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Sarah Jane Hughes

Indiana University School of Law, sjhughes@indiana.edu

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Policing Money Laundering Through Funds Transfers: A Critique of Regulation Under the Bank Secrecy Act

SARAH JANE HUGHES*

“Wire transfers, which are essentially unregulated, have emerged as the primary method by which high volume launderers ply their trade.”¹

“[M]oney launderers . . . always seem to be one step ahead of the cash cops.”²

INTRODUCTION

International funds transfers³ have become drug dealers' favorite mechanism for money laundering.⁴ The paucity of controls on wire transfers relative to other means of laundering monies is the primary reason for their popularity among drug dealers. For several years, Congress and drug enforcement officials have known of this state of affairs. Beginning with the Anti-Drug Abuse Act of 1988,⁵ Congress authorized the Department of

* Adjunct Associate Professor of Law, Indiana University School of Law at Bloomington. J.D., 1974, University of Washington; A.B., 1971, Mount Holyoke College. The author wishes to thank Chancellor Gerald L. Bepko of Indiana University-Purdue University at Indianapolis and Dean Ralph Rohner of The Columbus School of Law, Catholic University of America, for their encouragement of this work, and R. Kevin Belt, Indiana University School of Law, 1991, and Antje Petersen, Indiana University School of Law, 1992, for their assistance in researching and editing it.

1. AMERICAN BANKERS ASSOCIATION MONEY LAUNDERING TASK FORCE, TOWARD A NEW NATIONAL DRUG POLICY—THE BANKING INDUSTRY STRATEGY, *reprinted in* 135 CONG. REC. S5555, 5556 (daily ed. May 18, 1989) [hereinafter MONEY LAUNDERING TASK FORCE].

2. *Money Laundering in Florida: Banking Compliance, Federal Enforcement Measures, and the Efficacy of Current Law: Hearing Before the Subcomm. on Consumer and Regulatory Affairs of the Senate Comm. on Banking, Housing, and Urban Affairs*, 101st Cong., 1st Sess. 119 (1989) [hereinafter *Money Laundering in Florida*] (statement of Charles A. Intriago, Esq., Publisher of *Money Laundering Alert*).

3. Funds transfers also are called wire transfers.

4. As a senior Internal Revenue Service official explained it, “[m]oney laundering is the concealment of the existence, nature or illegal source of illicit funds in such a manner that the funds will appear legitimate if discovered. Thus, ‘dirty’ money is washed in order to appear ‘clean.’” *Business Community’s Compliance with Federal Money Laundering Statutes: Hearing Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 101st Cong., 2d Sess. 142 (1990) (statement of Michael J. Murphy, Senior Deputy Commissioner, Internal Revenue Service).

5. Pub. L. No. 100-690, 102 Stat. 4181 (1988) (codified as amended in scattered titles of U.S.C.). Section 4702 of the Act (codified as amended at 31 U.S.C. § 5311 (1988)) also instructed the Secretary of the Treasury to undertake negotiations with nations that have strict bank secrecy laws to increase access for United States enforcement authorities to bank records in aid of drug prosecutions.

the Treasury (Treasury) to impose more stringent controls on wire transfers. Congress's purpose was to enable law enforcement officials to trace the proceeds of narcotics trafficking more effectively.⁶ In October, 1989, the Treasury announced its intention, under that authority, to impose additional recordkeeping and reporting requirements on banks that originate or receive the proceeds of international wire transfers.⁷ By October, 1990, the Treasury issued a revised proposal (the 1990 Funds Transfer Proposal) and expanded its reach to domestic as well as international wire transfers.⁸ Throughout the Treasury's deliberations on this proposal, Congress has considered even stricter statutory controls on domestic as well as international wire transfers.⁹

These proposals have encountered substantial opposition on several fronts from financial institutions and financial regulatory agencies. In particular, opponents have pointed to the array of methods and the nonstandard formats used by financial institutions and communications systems in international and domestic wire transfers.¹⁰ They also have argued that the difficulty and costs associated with standardizing the communications formats to capture data sufficient for policing purposes would eliminate the

6. The Act authorized the Treasury to adopt specific recordkeeping and reporting requirements for wire transfers in addition to the long-standing general reporting requirements in 31 C.F.R. § 103.33 (1990). In addition, it enabled the Treasury to require financial institutions to report transactions, including international wire transfers of funds, with foreign financial institutions in a designated location for a limited period of time. 54 Fed. Reg. 45,770 (1989) (discussing 31 C.F.R. § 103.25 (1990), which authorizes the Treasury to require reports of financial institutions). Title 31 of the U.S.C. and the C.F.R., however, require the Secretary of the Treasury to balance law enforcement priorities against the effect of new recordkeeping on the cost and efficiency of the payments system. 31 U.S.C. § 5314 (1988); 31 C.F.R. § 103.25 (1990). The targeting for geographic areas permitted by 31 U.S.C. § 5326 (1988) and 31 C.F.R. § 103.26 (1990) is limited by the paucity of information about the parties to the wire transfer, known as the "originator" and "beneficiary," respectively. 54 Fed. Reg. 45,770 (1989).

7. 54 Fed. Reg. 45,769 (1989) (proposed Oct. 31, 1989) [hereinafter 1989 Funds Transfer Proposal]. The Treasury requested comment on several alternatives for the retention and maintenance of data on international wire transfers.

8. *Proposed Amendment to the Bank Secrecy Act Regulations Relating to Recordkeeping for Funds Transfers by Banks and Transmittals of Funds by Other Financial Institutions*, 55 Fed. Reg. 41,696 (1990) (proposed Oct. 15, 1990) [hereinafter 1990 Funds Transfer Proposal]. This notice of proposed rulemaking covers non-bank funds transmittals such as those processed by currency exchanges, telegraph companies, and registered securities broker-dealers. *Id.* at 41,704 (proposed amendments of 31 C.F.R. § 103.33, to be codified at 31 C.F.R. § 103.33(f)).

9. *E.g.*, 136 CONG. REC. at H1722-23 (daily ed. Apr. 25, 1990) (amendment to H.R. 3848 proposed by Sen. Torres). The House of Representatives passed H.R. 3848 without this provision. S. REP. NO. 460, 101st Cong., 2d Sess. 15-17 (1990); *House Passes Bank Bill on Money Laundering*, N.Y. Times, Apr. 26, 1990, at D2, col. 4.

10. *E.g.*, *Money Laundering Legislation: Hearing Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 2d Sess. 70-71 (1990) [hereinafter *Money Laundering Legislation*] (statement of Clyde H. Farnsworth, Jr., Director, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System). For more information about funds transfer systems, see J. DOLAN, UNIFORM COMMERCIAL CODE TERMS AND TRANSACTIONS IN COMMERCIAL LAW § 25 (1991).

chief attractions of wire transfers as inexpensive, speedy, efficient payment mechanisms.¹¹ In addition, bank regulators have pointed to other difficulties of policing international as well as domestic transfers due to the number of daily transactions¹² and to the problems of capturing data about the parties to the transfer who are not present in the United States.¹³ Finally, bankers have expressed their dissatisfaction with their increasing responsibilities in the current war against drug trafficking,¹⁴ particularly the proportion of the investigatory burden they must bear, and questioned the likelihood that records kept under the proposal would be useful in law enforcement proceedings.¹⁵

During the early debate about the need for stricter controls on funds transfers and on the scope of those controls, the National Conference of Commissioners on Uniform State Laws and the American Law Institute

11. See *Money Laundering Legislation*, *supra* note 10, at 16-17 (statement of Clyde H. Farnsworth, Jr., Director, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System); 136 CONG. REC. H1727, H1729 (daily ed. Apr. 25, 1990) (statements of Reps. McCollum and Hiler) (debate on Torres amendment to H.R. 3848).

12. The Board of Governors of the Federal Reserve System (Federal Reserve Board) reported that Fedwire and the Clearing House Interbank Payments System (CHIPS) process approximately 350,000 funds transfers each day with an aggregate worth of approximately \$1 trillion. 55 Fed. Reg. 40,791 (1990) (final rule amending 12 C.F.R. § 210, adopting U.C.C. Article 4A for funds transfers through Fedwire).

13. Witnesses expressed doubts that regulation of the domestic side of an international funds transfer would provide much useful data because of bank secrecy laws enforced by many nations. *E.g.*, *Money Laundering Legislation*, *supra* note 10, at 16 (statement of Clyde H. Farnsworth, Jr., Director, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System). Some predicted that without "significant changes" in the laws of other countries legislation such as H.R. 3848 and the funds transfer proposal would be "less meaningful." *E.g.*, H. REP. NO. 446, 101st Cong., 2d Sess. 21 (1990) (Depository Institution Money Laundering Amendments of 1990); see also *Other Agencies Say No Soap to Treasury's Push for High-Tech Tracking of Money Laundering*, Wall St. J., Dec. 14, 1989, at A22, col. 1.

14. See, *e.g.*, *Money Laundering in Florida*, *supra* note 2, at 109, 111 (prepared statement of Peter R. Fowler, Vice President and Department Head, International Private Banking, Barclays Bank, Miami, Fla.); see also Comment Letter from U.S. League of Savings and Loan Institutions to the Department of the Treasury 2 (Dec. 6, 1990) [hereinafter U.S. League Comment] (comment on proposed amendment to the Bank Secrecy Act Regulations relating to recordkeeping for funds transfers by banks; describing burden imposed on the industry by the extra strain on staffs to meet responsibilities of new requirements). All citations to comments in this Article are to comments to the 1990 Funds Transfer Proposal, *supra* note 8, unless otherwise specified. Copies of comments cited in this article are on file with the *Indiana Law Journal*; comments not cited are available from the Office of the Assistant Secretary (Enforcement), Department of the Treasury, Rm. 4320, 1500 Pennsylvania Ave., N.W., Washington, D.C., 20220. See also *Banks Question Marching Orders in Drug Battle*, Am. Banker, Jan. 23, 1990, at 1; *Tellers Take Crime Detection 101: Banks Bear the Burden of Training Frontline Workers to Spot Suspicious Transactions*, Am. Banker, July 24, 1989, at 19; Comment Letter from American Express Co. to the Department of the Treasury 2 (Jan. 15, 1991) [hereinafter American Express Comment].

15. 136 CONG. REC. H1729 (statement of Rep. Hiler); see Comment Letter from the Board of Governors of the Federal Reserve System to the Department of the Treasury 3 (Jan. 25, 1991) [hereinafter Federal Reserve Comment]; U.S. League Comment, *supra* note 14, at 2.

approved Uniform Commercial Code Article 4A.¹⁶ Article 4A represents the first attempt to standardize the relationships between banks and customers that use wholesale wire transfers as payment mechanisms both in the United States and abroad.¹⁷ Twenty-eight states have adopted Article 4A in the two years since its approval.¹⁸ In addition, Article 4A is being used by the United Nations Commission on International Trade Law as a basis for discussion of an international convention for wire transfers.¹⁹ Despite its emergence as the standard reference point for funds transfers, neither Treasury nor Congressional proposals have used Article 4A as a means of avoiding new regulations on the funds transfer industry.²⁰

This Article seeks to stimulate discussion of the United States strategy in policing money laundering through funds transfers. In particular, this Article criticizes the government's intent to impose substantial additional record-keeping and reporting burdens on the banking industry as opposed to combating money laundering by more traditional law enforcement techniques. Although this Article discusses only one of several proposed amendments to the Bank Secrecy Act regulations, by analyzing key issues concerning the 1990 Funds Transfer Proposal, this Article will illuminate the United States' general approach to Bank Secrecy Act regulation and the rationales and policy choices it presents.

Part I of this Article explains the special regulatory and investigatory problems presented by funds transfers. These include the enormous volume of daily transfers, the array of methods of effecting wire transfers, the lack of standard formats used by the financial institutions and the various communications systems involved in the transfers, and the effect of foreign bank secrecy laws on collection of information about the account and the originator or beneficiary that is outside the United States. Part II reviews existing Bank Secrecy Act requirements that pertain to international funds transfers and evaluates the Treasury's funds transfer proposal in light of

16. U.C.C. Article 4A (1991) (Article 4A was adopted in July 1989.).

17. No other country currently regulates funds transfers by statute. To the extent that wire transfers have been regulated, the "regulation" has consisted of rules of the major funds transfer systems, of the local banking associations that operate clearing houses for funds transfers, of Federal Reserve Board Regulation J, 55 Fed. Reg. 40,801 (1990) (as amended Oct. 5, 1990) (to be codified at 12 C.F.R. § 210 (Subpart B)), and of Federal Reserve Board Operating Circulars, 55 Fed. Reg. 40,801 (1990) (to be codified at 12 C.F.R. § 210.25(c)).

18. *Table of State Enactments of 1989 Amendments (Article 4A)*, U.C.C. Rep. Serv. State Correlation Tables (Callaghan) xvii (Supp. Sept. 1991).

19. Lanza, *Operational Aspects of Article 4A*, in U.C.C. ARTICLE 4A[:] A PRACTICAL GUIDE FOR BANKERS AND BANK COUNSEL 64 (Am. Bankers Ass'n, Greco ed. 1991). The United Nations Commission on International Trade Law is commonly known as "UNCITRAL."

20. The October 15, 1990 revised funds transfer proposal adopts key Article 4A definitions but did not adopt them uniformly, causing considerable controversy about the scope of several provisions in the proposal. See *infra* notes 134-39 and accompanying text. The proposal completely ignored the incentives for record retention that Article 4A provides and that are described in Part III of this Article.

the likely costs involved and the law enforcement benefits it could generate. Part III describes alternative sources of highly useful information, including the requirements of Article 4A, Regulation J, and other developments in the funds transfer industry, with emphasis on the provisions of Article 4A that are likely to generate additional records relating to funds transfers. Against this background, Part IV discourages adopting new regulations for funds transfers and recommends relying on the transfer contracts and records already maintained or likely to exist under Article 4A. It also argues for increased reliance on existing methods of detecting money laundering and on international cooperation in combatting drug trafficking and money laundering.

I. STRUCTURE OF FUNDS TRANSFERS

Funds transfers present special problems for regulators and drug enforcement personnel. Some of these problems stem from the large number of transfers made each day by United States banks and funds transfers systems.²¹ Other problems result from the lack of a uniform format in the principal funds transfer systems and from restrictions on the characters and information fields that can be transmitted. Still other problems relate to the ease with which beneficial ownership of funds and other details of transfers can be shielded through repetitive transfers outside the United States or through foreign banks in countries with strict bank secrecy laws.²² This portion of the Article first describes funds transfers as payment mechanisms and then discusses each of these issues in funds transfer regulation.

A. Fund Transfers as Payment Mechanisms

Fund transfers²³ involve the movement of *credits* from one *bank* to

21. See *supra* note 12.

22. *Money Laundering in Florida*, *supra* note 2, at 130 (statement of Larry Fuchs, Deputy Comptroller, Office of the Florida Comptroller) (discussing laundering trail from Florida to Switzerland); see Cox, *New Path for Money Laundering: Complexity of Wire Transfers Makes It Harder to Trace the Origins of Dirty Money*, *Am. Banker*, July 24, 1989, at 9; Federal Reserve Comment, *supra* note 15, at 4.

23. Article 4A uses the term "funds transfer" rather than "wire transfer" because transfers may be made in writing, or by telephone, telex, or computer link. U.C.C. Article 4A Prefatory Note (1991). Article 4A defines "funds transfer" in the industry's terms as the series of transactions, beginning with the originator's payment order, made for the purpose of making payment to the beneficiary of the order. The term includes any payment order issued by the originator's bank or an intermediary bank intended to carry out the originator's payment order. A funds transfer is

another, two features that distinguish funds transfers from other payment mechanisms. Funds transfers may be made between domestic banks by means of clearing houses established by banks within one locale,²⁴ by Fedwire,²⁵ or by transfers among correspondent banks by Fedwire or other means. The term also includes funds transfers involving a bank in the United States and a foreign bank that are communicated through SWIFT²⁶

completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order.

U.C.C. § 4A-104(a). The class of transfers subject to Article 4A is commonly known as "wholesale wire transfers." U.C.C. Article 4A Prefatory Note.

The terms "funds transfers" and "wire transfers" exclude two classes of transactions that are functionally similar to funds transfers. The first of these are consumer fund transfers under the federal Electronic Fund Transfer Act (EFTA), 15 U.S.C. §§ 1693-1693r (1988), Title IX of the Consumer Credit Protection Act. Article 4A excludes transactions subject to EFTA. U.C.C. § 4A-108; U.C.C. Article 4A Prefatory Note. In common EFTA transactions, a non-bank entity such as an insurance or mortgage company initiates the transfer, which pulls from or debits the consumer's account. The consumer has separate contracts with the non-bank creditor and with its bank that authorize recurring debits from the consumer's account, such as monthly mortgage payments. See 15 U.S.C. § 1693(a)(8)-(9), 1693(e).

Article 4A's "funds transfer" definition also excludes transactions through funds delivery or transmittal systems, such as those operated by Western Union and currency exchanges. U.C.C. § 4A-104 official comment 2. The funds transfer proposal recognizes the distinction with its separate requirements for funds transmittals. 1989 Funds Transfer Proposal, *supra* note 7, at 41,704. The originator of a funds transmittal uses cash or a check (rather than a bank credit) as the means of settling for the funds transferred, and the party on the receiving end of the transaction may receive cash or may have the funds credited to a bank account. Unlike EFTA transfers and most wholesale wire transfers, the contract between the originator and funds delivery system customarily pertains only to the individual transfer then being made.

