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THE EMERGENCE OF 'EXTRA TERRITORIAL' JURISDICTION AND ITS IMPACT ON FINANCIAL SERVICES

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There are periods of time when rapid change occurs often with ramifications that are not fully understood by those most affected by them. For the financial services industry the period since 9/11 has been such a period. As the tenth anniversary of the attacks approaches the pace of change is quickening and the consequences for financial services businesses are becoming more pronounced. The nature of that change can best be described as the 'extra territorialisation' of risk occasioned by successive governments adopting an expansive view of their jurisdiction as they seek to impose rules outside of their own borders.

Offshore jurisdictions have hard won experience of supranational rules being imposed upon them, but now we are beginning to see nation states acting not in concert, but unilaterally against financial services providers operating elsewhere. The effect is beginning to be felt. In addition to citing an increase in regulatory investigations in 2010 many businesses are now reporting an increased exposure to a wider range of regulatory authorities, most notably in the United States. The trend began with tax. Governments that had lost revenues to evasion flexed their muscle to demand that financial services businesses and in some cases individual officers, in foreign jurisdictions paid the price. The extradition of a Jersey citizen from Jersey to Australia in 2010 on suspicion of facilitating tax evasion by Australians was a recent example. Now the trend is becoming more pronounced in the sanctions arena. It is also plainly envisaged within the FATCA provisions of the HIRE Act and closer to home in the new UK Bribery Act.

SANCTIONS

Most countries domesticate UN or EU sanctions and no more. The United States is an exception. In addition to domesticating UN Sanctions it also imposes its own extensive sanctions regimes. The US Government has long regarded sanctions as key tools in support of their country's foreign policy objectives. That is important because the US regards anybody who does business with a person sanctioned by it, as effectively trading with the enemy. When couched in those terms you can begin to appreciate why the US authorities take such a dim view of OFAC breaches. A number of UK banks have discovered this at enormous cost recently.

The US OFAC sanctions regime does not apply to non US persons per se, but it can impact them in a number of ways. For example:

- OFAC applies to all transactions that take place in the US. That includes all US$ payments whoever makes them, whether or not they have a presence in the US
- OFAC applies to all non US persons operating within the US. Where the US presence is through a subsidiary, US jurisdiction is unlikely to permeate to the parent, but where the US presence is in the form of a branch or agency, the entire corporate body may become subject to US jurisdiction in respect of its activities in the US.

For example, a bank in Jersey is asked by an entity (X) to transfer dollars to Y. Y is on the OFAC list, but is not subject to a sanction in Jersey. What options are available to the bank and what are the potential consequences of each?

1. The bank may take the view that as a non US person it is not obliged to comply with OFAC and agrees to make the transfer. Consequence? The bank's US correspondent (which is a US person, obliged to have a rigorous sanctions compliance regime in place) identifies that the payer is sanctioned by OFAC and either blocks or freezes the transfer. Where it is frozen the Jersey bank faces the risk of double liability, because X will want to know why the money hasn't been received by Y. Additionally the US correspondent will file a report with OFAC, which will then be on notice that the Jersey bank is 'dealing with the enemy'. This is useful intelligence.
2. The bank may decide to 'strip' out of the payment message the identity of Y to avoid detection by the US Correspondent. Consequence? ABN Amro, Credit Suisse, Barclays and RBS have collectively been fined almost US$1 Billion by the US authorities in the last 3 years for such conduct. Note that nothing that the banks did was illegal in the jurisdictions in which the stripping activity took place. It was illegal only as matter of US law.
3. The bank may say to the customer 'because you are sanctioned by the Americans we will not do this for you in dollars but we can do it for you in sterling or Euros'. Consequence? It is this conduct that the Americans have the greatest difficulty exerting jurisdiction over and thus the conduct they are most frustrated with. Enormous pressure has been brought to bear on the UK banking sector by the US to play by their rules. The US is discouraging them by entertaining claims in US courts against foreign banks by civil plaintiffs able to show that such banks have 'facilitated' terrorism through the provision of financial services. NatWest is currently being sued for significant damages for having banked a registered UK charity that was at the time sanctioned by the Israeli government. The plaintiff is relying on evidence that NatWest was transferring money to a charity in the middle east which it is claimed was controlled by Hamas. Such claims are brought by class action lawyers acting in

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contingency fee arrangements. They are highly motivated, aggressive, able and vitally, they are tapped into the US public mood. NatWest will forget at its peril that lawyers from the same stable acted in the tobacco and asbestos litigation of the 80's and 90's.

