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## Private Banking Operations Under Section 312

# Overcoming the Challenges of Complying with Private Banking Operations Under Section 312

- **Don Temple** - Director of AML Investigations, Commerce Bank
- **Rita Gemayel** - AML Group Coverage Manager for Private Wealth Management, Morgan Stanley
- **John Panagopoulos** - Compliance Director, Financial Crimes Prevention & Intelligence, Lehman Brothers
- **Kevin McCleerey** - Managing Director -- Risk Management, JPMorgan Private Bank
- **Carmina Hughes** - Executive Director, Daylight Forensic & Advisory LLC



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**USA PATRIOT Act §312: Private Banking**

# 312: The Rule

**Don Temple**

Director of AML Investigations

Commerce Bank



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# 312: Whose Money is it?

**Rita Gemayel**

AML Group Coverage Manager  
Private Wealth Management

**Morgan Stanley**



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## USA PATRIOT Act §312: Private Banking

# Beneficial Owners

Beneficial Owner: Individuals with ability to fund the account (are source of assets) and have the ability to manage or direct the account (have control over assets).

- Does not include liaisons.
- Does not include passive investors with only financial interests.



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## Beneficial Owners

*What you need to know:*

- Understand the structure of the entity – directors, shareholders, etc.
- Identify individual beneficial owners through the multiple layers of ownership.
- Determine who is/are the beneficial owner(s).
- Perform due diligence on the beneficial owner
- Fulfill other Private Banking account requirements



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## Beneficial Owners

### *Remediation:*

- Identify entities in scope for Section 312 retrospective review
- Uncover the layers and identify ownership
- Perform due diligence



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# 312: Is your Client a Politically Exposed Person ?

**John Panagopoulos**

Compliance Director  
Financial Crimes Prevention & Intelligence  
Lehman Brothers



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## USA PATRIOT Act §312: Private Banking

# What is a PEP/SFPO?

A current or former:

- Senior official in the executive, legislative, administrative, military, or judicial branches of a foreign government;
- Senior official of a major foreign political party; or
- Senior executive of foreign government-owned commercial enterprise.

A corporation, business, or other entity that has been formed by, or for the benefit of, any such individual:

An immediate family member of any such individual; and

A person who is widely and publicly known to be a close associate of such individual.



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## USA PATRIOT Act §312: Private Banking

### *Relevant factors when examining your client:*

- the official responsibilities of the individual's office
- the nature of the title (honorary or salaried)
- the level of authority the individual has over government activities and over other officials
- whether the position affords the individual access to significant government assets and funds.
- Immediate family member: a spouse, parents, siblings, children, and a spouse's parents or siblings



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# Best Practices

- Do your new account documents ask whether the client is a PEP
- Vendor screening at the client on-boarding stage
- When conducting EDD on non-US private banking accounts do you review past and present employment history
- Forward monitoring of clients through vendor screening
- Does your transactional surveillance program risk rank by client type – including PEPs
- Do your firm's book reviews include reviews of accounts held by PEPs.
- Does branch management review and approve accounts identified as accounts for PEPs



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# 312: Source of Funds & Source of Wealth

**Kevin McCleerey**

Managing Director -- Risk Management  
JPMorgan Private Bank



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## USA PATRIOT Act §312: Private Banking

# Source of funds

*What is the expected source of account funding?*

- Cash
- Check Deposit
- Wire
- Security Transfer
- Other

*What is the approximate \$ amount funding the account?*



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## USA PATRIOT Act §312: Private Banking

Obtain and verify the source and legitimacy of wealth of the prospective client

Clients obtain wealth in a number of ways:

- Executive Management/Professional
- Inheritance
- Investments
- Retirement Distribution
- Client Owned Business
- Sale of Assets or Business
- Legal Settlement
- Lottery



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## USA PATRIOT Act §312: Private Banking

# Methods to evaluate validity of clients wealth

- **Meetings in person with prospective client**
- **Review of identification documents**
- **Public databases and media searches**
- **Industry reference sources and directories**
- **News articles and trade journals**
- **References with the firm, market, industry contacts, existing clients**
- **Financial statements, annual reports, business plans, sales literature**
- **Credit Bureau reports in the event of a credit transaction**



## Clients Purpose & Expected Activity of the Account

What is the purpose / intended use of the account? (describe why the account is being opened)

What types of accounts do you expect the client to open and what is the expected volume of account activity? (describe in detail expected account activity for this product)

<u>Product Type</u>	<u>Transaction Type</u>	<u>Volume of transactions</u>	<u>Dollar Range</u>
Deposit	Cash	Low / Medium / High	> \$10,000
	Check (deposit / paid)	Low / Medium / High	\$10,000 - \$25,000
	Wires transfers	Low / Medium / High	\$25,000 - \$50,000
	Internal transfers	Low / Medium / High	\$50,000 - \$100,000
	Other	Low / Medium / High	< \$100,000
<b>Asset, Brokerage, Custody, Investment Management, Fiduciary</b>	Cash	Low / Medium / High	> \$10,000
	Check (deposit / paid)	Low / Medium / High	\$10,000 - \$25,000
	Wires transfers	Low / Medium / High	\$25,000 - \$50,000
	Purchases / Sales	Low / Medium / High	\$50,000 - \$100,000
	Internal transfers	Low / Medium / High	< \$100,000
<b>Credit</b>	<b>Line of credit, Mortgage, Letter of credit</b>		



