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## United States

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# Bank Secrecy Laws: An American Perspective

G. Philip Rutledge\*

## I. Introduction

Bank secrecy laws are a species of financial privacy laws whose purpose is to establish statutory obligations and duties between a banker and his customer. Other species of financial privacy laws include structural banking forms and impediments and blocking statutes.<sup>1</sup> Structural banking forms and impediments include use of “anonymous (also known as numbered) accounts and accounts held under false names.<sup>2</sup> An anonymous account is used when an account holder signs an agreement with a personal bank agent agreeing to the conditions of the relationship and receives a number or pseudonym.”

Structural forms are intended to protect the customer by insulating bank employees who may be the target of inquiries or bribes from third parties seeking the identity of the account holder.<sup>3</sup> Trust and corporate structures also obfuscate financial transactions since a trust can include either an individual or a corporate fiduciary holding assets in its own name or for a beneficiary.<sup>4</sup> Combining a trust with a confidential account creates additional layers of anonymity.<sup>5</sup>

Statutes known as “blocking laws” are used to prohibit the disclosure, inspection, or removal of documents located in one

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1. See C. Todd Jones, *Compulsion over Comity: The United States' Assault on Foreign Bank Secrecy*, 12 NW. J. INT'L & BUS. 454 (1992).

2. *Id.* at 459.

3. *Id.*

4. *Id.* at 460.

5. *Id.*

country in compliance with the orders of another country.<sup>6</sup> Generally, there are two types of blocking laws. One "prohibits production of documents or testimony before a foreign tribunal."<sup>7</sup> The second type of blocking law "prohibits substantive compliance with foreign government orders."<sup>8</sup> While bank secrecy laws are designed to protect banking relationships, blocking laws are not uncommon in bank secrecy jurisdictions since they are used to impede legal discovery techniques.<sup>9</sup>

This article, however, is intended to focus primarily on bank secrecy laws. Some nations have enacted bank secrecy laws to provide an international safe haven for the assets of individuals persecuted by oppressive political regimes in their home countries. Developing countries faced with capital flight and lack of hard currency have adopted bank secrecy laws as an economic development measure.<sup>10</sup> Additionally, bank secrecy jurisdictions may provide an incentive by imposing zero or low rates of tax on foreign funds held in a jurisdiction.<sup>11</sup> Hence, bank secrecy laws often reflect deeply held traditions or the embodiment of national economic objectives.

Regardless of motivation, bank secrecy laws are all designed to provide institutional legal protection for the relationship between the banker and the client.<sup>12</sup> This often is accomplished by criminalizing the act of revealing information obtained in the course of such a relationship.<sup>13</sup> Exceptions generally are narrow and permitted only when the requirements of domestic law supersede the policy goal of the bank secrecy statute.<sup>14</sup> To engender compliance, breaches of the statutory duties imposed by bank secrecy statutes carry stiff penalties.<sup>15</sup>

Recently, there has been movement to persuade those countries with bank secrecy laws to waive secrecy provisions and to

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6. Jones, *supra* note 1, at 462.

7. *Id.*

8. *Id.*

9. *Id.* at 464.

10. *Id.* at 456.

11. Jones, *supra* note 1, at 462.

12. *Id.* at 461.

13. *Id.*

14. *Id.* at 462.

15. *Id.*; Bundesgesetz über die Banker und Sparkassen of Nov. 8, 1934 (Banking Law of 1934) [hereinafter Swiss Bank Secrecy Law], implemented in Verordnung of May 17, 1972 (Ordinance), and Vollziehungserordnung of Aug. 30, 1961 (Implementing Ordinance) (referring to article 47 of the 1934 Banking Law which has penalties of \$35,000 or \$21,000).

permit the release of banking information as part of an international effort to combat the laundering of money obtained through criminal activity.<sup>16</sup> While some countries have modified their bank secrecy laws to permit the release of information in the case of laundering drug money, these amendments have not been broadened to include illicit profits from insider dealing, tax evasion, terrorist activities, or other criminal enterprises.<sup>17</sup> In addition, the information only may be requested or obtained by a domestic authority which leaves some doubt as to the efficacy of these changes with respect to requests for information from foreign governments. A key element in the effort to ease secrecy laws is to convince the bank secrecy jurisdiction that participating in a conspiracy to facilitate money laundering is more damaging to its national interest than the economic benefit bestowed by retaining absolute bank secrecy laws.