24. J. DOLAN, *supra* note 10, at 388; P. OPPENHEIM, INTERNATIONAL BANKING 99 (4th ed. 1983). Chief among these local clearing houses is the New York Clearing House, which also operates the funds transfer system known as CHIPS. See *infra* note 27 and accompanying text; Comment Letter from the New York Clearing House to the Department of the Treasury 2 (Jan. 15, 1991) [hereinafter NYCH Comment].

25. Fedwire is a funds transfer system operated by the Federal Reserve System. It transmits the "message" and settlement of the wire transfer occurs simultaneously. Settlements for transferred funds occur through credits and debits of reserve accounts maintained by member commercial banks at the Federal Reserve Bank in their districts. P. OPPENHEIM, *supra* note 24, at 98. Fedwire transactions are governed by Federal Reserve Board Regulation J. 12 C.F.R. § 210 (1990) (as amended Oct. 5, 1990). Fedwire is available as a means of settling for international as well as for domestic wire transfers. Industry experts estimated that Fedwire processed 63.7 million transfers in 1990 with an aggregate worth of \$199 trillion. Comment Letter from the American Bankers Association to the Department of the Treasury 5 (Jan. 15, 1991) [hereinafter American Bankers Comment]; NYCH Comment, *supra* note 24, at 2.

26. "SWIFT" is the acronym for the Society for Worldwide Interbank Financial Telecommunication, a Belgian-based association of banks established in 1977, that provides the communications network for a large number of international funds transfers. It operates under Belgian law. SWIFT uses one of the most comprehensive standard formats for all transfer messages to aid processing and transmission of instructions. P. OPPENHEIM, *supra* note 24, at 95. SWIFT's standard formats allow participating banks to link SWIFT directly to automated processing systems in banks. *Id.* at 98. SWIFT is also used in intracountry transfers in a number of countries, including the United States and Japan. *Id.*

or another communications system and that are settled through CHIPS²⁷ and the Federal Reserve System or by book entries.²⁸

The party initiating the transfer, the "originator,"²⁹ pushes a credit, usually from an account the originator holds, to a beneficiary's account.³⁰ Although less common, banks process transfers in which neither the originator nor the beneficiary has accounts with the banks participating in the transfer. These funds transfers may involve originators or beneficiaries whose deposit institutions do not have the capacity to make the funds transfers or persons such as foreign travellers or students who do not have accounts at the time of the transfer.³¹ Funds transfers commonly involve a series of transactions as the funds move from the originator's account to the beneficiary's account, a series that can involve several intermediary banks.³²

27. "CHIPS" is the acronym for the Clearing House Interbank Payments System, which is a funds settlement system operated by the New York Clearing House. CHIPS uses the twelve New York Clearing House member banks as well as the New York Edge Act Corporations of the two largest banks headquartered outside New York for settlements of CHIPS transfers. *Id.* at 99. On each banking day in 1990, CHIPS handled an average of 148,801 transfers with an average aggregate value of \$885.5 billion. NYCH Comment, *supra* note 24, at 2. The New York Clearing House is revising the CHIPS message format to match SWIFT's format with an estimated effective date of mid-1992. American Bankers Comment, *supra* note 25, at 11.

28. U.C.C. § 4A-209 official comment 6. In addition to funds transfers processed through Fedwire, CHIPS, SWIFT, or other funds transfer systems or clearing houses, funds transfers may be effected by "book entries." Comment Letter from Morgan Guaranty Trust Co. of New York to the Department of the Treasury 3 (Feb. 5, 1991) [hereinafter JPMorgan Comment]. In funds transfers made by book entries, the originator and beneficiary have accounts at the same bank and the transfers are made on the books of that bank. In addition, foreign and domestic branches of the same bank communicate the details of the transfers and settle for transferred funds through a bank-owned communications system; settlement occurs by debits and credits (book entries) to affected accounts within the bank. Securities broker-dealers also may use book entries to transfer shares or proceeds between buyers and sellers who maintain accounts with the same firm.

29. U.C.C. § 4A-104(c); *see also* U.C.C. § 4A-104 official comment 4 (discussing types of transfers in reference to the parties involved); Scott, *Corporate Wire Transfers and the Uniform New Payments Code*, 1983 COLUM. L. REV. 1664, 1680.

30. U.C.C. § 4A-104 official comment 4; *see also* Scott, *supra* note 29, at 1668.

31. Comment Letter from the Bank Administration Institute to the Department of the Treasury 10 (Jan. 22, 1991) [hereinafter BAI Comment]; Comment Letter from Chase Manhattan Bank to the Department of the Treasury 10-11 (Jan. 14, 1991) [hereinafter Chase Manhattan Comment]; Comment Letter from Merchants National Bank Corporation to the Department of the Treasury 3 (Jan. 14, 1991) [hereinafter Merchants Nat'l Comment]. In cases in which the originator's bank lacks access to a major funds transfer system, it will contact a bank that does. The second bank will arrange the transfer so that the proceeds reach a bank accessible to the beneficiary or to the beneficiary's deposit institution. In such cases, the payment order may be given by telex or by mailing a payment order together with a cashier's check payable to the beneficiary's bank. *Drug Money Laundering Control Efforts: Hearing Before the Subcomm. on Consumer and Regulatory Affairs of the Senate Comm. on Banking, Housing, and Urban Affairs*, 101st Cong., 1st Sess. 121, 123 [hereinafter *Drug Money Laundering Control Efforts*] (statement of Joseph B.H. Madison, Joseph Madison Associates, Inc., Lanesborough, Mass.); *see also* U.C.C. § 4A-302(c) (allowing the receiving bank to execute a payment order by transmitting it through first-class mail or by any other means reasonable under the circumstances).

32. One commentator has described this series in the following way:

A funds transfer begins when the originator gives a "payment order" to its bank.³³ The originator may give the payment order by telephone, by magnetic tape, by a terminal connected to a bank computer, by telex,³⁴ or, infrequently, by completing and delivering a written instruction.³⁵ The originator also may transmit the payment order directly to its bank or through an agent, a funds-transfer system,³⁶ or other private communication system.³⁷ Customers who rarely use funds transfers are likely to give the payment order in person, in writing, or by telephone.³⁸ If the originator telephones the bank, receiving banks customarily tape record the instruction in its entirety to obtain a permanent record should there be a problem with the transfer.³⁹ Other customers who use funds transfers more frequently may send a telex, deliver a magnetic tape or other electronic device directly

Suppose Corporation A orders its bank, Bank One, to transfer \$1 million to the account of Corporation B at Bank Two. Bank One debits A's account and transmits a telex message to Middle Bank, at which Bank One has an account, requesting it to make a transfer to Corporation B at Bank Two. Middle Bank, in turn, debits Bank One's account and sends a telex to Bank Two requesting it to transfer funds to Corporation B, and promising to pay by FedWire before the end of the day.

Scott, *supra* note 29, at 1686.

33. Article 4A defines "payment order" as an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay, or to cause to pay, a fixed or determinable amount of money to a beneficiary if:

- (i) the instruction does not state a condition to payment to the beneficiary other than time of payment,
- (ii) the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and
- (iii) the instruction is transmitted by the sender directly to the receiving bank or to an agent, funds-transfer system, or communication system for transmittal to the receiving bank.

U.C.C. § 4A-103(a)(1).

34. A telex is a hard copy sent by a service available to the general public. Scott, *supra* note 29, at 1674 n.55. In funds transfers, the telex is only a method of communicating with a bank or beneficiary; it is not a means of settling for the transferred funds. See BAI Comment, *supra* note 31, at 7. Funds transfers communicated by telex cannot be processed by computer on a "straight-through" basis but must be reformatted for entry into a computer system for execution. *Drug Money Laundering Control Efforts*, *supra* note 31, at 116 (statement of Joseph B.H. Madison, Joseph Madison Associates, Inc., Lanesborough, Mass.). For more information about the use of telex in funds transfers, see Baxter & Bhala, *The Interrelationship of Article 4A with Other Law*, 45 BUS. LAW. 1485, 1499 & n.80 (1990).

35. U.C.C. Article 4A Prefatory Note.

36. U.C.C. § 4A-105(a)(5). A "funds transfer system" is "a wire transfer network, automated clearing house, or other communication system of a clearing house or other association of banks through which a payment order by a bank may be transmitted to the bank to which the order is addressed." *Id.*

37. See U.C.C. § 4A-103(a)(1) (defining the term "payment order"). Payment orders must travel directly from the originator to the receiving bank, U.C.C. §§ 4A-103(a)(iii), 4A-104 official comment 5, but they satisfy this requirement if they reach the receiving bank through a funds transfer system. As defined by § 4A-103(a)(4), the "receiving bank" is "the bank to which the sender's instruction is addressed."

38. BAI Comment, *supra* note 31, at 7.

39. U.C.C. § 4A-104 official comment 6.

to the bank, or may send transfer instructions to the bank through an intermediary, such as a local automated clearing house.⁴⁰ If the order is given on electronic tape, the receiving bank may retain the tape. To frequent funds transfer users, banks may provide automated access to the bank's internal funds transfer mechanisms.⁴¹

Before executing a payment order⁴² received other than in person, receiving banks test the payment order for authenticity.⁴³ In addition, the receiving bank will "reformat" the order into a format for transmission to an intermediary bank⁴⁴ or to the beneficiary's bank.⁴⁵ Furthermore, in some cases, the originator or sender sends separate payment instructions through independent channels, such as SWIFT, to the paying bank or to the beneficiary of the funds transfer.⁴⁶

Completing the funds transfer involves a series of transactions. In the simplest of transfers, one bank holds accounts of the originator and beneficiary; the bank adjusts accounts to reflect the debit of the sender's account and the credit to the beneficiary's and notifies the beneficiary of the credit.⁴⁷ In other cases that involve only the originator's bank and the beneficiary's

40. U.C.C. § 4A-104 official comment 6. The customer sending the payment order might retain a copy of the tape as a means of identifying unauthorized or erroneous transfers.

41. BAI Comment, *supra* note 31, at 7; JPMorgan Comment, *supra* note 28, at 4 (describing its proprietary automated access system).

42. U.C.C. § 4A-301.

43. This testing is necessary because no signature exists to authenticate the order. P. OPPENHEIM, *supra* note 24, at 89. Funds transfer systems employ other forms of security procedures to code or test for verification: they establish a unique identifier for the customer sending the payment order or a series of identifiers depending on the complexities of the funds transfers made by that customer. *Id.* at 89-90 (describing general practices in security procedures).

44. Article 4A defines an "intermediary bank" as "a receiving bank other than the originator's bank or the beneficiary's bank." U.C.C. § 4A-104(b).

45. A "beneficiary's bank" is "the bank identified in a payment order in which an account of the beneficiary is to be credited pursuant to the order or which otherwise is to make payment to the beneficiary if the order does not provide for payment to an account." U.C.C. § 4A-103(a)(3).

46. BAI Comment, *supra* note 31, at 8. Separate payment instructions, which are relatively more common in transactions originated by European banks, pose special concerns for law enforcement agencies investigating money laundering. Comment Letter from Republic National Bank of New York to the Department of the Treasury 3 (Jan. 11, 1991) [hereinafter Republic Bank Comment] (explaining that these transfers are identified "by their references stating 'Cover of Direct Payment Order.'"). Federal law enforcement officials cite the existence of separate payment instructions as the justification for the proposed requirements for originators' and beneficiaries' banks to record whatever additional payment instructions they may have pertaining to the transfer. 55 Fed. Reg. 41,700-01 (1990) (statement of the Treasury to support its rule).

47. In such cases, the bank will have a record of the payment order as well as records of the debit and credit. Records of these adjustments appear both as ordinary records of funds transfers and as entries on the account activity records maintained by the bank. U.C.C. § 4A-406. The Treasury requires banks to retain other records. *E.g.*, 31 C.F.R. § 103.33 (1990) (records of payment orders for international funds transfers of \$10,000 or more); 31 C.F.R. § 103.34 (1990) (records of direct or wire transfer deposits exceeding \$100).

bank, the receiving bank reformats the sender's payment order into a form to send to the beneficiary's bank, sends the payment order, and settles for the funds transferred (frequently through correspondent accounts held for settlement purposes).

In still other cases, completing the funds transfer involves multiple banks and, consequently, multiple payment orders. The receiving bank reformats the originator's payment order as necessary to communicate with the intermediary bank and to arrange the settlement of funds. The intermediary bank, in turn, reformats the payment order to communicate with the next bank (whether another intermediary bank or the beneficiary's bank), instructing the new bank which of the intermediary bank's accounts to debit, and sends on the new payment order. Each communication between the banks in the series from the originator's bank to the beneficiary's bank entails a separate payment order.

Transfers by Fedwire operate somewhat differently. The receiving bank executes the sender's payment order by delivering it to a Federal Reserve Bank⁴⁸ for processing. The Federal Reserve Bank, as intermediary bank, communicates with the beneficiary's bank, and settles for the funds by debiting and crediting the respective accounts that the originator's and beneficiary's banks maintain with the Federal Reserve Bank. Fedwire requires only the identification number of the sending bank online, the amount to be credited, the identification numbers of the receiving bank, and the specific account to be credited.⁴⁹

Payment orders customarily contain limited information: data that are pertinent to completion of the particular stage of the transfer involved⁵⁰ and that are peculiar to the funds transfer system used. For example, the sender's payment order to the receiving bank contains the sender's identity, the account to be debited, the identity of the beneficiary's bank, and the amount of the credit.⁵¹ It states the beneficiary's name or account number⁵²

48. U.C.C. § 4A-206 ("Transmission of Payment Order Through Funds-Transfer or Other Communication System"). Official comment 2 to that section explains the procedure if the originator's payment order is transmitted to the originator's bank by means of a funds transfer system or other third-party communication system and by means of Fedwire. U.C.C. § 4A-206 official comment 2.

49. 136 CONG. REC. H1724 (daily ed. Apr. 25, 1990) (statement of Rep. Torres). To date, the Board of Governors has not announced any intention to expand the format of data required to process transfers through Fedwire.

50. See U.C.C. § 4A-206 official comment 2.

51. JPMorgan Comment, *supra* note 28, at 7.

52. The beneficiary's name is not required to complete the transaction and apparently is not provided in many domestic funds transfers. See NYCH Comment, *supra* note 24, at 14-15. The beneficiary's name is useful in resolving questions about which account to credit with the proceeds of the funds transfer. Article 4A, however, provides interpretive rules for cases in which the name and account number provided refer to different beneficiaries. U.C.C. § 4A-207(b). Official comment 2 to § 4A-207 explains that "a very large percentage of payment

and may give other instructions such as the payment date⁵³ and routing information.⁵⁴

The receiving bank (now referred to as the originator's bank) gives an order to the next bank in the sequence. That order will state the account to be debited when the transfer is complete (which may be an account maintained by the receiving bank with the beneficiary's bank or in a mutual correspondent bank), the name of the beneficiary or number of the account to be credited,⁵⁵ and the amount of the credit. If the receiving bank employs one or more intermediary banks, the instruction to the intermediary bank may be more cryptic: it may order the intermediary to debit its account with the intermediary and credit the account of the beneficiary's bank and may specify the identity of the beneficiary to be credited (by name or account number). Each of these payment orders contains some of the information from the previous payment order; the bank processing that step of the transfer will add or delete information as appropriate to that step. Consequently, an intermediary bank will have information about its predecessor and successor banks, but not about the originator or the sender.

The consequence of routing is that originators and receiving banks can dictate certain information: the number of banks involved in the transfer, the content of the payment orders needed to complete the transfer, and the extent of the data that banks involved in the transfer sequence are likely to retain.⁵⁶ The beneficiary's bank also may know the originator's name but is less likely to know the originator's account number⁵⁷ or bank.⁵⁸

orders issued to the beneficiary's bank by another bank are processed by automated means using machines capable of reading orders on standard formats that identify the beneficiary by an identifying number or the number of a bank account" and that the bank completes the processing without "human reading of the payment order itself." U.C.C. § 4A-207 official comment 2. It remains to be seen whether Article 4A's rules on misdescription of the beneficiary will encourage inclusion of the beneficiary's name in the information customarily contained in a payment order.

At present, SWIFT is the only funds transfer system that requires the names of both the originator and beneficiary in the payment order. Payment orders lacking either name cannot be executed by the SWIFT system. 136 CONG. REC. H1724 (daily ed. Apr. 25, 1990) (statement of Rep. Torres); see also P. OPPENHEIM, *supra* note 24, at 97 (sample SWIFT message).

53. Section 4A-401 defines "payment date" as "the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank."

54. U.C.C. § 4A-302(b). Banks typically capture and retain the originator's identity, amount of the transfer, execution date, payment instructions, and name of the beneficiary's bank. JPMorgan Comment, *supra* note 28, at 7.

55. The originator may not know the beneficiary's account number at the time of its payment order. It also is possible that the beneficiary has no account. Federal Reserve Comment, *supra* note 15, at 29.

56. This option renders more expensive the task of capturing sufficient data to track those transfers related to money laundering because it requires more sophisticated matching of the paths of the transfers. U.C.C. § 4A-302 official comment 1.

57. Most banks consider the account number of the originator to be proprietary information, which they protect for security reasons. *E.g.*, JPMorgan Comment, *supra* note 28, at 1; see Comment Letter from The Sumitomo Bank, Ltd. to the Department of the Treasury 1 (Dec. 24, 1990) [hereinafter Sumitomo Comment].

