey indicated that many bankers expressed concern over cost burden of proposed KYC regulation).

286. See *supra* note 184 and accompanying text (noting FATF recommendation that KYC policies be implemented internationally).

287. See *supra* notes 31-34 and accompanying text (explaining effect of Medellin drug cartel's operations on Colombian economy).

288. See *supra* note 147 and accompanying text (remarking that Latin American banking clients are resistant to intrusive regulation).

289. See *supra* note 148 and accompanying text (noting that legitimate funds as well as illegitimate will flow to countries with strong privacy laws).

290. See *supra* notes 270-71 and accompanying text (explaining that many negative comments to proposed regulations centered on cost burden to banks and that added costs would particularly hurt small banks by creating competitive disadvantage).

proposed regulations, some experts believe that the costs are significant and have criticized them as economically unworkable.²⁹¹

Not only are KYC regulations unworkable for U.S. financial institutions, but they also create competitive disadvantages when divergent regulatory schemes, particularly those of Latin America, are involved.²⁹² For example, Ecuador has become a popular center for drug-related money laundering because it borders traditionally identified money laundering countries such as Peru and Columbia.²⁹³ Ecuador's exchange houses provide a convenient vehicle to cleanse illicit funds.²⁹⁴ In recent years, banking laws in Ecuador have been amended and measures have been adopted to fight money laundering effected through these channels, however, these changes include neither KYC guidelines nor suspicious transaction reporting.²⁹⁵ What appears to be a tightening of the regulatory scheme in Ecuador, therefore, has the effect, when applied in conjunction with U.S. regulations, of causing U.S. banks to compete at a competitive disadvantage to Ecuadorian banks with respect to KYC guidelines and BSA suspicious transaction reporting. The ineffectiveness of current reporting requirements²⁹⁶ should lead regulators to conclude that the proposed KYC regulations should be curtailed in order to enable banks to allocate resources where they might deter money laundering more effectively and to allow banks to compete equally in the international financial marketplace.²⁹⁷

291. Smith, *supra* note 153, at 131.

292. See *supra* notes 213-15 and accompanying text (noting recognition of problem of lax banking standards in Latin America and need to address issue through Model Regulations).

293. See *supra* notes 24-25 and accompanying text (discussing Adecian region countries of Colombia and Peru as main source countries of Latin American drug trade).

294. See *supra* note 5 and accompanying text (describing use of exchange houses to avoid regulation).

295. See *supra* note 212 and accompanying text (noting that Ecuadorian law has criminalized money laundering but has not enacted U.S. type anti-money laundering legislation).

296. See *supra* notes 105-07 and accompanying text (noting lack of effectiveness of CTR reports).

297. See *supra* note 75 and accompanying text (suggesting that bankers may be able to address money laundering issues more effectively if not for burden of reporting requirements).

B. *KYC Regulations Imposed Internationally Are Not Feasible in, or Equitable to, All Countries*

A critical examination of the 1987 Conference, the 1988 Convention, and their predecessors²⁹⁸ reveals that the United Nations is supporting an international anti-money laundering regime that focuses on a move from very general towards very specific concepts.²⁹⁹ Support for this move continues to be found in the specific recommendations of FATF³⁰⁰ and the Model Regulations issued by CICAD.³⁰¹ While these efforts purport to endorse general guidelines meant to fit the cultural, economic, and political diversity of the countries that are party to them,³⁰² these efforts have in fact incorporated very specific requirements to satisfy their provisions.³⁰³ Although many of these efforts are not binding on the signatory countries³⁰⁴ and others such as the Model Regulations and the Forty Recommendations are purely suggestions, these efforts have found their way into binding documents.³⁰⁵ The international community should consider whether this is the best way to address the problem. Questions of feasibility and equity must be answered before implementation of a tightly defined uniform international regime is adopted.

1. *KYC Regulation Is Not Feasible in All Countries*

Not every country is equipped to handle the regulatory burdens accompanying KYC regulation. U.S. legislation already

298. See *supra* notes 150-75 and accompanying text (examining evolution of U.N. initiatives to prevent money laundering from 1961 through 1988).

299. See *supra* note 175 and accompanying text (noting requirement that party states mandate their courts to produce bank records notwithstanding bank secrecy laws under 1988 Convention).

300. See *supra* notes 180-84 and accompanying text (discussing specifics of Forty Recommendations).

301. See *supra* note 211 and accompanying text (noting that Model Regulations require banks to file reports similar to CTRs).

302. See *supra* note 189 and accompanying text (suggesting that Forty Recommendations are intended to be flexible).

303. See *supra* notes 183-84 and accompanying text (noting that FATF's Forty Recommendations include criminalization of money laundering, reporting requirements very similar to those imposed by BSA and KYC programs).

304. See *supra* notes 201-02 and accompanying text (discussing non-binding nature of Basle Committee's Minimum Standards).