The individual right to privacy is enshrined in the U.S. Constitution and is articulated in a number of international human rights agreements.<sup>18</sup> Should not the individual right to privacy extend to one's financial affairs with appropriate laws to protect the confidentiality of private financial transactions? At first blush, it appears that the United States, in several respects, extends such confidentiality.<sup>19</sup>

First, U.S. common law on the contractual relationship between a banker and his client follows the English decision in *Tournier v. National Provincial and Union Bank of England*.<sup>20</sup> The *Tournier* case held that a banker owed a client an implied contractual duty to its customer not to disclose customer information to third parties except when: (1) disclosures are required by law; (2) there is a duty to the public to disclose; (3) the interests of the bank require disclosure; or (4) disclosure is made with the

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16. Ostvogles, *Luxembourg Banking Secrecy Law*, 21 INT'L BUS. LAW. 367 (1993).

17. *Id.* at 368.

18. U.S.C.A. Const. amend. 4 (1791); The Universal Declaration of Human Rights, Dec. 10, 1948, G.A. Res. 217 A(III), U.N.Doc. A/A to 10, at art. 12 (1948); European Convention For The Protection of Human Rights and Fundamental Freedoms, Nov. 4, 1950, art. 8 x (1), Council of Europe, Eur. T.S. No. 5, 213 U.N.T.S. 211 (1954).

19. See Berta E. Hernandez, *RIP to IRP — Money Laundering and Drug Traffic Controls Score a Knockout Victory over Bank Secrecy*, 18 N.C. J. INT'L L. & COM. REG. 235 (1993).

20. *Tournier v. Nat'l Provincial and Union Bank of England*, 1 K.B. 461 (1924).

express or implied consent of the customer.<sup>21</sup> Second, a federal law known as the Bank Secrecy Act (BSA)<sup>22</sup> and third, a federal law known as the Right to Financial Privacy Act (RFPA)<sup>23</sup> also exist.

As will be shown, the BSA has built upon the exceptions in *Tournier* and the RFPA. The BSA generally requires notification to bank customers of government requests for financial records and mandates, in certain instances, that financial institutions not reveal to its customers that their records are being reviewed. Furthermore, the Federal Rules of Civil Procedure permit civil discovery of private financial information provided that the information sought (1) is not privileged and (2) is relevant to the subject matter involved in the pending action.<sup>24</sup>

While some countries enacted bank secrecy legislation that has imposed specific statutory duties on the banker-client relationship and attached criminal penalties for breaches of those duties, the United States has taken a very different view toward the banker-client relationship and the client's use of the U.S. banking system. The view of the United States was fostered by evidence presented to the U.S. Congress<sup>25</sup> that mandatory reporting of certain financial transactions by financial institutions was crucial in the fight against organized and white collar crime. The House of Representatives Report on the BSA provided, in part:

Secret foreign bank accounts and secret foreign financial institutions have permitted proliferation of 'white collar' crime; have served as the financial underpinning of organized criminal operations in the United States; have served as the ultimate depository of black market proceeds from Vietnam; have served as a source of questionable financing for conglomerate and other corporate stock acquisitions, mergers and takeovers; have covered conspiracies to steal from U.S. defense and foreign aid funds; and have served as the cleaning agent for 'hot' or illegally obtained monies.<sup>26</sup>

The BSA requires that a domestic U.S. financial institution<sup>27</sup>

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21. *Id.*

22. 12 U.S.C.A. §§ 1730d (repealed 1989), 1951-59 (West 1989 & Supp. 1996).