58. U.C.C. § 4A-104(d) ("Originator's bank" means (i) the receiving bank to which the

The beneficiary's bank has two options on receipt of the payment order: it may reject a payment order (for example, if the beneficiary named has no account), or it may "accept" the transfer.⁵⁹ If the beneficiary bank "accepts" the transfer,⁶⁰ it credits the account specified, notifies the beneficiary,⁶¹ and makes the credit available to the beneficiary either when settlement occurs or on the payment date specified in the payment order.⁶² The bank's acceptance of the payment order triggers debits that ultimately reach the originator's account and (unless the payment order requires notice to the beneficiary) generally is the last act necessary to make the transfer "final" as between originator and beneficiary.⁶³

B. Mechanical Issues in Tracing Drug Proceeds Through Funds Transfers

The particular manner in which banks maintain records of funds transfers makes the task of examining these transactions for law enforcement purposes a daunting one at best. This problem is exacerbated, as noted previously,

payment order of the originator is issued if the originator is not a bank . . ."). In transfers involving banks other than the originator's and beneficiary's banks, each bank pushes a credit forward to the next bank in the sequence and relies on the ability to collect that credit once the beneficiary's bank "accepts" the payment order on behalf of the beneficiary. See U.C.C. § 4A-302(a)-(b) and official comment 2.

59. U.C.C. §§ 4A-209(c), 4A-210, 4A-212. The beneficiary's bank may reject a payment order by notifying the originator of its rejection. U.C.C. § 4A-210(a). It must do so before acceptance occurs. U.C.C. § 4A-209(b)(2)-(3).

60. U.C.C. § 4A-209 ("Acceptance of Payment Order").

61. Notice to the beneficiary is required unless excused by agreement, by the payment order, or by a funds transfer system or clearing house association rule. U.C.C. § 4A-404(b)-(c).

62. U.C.C. § 4A-401.

63. Acceptance of the payment order by the beneficiary's bank is a key event in the funds transfer. Ballen and Diana describe its effect:

If the beneficiary's bank accepts a payment order, the bank generally must pay the beneficiary the amount of the order on the payment date. . . .

The beneficiary may recover consequential damages if the bank refuses to pay the beneficiary after the beneficiary has demanded payment and notified the bank of the special circumstances that will give rise to the consequential damages which will result from nonpayment and of the general type or nature of the damages that will be suffered as a result of such nonpayment and their general magnitude. However, the bank will not be liable for consequential damages if the bank proves that it did not pay because of a reasonable doubt concerning the right of the beneficiary to the payment. . . . Reasonable doubt also could occur if there is doubt about whether the person demanding payment is the person identified in the payment order as the beneficiary of the [payment] order.

Ballen & Diana, *Duties of the Beneficiary's Bank*, 45 BUS. LAW. 1467, 1468-69 (1990) (citations omitted).

by the high volume of transfers which occur daily—350,000 through Fedwire and CHIPS alone, plus additional transfers outside these systems, such as by telex and book entries.⁶⁴

Aside from the limited information contained in payment orders, banks maintain records of all funds transfers they process for customers.⁶⁵ But banks at different stages of the funds transfer possess data related only to that portion with which they are involved.⁶⁶ Originators' banks have data, such as cross-references to outstanding letters of credit,⁶⁷ that are unavailable to other participants in the funds transfer. Beneficiaries' banks likewise have data on the beneficiary that are unavailable to other banks in the funds transfer. Thus, there is no lack of records, but because information is kept in separate locations throughout and after the transaction, each record would have to be located and examined to create a complete trail of the funds transfer. For example, in a two-bank funds transfer, each bank has a record that relates to the transfer; in a three-bank transfer (one involving the originator's bank, an intermediary bank or Fedwire, and the beneficiary's bank), each bank likewise has a record, for a total of three records, and each bank's records contain only some of the detail relating to the transfer. The real issue in tracing drug proceeds through money laundering, therefore, is located in the volume of records that banks have.⁶⁸

The task of tracing laundered drug proceeds is further complicated by the message formats employed in the major funds transfer systems. As explained previously,⁶⁹ funds transfer systems restrict the number and type of characters used to communicate key information about the transaction.⁷⁰ Accordingly, when the receiving bank reformats the sender's payment order

64. *Supra* notes 12 and 28.

65. As described above, these records may consist of a copy of a payment order delivered in writing, a recording of a telephone instruction, a magnetic tape or other device, or a computer record of an instruction transmitted directly by the sender to the receiving bank's computer. Receiving banks have internal guidelines concerning the period for which each maintains records of payment orders. See American Bankers Comment, *supra* note 25, at 2; Chase Manhattan Comment, *supra* note 31, at 4. In addition, statements of demand account activity (whether debits or credits) show funds transfer activity for each account; these records contain the date of the debit or credit, the amount, and the reference number that the bank assigned to the transfer. Comment Letter from Marshall & Insley Bank to the Department of the Treasury 1 (Jan. 9, 1991) [hereinafter Marshall & Insley Comment].

66. *Drug Money Laundering Control Efforts*, *supra* note 31, at 75 (statement of John F. Lee, President, New York Clearing House Association).

67. See Comment Letter of Mayfair Bank to the Department of the Treasury 1 (Nov. 28, 1990).

68. *E.g.*, Chase Manhattan Comment, *supra* note 31, at 3-4.

69. See *supra* notes 37-43.

70. These restrictions relate to the compatibility of sending and receiving banks' computers and support fully automated processing of payment orders, which increases the speed and reliability with which they can be processed, and protects the system from unauthorized users. *E.g.*, JPMorgan Comment, *supra* note 28, at 4; see Comment Letter from Citicorp to the Department of the Treasury 3, 9 (Jan. 15, 1991) [hereinafter Citicorp Comment II].

for transmission to the next bank in sequence, format and space considerations may force it to omit information supplied by the sender (such as the originator's identity) that is not essential to the intermediary bank's role in the transfer.⁷¹ The intermediary bank, in turn, may omit data not essential to the next stage of the transfer.⁷² These field restrictions effectively preserve the anonymity of the originator and beneficiary from other participants in the funds transfer.⁷³

Another practical problem for law enforcement personnel evolves from the highly specialized nature of these formats. Because the formats of the major funds transfer systems differ,⁷⁴ so that only someone trained to read each system can decipher the contents of its records, federal law enforcement officials refer to the burden of locating multiple records and of deciphering nonstandard format entries to justify their interest in the additional record-keeping requirements sought in the funds transfer proposal.⁷⁵

C. Ability to Obscure Beneficial Ownership of Transferred Funds

Funds transfers and foreign bank secrecy laws offer money launderers an easy means of obscuring the beneficial ownership of funds transferred and received. Funds transfers generally are processed by electronic means and are handled more speedily and safely than traditional paper-based payment mechanisms, such as checks and bank drafts. International funds transfers are particularly suitable for money laundering because it is possible to route a transfer through a foreign bank account that is protected by a strict bank secrecy law or through a series of accounts so protected.⁷⁶ In addition, the originator or sender may send a payment order through the CHIPS and Fedwire funds transfer systems that does not identify the originator—or, in a CHIPS transfer, that identifies the originator as “one of our customers.”⁷⁷

71. For example, the receiving bank could omit any routing instructions, as well as the sender's account number, not required by the intermediary bank.

72. At this stage, for example, the intermediary bank may omit the number identifying the originator's bank.

73. *Drug Money Laundering Control Efforts*, *supra* note 31, at 71-81, 89-132 (statements of John F. Lee, President, New York Clearing House Association, and Joseph B.H. Madison, Joseph Madison Associates, Inc., Lanesborough, Mass., respectively).

74. See *supra* notes 10, 25-27 and accompanying text.

75. 1990 Funds Transfer Proposal, *supra* note 8, at 41,696; 1989 Funds Transfer Proposal, *supra* note 7, at 45,769.

76. *E.g.*, 134 CONG. REC. 30,737 (1988) (statement of Sen. Kerry); *id.* at 30,771-72 (reprinting U.S. Customs Service Documents); Republic Bank Comment, *supra* note 46, at 3; U.S. League Comment, *supra* note 14, at 2.

77. *Drug Money Laundering Control Efforts*, *supra* note 31, at 95 (statement of Joseph B.H. Madison, Joseph Madison Associates, Inc., Lanesborough, Mass.). In addition, if formats were changed to accommodate “on-whose-behalf” information, one comment explained that “[a] client could simply insert ‘XXX’ or ‘N/A’ in the relevant mandatory field, and systems in place today would recognize such characters as fulfilling the requirement to provide information in a mandatory field and process the payment order.” JPMorgan Comment, *supra* note 28, at 8; see Chase Manhattan Comment, *supra* note 31, at 5.

As a consequence, law enforcement agencies encounter a very different burden in tracing the proceeds of money laundering through funds transfers than through paper-based payment systems.

II. EVALUATION OF FUNDS TRANSFER PROPOSAL

Under the Currency and Foreign Transactions Reporting Act of 1970,⁷⁸ the Treasury has gained increasing authority to require banks and other financial institutions⁷⁹ to maintain records and make reports that have special utility in criminal, tax, or regulatory investigations or proceedings. The Treasury has promulgated regulations⁸⁰ that require institutions to file reports of domestic and foreign financial transactions of all types and to maintain records of other transactions. The primary purpose of these requirements is to identify the sources, volumes, and movements of monies moving into and out of the country and through domestic financial institutions.

Until recent years, law enforcement and regulatory efforts focused on cash deposits and transactions in which cash was exchanged for currency equivalents such as money orders and travelers' and tellers' checks.⁸¹ These efforts altered the methods used by money launderers: they first broke their domestic cash transactions into sums of less than \$10,000 so that they would trigger no reporting.⁸² Money launderers apparently found it easier to carry suitcases of cash out of the country,⁸³ deposit the cash in foreign banks, and retrieve the proceeds through wire transfers.⁸⁴

78. Pub. L. No. 91-508, 84 Stat. 114 (1970) (codified as amended at 31 U.S.C. §§ 321, 5311-5314, 5316-5322 (1988 & Supp. I 1989).

79. The terms "bank" and "financial institution" are defined in 31 C.F.R. § 103.11 (1990).

80. 31 C.F.R. § 103 (1990).

81. Treasury regulations require a "currency transaction report" (also known as "CTR" or "IRS Form 4789") for each deposit, withdrawal, exchange of currency, or other payment or transfer that involves a physical transfer of currency of \$10,000 or more. See 31 C.F.R. § 103.22(a) (1990). Banks and other financial institutions may exempt certain classes of customers (typically restaurants) from these reporting requirements without special permission from the Internal Revenue Service. 31 C.F.R. § 103.22. In recent years, banks and financial institutions (including businesses such as automobile and jewelry dealers, real estate brokers, and title companies) filed approximately six million currency transaction reports each year. See 55 Fed. Reg. 36,663, 36,664 (Treasury estimate).

82. Structuring cash transactions into sums of less than \$10,000 to avoid reporting requirements is a practice known as "smurfing." It has attracted considerable attention from scholars. E.g., Welling, *Smurfs, Money Laundering, and the Federal Criminal Law: The Crime of Structuring Transactions*, 41 U. FLA. L. REV. 287 (1989).

83. *Money Laundering: Hearings Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 1st Sess. 123-24 (1989) [hereinafter *Money Laundering*] (statement of Terrence M. Burke, Acting Deputy Administrator, Drug Enforcement Administration).

84. Money launderers devised elaborate schemes for washing drug proceeds. Among the most elaborate was a scheme developed by a Columbian drug ring that deposited with Bank

As banks began to report patterns of smaller cash transactions and as evidence revealed that money launderers were using new methods,⁸⁵ the Treasury proposed a series of additional reporting and recordkeeping requirements designed both to create a paper trail of the movements of drug proceeds and to deter money launderers from using domestic banking transactions in money laundering.⁸⁶ The 1990 Funds Transfer Proposal⁸⁷ is one of that series.

The additional reporting and recordkeeping requirements implemented or proposed in 1990 have prompted bankers and other financial service providers to complain that there is no cohesive strategy for overseeing money launderers' use of banks.⁸⁸ In addition, they argue that the costs associated

of Credit and Commerce International (BCCI)'s Tampa branch, wired those funds to the United Kingdom and elsewhere abroad, and invested them in certificates of deposit that then secured loans made by a bank in a haven country in the Caribbean and elsewhere, and finally wired the loan proceeds back to a BCCI account in Tampa. 134 CONG. REC. 30,771-72 (1988) (reprinting U.S. Customs Service release); see also *Money Laundering in Florida*, *supra* note 2, at 129-30 (1989) (statement of Larry Fuchs, Deputy Comptroller, Office of the Florida Comptroller, describing laundering trail from Florida to Switzerland).

85. For example, Mark M. Richard, Deputy Assistant Attorney General, Criminal Division, Department of Justice, testified:

While we no longer are seeing the volume of drug traffickers arriving openly at teller's windows with suitcases filled with cash, buying stacks of \$9,000 cashiers checks, we are seeing a wide variety of new schemes involving wire transfers, legitimate businesses, flight capital from abroad, and so forth.

Money Laundering Legislation, *supra* note 10, at 13; see also 134 CONG. REC. at S16,026-27 (daily ed. Oct. 14, 1988) (describing a shift in late 1987 from selling checks on the black market to a complex series of transactions in which funds were transferred via New York to BCCI Luxembourg and placed in a certificate of deposit in BCCI's London bank, which guaranteed a loan from BCCI in Nassau, the proceeds of which were then wired back to Tampa).

86. In 1990, the Treasury implemented and proposed other new regulations. Those implemented included revised Currency Transaction Reports, 55 Fed. Reg. 1021 (1990); amendments to geographic targeting orders first adopted in 1989 (54 Fed. Reg. 33,675, 33,679 (1989) (proposed Aug. 16, 1989)), 54 Fed. Reg. 34,976 (1990); and the so-called \$3,000 rule, an Amendment to the Bank Secrecy Act Regulations Relating to Identification Required to Purchase Bank Checks and Drafts, Cashier's Checks, Money Orders and Travelers' Checks, 55 Fed. Reg. 20,139 (1990) (implementing Section 6185(b) of Title VI of the Anti-Drug Abuse Act of 1988, Pub. L. No. 100-690, 102 Stat. 4181 (1988) (codified as amended in scattered titles of U.S.C.)), which prohibits the sale of instruments in amounts of \$3,000 or more unless the financial institution verifies and records the identity of purchaser.

The proposed regulations include the funds transfer proposals, 1989 Funds Transfer Proposal, *supra* note 7, and 1990 Funds Transfer Proposal, *supra* note 8, and the notice of proposed rulemaking dealing with mandatory aggregation of currency transactions and mandatory magnetic media reporting of Currency Transaction Reports, 55 Fed. Reg. 36,663 (1990) (to be codified at 31 C.F.R. § 103) (proposed Sept. 6, 1990).

87. The proposed amendments also cover funds transmittals, which are made by non-bank financial institutions. The Treasury also expressed interest in additional regulation of funds transfers, particularly in reporting requirements. 1990 Funds Transfer Proposal, *supra* note 8, at 41,697.

88. A substantial number of the 331 comments filed in response to the 1990 Funds Transfer Proposal objected to the lack of overall regulatory strategy. *E.g.*, Comment Letter from

with bank secrecy compliance are "spiraling"⁸⁹ and that the costs associated with implementing the current "piecemeal" approach⁹⁰ to bank secrecy regulation far exceed the usefulness of the reports and records they produce.⁹¹ Several commentators on the 1990 Funds Transfer Proposal argued that because most of the information sought under the proposal is already embedded in existing funds transfer formats and is retained under existing Bank Secrecy Act regulations, the Treasury's proposal must seek to reduce the information to a uniform format for the sake of "retrievability," a procedure that one commentator described as "one stop shopping" for law enforcement officials.⁹²

This portion of the Article describes existing recordkeeping requirements for funds transfers. It also evaluates the Treasury's 1990 Funds Transfer Proposal in terms of the Bank Secrecy Act's "utility" standard, the regulatory burden it would impose on the wire transfer industry, and the extraterritorial problems it leaves unanswered. It concludes that the proposed recordkeeping requirements would impose significant additional costs on financial institutions and other wire transfer industry members without yielding information that would be highly useful in law enforcement proceedings.⁹³

A. Existing Regulation of Funds Transfers Under the Bank Secrecy Act

Existing federal regulations require banks and other financial institutions to maintain and retain for five years records of all funds transfers from or to the United States in which the amount transferred is \$10,000 or more.⁹⁴ Banking regulations also require banks to maintain records of all direct and wire transfer deposits of \$100 or more.⁹⁵

Citicorp to the Department of the Treasury 2 (Dec. 5, 1990) [hereinafter Citicorp Comment I] (responding to the Sept. 6, 1990 proposal requiring mandatory media reporting of certain financial institutions; objecting in particular to an apparent absence of strategy for using new raw data to be created by banks).

89. American Bankers Comment, *supra* note 25, at 6-7; see *Treasury Issues Wire Transfer Proposal as Bankers Blast Latest Industry Burden*, 55 Banking Rep. (BNA) No. 16, at 549 (Oct. 22, 1990); *Banks Fear Big Burden in New Rules on Wires*, Am. Banker, Oct. 3, 1990, at 1.

90. See Citicorp Comment II, *supra* note 70, at 2; NYCH Comment, *supra* note 24, at 6.

91. See American Bankers Comment, *supra* note 25, at 6; Citicorp Comment I, *supra* note 86, at 2; JPMorgan Comment, *supra* note 28, at 11; NYCH Comment, *supra* note 24, at 7.

92. Citicorp Comment II, *supra* note 70, at 10.

93. The Bank Secrecy Act authorized the Secretary of the Treasury to promulgate regulations to provide information on wire transfers that would have a "high degree of utility" in criminal, tax, or regulatory investigations. Bank Secrecy Act, Pub. L. No. 91-508, 84 Stat. 114 (1970).

94. 31 C.F.R. § 103.33 (1990). The current regulation does not specify the precise records that banks must maintain with respect to these transfers.