In consequence, non US banks are increasingly shying away from transacting with OFAC sanctioned persons or entities in any currency and some banks are going further and refusing to do business with persons sanctioned anywhere in order to avoid the risk of an Anti Terror Act claims in the United States and Canada which recently enacted similar legislation.

FATCA

Described as the most far-reaching information sharing legislation ever enacted, FATCA comes hot on the heels of the UBS Deferred Prosecution Agreement with the Department of Justice for systematically assisting US citizens to evade US taxes. Other banks are caught up in the DoJ investigation which is wide ranging and is likely to result in similar settlements and swingeing fine levels. FATCA is designed to discourage foreign financial institutions (FFI's) from doing business with US citizens by obliging FFI's to enter into an information sharing agreement that will oblige them to identify and report on all US accounts, or face a 30% withholding tax on US assets.

The U.S. is leveraging its economic superpower status (despite its woes, it remains the World's biggest economy) and the role of the US Dollar as the World's reserve currency, to effect a change in the behaviour not only of US tax evaders but of foreign financial institutions. It is an extraordinary display of power by a country that technically has no jurisdiction over the FFI's that will be most affected by the provisions.

THE UK BRIBERY ACT

The Bribery Act is controversial because of the creation of the new offence of failing to prevent bribery, but it is also controversial for another reason that has attracted little comment. The Act applies to all British Nationals wherever they operate and in addition to UK businesses, to non UK businesses that do business in the UK. What does this mean in practice? Consider the following examples:

1. A Trust Company in Geneva, manages and controls a group of BVI companies owned ultimately by clients resident in the UK. Representatives of the trust company travel regularly to the UK to meet the clients. The trust company is likely to be caught by the Bribery Act because of its activities in the UK. It should implement controls to prevent bribery in accordance with the Act
2. A Trust company in Jersey manages and controls a group of entities that conduct trade in the UK. The entities are caught by the Bribery Act. The directors (provided by the Jersey TCB) should ensure that the entities comply with it. Any offence committed by those companies attributable to the consent or connivance of an officer will bring that officer into the line of fire of a prosecutor. The risk is not a theoretical one. The last decade has been littered with investigations of Jersey trust companies that have been abused by bribe payers or corrupt politicians in pursuit of their illicit objectives.

If you remain sceptical about the reality of the risk consider this example: A Jersey trust company manages and controls a company owned by X Co. X Co manufactures oil drilling equipment. It is desirous of obtaining a contract for the supply of machinery to the government of Equatorial Guinea, one of the World's largest oil producing countries. Equatorial Guinea is endemically corrupt. X Co is told that it will be awarded the contract if it funds a charitable foundation to promote healthcare in EG. It does so. It is awarded the contract. 90% of the money that it transfers to the foundation is diverted for the benefit of the Minister for Oil's family. Credit card statements show that in one day's shopping in Paris the Minister's wife spent fifteen times more than her husband's official salary on luxury goods.

With the benefit of hindsight the authorities conclude that X Co knew that the Charitable Foundation was a 'front' for the transfer of a bribe to the Oil Minister and an investigation is launched, The investigation attracts significant publicity in the UK and the US. NGO's including Global Witness and Amnesty International make critical observations of X Co and the Jersey Company. It transpires that X Co had no anti bribery procedures in place. The UK authorities request the extradition of the director of the Trust company responsible for X Co. In such circumstances would Jersey resist the extradition? What would the public sentiment be? If the director were prosecuted how would a jury confronted with these facts, react?

We have long known that the world is a village when it comes to financial services business. Billions of dollars cross borders in milliseconds at the push of computer keys every day. But while financial professionals have been driving Ferraris revenue authorities and law enforcement agencies have been riding bicycles as they have navigated the mutual legal assistance treaties and protocols governing the use of evidence. Now the race is being 'thrown' in favour of law enforcement by governments that are exerting their jurisdiction extra territorially. The financial services community will ignore this trend at its peril. Just as many businesses in the sector have grown multi jurisdictionally over the past decade so the risks that they face have 'gone global' too.

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