23. 12 U.S.C.A. §§ 3401-3422 (West 1989 & Supp. 1996).

24. FED. R. CIV. P. 26(b)(1).

25. See H.R. REP. NO. 975, 91st Cong., 2d Sess.

26. *Id.*

27. A "domestic U.S. financial institution" includes each agent, agency, branch or office within the U.S. of a bank (including U.S. branches and agencies of foreign banks); a broker or dealer in securities; a currency dealer or exchanger

file a report with the U.S. Treasury Department within 15 days of when it is involved in a transaction for the payment, receipt, or transfer of U.S. currency or other monetary instruments<sup>28</sup> totalling more than \$10,000.<sup>29</sup> In addition, currency or monetary instruments taken in or out of the U.S. exceeding \$10,000 must be reported, in addition to, transactions above certain amounts involving foreign bank accounts.<sup>30</sup>

The BSA makes it an offense for any person, for the purpose of evading these reporting requirements, to cause or attempt to cause a domestic financial institution to fail to file a required report or to file a required report that contains a material omission or misstatement of fact.<sup>31</sup> It is also an offense for any person, for the purpose of evading these reporting requirements, to structure or assist in structuring, or to attempt to structure or assist in structuring, any transaction with one or more domestic financial institutions.<sup>32</sup>

The failure of domestic financial institutions to comply with the reporting requirements of the BSA may result in substantial penalties.<sup>33</sup> For a willful violation of any *recordkeeping* requirement by a domestic financial institution, the Treasury Secretary may assess the institution and any partner, director, officer, or employee thereof who willfully participated in the violation a civil monetary penalty not exceeding \$1,000.<sup>34</sup> For a willful violation of the BSA *reporting* requirement itself by a domestic financial institution or any partner, director, officer, or employee thereof, the

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(including check cashers); an issuer, seller or redeemer of travellers checks or money orders (except those who sell less than \$150,000 in a 30 day period); a licensed transmitter of funds; a telegraph company; a casino or gambling casino having annual gross revenues in excess of \$1 million; the U.S. Postal Service, with respect to the sale of money orders; and any person subject to supervision by any state or federal bank supervisory authority.

28. 31 U.S.C.A. § 5312 (West 1989 & Supp. 1996). "Monetary instruments" include currency; travellers checks in any form; all negotiable instruments (including personal checks, official bank checks, cashier's checks, promissory notes and money orders) that either are in bearer form, endorsed without restriction or otherwise in such form that title thereto passes upon delivery; incomplete instruments signed but with the payee's name omitted; and securities or stock in bearer form or otherwise in such form that title thereto passes upon delivery.

29. 31 U.S.C.A. § 5316(a)(1) (West 1983 & Supp. 1995).

30. 31 U.S.C.A. §§ 5313, 5316 (West 1983).

31. 31 U.S.C.A. §§ 5317, 5321 (West 1983 & Supp. 1995).

32. *Id.* 31 U.S.C.A. § 5321 (West 1983 & Supp. 1995).

33. 31 U.S.C.A. § 5321 (West 1993); 31 C.F.R. § 103.47 (1995).

34. *Id.* 31 C.F.R. § 103.47(a) (West 1995). See generally 31 U.S.C. § 5321 (West 1983 & Supp. 1995).

violation shall be subject to a civil penalty of not more than the greater of the amount involved in the transaction (not to exceed \$100,000) or \$25,000.<sup>35</sup> The Treasury Secretary may also impose a civil monetary penalty of not more than \$500 against any domestic financial institution which *negligently* violates any provision of the reporting requirements.<sup>36</sup>

The BSA also contains criminal penalties.<sup>37</sup> A person who willfully violates any Currency and Foreign Transaction Reporting Act (CFTA) provisions of the BSA or any regulation prescribed thereunder may be fined not more than \$250,000, imprisoned for not more than five years, or both.<sup>38</sup> A person who willfully violates any provision of the CFTA, or any regulation prescribed thereunder while violating another law of the United States or as part of a pattern of any illegal activity involving more than \$100,000 in a 12 month period may be fined not more than \$500,000, imprisoned for not more than ten years, or both.<sup>39</sup>