95. 31 C.F.R. § 103.34.

In their comments on the funds transfer proposal, bankers point out that they make records of all international funds transfers,⁹⁶ although the form of the record depends in part on the means by which the payment order reached the receiving bank. In addition to records specific to the payment orders banks receive and execute, they also have back-up records of transfers, such as records of demand account activity that show the date of the execution of the transfer, a transaction reference number, and the amount of the transfer.⁹⁷ Bankers maintain that they have had no trouble responding to subpoenas from law enforcement agencies⁹⁸ and that they usually have information sufficient to enable trained investigators to trace the trail of the funds transferred.⁹⁹

In addition to their duty to maintain records of international transfers and deposits, banks have an obligation to report any known or suspected criminal activity.¹⁰⁰ Banks also must respond to targeting orders from the Treasury Department to record and report on certain types of transactions with foreign financial agencies.¹⁰¹

B. Regulatory Burdens of the Funds Transfer Proposal

The funds transfer proposal, if adopted, would add significantly to the burden of existing Bank Secrecy Act requirements. Many funds transfer industry members and experts see it as a threat to the efficiency of the funds transfer systems in the United States.¹⁰²

In addition to the generalized burdens associated with any new regulation,¹⁰³ the funds transfer proposal would impose four different burdens on banks' funds transfer businesses. These burdens relate to (1) the technical capacity of current funds transfer systems and internal bank computers that interact with those systems;¹⁰⁴ (2) the interruption of the funds transfer

96. See, e.g., BAI Comment, *supra* note 31, at 2; Chase Manhattan Comment, *supra* note 31, at 4. For example, the Bank Administration Institute explained that most wire systems maintain records of transactions for six months, which are thereafter stored in "offline" copy. BAI Comment, *supra* note 31, at 11.

97. *Supra* note 65 and accompanying text. These records are required for error resolution and complement records of items processed for compliance with the requirements of state laws on bank collection. U.C.C. § 4A-406 (1991); see Chase Manhattan Comment, *supra* note 31, at 3.

98. E.g., Chase Manhattan Comment, *supra* note 31, at 4.

99. *Id.*

100. 12 C.F.R. § 21.11 (1991). Office of the Comptroller of the Currency Banking Circular 227 describes the requirements and procedures for reporting suspected criminal activity. 1 Banking L. Rep. (CCH) ¶ 11,635 (Feb. 7, 1990).

101. 31 C.F.R. § 103.25 (1990).

102. E.g., JPMorgan Comment, *supra* note 28, at 3-5.

103. See Federal Reserve Comment, *supra* note 15, at 7.

104. Two phases of adjustments would be necessary to enhance the technical capacity to capture and retain information called for by the funds transfer proposal—revising and upgrading the message formats of the major funds transfer systems (CHIPS, Fedwire, and SWIFT) and rendering individual banks' computers compatible with those systems.

process by necessary manual intervention; (3) the loss of international funds transfer commerce and encouragement of offshore netting; and (4) compliance costs associated with ambiguous requirements. These burdens are in addition to the cumulative and impending impositions of other requirements under the Bank Secrecy Act regulations.¹⁰⁵

The funds transfer proposal would require banks to capture and retain information beyond the capacity of existing automated funds transfer systems. As a result, banks would have to reformat or acquire automated systems capable of retaining and retrieving data required by the proposal and would incur related training and storage costs.

Industry experts estimate that these costs would be sizeable¹⁰⁶ and that implementing these requirements would be especially time-consuming.¹⁰⁷ For example, of the three principal funds transfer communications formats (SWIFT, CHIPS, and Fedwire), none currently has sufficient capacity to comply with the funds transfer proposal.¹⁰⁸ Only SWIFT's message contains most of the information required of originators' banks under the proposal:¹⁰⁹ it conveys the identity of the originator and its account number, the identity of the beneficiary (but not the beneficiary's account number), the payment date, the amount of the transfer, the identities of the banks involved in the transfer (including the intermediary bank), and payment details. SWIFT, like the CHIPS and Fedwire communications formats, omits the name of the person "on whose behalf" the originator is acting.¹¹⁰

105. *Supra* notes 86-87 and accompanying text.

106. Industry experts have estimated the total costs for the first year at \$200 million. BAI Comment, *supra* note 31, at 5. This figure is far in excess of the amount that triggers a Regulatory Impact Analysis under Executive Order 12,291. See Exec. Order No. 12,291, 3 C.F.R. § 127 (1982), reprinted in 5 U.S.C. § 601, at 473 (1988). The American Bankers Association more modestly estimates the start-up costs for the commercial banking industry (not including others affected by the 1990 proposal) in the range of \$120 to \$200 million. American Bankers Comment, *supra* note 25, at 7.

107. *Money Laundering Legislation*, *supra* note 10, at 15-16 (statement of Clyde H. Farnsworth, Jr., Director, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System).

108. NYCH Comment, *supra* note 24, at 16.

109. See generally 1990 Funds Transfer Proposal, *supra* note 8, at 41,703 (detailing the information required by the proposal). SWIFT's fields are not mandatory, and at least one expert has suggested that they would have to be made mandatory to meet the requirements of the proposal. Comment Letter from the Boston Clearing House Association to the Department of the Treasury 4 (Jan. 11, 1991) [hereinafter BCHA Comment]. The BCHA Comment points to an irony in designating mandatory fields for SWIFT messages: foreign banks will be "prohibited by their country's [sic] laws from supplying the required information." *Id.* For a sample SWIFT format, see JPMorgan Comment, *supra* note 28, Exhibit A. For more information about field components of SWIFT messages, see J. DOLAN, *supra* note 10, at 390-91; P. ОРЕННЕМ, *supra* note 24, at 95-98.

110. 1990 Funds Transfer Proposal, *supra* note 8, at 41,703. The proposal contains limited exceptions to this requirement, such as transfers originated by publicly traded corporations, public utilities, and government agencies. *Id.*

Fedwire and CHIPS each omit different items required by the proposed regulation. Fedwire has the least comprehensive message format, requiring only identification of the banks participating in the Fedwire transaction,¹¹¹ the amount of the transfer, and the beneficiary's account number. It allows little in terms of the amount and types of third-party and other information not essential to completion of the payment and tolerates anonymity of the originator and beneficiary.¹¹² The Federal Reserve Board has not proposed a modification to accommodate the third-party information contemplated by the funds transfer proposal.¹¹³ CHIPS messages contain information that

111. See *Drug Money Laundering Control Efforts*, *supra* note 31, at 101-02 (statement of Joseph B.H. Madison, Joseph Madison Associates, Inc., Lanesborough, Mass.). A Fedwire message identifies parties in a structured sequence that customarily begins with the "Fed Sending Bank" (bank connected to Fedwire that sends the message) and may end with the "Fed Receiving Bank" (bank connected to Fedwire that receives the message). *Id.* at 124-26. These transactions rely on the originator's and beneficiary's banks to maintain data necessary to reconstruct the transfer in the event of error. In transactions in which the Fed Receiving Bank does not hold the last account to be credited in the funds transfer, Fedwire requires numeric identification (based on codes developed by the American Bankers Association) of the intermediary bank (the bank credited by the Fed Receiving Bank), beneficiary's bank (bank that credits the account of the beneficiary), and beneficiary (required if a separate beneficiary's bank is specified). *Id.* at 125. Neither the originator nor beneficiary need be identified by name. *Id.* at 90.

112. Fedwire's existing message format contains space for the identity of the originator and beneficiary but requires neither before entry of a transfer; the format has no field for what the funds transfer industry calls "by order" information (the equivalent of the identity of the beneficial owner of the funds transferred). See *Drug Money Laundering Control Efforts*, *supra* note 31, at 101-02. The Boston Clearing House Association estimates that Fedwire would have to add a line to accommodate these as mandatory information—a change that it describes as a "very significant" undertaking. BCHA Comment, *supra* note 109, at 4. The American Bankers Association, comparing Fedwire's limited message capacity with the requirements of the proposal, observed that requiring Fedwire to designate one of the fields in its existing format for new information

might jeopardize the field's current usage for regular commercial purposes by precluding routine instruction information. If this is the case, extensive modifications of Fedwire might be necessary to fully accommodate such information (e.g., by adopting a SWIFT format). These modifications would be costly to the Federal Reserve, and thus be reflected in increased Fedwire prices borne by the private sector. Such extensive modifications to the Fedwire format would also require each online Fedwire bank to modify, at great cost, its interface with Fedwire and perhaps even dissuade offline Fedwire banks from seeking online connections. Finally, it is likely that such modifications could be made to Fedwire only over a period of 24 to 36 months.

American Bankers Comment, *supra* note 25, at 11; see also Marshall & Insley Comment, *supra* note 65, at 1-2 (bank retains data only in Fedwire format and generally has no beneficiary data when acting as originator's bank or data on originator when acting as beneficiary's bank).

113. NYCH Comment, *supra* note 24, at 16. One industry expert observed that changing the Fedwire format, for example, by making optional data mandatory or by requiring names as well as numeric identifiers (as would be required by the funds transfer proposal), would involve considerable time and expense and that the Federal Reserve Board might have to provide an opportunity for public comment before it could implement such a change. BCHA Comment, *supra* note 109, at 4; see American Bankers Comment, *supra* note 25, at 11.

is similar to Fedwire messages.¹¹⁴ The CHIPS format, however, will have the capacity to comply with all aspects of the funds transfer proposal except the "on-whose-behalf" information by mid-1992.¹¹⁵

To magnify the burden of capturing additional information, originators' banks would be required to obtain this information "prior to the initiation of the first payment order."¹¹⁶ As a consequence, originators' banks would need the capability of separating those incoming payment orders that contained all required information, such as the "on-behalf-of" information, from those that lacked it. This capability would require additional computer capacity and impose a second burden—manual intervention.¹¹⁷

114. CHIPS messages currently must identify the sending CHIPS participant ("Send Bank"), the receiving CHIPS participant ("Receive Bank"), and the account to be credited by the Receive Bank ("Receive Account"). *Drug Money Laundering Control Efforts, supra* note 31, at 121. The message format also permits inclusion of the identities of the originator's bank (the "OGB"), the bank instructing the CHIPS participant to make the transfer (the "INS"), and the customer of the CHIPS participant ("Send Account"). *Id.* The identities of the originator's bank and the bank instructing the CHIPS participant to make the transfer are frequently omitted. *Id.*

115. NYCH Comment, *supra* note 24, at 16; see American Bankers Comment, *supra* note 25, at 11. The requirement that the originator's bank inquire about the identity of anyone "on-whose-behalf" the originator is acting is one of the most controversial provisions in the funds transfer proposal. See generally 1990 Funds Transfer Proposal, *supra* note 8, at 41,703 (discussing the requirement).

116. 1990 Funds Transfer Proposal, *supra* note 8, at 41,703.

117. The problems presented by manual intervention are discussed at notes 120-28 and accompanying text. One commentator explained the special burden of this requirement on originators' banks:

In order for Morgan to obtain this information from non-exempt originators before executing a payment order, changes to both proprietary software systems as well as interbank transfer systems must be made. Changes to formats used in non-electronic or non-automated means of making payments [sic] instructions must also be made. . . .

Even if such system changes are made, because beneficial interest information is not critical to the routing of a payment order, a customer's payment [order] need not necessarily contain applicable beneficial interest information in order to be processed on an automated basis. A client could simply insert "XXX" or "N/A" in the relevant mandatory field, and systems in place today would recognize such characters as fulfilling the requirement to provide information in a mandatory field and process the payment order. A payment order could be transmitted to or further transmitted or applied by an intermediary bank or the beneficiary's bank without "real" information in this field.

If Treasury intends an originator's bank actually to verify the existence or non-existence of information relating to the party on whose behalf the originator is initiating a payment, then an originating bank's funds transfer system must be programmed to reject any payment order which is not originated by an exempt entity, "a publicly traded corporation." . . . In other words, many payments which previously would have been processed in 60 seconds or less on a straight-through basis [would have to be] handled manually, a process which could take up to several days. . . . Even payments which are processed manually today would require additional manual processing.

JPMorgan Comment, *supra* note 28, at 8; see NYCH Comment, *supra* note 24, at 10-11.

Beneficiaries' banks similarly would be required to capture and retain, in addition to the name and account number of the beneficiary, the name of the person on whose behalf the funds transfer was received, if different from the beneficiary, unless the beneficiary is a publicly traded corporation, public utility, or government agency, and the name of the originator of the payment order and the account number, if applicable and known by the beneficiary.¹¹⁸ The beneficiary's bank would have to obtain this information within fifteen days after the payment of the funds transfer to the beneficiary.¹¹⁹ This requirement would necessitate compliance expenditures for beneficiaries' banks similar to those that originator's banks would incur, *viz.*, acquiring new computer equipment and software, retraining personnel, and expanding storage capacity.

The second type of burden that the proposal would impose on originators' and beneficiaries' banks results from the elimination of existing efficiencies of the automated systems. Those portions of the proposal that would require banks to obtain data about parties to the transfer not communicated by standard message formats would eliminate the industry's ability to process many funds transfers on a "straight-through basis."¹²⁰ Instead of processing

118. 1990 Funds Transfer Proposal, *supra* note 8, at 41,703.

119. *Id.* The obligation on the beneficiary's bank to obtain from the beneficiary information omitted from the payment order requires the beneficiary's bank to recognize and segregate incomplete payment orders, contact the beneficiary, match any response made by the beneficiary with the corresponding record of the incoming transfer or remind the beneficiary of her failure to respond, and, where it receives no response, record the names, addresses, and account numbers of "those persons originating funds transfers on which there is incomplete information." *Id.* Some commentators observed that it would be impossible to guarantee receipt of information within 15 days, thus increasing substantially the numbers of transactions that would be on the list of those containing incomplete information, as required under the proposal. American Bankers Comment, *supra* note 25, at 12 (also describing steps necessary to obtain the information required by proposed section 103.33(e)(2)(ii)(A)(2)); *see also* Federal Reserve Comment, *supra* note 15, at 10 (discussing the steps necessary for the beneficiary bank's collection of this information); NYCH Comment, *supra* note 24, at 11 (discussing the 15-day requirement and doubting banks' ability to obtain the "on-whose-behalf" information regardless of the time period permitted).

120. JPMorgan Comment *supra* note 28, at 4-5. The comment explains that JPMorgan processes more than 60% of all payment orders or funds transfers it handles on a straight-through basis. . . . [T]here is no need for a Morgan employee to examine, repair or route these transfers. More than 80% of the payment orders transmitted to Morgan by clients by means of our proprietary computerized funds-transfer system are processed on a straight-through basis. Straight-through processing is made possible by the use of computer-generated payment orders, creating compatible interfaces between data processing systems, standard formats and sophisticated telecommunications technology. . . .

This type of automated processing is common to the industry and to large providers of these services. It is one of the great strengths of the United States large dollar, or wholesale payments system and one reason that U.S. dollar denominated funds transfers continue to be the settlement means of choice in international commerce. The speed, accuracy, sophistication, security and low cost to the user of the U.S. payments systems contribute to maintaining this role for the U.S. dollar and in maintaining on-shore dollar clearing and settlements.

the payment order by wholly automated means, the proposal would require originators' and beneficiaries' banks to perform manual checks of many payment orders for completeness.¹²¹ One commentator explained that although many data can be verified on an automated basis information such as the name of the originator cannot be verified automatically because existing technologies checking for alphabetical entries "would not reveal an originator listed as 'on behalf of our good customer' or 'Mickey Mouse.'"¹²²

Once a beneficiary's bank identifies an incomplete payment order, it must request the missing information from the beneficiary (who is usually an account holder).¹²³ Although the automated system processing the incoming payment order may be programmed to send the beneficiary a notice of the receipt of the transfer (called a credit advice), the system may not be able to include the request for information in the same notice for timing reasons: the necessity of a request arises only after manual determination.¹²⁴ In addition, the beneficiary's bank would have to implement for matching information received from the beneficiary with the original record of the incoming payment order. This means that the bank would not only have to be capable of locating the record of the incoming payment order by its reference number but also of placing the missing information in the proper position in the record. The method could be manual or automated.¹²⁵ Should the beneficiary fail to respond—which he or she would be very likely to do, according to industry experts,¹²⁶—the beneficiary's bank would be required to initiate a follow-up notice or call, requiring both a means of triggering the follow-up and of tracking the response. A beneficiary's bank that did not follow up would have failed to make a reasonable effort to obtain the on-whose-behalf information, as required under the proposal.¹²⁷

121. The originator's bank must collect this information before originating the first payment order "unless the originator is a publicly traded corporation, public utility or government agency." 1990 Funds Transfer Proposal, *supra* note 8, at 41,703. Although this appears to exclude a substantial number of transfers, commentators do not agree.

In addition, the New York Clearing House pointed to the fact that the only situations in which the originator's bank could readily obtain the on-behalf-of information were those payment orders that the originator telephoned in and those that the originator made in person at a branch. NYCH Comment, *supra* note 23, at 10. It also estimated that this proposal would mandate manual intervention in "ten times the number of cases in which it is presently required." *Id.*

122. BAI Comment, *supra* note 31, at 9.

123. 1990 Funds Transfer Proposal, *supra* note 8, at 41,703.

124. See BAI Comment, *supra* note 31, at 9. Other commentators foresee the likelihood that the beneficiary's bank would have to solicit the missing information by telephone. Comment Letter from the Institute of International Bankers to the Department of the Treasury 5 (Jan. 15, 1991) [hereinafter Inst. Int'l Bankers Comment].