305. See *supra* note 230 and accompanying text (noting that language very similar to that found in BSA and suggested by U.N. Conventions and FATF is included in agreements between United States and Colombia and United States and Paraguay).

places too great a burden on financial institutions,³⁰⁶ but nonetheless it is the single most significant influence on international money laundering standards.³⁰⁷ Incorporating tenets of U.S. regulation into international binding regulation may not be feasible in countries that have weak banking systems ill-equipped to handle the burdensome requirements associated with such strict regulation.³⁰⁸

Because the Latin and South American drug trade generates such a large portion of illegally laundered money, international money laundering efforts focus on these countries.³⁰⁹ Because these efforts to incorporate KYC guidelines,³¹⁰ examination should be made of the effects of cumbersome regulations on the banking systems of Latin American countries, which for the most part, are historically weak.³¹¹ For instance, some experts believe the lagging economies of Asia in the late 1990s is directly related to the ineffectiveness of its banking system.³¹² The collapsing markets of Asia, led by Japan, can be partially attributed to Japan's over-regulated, therefore weak, banking system. To impose KYC regulation on Latin American countries either will result in the same result as over-regulation in Japan, increasing the already extensive economic strife,³¹³ or will result in lax adherence to standards, as was the case with BSA reporting requirements in this country.³¹⁴

306. *See supra* note 104 and accompanying text (discussing financial burden accompanied by U.S. reporting requirements).

307. *See supra* note 146 and accompanying text (noting, for example, incorporation of U.S. money laundering principles in Model Regulations).

308. *See supra* notes 212-14 and accompanying text (noting that Latin American countries such as Ecuador have lax banking standards possibly due in part to lack of resources).

309. *See supra* notes 204-30 (discussing OAS, Model Regulations, and international treaties and agreements with South American countries).

310. *See supra* note 219 and accompanying text (noting inclusion of KYC programs in Model Regulations).

311. *See supra* note 213 and accompanying text (explaining that Latin American banking systems are part of problem of weak economies).

312. *See supra* note 188 and accompanying text (commenting that excessive regulation has had detrimental effects on Japanese economy).

313. *See supra* notes 27-28 and accompanying text (describing economic strife associated with drug trade in Latin America).

314. *See supra* notes 102-07 and accompanying text (noting administrative burdens that led to lack of compliance with CTR reporting requirement and subsequent need to bolster requirements through additional legislation).

2. KYC Regulation Creates Inequities Among Countries with Divergent Banking Systems

Binding agreements, made between countries with weak banking systems, limited resources, and a lack of financial independence, and countries with strong banking systems, large amounts of financial resources, and divergent agendas concerning money laundering, will inevitably lead to inequities. When countries enter into binding agreements and treaties with one another, the relative bargaining positions of those countries should be considered. In the United States, political will has been focused on the eradication of money laundering through stringent regulation.³¹⁵ The United States also provides significant economic assistance to many of the countries where the money laundering problem originates.³¹⁶ Further, there is no question that this assistance is sorely needed and is directly related to the problems posed by the drug trade in the assisted countries.³¹⁷ When treaties are made between such countries, there is an inherent inequality in bargaining position. The influence that U.S. legislation has had on such treaties is a clear indication that one party's goals may be given priority over the others.³¹⁸ Consequently, the countries that so desperately need financial assistance from the United States are forced to acquiesce to stringent regulation that they may otherwise have avoided. These countries are faced with the legitimate concern that their banking systems will be unable to support the weight of such regulation, yet cannot forgo economic aid from the United States.

CONCLUSION

The proposed KYC regulations were properly withdrawn. Withdrawal, however, should be only the first step towards eradicating KYC guidelines and principles in U.S. and international

315. *See supra* notes 68-127 (discussing BSA and additional U.S. anti-money laundering legislation).

316. *See supra* note 226 and accompanying text (noting economic incentives are given to Andean countries under Andean Trade Preference Act).

317. *See supra* notes 27-37 and accompanying text (describing economic dependence of Latin American countries on profits generated by drug trade).

318. *See supra* note 230 and accompanying text (noting inclusion of language found in BSA in agreements between United States and Colombia and United States and Paraguay).

regulation. The U.S. government should examine the traditional concept of allowing banks to self-regulate. For most banks it is simply prudent business to know one's customer.³¹⁹ This is not to say that self-regulation by itself will strike the proper balance. Perhaps expressly limiting the scope of KYC guidelines to direct customers and making the guidelines clear as to what is needed to comply, in place of the ambiguous language currently under consideration would be a significant starting point.

The infiltration of KYC principles into the international regulatory framework will likely be curtailed in the wake of the rejection of the proposed regulations. Hopefully, this will be the case, as imposition of international norms concerning the development KYC principles may have wildly different and detrimental effects on the banking systems of financially weaker countries. While uniform KYC standards applied in countries with strong banking systems may be somewhat effective, they adversely effect the soundness of countries with less developed banking systems. Consideration must be given to a framework that allows countries to address the KYC issues in ways that their resources will permit, not by having them adhere to blanket regulations imposed equally on unequal parties. The banking systems of less stable countries should be allowed to grow unfettered by wasteful and ineffective regulation.

To a certain extent this type of international regime exists. The flexible framework intended by the United Nations, FATF, and CICAD, for instance, should be maintained. In the end, specificity should give way to generality. Within that framework KYC principles should be suggested, not mandated. A self-regulatory system that adheres to certain prudent KYC principles, but that will allow nations the flexibility to address KYC issues in a manner that is fair, efficient, and equitable will be most beneficial to the entire international financial community.

319. See *supra* note 278 (noting that most banks have already implemented KYC programs).