A person who knowingly makes any false, fictitious, or fraudulent statements or representations in any report required to be filed under the CFTA may be fined an amount not to exceed \$10,000, imprisoned for not more than five years, or both.<sup>40</sup> More recent legislation provides that the government may terminate the authority of a financial institution to do business in the United States, may terminate a state bank's coverage under federal deposit insurance, or prohibit a foreign bank from operating an agency, branch, or commercial lending subsidiary if it is convicted of a criminal violation under the BSA.<sup>41</sup>

The constitutionality of these BSA reporting requirements was upheld by the U.S. Supreme Court in *California Bankers Association v. Schultz*.<sup>42</sup> In *Schultz*, the Court concluded that mere maintenance of records by banks under the Treasury Secretary's regulations did not constitute a seizure.<sup>43</sup> The U.S. Supreme

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35. *Id.* 31 U.S.C.A. § 5321(5)(B)(ii) (West 1983 & Supp. 1995).

36. *Id.* 31 U.S.C.A. § 5321(6) (West 1983 & Supp. 1995).

37. 31 U.S.C.A. § 5322 (West 1983 & Supp. 1995); 31 C.F.R. §103.49 (1995).

38. *Id.* 31 C.F.R. § 103.49(b) (1995). *See also* 31 U.S.C.A. § 5322(a) (West 1983 & Supp. 1995).

39. *Id.* 31 C.F.R. § 103.49(2) (1995). *See generally* 31 U.S.C.A. § 5322 (West 1983 & Supp. 1995).

40. *Id.* 31 C.F.R. § 103.49(d) (1995). *See also* 31 U.S.C.A. § 5322 (West 1983 & Supp. 1995).

41. 12 U.S.C.A. §§ 93, 1818, 9305 (West 1989 & Supp. 1996).

42. 416 U.S. 21 (1974).

43. *Id.*

Court, in *U.S. v. Miller*,<sup>44</sup> decided that the constitutional right to be free from unreasonable searches and seizures did not apply to records held under the BSA. In *Miller*, the Court explained that the records of the depositor's account were business records of the bank and not the private papers of the depositor. Thus, the depositor could assert neither ownership nor possession in a claim of illegal seizure.<sup>45</sup>

Having established the statutory requirements in the BSA and having overcome the constitutional challenges presented by the previously mentioned cases, the authority of the U.S. Treasury Department requiring domestic financial institutions to provide reports on specified financial transactions is unquestioned.<sup>46</sup> While the banking community continues to claim that the reporting requirements are onerous and extremely costly, the U.S. Government asserts that such controls and reporting are necessary to prevent criminal enterprises from using the United States' banking system.<sup>47</sup>

Eight years after enacting the BSA, Congress passed the RFPA. The RFPA was advertised as an attempt to restrict government access to the private banking information of individuals.<sup>48</sup> While most Americans probably believe that their financial information is confidential and protected from government intrusion by the RFPA, in reality, the RFPA only requires that the financial institution notify its customer prior to providing the banking information that the government has requested. In some instances, the RFPA requires them *not* to notify their customers of the government's request.<sup>49</sup>

The premise of the RFPA was that the customer would be given notice so that he would have the opportunity to challenge the government's request.<sup>50</sup> In order to challenge the government's access to his records, a customer must show some factual basis supporting an allegation that the records are not being sought for a legitimate purpose. The government, however, has the burden of proof that it is justified in receiving the requested records.<sup>51</sup>

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44. 425 U.S. 435 (1976).

45. *Id.*

46. *See Hernandez, supra* note 19.

47. *See Jones, supra* note 1, at 457.

48. *See Hernandez, supra* note 19.

49. *Id.*

50. *Id.*

51. 12 U.S.C.A. §§ 3405, 3410 (West 1989).