125. See BAI Comment, *supra* note 31, at 10.

126. NYCH Comment, *supra* note 24, at 11. NYCH members estimated that "at least 75 percent" of the beneficiaries would fail to respond to the initial request. *Id.*

127. 1990 Funds Transfer Proposal, *supra* note 8, at 41,703.

The bank finally must maintain a listing of those transfers for which it did not obtain the missing information from the beneficiary.¹²⁸

A third burden of the proposal is the loss of funds transfer business that the industry expects following adoption and the projected effect on the United States government securities market both from the loss of efficiency in the funds transfer systems and from the proposed extension of record-keeping requirements to book entries.¹²⁹ At this point, straight-through processing still offers substantial efficiencies in terms of speed, accuracy, and security¹³⁰ and is considered by many in the funds transfer industry to be the reason that so many international trade transactions have been dollar-denominated.¹³¹ The new regulations could change this situation rapidly. One commentator explained that "[h]uman intervention in the automated funds transfer process would result in a dramatic increase in funds transfer costs to the U.S. banking industry and its customers, a slowing of domestic and international payments, and a general disruption of legitimate world trade."¹³² This view was supported by many in the funds transfer industry.¹³³

The final type of regulatory burden relates to provisions that the industry considers ambiguous. Such provisions raise the costs of complying with any new regulation¹³⁴ and also increase the regulated industry's anxiety about prosecution.¹³⁵ For the most part, industry concerns of this type relate to definitions of key terms such as "originator's bank," "intermediary bank," and "payment order" and to the proposal that beneficiaries' banks obtain information to complete their records with respect to the funds transfer from the beneficiary.¹³⁶ For example, some commentators questioned the

128. *Id.*

129. *Money Laundering Legislation*, *supra* note 10, at 17 (statement of Clyde H. Farnsworth, Jr., Director, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System).

130. John F. Lee, President of the New York Clearing House Association, explained the benefit of the restricted formats now in use by funds transfer systems, such as CHIPS: "Our format requires payment information to be transmitted in a rigid sequence. Only by adherence to such specifications can payments be computer processed quickly and accurately and thereby meet the needs of the international commercial community." *Drug Money Laundering Control Efforts*, *supra* note 31, at 73.

131. See JPMorgan Comment, *supra* note 28, at 4.

132. American Bankers Comment, *supra* note 25, at 8; see also Federal Reserve Comment, *supra* note 15, at 31. Manual processing also is considered to increase the risks of human error in execution of payment orders. U.C.C. § 4A-207 official comment 2.

133. See NYCH Comment, *supra* note 24, at 5, 9.

134. The Federal Reserve Board suggested that "ambiguous and confusing drafting of the regulation [would] hinder bank efforts to familiarize themselves with its requirements," in particular as they may "require extensive interpretation and subsequent revision of operating procedures." Federal Reserve Comment, *supra* note 15, at 7.

135. See 136 CONG. REC. H41,701 (daily ed. Apr. 25, 1990) (statement of Rep. Gonzales); Chase Manhattan Comment, *supra* note 31, at 11; Comment Letter from the Securities Industry Association to the Department of the Treasury 3 (Jan. 15, 1991) [hereinafter SIA Comment].

136. See American Express Comment, *supra* note 14, at 10; Federal Reserve Comment,

scope of the phrase "publicly traded corporation"; they asked whether corporations whose securities were traded over-the-counter were exempt or whether only those corporations that were listed on an exchange were exempt.¹³⁷ Others argued that the classes of transfers exempt from this requirement ought to be expanded.¹³⁸ In addition to concerns about specific definitions or requirements, some funds transfer industry members were concerned about the lack of industry-protective features and proposed the inclusion of a "safe harbor" rule for good faith compliance with the amended regulation.¹³⁹

C. Questionable Utility for Law Enforcement Purposes

Under the Bank Secrecy Act, the Treasury's authority to adopt regulations extends to those requirements that have a "high degree of utility in tax, criminal, and regulatory investigations and proceedings."¹⁴⁰ The Department has not established that the proposed requirements would yield highly useful information.

The sheer volume of funds transfers will undermine the proposal's utility to law enforcement agencies. The Board of Governors of the Federal Reserve System estimates that the proposal's enhanced recordkeeping requirements would apply to "approximately 100 million transfers annually."¹⁴¹ The funds transfer industry estimates that nearly all funds transfers relate to legitimate business transactions.¹⁴² Assuming that its estimate is accurate, the funds

supra note 15, at 16; JPMorgan Comment, *supra* note 28, at 14-15; Comment Letter from Bank of Oklahoma-Tulsa to the Department of the Treasury 1-3 (Jan. 8, 1991) [hereinafter Bank of Oklahoma-Tulsa Comment].

137. NYCH Comment, *supra* note 24, at 20.

138. See, e.g., 12 C.F.R. § 205 (1991); BAI Comment, *supra* note 31, at 8 (calling, *inter alia*, for exemptions for transactions made by mutual funds or brokers on behalf of beneficial owners of funds (presumably because their identities are known), transactions of bank acting on behalf of non-banking subsidiary, and transactions by subsidiaries of regulated companies); NYCH Comment, *supra* note 24, at 18 (urging exemptions for transfers in which originator or beneficiary is a regulated entity and also for those transfers subject to Federal Reserve Board Regulation E (Electronic Fund Transfers)). Others called for dollar thresholds as a means of limiting the implementation burdens on banks. See American Bankers Comment, *supra* note 25, at 15 (calling for a \$10,000 floor for coverage); American Express Comment, *supra* note 14, at 6-7 (calling for a \$10,000 floor and a \$10,000,000 ceiling); Citicorp Comment II, *supra* note 70, at 10-11 (also urging a \$10,000 floor for coverage).

139. A number of the comments expressed concern in light of the prospect that non-compliance with Bank Secrecy Act regulations could result in severe penalties, including charter termination.

140. 12 U.S.C. § 5311 (1988).

141. Federal Reserve Comment, *supra* note 15, at 6. The Board assumed that the Treasury would exempt all inter-bank transfers from the proposed recordkeeping requirements. *Id.*

142. See NYCH Comment, *supra* note 24, at 3 (estimated that 99.75% of all transfers relate to legitimate transactions); Merchants Nat'l Comment, *supra* note 31, at 2 (estimated that if industry's estimate that .0002% of transfers are laundering-related is accurate then only 40 of 200,000 transfers Merchants National handles annually would be related to money laundering).

transfer proposal would generate millions of records annually that relate only to *legitimate* transactions and consequently would increase the burden of identifying *illegal* transactions.¹⁴³ In light of the regulatory burden likely to be imposed if the proposal is adopted, one must ask whether the proposed recordkeeping requirements will produce information that will prove highly useful in policing money laundering. The new requirements are apparently easily circumvented. Moreover, funds transfer industry members contend that of the prosecutions that have actually occurred those most widely touted by law enforcement agencies were not the result of tracing funds transfer records but were the product of more traditional law enforcement techniques, such as leads.¹⁴⁴ Finally, members of the industry point out that the nature of wire transfers makes them extremely difficult to examine for potential laundering.¹⁴⁵

1. Percentage of Funds Transfers Actually Involving Money Laundering

The funds transfer proposal addresses problems in only a very small percentage of transfers conducted by domestic banks.¹⁴⁶ Federal law enforcement officials generally estimate that drug trafficking generates between \$100 and \$150 billion in cash annually¹⁴⁷ and that "approximately 50-70% of this figure is available for laundering and investment."¹⁴⁸ To put these figures in perspective, JPMorgan, a leading provider of U.S. dollar-denominated payment and clearing services, explained that "in a single day [it] processes a dollar volume of legitimate funds transfers greater than the annual cash proceeds of illegal drug dealing in the United States."¹⁴⁹ Another industry member compared the task of finding a money-laundering transfer to "searching for tainted dollars that mathematically represent a grain of sand in the Sahara."¹⁵⁰

143. Chase Manhattan Comment, *supra* note 31, at 3.

144. Citicorp Comment II, *supra* note 70, at 3. For a discussion of specific law enforcement proceedings and the nature of the lead in each, see *Money Laundering*, *supra* note 83, at 160-65 (statement of Cliff E. Cook, Vice President and Compliance Officer, Puget Sound National Bank, speaking on behalf of the American Bankers Association).

145. *Money Laundering*, *supra* note 83, at 73 (statement of Cliff E. Cook, Vice President and Compliance Officer, Puget Sound National Bank, speaking on behalf of the American Bankers Association); see also Federal Reserve Comment, *supra* note 15, at 3-4 (distinguishing funds transfers from large cash transactions and noting that patterns of transfer activity for legitimate and illegitimate means appear similar).

146. For example, Citibank annually processes more than one million funds transfers, representing "a value of one trillion, seven hundred thirty-eight billion dollars." Citicorp Comment II, *supra* note 70, at 1.

147. JPMorgan Comment, *supra* note 28, at 3; see *Money Laundering*, *supra* note 83, at 90 (statement of Rep. Torres); Citicorp Comment II, *supra* note 70, at 3 (citation omitted).

148. See Citicorp Comment II, *supra* note 70, at 3; NYCH Comment, *supra* note 24, at 3.

149. JPMorgan Comment, *supra* note 28, at 3.

150. Citicorp Comment II, *supra* note 70, at 3.

In addition, funds transfer industry members generally agree that whole categories of funds transfers are not likely to be used in money laundering.¹⁵¹ Among these are transfers involving very small and very large dollar amounts,¹⁵² transfers on behalf of persons who are not customers of the bank,¹⁵³ transfers by regulated companies and their subsidiaries,¹⁵⁴ and transfers in which the beneficiary will receive the proceeds in cash.¹⁵⁵ Industry experts also consider transfers transmitted directly by non-bank senders to regional Federal Reserve Banks safe from money laundering because of the review undertaken by the Bank before permitting non-banks direct access to Fedwire.¹⁵⁶ As a consequence of these factors, the funds transfer proposal will affect millions of transfers that are not likely to involve money laundering.¹⁵⁷

151. The industry has offered support for its position that the vast majority of transfers are legitimate commercial payments. See *Drug Money Laundering Control Efforts*, *supra* note 31, at 74 (statement of NYCH President John F. Lee, summarizing a 1988 study by the Federal Reserve Bank of New York, which revealed that "approximately 42% of the dollar amount of our [CHIPS] payments are foreign exchange trades, 33% are Eurodollar placements [transactions in non-local currencies], and 25% are commercial, settlement and miscellaneous transactions [bank loans and Federal funds]").

152. NYCH Comment, *supra* note 24, at 18-19 (arguing as to large dollar transfers that drug industry is not highly concentrated, that it involves many small dealers and middlemen, and that prominent traffickers spread proceeds around to minimize losses from seizures). The comment argues for exemptions for transfers of less than \$10,000 or greater than \$10,000,000. *Id.*

153. BAI Comment, *supra* note 31, at 4 (arguing that most banks do not execute wires for non-customers, that banks that do will limit amounts transferred for non-customers, and that for beneficiaries engaged in money laundering and drug trafficking the "last thing they want is cash").

154. *Id.* at 8.

155. *Id.* at 4. The Institute observed that it is not clear why a beneficiary involved in drug trafficking or money laundering would wish to have the proceeds of the transfer in cash on the grounds that they already have huge amounts of surplus cash and that such beneficiaries are more likely to want the proceeds deposited in an account (a transaction already subject to Bank Secrecy Act recordkeeping or reporting requirements) or in a monetary instrument (also subject to recordkeeping or reporting depending on amount of monetary instrument purchased). See *id.* at 4, 11.

156. All senders that send payment orders directly to a regional Federal Reserve Bank for Fedwire must have that Reserve Bank's agreement before they can commence sending. See 12 C.F.R. § 210.30(a), 55 Fed. Reg. 40,805 (1990) (adoption of Uniform Commercial Code Article 4A for Fedwire transfers).

157. The comments suggested additional categories of exemptions that would reduce the burden of the funds transfer proposal. Principal among these were thresholds for recordkeeping at \$10,000 and \$10,000,000. Inst. of Int'l Bankers Comment, *supra* note 124, at 8 (arguing that a \$10,000 threshold for recordkeeping requirements would provide relief for financial institutions while not reducing law enforcement results); NYCH Comment, *supra* note 24, at 19 (suggesting that few money launderers would risk exposure of more than \$10,000,000). The Federal Reserve Board suggested that the planned exemption for bank-to-bank transactions would take roughly 50% of transfers outside the scope of regulation. Federal Reserve Comment, *supra* note 15, at 6.

2. Circumventing Aspects of Funds Transfer

Certain provisions of the funds transfer proposal could be circumvented easily. For example, although the proposal mandates that banks maintain extensive records of transfers, *users* of funds transfer services are not required to disclose complete and accurate information about the transfer,¹⁵⁸ nor will they incur liability for providing inaccurate or incomplete responses about the beneficial ownership of funds transferred or of funds received¹⁵⁹ or about the existence of separate payment instructions.¹⁶⁰ Moreover, the proposal requires only that banks inquire and record whatever response they receive from their customers. There is no reason to believe that money launderers would provide truthful information about persons on whose behalf they are acting and whose identity they are attempting to conceal.¹⁶¹ As a consequence of these and other factors,¹⁶² it is unclear what utility these provisions will offer.

In addition, money launderers need not use funds transfers at all. They can evade the new funds transfer requirements by restructuring their transactions and changing to payments by checks and drafts¹⁶³ or by shifting to offshore settlements.¹⁶⁴

Assuming significant changes to funds transfer formats to communicate more information about participants in funds transfers, one expert explained that “[t]here is no assurance that wire transfers originating in foreign countries will contain information sufficient to satisfy the [proposed] recordkeeping requirements.”¹⁶⁵ To the extent that money launderers are able to route their transactions through a series of transfers outside the United

158. *E.g.*, American Bankers Comment, *supra* note 25, at 6; Chase Manhattan Comment, *supra* note 31, at 3.

159. See 1990 Funds Transfer Proposal, *supra* note 8, at 41,703 (to be codified at 31 C.F.R. § 103.33(e)(1)(i)(E), (e)(1)(iii)(E)) (referred to elsewhere as “on-whose-behalf” information).

160. See *id.*

161. Federal Reserve Comment, *supra* note 15, at 11.

162. For example, the New York Clearing House questioned the utility of the “on-whose-behalf” provisions on the ground that the data recorded will not be reported to the federal government. NYCH Comment, *supra* note 24, at 13. The comment concluded that investigative leads would “continue to come to the government as they do today: from informants, undercover operations, and other traditional police techniques.” *Id.*

163. *Money Laundering Legislation*, *supra* note 10, at 71 (statement of Clyde H. Farnsworth, Jr., Director, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System).

164. *Drug Money Laundering Control Efforts*, *supra* note 31, at 9 (statement of Sen. D’Amato) (suggesting that the Bank of Japan is preparing its own funds transfer system for offshore clearing).

165. *Money Laundering Legislation*, *supra* note 10, at 16 (statement of Clyde H. Farnsworth, Jr., Director, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System); see BAI Comment, *supra* note 31, at 3 (arguing that transfers originating abroad often will lack some of the data required by the proposal).

States or through countries with strict bank secrecy laws to obscure ownership of the funds,¹⁶⁶ enhanced recordkeeping requirements for funds transfers involving domestic banks will not reduce the potential for circumvention of the detection system.¹⁶⁷

3. Retrieval of Information Imposes Significant Costs

Retrieval of information appears to be the paramount goal of the funds transfer proposal. The proposal would require that originators' banks have the capacity to retrieve records of funds transfers by the name of the originator of the transfer and the originator's account number, if applicable.¹⁶⁸ It would impose a similar duty on beneficiaries' banks in reference to the beneficiary's name and account number.¹⁶⁹ These requirements would necessitate considerable reorganization of the method in which the funds transfer industry in general, and banks in particular, store information about transactions.

Some industry members have questioned their capacity to retrieve information by the name of the originator or beneficiary, as opposed to retrieval by account number. Retrieval by name presents unique problems for banks. One commentator observed:

Since some names are quite common, it becomes difficult for banks to comply with a request by name alone.

. . . .
. . . . When law enforcement requests transfers under these provisions, the bank will initiate the search by verifying whether or not the individual is a customer. Assuming they are, most banks will be able to check the DDA (demand deposit account) activity listing for wire transactions. This list will direct the bank to the date and perhaps identifying number of all transactions. The materials will then be manually copied from daily files.¹⁷⁰

Another commentator noted that retrieval by the name of the sender or beneficiary "would not seem to be needed for the government to trace proceeds of illegal activities. All that is necessary for such tracing is to be able to identify the account into which illegal profits have been deposited and follow the money's trail from there."¹⁷¹ Still another commentator

166. See *supra* notes 76-77 and accompanying text.

167. Money launderers are unlikely to be deterred by the small additional expense and modest delays associated with additional layers of international funds transfers.

168. 1990 Funds Transfer Proposal, *supra* note 8, at 41,703.