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## USA PATRIOT Act §312: Private Banking

# Implement a monitoring program to review actual account activity

Use automated monitoring tools to identify unusual transaction activity  
Include multiple disciplines (e.g., bankers, service teams, compliance) in monitoring account activity

### *Examples:*

- **Significant Variance Alert** – current transaction activity is outside a range of activity over a specified time frame
- **Flow Through Alert** – Large amounts flowing through the account (most of the funds come in and immediately goes back out)
- **Sudden Activity Alerts** – current activity after a period of inactivity
- **High Risk Transaction Alerts** – transactions to / from high risk countries
- **Cash Transaction Alerts** – review for structuring patterns



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# 312: The Rule Versus the Expectation

**Carmina Hughes**

Executive Director

Daylight Forensic & Advisory LLC



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# Why Following the Letter of the Regulation Isn't Enough

- Section 312 pertains to ***Foreign*** Politically Exposed Persons
  - Examiners may ask about lists of ***all*** Politically Exposed Persons, no matter what their nationality



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# Why Following the Letter of the Regulation Isn't Enough

- Section 312 is confined to foreign PEPs located in the private banking department
  - Examiners may ask for a list of ***all*** foreign PEPs no matter in which line of business they reside



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# Why Following the Letter of the Regulation Isn't Enough

- Section 312 only applies to those private banking departments that have a \$1,000,000 threshold
  - **All** private banking accounts or accounts involving high net worth individuals are considered to be high risk



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# Why Following the Letter of the Regulation Isn't Enough

- Section 312 is the only regulation that references beneficial ownership
  - Financial institutions are expected to be able to produce beneficial ownership information for accounts when asked



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# Reasons Beyond Regulatory Expectations

- Understanding and mitigating your risks
- Robust SAR reporting
- Smoother examinations



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# USA PATRIOT Act §312: Private Banking

## Section 312 Private Banking Scenario



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## USA PATRIOT Act §312: Private Banking

# Section 312: Private Banking Scenario

- Corey Spondent, a local prosperous attorney with the firm Nesting and Straw, partners and known to you inquires about opening an account with your private banking group. He would like to transfer 8.5 million dollars into the account from an account at a bank located in a country known to be an offshore financial center.
  - What due diligence would you consider performing that would be considered sufficient due diligence prior to opening the account?
  - What information would you request from Corey?
  - Would you consider conducting less due diligence for an existing account?



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## Corey Spondent - Continued

Assume the same facts as above except in this case the funds are being transferred from a domestic financial institution.

- Would you consider a 314b request from the domestic financial institution?



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## Corey Spondent 314(b)

The 314b request disclosed that the other FI is in the process of closing the customers account.

- What action would you take?
- Are you prohibited from opening the acct
- What due diligence would you conduct prior to opening the acct?



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# Corey Spondent Questions

Which questions would you consider asking Corey?

- Source of funds
- Possibly contact the source of funds
- Contact the originating financial institution
- Web search & other public information searches
- Attempt to identify employment & other sources of income
- Require other banking reference
- What is the anticipated activity in the account



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## Corey Spondent DD Results

Your due diligence discloses that the beneficial owner of the account is Henry Tank, a known PEP

- Are you prohibited from opening the account for Henry, the Minister of Finance for Macau, an offshore financial center & considered a high risk jurisdiction by your firm?
- What would you do at this point?
- What relevant factors would you consider to determine that Henry is a PEP?
- What additional due diligence would you consider?
- Who if anyone would you involve in the decision to open the account?



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## USA PATRIOT Act §312: Private Banking

# Banking PEPs

- Is a financial institution required to identify all PEPs?
- Can you provide an account for a PEP?
- Provide examples of cases when you would not provide an account for a PEP.



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# Corey Spondent DD

Your due diligence discloses that Henry's only source of income is his government salary

- He intends to transfer \$8.5 million to your financial institution
- Would you now provide the account for Henry?



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# Corey Provides False Information

Assume the customer does not disclose that they are a PEP

- Who other than an SFPO would you consider to be a PEP?
- What due diligence steps would you consider taking to determine that a customer is a PEP?
  - Consult branches in the customers home country?
  - would you consider relying on foreign intermediaries to satisfy the due diligence requirements?



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# You Open Corey's Account

The customer's account is credited for \$3 million dollars, this is inconsistent with the anticipated activity

- What if anything would you do at this point?
- The customer refuses to provide additional information or to explain the transactions
  - What action would now take?
  - Would you consider filing a SAR
  - would you consider closing the account?



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# Corey is a Former PEP

Corey is a former PEP

- What due diligence would you consider prior to opening the account?
  - How long has the PEP been out of office?
  - Any adverse publicity or indications of political corruption or continued involvement in politics
  - Contact your office in the PEPs home country



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## USA PATRIOT Act §312: Private Banking

# Future Due Diligence

You have now completed due diligence, you are comfortable with the customer.

- Should you have any future due diligence concerns?



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## Private Banking Operations Under Section 312

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