Under the RFPA, the government may obtain access to financial records by: (1) the written consent of the customer; (2) a search warrant; (3) an administrative subpoena issued by a government agency;<sup>52</sup> (4) a formal written request;<sup>53</sup> (5) a judicial subpoena; or (6) a grand jury subpoena.<sup>54</sup> These prerequisites do not apply when the bank elects to provide information voluntarily to government authorities upon suspicion of a violation of law inferred from records in its custody.<sup>55</sup>

Under the exception, banks may provide the name of the account holder, the account number in question, the nature of the suspected illegal activity, and whatever additional information may be necessary for law enforcement authorities to determine if an offense has been committed or to initiate an investigation. Reporting suspected criminal activity does not make a bank liable to those suspected of such activity.<sup>56</sup>

Amendments to the RFPA contained in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 prohibit a financial institution from notifying any person named in a grand jury subpoena about the subpoena.<sup>57</sup> The amendments also authorize the government to apply for a court order to delay the required RFPA notice to the customer.<sup>58</sup> A specific delay of notification is permitted when there is reason to believe that

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52. For instance, the U.S. Securities & Exchange Commission (SEC), which is an administrative agency, is authorized under Section 21(g) of the Securities Exchange Act of 1934 to obtain financial records of persons without prior notice pursuant to an administrative subpoena when the SEC has reason to believe that (1) a delay in obtaining access to such financial records or the required notice will result in flight from prosecution, destruction of evidence, transfer of assets or records outside the territorial limits of the United States, improper conversion of investor assets or impeding the ability of the SEC to identify or trace the source or disposition of funds involved in any securities transaction; (2) such financial records are necessary to identify or trace the record or beneficial ownership interest in any security; (3) the acts, practices or course of conduct under investigation involve the dissemination of materially false or misleading information concerning any security, issuer, or market or the failure to make disclosures required under the securities laws, which remain uncorrected or a financial loss to investors or other persons protected under the securities laws which remains substantially uncompensated; or (4) the acts, practices or course of conduct under investigation involve significant financial speculation in securities or endanger the stability of any financial or investment intermediary.

53. 12 U.S.C. § 3408 (West 1989). This is used where government authorities seek information but are not authorized by law to issue administrative subpoenas.

54. 12 U.S.C. § 3409 (West 1989).

55. 12 U.S.C. § 3403(c) (West 1989 & Supp. 1996).

56. 12 U.S.C. § 3403(c), § 3417(c) (West 1989 & Supp. 1996).

57. 12 U.S.C. § 3420(b)(1) (West 1989 & Supp. 1996).

58. 12 U.S.C.A. § 3409(a) (West 1989).

notification would result in: (1) endangerment of a person's life; (2) flight from prosecution; (3) destruction or tampering with evidence; (4) intimidation of witnesses; or (5) placing an investigation in serious jeopardy.<sup>59</sup>

Under the RFPA, there are four situations where the notification requirements do not apply.<sup>60</sup> First, RFPA does not apply when the records are being sought in connection with a judicial proceeding in which the government and customer are a party.<sup>61</sup> Second, no notification is required if the bank is merely being asked to provide basic account information such as a name, type of account, and account number.<sup>62</sup> Third, authorized foreign intelligence investigations and secret service functions are permitted access to records of customers of financial institutions without notifying such customers.<sup>63</sup> Lastly, government access to customer information without notification can be obtained in emergency situations where delay would create imminent danger of physical injury, serious property damage, or flight from prosecution.<sup>64</sup>

A major source of international conflict in the bank secrecy area has been over the efforts exerted by U.S. government agencies, particularly the SEC, to obtain financial records from bank secrecy jurisdictions. Recent memoranda of understanding<sup>65</sup> and federal legislation amending the Securities Exchange Act of 1934 (1934 Act) have created a better atmosphere for international cooperation in the investigation of cross-border crime and the tracing of proceeds derived from illicit activities.