169. *Id.*

170. BAI Comment, *supra* note 31, at 11 (discussing proposed 31 C.F.R. § 103.33(e)).

171. NYCH Comment, *supra* note 24, at 13 (discussing the requirements for on-behalf-of information).

suggested that retrieval by name would not be sufficient for tracing funds transfers.¹⁷²

4. General Utility Not Demonstrated

The funds transfer proposal also raises serious issues of general utility in light of the ease with which money launderers can find other avenues to wash their proceeds, the cumbersome process of obtaining records under existing Mutual Legal Assistance Treaties,¹⁷³ and other barriers to obtaining bank records from countries with strict bank secrecy laws.¹⁷⁴

Money launderers can select funds transfer methods that generate less information than others.¹⁷⁵ Additionally, money launderers are adept at locating the medium least likely to attract attention.¹⁷⁶ In a very brief period in the mid-1980s, they switched from cash deposits to cash purchases of monetary instruments, to smaller, "smurfed" cash deposits and purchases of instruments, to funds transfers, and, more recently, to funds transmittals.¹⁷⁷

Industry experts have suggested the possibility that the funds transfer proposal could have the effect of driving transactions—legitimate as well as money laundering—to offshore netting. One industry expert explained,

overly burdensome [reporting] requirements could drive transactions tied to money laundering into offshore clearing systems where they would be even more difficult to detect. These burdensome requirements could also drive legitimate transactions offshore as well. Networks have already been established in several foreign countries to facilitate the transfer of dollar-denominated payment.¹⁷⁸

172. Comment Letter from The Swiss Bankers Association to the Department of the Treasury 3 (Nov. 21, 1990) [hereinafter Swiss Bankers Comment] (arguing that without transaction dates there is little chance of finding useful information and that intermediary banks are unable to retrieve funds transfer data by the names of the originator or beneficiary, or by account numbers alone, even when these records are maintained).

173. For a thorough discussion of the status of Mutual Legal Assistance Treaties and of the processes necessary to obtain information, see Knapp, *Mutual Legal Assistance Treaties as a Way to Pierce Bank Secrecy*, 20 CASE W. RES. J. INT'L L. 405 (1988); Zagaris, *Developments in International Judicial Assistance and Related Matters*, 18 DEN. J. INT'L L. & POL'Y 339, 351-58 (1990).

174. See *supra* notes 76-77 and accompanying text.

175. For example, they may send key payment instructions separately as do some European banks. Republic Bank Comment, *supra* note 46, at 3.

176. See I. WALTER, *THE SECRET MONEY MARKET* 157-71 (1990).

177. Cf. *Money Laundering Legislation*, *supra* note 10, at 159 (statement of Rep. Saxton on funds transmittals and H.R. 4044, observing that money launderers "run from the light focused on the banks").

178. *Money Laundering Legislation*, *supra* note 10, at 72 (statement of Clyde H. Farnsworth, Jr., Director, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System); see JPMorgan Comment, *supra* note 28, at 4 (citing Federal Reserve Board Interim Policy Statement on Offshore Netting and Clearing Arrangements, 54 Fed. Reg. 26,092 (June 21, 1989)); NYCH Comment, *supra* note 24, at 6. Offshore branches of U.S. banks are not required to report cash transactions. 134 CONG. REC. S15,993 (daily ed. Oct. 14, 1988) (statement of Sen. Kerry).

Some evidence suggests that banking transactions move to the least-regulated and least-taxed jurisdictions.¹⁷⁹ Funds transfer industry members and experts worry that further increases in the flow of funds to offshore branches of U.S. banks would cost the U.S. banking industry substantial income and exchange business.¹⁸⁰ The Federal Reserve Board's staff also projected that the funds transfer proposal "could have adverse consequences for the competitive position of U.S. financial institutions and at the margin, for the attractiveness of the dollar as a vehicle for international payments."¹⁸¹

Other weaknesses in the proposal stem from misconceptions about the value of the proposed funds transfer records. The Treasury and federal law enforcement officials appear to assume that records of wire transfers would be as valuable as currency transaction reports.¹⁸² Funds transfer industry experts, however, question this assumption primarily because funds transfers are far less likely to involve face-to-face encounters between the bank and the customer than are currency transactions.¹⁸³ They also observe that even if funds transfer records would prove as useful as currency transaction reports, the former nevertheless will be far more numerous than the latter.¹⁸⁴

179. Terrel & Mills, *International Banking Facilities and the Eurodollar Market*, in EURO-DOLLARS AND INTERNATIONAL BANKING 183, 199 (P. Savona & G. Sutija eds. 1985). The authors explain that international banking facilities and Eurodollar transactions are important sources of revenue for U.S. banks because they can pay higher rates of interest due to their freedom from reserve requirements and deposit insurance premiums. They also describe a dramatic rise generally in the business of U.S. banks in offshore banking centers and especially in the deposits in the Bahamas and the Cayman Islands. *Id.* at 183; see also I. WALTER, *supra* note 176, at 160 (Figure 6.1—U.S. bank liabilities to Latin America and the Caribbean, 1970, 1975, 1980-85) (revealing especially large increases in bank liabilities to the Cayman Islands and the Bahamas).

180. See *Money Laundering in Florida*, *supra* note 2, at 111 (statement of Peter R. Fowler, Vice President, Barclays Bank, PLC, Miami); Chase Manhattan Comment, *supra* note 31, at 2.

181. *Money Laundering Legislation*, *supra* note 10, at 17 (statement of Clyde H. Farnsworth, Jr., Director, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System); see NYCH Comment, *supra* note 24, at 5.

182. See *Money Laundering Legislation*, *supra* note 10, at 69-70 (statement of Clyde H. Farnsworth, Jr., Director, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System); *Money Laundering in Florida*, *supra* note 2, at 62-63, 68-69 (statements of Rep. Shaw, Merlin Heye, District Director, I.R.S. Ft. Lauderdale District, Sen. Graham, and Charles Saphos, Chief, Narcotics and Dangerous Drugs Section, Criminal Division, U.S. Department of Justice); Federal Reserve Comment, *supra* note 15, at 3-5.

183. *E.g.*, Bank of Oklahoma-Tulsa Comment, *supra* note 136, at 13; NYCH Comment, *supra* note 24, at 13.

184. Under the funds transfer proposal, assuming the current volumes of funds transfers, the industry would be required to make records of roughly 100 million transfers. See Federal Reserve Comment, *supra* note 15, at 6, 9. By contrast, banks and other businesses file about 7 million currency transaction reports annually. MONEY LAUNDERING TASK FORCE, *supra* note 1, at S5556. Industry experts anticipate that funds transfers will become far more numerous, as corporate dividend and interest payments, municipal bond interest payments, and bond redemptions become payable in federal funds in 1992. SIA Comment, *supra* note 135, at 3.

Additionally, they point out that law enforcement agencies have underutilized currency transaction reports because of their large volume and the agencies' staffing problems.¹⁸⁵ For this reason, funds transfer industry members express concern that if the proposal were to be adopted it would generate records that law enforcement agencies will not be capable of processing.¹⁸⁶

The Board of Governors of the Federal Reserve System also questioned the utility of the additional records required by the proposal. The Board's comment letter explained that:

the pattern of funds transfers for much legitimate activity is likely to be similar to the pattern of funds transfers for illegitimate activity. For example, a legitimate business managing its cash position carefully is likely to draw down its deposits promptly and concentrate the funds in a few locations for investment or disbursement purposes. Many legitimate businesses will have legitimate reasons for regularly transferring funds overseas, to make either payments or investments. Foreign transfers may be particularly frequent and commonplace for those businesses investing in the Eurodollar markets or in foreign currencies. Similarly, a money launderer is likely to remove the proceeds of deposits from accounts quickly, concentrate them at one or more concentration points and thereafter transfer the funds overseas where they can be concealed more readily and where they may be more difficult for United States law enforcement agencies to reach.¹⁸⁷

5. Information Already Recorded

The funds transfer industry at this point already records and retains the data that would be required by the proposed regulation,¹⁸⁸ with the exception of those types of information not communicated in standard funds transfer formats.¹⁸⁹ The industry¹⁹⁰ as well as the Federal Reserve Board¹⁹¹ apparently

185. See *Money Laundering Legislation*, *supra* note 10, at 55 (the Internal Revenue Service's Detroit Center reviews incoming currency transaction reports (CTR) within 33 days of receipt); *Money Laundering in Florida*, *supra* note 2, at 76 (statement of Gerald Lewis, Florida Comptroller); *Drug Money Laundering Control Efforts*, *supra* note 31, at 35 (statement of Timothy D. Mahoney, Director of Special Investigations Division, New York State Dept. of Banks).

186. See Citicorp Comment I, *supra* note 86, at 2; Inst. Int'l Bankers Comment, *supra* note 124, at 10.

187. Federal Reserve Comment, *supra* note 15, at 3-4; see also *Drug Money Laundering Control Efforts*, *supra* note 31, at 74 (statement of John H. Lee, President, New York Clearing House Association) (describing appearance of CHIPS transfers as consolidations).

188. BAI Comment, *supra* note 31, at 2 (citing existing Bank Secrecy Act requirements affecting the industry's existing recordation and retention policies); *Money Laundering in Florida*, *supra* note 2, at 129 (statement of Peter R. Fowler, Vice President, Barclays Bank, PLC, Miami).

189. See *supra* notes 37-43 and accompanying text; see American Bankers Comment, *supra* note 25, at 1, 8, 16; Chase Manhattan Comment, *supra* note 31, at 4.

190. E.g., JPMorgan Comment, *supra* note 28, at 2; NYCH Comment, *supra* note 24, at 4.

191. Federal Reserve Comment, *supra* note 15, at 5.

considers the existing information—whether required by current Bank Secrecy Act regulations or by banks' internal procedures—sufficient for purposes of creating trails of funds transfers. A number of commentators suggest that making an effort to bring all members of the industry into compliance with *existing* regulations would be more productive than imposing *new* requirements on the industry as a whole.¹⁹² Commentators instead suggest that law enforcement personnel could use existing records at a far smaller cost than the costs anticipated in connection with the proposal.¹⁹³

III. ALTERNATIVE SOURCES OF INFORMATION · USEFUL TO LAW ENFORCEMENT AGENCIES

Assuming that the Treasury's goals in the funds transfer proposal are uniformity of information and ease of retrievability, the question arises whether another mechanism exists for satisfying those goals that would not impose as large a regulatory burden on the funds transfer industry. This Article asserts that information comparable to that sought by the funds transfer proposal is or soon will be generated as the funds transfer industry in the United States adapts itself to the requirements of Uniform Commercial Code Article 4A,¹⁹⁴ to the substantial adoption of Article 4A for Fedwire transactions that became effective on January 1, 1991,¹⁹⁵ and to the expansion of the CHIPS message format anticipated by mid-1992.¹⁹⁶ In addition, this Article argues for increased enforcement of existing bank secrecy requirements in lieu of new regulations. Finally, it calls for greater reliance on banks' knowledge of their customer bases to identify suspect transfers.¹⁹⁷

A. Information Likely to Flow from Article 4A

Prior to the adoption of Article 4A, no comprehensive body of law existed for funds transfers.¹⁹⁸ Rather, rules of the principal funds transfer

192. E.g., BAI Comment, *supra* note 31, at 2.

193. E.g., Federal Reserve Comment, *supra* note 15, at 5.

194. U.C.C. Article 4A (1991). Twenty-eight states, including New York, have adopted Article 4A. See *supra* note 18 and accompanying text. Because New York law governs CHIPS transactions, New York's adoption significantly increases the number of funds transfers subject to Article 4A.

195. 12 C.F.R. § 210 (1991).

196. NYCH Comment, *supra* note 24, at 16.

197. Many U.S. and foreign banks have adopted procedures, known in banking circles as "know your customer" standards, to identify patterns of suspicious activity. In December 1988, the Basle Committee on Banking Regulations and Supervisory Practices (Basle Committee) endorsed "know your customer" standards as one of the best means of curtailing money laundering through banks. OCC Banking Circular 227, *supra* note 100, at ¶ 11,635; see Swiss Bankers Comment, *supra* note 172, at 2. For an explanation of the functions of the Basle Committee, see *infra* note 245.

198. U.C.C. Article 4A Prefatory Note; see also Ballen & Diana, *The Need for Article 4A*, 45 Bus. Law. 1399 (1990).

systems (such as CHIPS and Fedwire) governed transfers made through those systems,¹⁹⁹ while operating rules of regional clearing house associations, Federal Reserve System rules, and operating circulars applied to transfers made outside of Fedwire and CHIPS.²⁰⁰ Contracts between banks and their customers covered other, but not all, aspects of funds transfers.²⁰¹ The chief goals of the authors of Article 4A were to provide a comprehensive body of law for funds transfers and, in particular, to remove "uncertainty" about the "juridical nature of a wire transfer and consequently of the rights and obligations that are created."²⁰²

Article 4A establishes the first industry-wide set of rules for resolving critical disputes that may arise in funds transfers. For example, Article 4A, *inter alia*, addresses (1) the responsibility for unauthorized, erroneous, or erroneously executed funds transfers;²⁰³ (2) the risk of loss associated with the insolvency of a bank handling a funds transfer; (3) the responsibility to pay for and the right to receive payment for funds transfers; and (4) the effect of payment by funds transfer on any contractual obligation between an originator and a beneficiary. In so doing, Article 4A also provides for common understanding of concepts such as "acceptance" (the point at which the beneficiary's bank becomes obligated to the beneficiary to pay the amount of the payment order),²⁰⁴ for resolving bank errors in funds transfers, and for allocating losses for unauthorized payment orders. These

199. See U.C.C. § 4A-501 official comment 1:

Funds-transfer system rules . . . cover a wide variety of matters such as form and content of payment orders, security procedures, cancellation rights and procedures, indemnity rights, compensation rules for delays in completion of a funds transfer, time and method of settlement, credit restrictions with respect to senders of payment orders and risk allocation with respect to suspension of payments by a participating bank.

Id.

200. *Id.* Section 4A-107 expressly provides that "[r]egulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency." U.C.C. § 4A-107.

201. U.C.C. Article 4A Prefatory Note ("Why is Article 4A Needed?"); see Ballen & Diana, *supra* note 198, at 1399 ("[T]here often are no agreements between the parties to a wholesale wire transfer, or such agreements do not address all of the necessary issues."); Scott, *supra* note 29, at 1668.

202. U.C.C. Article 4A Prefatory Note.

203. These issues are addressed by a number of provisions of Article 4A. *E.g.*, U.C.C. §§ 4A-202 ("Authorized and Verified Payment Orders"), 4A-203 ("Unenforceability of Certain Verified Payment Orders"), 4A-207 ("Misdescription of Beneficiary"), 4A-302 ("Obligations of Receiving Bank in Execution of Payment Order"), 4A-303 ("Erroneous Execution of Payment Order"), and 4A-305 ("Liability for Late or Improper Execution or Failure to Execute Payment Order"). In addition, section 4A-304 imposes a duty on the sender to report erroneously executed payment orders. Section 4A-204 imposes a similar duty on the sender in the event of unauthorized payment orders. As a consequence of these provisions, parties to a funds transfer subject to Article 4A have substantial incentives for maintaining precise records relating to the payment orders sent and received.

204. U.C.C. § 4A-209.

comprehensive laws facilitate standardized resolution of disputes involving portions of the funds transfer handled by different funds transfer systems.²⁰⁵ As a consequence, Article 4A offers to the funds transfer industry a number of incentives for better recordkeeping, in particular, in the forms of more frequent or expanded written agreements between banks and their customers and of records demonstrating that the bank has complied with any security procedure that the bank and customer may have established. Each of these characteristics of Article 4A touches on a key concern in the Treasury's proposal.

Article 4A is likely to increase the number of written agreements between banks and their customers or to expand the scope of existing written agreements. In the customary funds transfer, the "originator"²⁰⁶ of the payment order is known to the "receiving bank"²⁰⁷ because the bank acts for an account holder.²⁰⁸ As previously described, originators fall into three categories. The first category includes those who use the wire service infrequently or who have had no prior wire transactions and from whom the bank has a written payment order or a record of a payment order transmitted by telephone. The common point in these transactions is the requirement that the bank assure itself that it is acting for the account holder as the owner of the funds.²⁰⁹ Customers in the second category of originators frequently use funds transfers in their business. Banks may have standing orders from them that may or may not be reduced to contracts,²¹⁰ together with corporate resolutions listing employees authorized to send payment orders²¹¹ and separate lists of creditors that the customers expect

205. It is possible for a domestic funds transfer to involve more than one of the major funds transfer systems. For example, in a transfer in which some of the banks are not participants in Fedwire, the sender may communicate with its bank (the receiving bank) by means of a local clearing house (a funds transfer system). The receiving bank (now designated the originator's bank) in turn communicates with an intermediary bank by means of Fedwire (itself a funds transfer system); and the intermediary bank communicates with the beneficiary's bank by means of another local clearing house.

206. U.C.C. § 4A-104(d). Section 4A-103(a)(5) defines "sender" as "the person giving the instruction to the receiving bank." There is only one "originator" in a funds transfer, but there may be a number of "senders" as the transfer moves through the series of separate payment orders necessary to effect the original instruction.

207. U.C.C. § 4A-103(a)(4) defines "receiving bank" as "the bank to which the sender's instruction is addressed."

208. This account relationship caused a number of comments on the funds transfer proposal to question the necessity of obtaining "on-whose-behalf" information from the majority of the senders of funds transfers. *E.g.*, American Bankers Comment, *supra* note 25, at 9; BAI Comment, *supra* note 31, at 7; *cf.* Republic Bank Comment, *supra* note 46, at 1 (questioning the feasibility of the requirements for "on-whose-behalf" information).

209. *See* BAI Comment, *supra* note 31, at 7.

210. U.C.C. § 4A-203 official comment 3.

211. BAI Comment, *supra* note 31, at 7. The Institute observed that "[a]lthough the person conducting the transaction may not be the beneficial owner of the account, a list of all authorized individuals is already a matter of bank recordkeeping." *Id.*

to pay by funds transfers.²¹² In these cases, the customer may deliver a magnetic tape containing numerous payment orders that the bank may retain as support for the transfers. Customers in the third category of originators make heavy use of wire transfers and consequently have automated access to the funds transfer functions within the bank.²¹³ Banks thoroughly scrutinize the customers who are allowed automated access.²¹⁴

It is in the area of electronic transmission of payment orders that Article 4A supplies rules that could achieve many of the benefits expected from the funds transfer proposal. For customers who are eligible to transmit their payment orders electronically, banks' "normal practice is to establish security procedures that usually involve the use of codes or identifying numbers or words."²¹⁵ Article 4A encourages banks to establish security procedures by binding the customer to pay payment orders that "purport[] to be that of its customer after verifying its authenticity by complying with a security procedure agreed to by the customer and the bank" even if the orders were not authorized.²¹⁶ In addition, should the bank accept an unauthorized payment order without verifying it in compliance with the security procedure, any loss would fall on the bank.²¹⁷ Security procedures under Article 4A must be established by agreement between a customer and a receiving bank.²¹⁸ The procedure may be for the purpose of "(i) verifying that a payment order or communication amending or cancelling a payment order is that of the customer, or (ii) detecting error in the transmission or the content of the payment order or communication."²¹⁹ The procedure may consist of "the use of algorithms or other codes, identifying words or numbers, encryption, callback procedures, or similar security devices."²²⁰

212. U.C.C. § 4A-203 official comment 3; see BAI Comment, *supra* note 31, at 7.

213. BAI Comment, *supra* note 31, at 7.

214. *Id.* The Institute explained that banks conduct reviews of prospective automated-access customers that are "no less thorough than the review performed on customers who are placed on the [currency transaction report] exemption list." *Id.* (suggesting that there is less need to expend additional effort to identify the person "on-whose-behalf" the transfer is being made in this category of transfers than there would be for persons who rarely use funds transfer services or for persons who are not regular customers of the bank making the transfer).

215. U.C.C. Article 4A Prefatory Note ("Unauthorized Payment Orders").

216. *Id.* (describing U.C.C. § 4A-203). The Prefatory Note explains that the bank must establish that the security procedure was

a commercially reasonable method of providing security against unauthorized payment orders. The customer can also avoid liability if it can prove that the unauthorized order was not initiated by an employee or other agent of the customer having access to confidential security information or by a person who obtained that information from a source controlled by the customer.

Id.

217. *Id.*

218. U.C.C. § 4A-201.

219. *Id.*

220. *Id.* The section also provides that "[c]omparison of a signature on a payment order or communication with an authorized specimen signature of the customer is not by itself a security procedure." *Id.*

The term "security procedure" "does not apply to procedures that the receiving bank may follow unilaterally in processing payment orders."²²¹

Ordinarily, each payment order is transmitted electronically and individually. The receiving bank will apply a testing procedure to each payment order. Customers that make multiple funds transfers may deliver them to their banks through an automated clearing house. In these cases, the customer delivers an electronic device, such as a magnetic tape, which carries many payment orders. The automated clearing house in turn delivers the tape or other device to the bank. Although each instruction qualifies as an individual payment order,²²² it is not considered feasible to test each of the individual payment orders contained on the tape.²²³

Under Article 4A, payment orders are effective against the customer if the receiving bank can prove (1) that it and its customer agreed that the bank would verify payment orders in accordance with a security procedure, (2) that the security procedure is a commercially reasonable method²²⁴ of proving security against unauthorized payment orders, and (3) that it accepted the payment order "in good faith and in compliance with the security procedure and any written agreement or instruction of the customer restricting acceptance of payment orders issued in the name of the customer."²²⁵ As a consequence of these steps required to bind the customer, receiving banks have substantial incentives to (1) enter into written agreements establishing security procedures with their funds transfer customers, (2) maintain records that reflect their application of the agreed security procedure prior to executing the payment order in issue,²²⁶ and (3) maintain records demonstrating that the customer selected the security procedure, and showing, where applicable, that the customer "expressly agreed in writing" to be

221. U.C.C. § 4A-201 official comment.

222. U.C.C. § 4A-103(b).

223. U.C.C. § 4A-203 official comment 4.

224. To determine whether the security procedure is "commercially reasonable," section 4A-202(c) looks to:

the wishes of the customer expressed to the bank, the circumstances of the customer known to the bank, including the size, type, and frequency of payment orders normally issued by the customer to the bank, alternative security procedures offered to the customer, and security procedures in general use by customers and receiving banks similarly situated.

Id. Security procedures are deemed to be commercially reasonable if:

(i) the security procedure was chosen by the customer after the bank offered, and the customer refused, a security procedure that was commercially reasonable for that customer, and (ii) the customer *expressly agreed in writing to be bound by any payment order*, whether or not authorized, issued in its name and accepted by the bank *in compliance with* the security procedure chosen by the customer.

Id. (emphasis added).

225. U.C.C. § 4A-202(b) ("Authorized and Verified Payment Orders").

226. The necessity of proving use of the security procedure—a function the industry calls "testing"—should cause receiving banks that were not retaining any response to the test from the sender to begin retaining them.

bound.²²⁷ In addition, the Official Comment to section 4A-203 explains, "Given the large amount of the typical payment order, a prudent receiving bank will be unwilling to accept a payment order unless it has assurance that the order is what it purports to be. This assurance is normally provided by security procedures described in Section 4A-201."²²⁸

Security procedures also play an important role in resolving errors in the transmission of payment orders. Under Article 4A, if the bank agrees to a security procedure for the detection of error and fails to comply with the procedure, the bank bears "any resulting loss."²²⁹ Section 4A-205 describes situations involving erroneous payment orders in which the sender is not obligated to the bank.²³⁰ In each case, the sender's obligation turns on whether the receiving bank can prove its compliance with the security procedure established by the customer and the receiving bank. In addition, section 4A-205(b) places the loss on the sender only in cases in which the bank can prove the sender received notice of the bank's acceptance of the payment order²³¹ and failed to discover the error and to report it "within a reasonable time, not exceeding 90 days."²³² Section 4A-501 permits banks and their customers to vary by agreement the bank's liability for failing to detect an error.²³³

Security procedures, whether designed to detect unauthorized payment orders or to detect erroneous payment orders, may facilitate identifying those funds transfers that fall outside the sender's transfer pattern. For example, security procedures may reveal sudden increases in the amounts transferred, in funds transfers to banks in so-called tax-haven countries, or in funds transfers to new beneficiaries or beneficiaries outside the United States.²³⁴ In addition, some security procedures are designed to "detect an account number that is not one to which [the] [s]ender normally makes payment. In that case, the security procedure may require a special verifi-

227. U.C.C. § 4A-202(c).

228. U.C.C. § 4A-203 official comment 1.

229. U.C.C. Article 4A Prefatory Note ("Unauthorized Payment Orders"). Banks are not obligated to agree to special security procedures to detect errors in transmission. *Id.*

230. U.C.C. § 4A-205.

231. "Acceptance" by the receiving bank carries a duty to "execute" (that is, to transmit the payment order to the next bank in sequence and to pay if the beneficiary's bank in turn accepts the payment order). U.C.C. § 4A-209(a) & official comment 1; *see also* U.C.C. § 4A-302(a)-(c) ("Obligations of Receiving Bank in Execution of Payment Order").

232. U.C.C. § 4A-205(b). In these cases, the sender's liability is limited to the loss that the bank proves it suffered as a result of the sender's failure to report the error. *Id.*

233. U.C.C. § 4A-501 ("Variation by Agreement and Effect of Funds-Transfer System Rule").

234. A list of authorized beneficiaries alone would be useful in establishing the trail of laundered monies because it facilitates understanding of the regular business habits of the bank's customer and also identifies transfers (whether in amount or beneficiary) that fall outside previously established patterns. *See* Federal Reserve Comment, *supra* note 15, at 5.

cation that payment to the stated account number was intended."²³⁵ Other potential uses exist for security procedures that would assist in identifying suspicious transactions from funds transfer records likely to be retained by receiving banks. For example, a customer may

prohibit the bank from accepting a payment order that is not payable from an authorized account, that exceeds the credit balance in specified accounts of the customer, or that exceeds some other amount. . . . Such limitations may be incorporated into the security procedure itself or they may be covered by a separate agreement or instruction.²³⁶

To the extent that such restrictions form the agreements between the sender and receiving bank, Article 4A may encourage their reduction to written contracts that can be used to assist law enforcement officials in tracing drug proceeds.

Among the other incentives for enhanced recordkeeping are Article 4A's rules imposing interest for delayed transfers. For example, section 4A-210(b) imposes interest on a receiving bank, other than a beneficiary's bank, that fails to execute a payment order despite the availability of funds in the sender's account sufficient to cover the transfer.²³⁷ If the sender does not receive notice of the rejection of the payment order and if the account that was to be debited does not bear interest, the receiving bank is obligated to the sender for interest on the amount of the order.²³⁸ Pursuant to this provision, the receiving bank will maintain records of the execution date and the date it gave any notice of rejection to the sender. Additionally, because the only remedy available to a receiving bank that executes an unauthorized payment order is to recover from the person who received payment,²³⁹ it is likely that receiving banks will retain all information about the named beneficiary from the payment orders they execute.

Because of the size of many wholesale wire transfers, Article 4A encourages banks and their customers to negotiate the level of security procedure desired by the customer, assuming that it is consistent with the capacity of the bank. Customers who send many payment orders or whose orders are for larger sums may ask for more secure communications and more extensive testing of their payment orders than they otherwise would require.²⁴⁰

B. Fedwire's Adoption of Article 4A

The Federal Reserve System recently amended Regulation J to incorporate Article 4A for funds transfers through Fedwire.²⁴¹ This amendment

235. U.C.C. § 4A-205 official comment 1.

236. U.C.C. § 4A-203 official comment 3.

237. U.C.C. § 4A-210(b).

238. Section 4A-210(b) establishes the formula for interest to be paid to the sender under this circumstance.

239. U.C.C. § 4A-203 official comment 1.

240. See U.C.C. § 4A-203 official comment 3.

241. 12 C.F.R. § 210 (1991).

significantly expands the number of transfers for which the market will demand enhanced recordkeeping because Regulation J applies to transactions involving Federal Reserve Banks in states that have not yet adopted Article 4A.²⁴² Any new contracts and transaction records resulting from the incorporation of Article 4A into Regulation J will augment the Federal Reserve System's existing capacity to provide detailed information on currency flows and funds transfers to law enforcement agencies.²⁴³ Accordingly, the amount of information potentially available to law enforcement agencies currently is significantly greater than it was when the funds transfer proposal first was announced two years ago.

C. Expanded Message Format for CHIPS Transfers

Assuming that CHIPS completes the revision of its message format by mid-1992, information about CHIPS funds transfers will increase. To the extent that the funds transfer proposal would require information in addition to that provided for in the CHIPS revision, the format would have to be changed again,²⁴⁴ as would computer capacity, training, and storage. This,

242. *Id.*

243. The Federal Reserve System has the capacity to make detailed reports on the movements of cash within Federal Reserve Board regions and from the United States to foreign countries. For example, the Federal Reserve System can reveal foreign countries with surpluses in United States dollars. This data has been used in the past by federal law enforcement officials to focus their investigations of drug and arms trafficking. See 136 CONG. REC. H1706, H1706 (daily ed. Apr. 25, 1990) (statement of Rep. Levine). In addition, the Federal Reserve System can identify local banks that may be violating currency transaction reporting requirements by comparing the numbers of bills of certain values in the bank's possession against the amounts known to be in circulation in that Federal Reserve district. Information of this type has led federal and state investigators to Texas and Florida banks involved in money laundering. H. REP. NO. 446, *supra* note 13, at 19. A Federal Reserve Board official testified before Congress that the Board's computers were capable of generating data on the movement of currency "at any level of detail" necessary for law enforcement purposes and that the Board makes currency surplus data reports available to federal enforcement agencies. *Money Laundering Legislation*, *supra* note 10, at 73 (statement of Clyde H. Farnsworth, Jr., Director, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System).

In addition to information about currency movements, the Federal Reserve System employs "type codes" to distinguish between "on-line" and "offline" beneficiaries' banks participating in Fedwire funds transfers. 12 C.F.R. § 210.29 (1991) (commentary in Appendix A). At this time, however, it cannot distinguish between transactions in which the offline bank is the beneficiary of the payment order and those in which it is the beneficiary's bank for another bank. *Id.* It also can distinguish between "customer transfers" and bank transfers. *Drug Money Laundering Control Efforts*, *supra* note 31, at 124 (statement of Joseph B. H. Madison, Joseph Madison Associates, Inc., Lanesborough, Mass.).

244. The current format changes have taken more than two years to complete. See *Drug Money Laundering Control Efforts*, *supra* note 31, at 75 (statement of John F. Lee, President of New York Clearing House Association) (discussing attempts at alterations in the CHIPS format to allow for more information and describing the status of the work as of November 1989).

accordingly, would raise significantly the burdens of meeting the proposal's requirements.

D. Increased Enforcement of Existing Bank Secrecy Act Requirements for Funds Transfers

In addition to the data relating to funds transfers that are likely to be generated by Article 4A, Fedwire, and CHIPS, the greatest source of information about money laundering through funds transfers is in existing records of funds transfers. Many commentators on the funds transfer proposal called for increased enforcement of existing bank secrecy requirements in lieu of additional regulations.²⁴⁵

Commentators also advocated increased reliance on banks' knowledge of their customers and their banking habits. National banks, for example, are required to set up internal procedures through which they can scrutinize transactions and report suspicious activity to law enforcement agencies.²⁴⁶ These internal procedures are known in the banking industry as "know your customer" standards.

Banking experts have focused on the "know your customer" standards as a key means of identifying illegal transactions such as money laundering. In December, 1988, the Basle Committee on Banking Regulations and Supervisory Practices promulgated a "Statement of Principles" on the "Prevention of Criminal Use of the Banking System for the Purpose of Money-Laundering."²⁴⁷ The statement also called for wider use of "know your customer" standards and for specific additions to those standards.²⁴⁸ Members of the United States banking and funds transfer industries have called upon the Treasury, the Office of the Comptroller of the Currency, and the Federal Reserve Board to promulgate more detailed "know your customer" standards to aid U.S. banks and other financial institutions in

245. E.g., Chase Manhattan Comment, *supra* note 31, at 3. For a discussion of existing requirements, see *supra* notes 94-101 and accompanying text.

246. *Money Laundering Through Wire Transfers*, Advisory Letter 88-5, 1 Fed. Banking L. Rep. (CCH) ¶ 11,781 (Oct. 26, 1988); see 12 C.F.R. § 21.11 (1991); OCC Banking Circular 227, *supra* note 100, at ¶ 11,635.

247. The "Statement of Principles" is modeled after an agreement between the Swiss National Bank and the Swiss Bankers Association originally concluded in 1977 and amended in 1987. Swiss Bankers Comment, *supra* note 172, at 3. The Office of the Comptroller of the Currency circulated the Statement of Principles to all national banks. *Statement of Principles*, OCC Banking Circular 231, 1 Fed. Banking L. Rep. (CCH) ¶ 11,785 (Jan. 9, 1989). The FDIC circulated the Statement to all FDIC banks and savings and loan associations. *Statement of Principles on Money Laundering Practices*, FDIC BL-1-89, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 87,562 (Jan. 27, 1989).

248. *Statement of Principles*, OCC Banking Circular 231, *supra* note 247, at ¶ 11,785.

identifying money-laundering transactions.²⁴⁹ In connection with the funds transfer proposal, one industry expert explained why the "know your customer" approach was preferable to more recordkeeping:

Money laundering deterrence that probes beyond cash entering the financial system, what we call secondary laundering, is harder to control by reporting or recordkeeping. In fact, secondary laundering is probably only detectable through a comprehensive "know your customer" program, where the bank understands both a customer's source of cash and their normal business activity for the disposition of funds. Other than through information derived from adequate "know your customer" procedures, banks find that there is nothing inherently suspicious about a check, a wire transfer or an [automated clearing house] transaction drawn on collected funds. It appears, therefore, that the quick and easy traceability of criminal proceeds is the primary law enforcement objective of this proposed regulation. We imagine that law enforcement would also prefer that regulations governing the wire transfer function make money launderers less likely to use the wire system, and that if the system is used, that transfers of criminal proceeds are more likely to be detected. Without addressing "know your customer" standards, these proposed regulations do not address these goals.²⁵⁰

To the extent that the Treasury and the federal bank regulatory agencies can develop profiles of transfers that are inherently suspect, they can enhance significantly the value of whatever records that banks ultimately will be required to keep by narrowing the number of accounts or records of account activity for evaluation.²⁵¹

IV. RECOMMENDATIONS

The Treasury's funds transfer proposal reflects a number of flaws inherent in its exercise of its regulatory authority under the Bank Secrecy Act.

249. See BAI Comment, *supra* note 31, at 2 (The Comment called for the funds transfer proposal to address "know your customer" standards on the grounds that without knowledge of the customer, "there is nothing inherently suspicious about a check, a wire transfer, or an [automated clearing house] transaction drawn on collected funds."); see also *Money Laundering*, *supra* note 83, at 169 (statement of Cliff E. Cook, Vice President and Compliance Officer, Puget Sound National Bank, speaking on behalf of the American Bankers Association) ("[T]he key reporting goal is the time-honored 'know your customer' standard.").

250. BAI Comment, *supra* note 31, at 2.

251. Of course, any reduction in the numbers of accounts or transfers subject to record-keeping assists both the law enforcement agencies that must review records and the banks and other financial institutions that otherwise have to capture, record, and maintain records and respond to requests for information about those accounts. *But see Money Laundering Enforcement Amendments of 1991 (H.R. 26): Hearing on H.R. 26 Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs, 102d Cong., 1st Sess. 9 (1991) [hereinafter Money Laundering Enforcement Amendments of 1991]* (statement of Peter K. Nunez, Assistant Secretary for Enforcement, Department of Treasury, opposing issuance of guidelines as too useful to money launderers).