The Insider Trading and Securities Fraud Enforcement Act of 1988 enacted a new Section 21(a)(2) to the 1934 Act which authorizes the SEC to provide assistance to foreign securities authorities.<sup>66</sup> The SEC, upon request of a foreign securities

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59. These provisions apply to individuals and partnerships of less than five persons. *Id.*

60. 12 U.S.C.A. § 3413 (West 1989).

61. 12 U.S.C. § 3413(h) - (i) (West 1989).

62. 12 U.S.C. § 3413(g) (West 1989).

63. 12 U.S.C. § 3414(a) (West 1989).

64. 12 U.S.C. § 3414(b)(1) (West 1989).

65. The 1987 Memorandum of Understanding between the U.S. and Switzerland on the exchange of information in investigations of insider dealing, money laundering and other crimes provides for procedures to collect information under the 1977 Treaty for Mutual Assistance in Criminal Matters between the Swiss Confederation and the United States. See 19 Sec. Reg. & L. Rep. 1729 (Nov. 13, 1987); Jill E. Asch, *Bank Secrecy: A Barrier to the Prosecution of Insider Trading*, 4 EMORY INT'L L. REV. 185 (1990).

66. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-74, 102 Stat. 4677 (1989).

authority, may provide assistance if the requesting authority states that it is conducting an investigation necessary to determine whether a person has violated, is violating, or is about to violate any laws or rules relating to securities matters that the requesting authority administers or enforces. If necessary, the SEC may conduct its own investigation to collect information and evidence pertinent to the request for assistance.<sup>67</sup>

It is important to note that the SEC is permitted to provide assistance without regard to whether the facts stated in the request of the foreign securities authority would also constitute a violation of United States law. Therefore, in the spirit of reciprocity, the SEC can offer foreign authorities access to financial information in the United States in an effort to obtain similar levels of cooperation when the SEC makes an assistance request to the foreign authority.

In this regard, however, foreign jurisdictions have always been concerned about the U.S. Freedom of Information Act (FOIA) which requires mandatory disclosure of information held by government agencies.<sup>68</sup> This concern was addressed in the enactment of section 24(d) to the 1934 Act as part of the International Securities Enforcement Cooperation Act of 1990.<sup>69</sup> Under this provision, the SEC shall not be compelled, pursuant to the FOIA, to disclose records obtained from a foreign securities authority if changed to conform to internal consistency (1) the foreign securities authority has in good faith determined and represented to the SEC that public disclosure of such records would violate the laws applicable to that foreign securities authority and (2) the SEC obtains the records pursuant to a memorandum of understanding or any procedure available to it for the administration and enforcement of the United States securities laws.<sup>70</sup>

Despite a law entitled the Bank Secrecy Act, there is no bank secrecy in the United States in the traditional sense. While the Supreme Court reminds that there can be no constitutional expectation of privacy in banking transactions in the United States, the popular notion among Americans is that normal, everyday banking transactions are not usually the subject of government

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67. See G. Philip Rutledge, *Insider Conflicts in Japan and the US*, in *THE FIDUCIARY, THE INSIDER AND THE CONFLICT* 159 (Sweet Maxwell Brehon eds., 1995).

68. 5 U.S.C. § 552 (1988 & Supp. III 1991).

69. 15 U.S.C. § 78x (1988 & Supp. III 1991).

70. *Id.*

inquiries. Yet, Americans should realize that if the government wants personal financial information, it generally can obtain the information it requires.

## II. Conclusion

The essence of the U.S. approach to the banking system may be characterized as contractual. The government seeks to maintain a safe and sound banking system for the benefit of its citizens who, in exchange for participating in the system and enjoying its benefits, implicitly authorize the government to take necessary steps to obtain information which will prevent the abuse of the banking system by criminal enterprises. The United States government also has been willing to impose upon the nation's financial institutions, under threat of substantial civil and criminal penalties, the cost of operating a sophisticated financial reporting system which it has deemed essential to safeguard the domestic banking system from misuse by criminal organizations.