Among the most problematic aspects of the funds transfer proposal is its failure to consider the technological state of the industry and the nature of the majority of transfers conducted through the system. As a result, the Treasury seeks to restructure the industry to obtain information that is largely available in other forms and that will be of questionable utility because of foreign bank secrecy laws. The Treasury shows no consideration of the substantial (initial and ongoing) costs of creating more readily retrievable data for the minimal percentage of transfers processed annually through the United States system that actually involve money laundering. As one commentator explained, it is not accurate to describe the proposal as "enhanced recordkeeping" when it calls for the acquisition of completely new information not currently in the bank's possession, a task entailing significant additional cost.²⁵²

Another flaw of the proposal is the manner of its preparation: the Treasury did not conduct a Regulatory Impact Analysis²⁵³ as it formulated the proposal.²⁵⁴ As a consequence, the Treasury did not address the basic implementation costs or risks to domestic banks in terms of loss of income from customers currently using funds transfers as a large-dollar payment mechanism and other risks such as the attendant danger to the country's currency position and of the likelihood of increasing offshore netting and clearing arrangements. While the proposal, along with other recent regulation under the Bank Secrecy Act, demonstrates the zeal with which the United States government wishes to pursue those who traffic in drugs and those who aid them in concealing their identities and profits, law enforcement and regulatory agencies appear to have assumed that the benefits of each regulation proffered as part of the overall antidrug strategy would exceed the costs. The banking industry has seemed unwilling to challenge

252. Comment Letter from National Westminster Bank USA to the Department of the Treasury 3 (Jan. 17, 1991).

253. A Regulatory Impact Analysis is required under Executive Order 12,291 for every "major rule." Exec. Order No. 12,291, 3 C.F.R. § 127 (1982), *reprinted in* 5 U.S.C. § 601, at 473 (1988).

254. In the 1990 Funds Transfer Proposal, the Treasury explained that because commentators on the 1989 Advance Notice of Proposed Rulemaking did not demonstrate that that proposal would cost more than \$100 million to implement the Treasury did not perform a Regulatory Impact Analysis on the revised proposal. 1990 Funds Transfer Proposal, *supra* note 8, at 41,702. This approach ignores the vast differences between the 1989 Advance Notice and the 1990 Funds Transfer Proposal in terms of the scope and the amount of technological change that industry members estimate would be necessary to implement the revised proposal.

The Bank Association for Foreign Trade (BAFT) conducted a cost analysis of the proposal, which it submitted to the Treasury. BAI Comment, *supra* note 31, at 5 n.2. Banks and non-bank financial institutions see the Treasury's failure to evaluate the costs and benefits of the proposal as a major issue in the proceeding. *See* American Express Comment, *supra* note 14, at 2-3; Citicorp Comment II, *supra* note 70, at 6.

them on this issue.²⁵⁵ Accordingly, the United States government has not hesitated to impose additional burdens on the banking industry,²⁵⁶ an industry that it perceived (perhaps appropriately) as making huge profits from deposits held by money launderers.²⁵⁷ It was not until the spate of proposals in 1989 and 1990²⁵⁸ that the banking industry began to voice major objections to additional bank secrecy regulations.

If the burdens of the Treasury's funds transfer proposal exceed the benefits that it would produce for law enforcement purposes, it is time to consider what alternatives exist for policing money laundering through financial institutions and, in particular, for investigating money laundering through funds transfers.²⁵⁹ This Article describes new incentives for the creation of records and contracts and highlights the increase in data about funds transfers that will be generated as Article 4A comes into effect.²⁶⁰ These records and contracts would reach some of the more significant issues identified in the funds transfer proposal, such as the identity of the beneficial owners of the funds transferred.²⁶¹ In addition, to the extent that the Fedwire regulations²⁶² now follow Article 4A's definitions of key terms such as

255. Judging from the comments on the funds transfer proposal, banks have seen a great risk in opposing the burdens of regulation under the Bank Secrecy Act. *E.g.*, Republic Bank Comment, *supra* note 46, at 1. Banks' overall reaction suggests their belief that challenging any regulation under the Bank Secrecy Act is tantamount to opposing the proverbial "mothhood and apple pie."

256. See *supra* notes 86-87 and accompanying text.

257. See generally I. WALTER, *supra* note 176, at 161, 167, 245 (1990) (describing, inter alia, Eduardo Orozco Prada, who deposited more than \$150 million in cash in approximately 18 banks and foreign currency firms primarily in New York, and transferred it to Panama, the Cayman Islands, the Bahamas, and accounts throughout the U.S.; Latin couriers who deposited bags of bills in small denominations in Florida banks, known as "Coin-O-Wasters;" and 1,163 currency transactions totalling \$1.22 billion in which Bank of Boston had participated without filing currency transaction reports); *How Bankers Lent a Hand to Money Laundering Schemes*, Am. Banker, Feb. 15, 1985, at 4, col. 1.

258. See *supra* notes 86-87 and accompanying text.

259. Other commentators have called for re-evaluation of United States policy on money laundering. See Rusch, *Hue and Cry in the Counting-House: Some Observations of the Bank Secrecy Act*, 37 CATH. U. L. REV. 465 (1988); Villa, *A Critical View of Bank Secrecy Act Enforcement and the Money Laundering Statutes*, 37 CATH. U. L. REV. 489 (1988). For a recent discussion of funds transfer and Bank Secrecy Act requirements, see Maroldy, Note, *Recordkeeping and Reporting in an Attempt to Stop the Money Laundering Cycle: Why Blanket Recording and Reporting of Wire and Electronic Funds Transfers Is Not the Answer*, 66 NOTRE DAME L. REV. 863 (1991).

260. Because New York has adopted U.C.C. Article 4A and New York law applies to CHIPS transfers and because the Federal Reserve Board adopted much of Article 4A for Fedwire transfers, Article 4A became the instant standard for a very large percentage of the world's funds transfers. See *supra* notes 193-94, 239-41 and accompanying text.

I hesitate to describe Article 4A's incentives as market-based. The incentives, however, exist so that originators' banks and their customers can allocate the risks that each will bear if a funds transfer is unauthorized or improperly executed.

261. See *supra* notes 76-77 & 206-22 and accompanying text.

262. The October 1990 amendments to Regulation J adopt most of the definitions of Article 4A. 55 Fed. Reg. 40,791 (1990) (to be codified at 12 C.F.R. § 210).

“sender,”²⁶³ “originator,”²⁶⁴ “receiving bank,”²⁶⁵ “originator’s bank,”²⁶⁶ and “beneficiary’s bank,”²⁶⁷ the identity of the funds transfer participants should become clearer and the trail of monies transferred between accounts within the United States likewise should become easier to trace. As a companion to these records, the funds transfer industry can enhance the capacity of its communications systems to provide additional data, such as the identity of the “originator”²⁶⁸ and the purpose of the transfer.²⁶⁹ The amount of data available without the imposition of additional regulation also will expand as the Federal Reserve Board obtains results from its initiatives designed to provide data about the flow of cash and of funds transfers within particular regions, around the United States, or to or from specific foreign countries.²⁷⁰

In addition to relying increasingly on existing or market-generated records of funds transfers and funds transfer users, banking industry experts here and abroad suggest that the federal government should focus on “primary laundering,” the process by which cash is moved around and out of the United States.²⁷¹ They contend that it is easier to catch domestic mail parcels and couriers with suitcases of cash²⁷² as the cash moves to a depository bank or laundering business front²⁷³ than it is to identify the money as laundered when it is transferred back into the United States.²⁷⁴ Investigation of primary laundering relies on traditional law enforcement techniques such as leads and informers, and on effective enforcement of existing (and anticipated) currency transaction reporting requirements against banks, financial institutions, and others subject to currency transaction requirements.²⁷⁵ This approach requires

263. U.C.C. § 4A-103(a)(5) (1991).

264. U.C.C. § 4A-104(c).

265. U.C.C. § 4A-103(a)(4).

266. U.C.C. § 4A-104(d).

267. U.C.C. § 4A-103(a)(3).

268. Article 4A defines “originator” as “the sender of the first payment order in a funds transfer.” U.C.C. § 4A-104(c).

269. See NYCH Comment, *supra* note 24, at 16.

270. See *Money Laundering Legislation*, *supra* note 10, at 72-73 (statement of Clyde H. Farnsworth, Jr., Director, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System). The Federal Reserve Board maintains it can provide data about Fedwire transfers at practically “any level of detail.” *Id.* at 73.

271. See Federal Reserve Board Comment, *supra* note 15, at 14; Lascelles, *Money Laundering Under Siege*, *Financial Times*, Apr. 20, 1990, at 39, col.5.

272. The proceeds of drug trafficking, customarily caches of \$20 bills, are extremely heavy. For example, \$1 million in \$20’s weighs 113 pounds (at 441 bills per pound). *Money Laundering in Florida*, *supra* note 2, at 113 (statement of Charles Intriaigo, Esq., Publisher of *Money Laundering Alert*).

273. *Drug Money Laundering Control Efforts*, *supra* note 31, at 43 (statement of Timothy D. Mahoney, Director of Special Investigations Division, New York Banking Department); Federal Reserve Comment, *supra* note 15, at 14.

274. *E.g.*, *Federal Reserve Comment*, *supra* note 15, at 14.

275. See 31 C.F.R. § 103.22 (1990). For a discussion of the history of Bank Secrecy Act

aggressive use of all existing data—data on domestic and international movements of United States currency and on funds transfers processed through Fedwire. It also presupposes increased reliance on banks and others to “know” their customers and to report suspect transactions in accordance with procedures already employed by major banks²⁷⁶ and with the Basle Committee’s Principles.²⁷⁷

The Treasury furthermore should stop playing regulatory “leapfrog” with money launderers and concentrate its efforts on designing a cohesive strategy involving domestic enforcement efforts. Regulatory leapfrog imposes many costs on the banking industry in addition to those associated with implementing and maintaining compliance with new regulatory requirements. These additional costs to the industry include the significant expense associated with evaluating and commenting on each proposal,²⁷⁸ as well as the intangible, unpredictable costs created by raised anxiety levels about future regulations.²⁷⁹

The current approach of imposing additional layers of regulations also provides too much notice to money launderers of the coming changes in investigative approach.²⁸⁰ Lengthy delays associated with rulemaking pro-

requirements, see DeFeo, *Depriving International Narcotics Traffickers and Other Organized Criminals of Illegal Proceeds and Combatting Money Laundering*, 18 DEN. J. INT’L L. & POL’Y 405 (1990).

276. See e.g., *Money Laundering*, *supra* note 83, at 160-65 (statement of Cliff E. Cook, Vice President and Compliance Officer, Puget Sound National Bank, speaking on behalf of the American Bankers Association) (describing activities of major banks concerning suspicious transaction reports). The Department of Justice has advocated reliance on “know your customer” standards in preference to prosecutorial guidelines such as those called for in H.R. 26, the “Money Laundering Enforcement Amendments of 1991,” on the ground that “law enforcement can only give general advice [regarding what constitutes suspicious transactions] given the fluid, ever-changing nature of money laundering operations. Were black and white rules developed, money launderers would switch methods of operations so as to the [sic] bypass these profiles.” Letter from W. Lee Rawls, Assistant Attorney General, U.S. Dept. of Justice to Hon. Frank Annunzio, House of Representatives (Feb. 14, 1991), *reprinted in Money Laundering Enforcement Amendments of 1991*, *supra* note 251, at 75.

277. See *supra* note 247 and accompanying text.

278. The costs for the funds transfer proposal to date have included analysis of the 1989 Advanced Notice of Proposed Rulemaking and of the 1990 Advanced Notice of Proposed Rulemaking, preparation of one or two rounds of formal comments, and delays in acquiring computer hardware and software while the rulemaking is pending. If one assumed an average cost of \$2,000 to produce each of the approximately 500 comments on the two phases of the funds transfer proposal—a ridiculously low figure given the length and thoughtfulness of many of the comments reviewed by this author—the industry has already spent \$1 million on the funds transfer proposal.

279. A few of the comments on the funds transfer proposal, reflecting these anxieties, called for a “safe harbor” provision for banks that make good faith efforts to comply. See *supra* note 139 and accompanying text.

280. We must assume that money launderers have known of the funds transfer proposal from the date of each publication in the Federal Register—in part because both the 1989 Advance Notice of Proposed Rulemaking and the 1990 Advance Notice of Proposed Rulemaking attracted considerable attention in the lay and trade presses. See *Treasury Issues Wire*

ceedings in fact provide opportunities for money launderers to restructure their activities to avoid detection. As part of a new comprehensive strategy, the Treasury Department should rethink its current reliance on new specialized records, such as those called for in the funds transfer proposal, and focus instead on training to use existing records of funds transfers and cash or monetary instruments transactions. One of the advantages of training is that it gives money launderers less notice of the shift of attention. In addition, new initiatives in investigation of money laundering should focus on "primary laundering," particularly on face-to-face cash and monetary instruments transactions, which are more likely to involve money laundering than most other transactions.

In addition to rethinking its policy of requiring specialized records and reporting of transactions that may involve money laundering, the United States should continue to work with its allies, such as the G-7 Financial Action Task Force,²⁸¹ and with international organizations, particularly the United Nations, to increase international efforts to stem drug trafficking and associated money laundering.²⁸² In particular, the United States needs to work more closely with the G-7 group and its other trading partners to achieve consistency in their approaches to money laundering so that it becomes increasingly more difficult to hide drug proceeds in banks throughout the world.²⁸³ The United States government must do this with full recognition of the sensitivity of other nations to its previous extraterritorial excursions, particularly the attempts by United States law enforcement

Transfer Proposal as Bankers Blast Latest Industry Burden, supra note 89, at 549; *Treasury Department Prepares to Issue Rule Governing National, Global Wire Transfers*, 90-39 Savings & Loan Rep. 5 (Oct. 19, 1990); B. Atkinson, *Regulatory Agencies Poised for Big Changes*, Am. Banker, Dec. 26, 1990, at 1; N.Y. Times, Oct. 27, 1990, § 1, at 9, col. 1 (late ed.); Garsson, *Banks Fear Big Burden in New Rules on Wires*, Am. Banker, Oct. 3, 1990, at 1. As a result, it would have been easy for money launderers to learn of the proposals whether or not they employed lawyers to follow such developments. In addition, it is likely that they have known of the prospect of additional funds transfer regulations since the enactment of the Anti-Drug Abuse Act of 1988, Pub. L. No. 100-690, 102 Stat. 4181 (codified as amended in scattered titles of U.S.C.). Indeed, since October 14, 1990, money laundering has been the topic of 1720 articles accessible through the Lexis-Nexis legal research system and, no doubt, of countless more in newspapers not accessible through Lexis-Nexis.

281. In one commentator's view, this group has emerged as the primary international organization focusing on money laundering. *Money Laundering Enforcement Amendments of 1991*, supra note 251, at 11 (statement of Peter K. Nunez, Assistant Secretary for Enforcement, Department of Treasury). Section 22 of H.R. 26 directs the Secretary of the Treasury to enter discussions with countries whose institutions are engaging in activities involving the proceeds of international drug trafficking to encourage the countries to adopt comprehensive antimoney laundering laws and to obtain cooperation in prosecution of drug traffickers and money launderers. *Id.*

282. One of the greatest successes in improving international cooperation is the U.N. Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, Dec. 20, 1988, U.N. Doc. E/CONF. 82/15 (1988), reprinted in 28 I.L.M. 493 (1989). Of course, international cooperation on money laundering also would aid international efforts to thwart terrorism and others using money laundering to obscure illegal activities.

283. For example, the European Community has proposed a bank directive on money

agencies to reach foreign bank records without following recognized international procedures.²⁸⁴

CONCLUSION

The funds transfer proposal reflects weaknesses in the Treasury's current approach to regulations under the Bank Secrecy Act. It demonstrates a willingness to impose substantial new obligations on the banking system without careful evaluation of their potential efficacy, without measuring the utility of prior regulations before adopting additional regulations, and without regard to costs imposed on the banking community. It also suggests a lack of coordination with other federal financial regulatory agencies, particularly the Federal Reserve Board, and a lack of appreciation of potential benefits in developments such as the adoption of U.C.C. Article 4A and the forthcoming revision of the CHIPS format.²⁸⁵ Finally, the funds transfer proposal, as well as the other new requirements proposed in 1989 and 1990, suggests that existing methods of detecting money laundering are not working and argues for a comprehensive approach to detecting, prosecuting, and deterring money laundering.

laundrying that would become Community law. *Bank Check on Drug Monies*, [London] Daily Telegraph, June 25, 1990, at 18.

284. See *supra* notes 173-74 and accompanying text. These procedures include those set out in the Mutual Legal Assistance Treaties ratified in the last decade or letters rogatory. Letters rogatory are the means by which one country, speaking through one of its courts, requests another country, acting through its own courts and by methods of its court procedures and entirely within the latter's control, to assist the administration of justice in the former country. Governments and others use letters rogatory to secure the testimony of a witness resident in the latter's jurisdiction and to obtain the testimony for use in the action pending in the former jurisdiction. See *The Signe*, 37 F. Supp. 819, 820 (E.D. La. 1941); FED. R. CIV. P. 28; BLACK'S LAW DICTIONARY 815 (5th ed. 1979).

285. See *supra* notes 188-93 and accompanying text. For example, the Federal Reserve Board's adoption of U.C.C. Article 4A for Fedwire preceded the Treasury's 1990 Funds Transfer Proposal by only ten days, but the funds transfer proposal makes no mention or use of the Board's action. See generally 1990 Funds Transfer Proposal, *supra* note 8.