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*Chapter 13: Anti-Money Laundering
and Economic Sanctions Laws*

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Chapter 13

Anti-Money Laundering and Economic Sanctions Laws

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§ 13:1 Introduction

[1] Anti-Money Laundering Measures

Anti-money laundering measures and economic sanctions have long been a matter of legal and regulatory focus in the United States. Concern with anti-money laundering measures and economic sanctions, however, acquired a new sense of urgency in the United States after the events of September 11, 2001. The focus of concern also expanded with the realization of the dangers presented by the virulent new strain of terrorist financing. This new sense of urgency found its first and perhaps most dramatic expression in the passage of the USA PATRIOT Act in October 2001.¹ Economic sanction provisions, which have been in U.S. law for many decades, also acquired a renewed and expanded focus in the period after September 11, 2001, with a particular focus on terrorist activities. The regulatory and law-enforcement authorities in the United States rigorously enforce the requirements of U.S. law relating to anti-money laundering measures and economic sanctions against U.S. banks and foreign banks operating in the United States.

The passage of the USA PATRIOT Act brought wide-ranging

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¹Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act), Pub. L. No. 107-56, 115 Stat. 272 to 402 (2001).

changes to the anti-money laundering regime in the United States, extending both the breadth and depth of anti-money laundering measures as required under a U.S. law commonly and oxymoronically referred to as the Bank Secrecy Act (the BSA).²

Title III of the USA PATRIOT Act, entitled the “International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001” (IMLA), amended the BSA to add a number of new anti-money laundering provisions applicable to a broad range of financial institutions operating in the United States.³ It also added a number of significant provisions applicable to foreign financial institutions seeking access to the financial or banking systems in the United States. However, more important than any one of its individual provisions, the passage itself of the USA PATRIOT Act reshaped the contours of political discourse and the bounds of regulatory action in the United States to an extent perhaps not fully understood by many foreign institutions or even some domestic institutions. The legal and reputational risks to financial institutions operating in the United States that do not implement robust and comprehensive anti-money laundering compliance programs have been highlighted by a series of prominent regulatory and law-enforcement actions taken against financial institutions, especially since the passage of the USA PATRIOT Act.

The implications of the heightened regulatory and law-enforcement scrutiny of anti-money laundering and anti-terrorist financing requirements for foreign banks are manifold. In the first instance, foreign banks that have or wish to have access to banking services in the United States have found themselves subject to a number of requirements in the USA PATRIOT Act. For a relatively small subset of foreign banks (foreign shell banks), the anti-money laundering provisions of the USA PATRIOT Act have meant that they are precluded from access to banking accounts and other financial services in the United States.⁴ For a much larger set of foreign banks that maintain correspondent accounts in the United States, the provisions of the USA PATRIOT Act have meant additional documentation and legal requirements.⁵ However, the implications of the heightened regulatory and law-enforcement scrutiny are most significant for

²Pub. L. No. 91-508, 84 Stat. 1114 (1970) (codified as amended at 12 U.S.C.A. §§ 1829b and 1951 to 1959 and 31 U.S.C.A. §§ 5311 to 5322).

³Pub. L. No. 107-56, Title III, 115 Stat. 272, 296 to 342 (2001).

⁴See § 13:6.

⁵See § 13:7.

those foreign banks that have operations in the United States or wish to establish operations in the United States. For the large subset of foreign banks that already have licensed banking operations in the United States, the anti-money laundering requirements and the heightened scrutiny of existing anti-money laundering requirements have meant a substantial increase in operating costs and a significant increase in senior management attention devoted to compliance issues. Failing the commitment of additional resources and management attention to these compliance matters, foreign banks operating in the United States run the very substantial risk of adverse regulatory or law-enforcement action. The range of potential regulatory and law-enforcement action is broad, including possible civil fines, criminal sanctions, or even the loss of a banking license to operate in the United States. Regulatory enforcement action may also result in supervisory restrictions on the ability of a foreign bank to expand its activities or make acquisitions in the United States during the period that the enforcement action remains in effect. A number of foreign banks operating in the United States have already experienced the law-enforcement and regulatory consequences of the failure to implement adequate anti-money laundering compliance programs in the United States. For the subset of foreign banks that do not already have licensed banking operations in the United States, but seek to establish such operations, the intensified scrutiny of anti-money laundering policies and procedures has meant a more difficult, lengthy, and uncertain approval process.⁶

This Chapter discusses the principal anti-money laundering provisions of the USA PATRIOT Act as they apply to foreign banks and foreign banking operations in the United States. References to anti-money laundering requirements in these discussions are intended to include anti-terrorist financing requirements as well. The discussion covers the statutory and regulatory provisions, the supervisory and examination process, and recent regulatory and law-enforcement actions taken against foreign banks operating in the United States under U.S. anti-money laundering laws and economic sanctions laws. The focus of the discussion is on the anti-money laundering and economic sanc-

⁶An assessment of the anti-money laundering systems of a foreign bank applicant and an assessment of the anti-money laundering regime of the applicant's home jurisdiction are key factors in the U.S. regulatory approval process for a banking license to operate in the United States. *See* 12 U.S.C.A. § 3105(d)(6)(B); 12 C.F.R. § 211.24(c)(1)(iii)(B) and (2)(vii). *See also* §§ 1:1 et seq. for a general discussion of the factors considered in the approval process for a branch or agency.

tions requirements applicable to the banking operations of a foreign bank in the United States through a branch, agency, or banking subsidiary. A foreign bank operating through a branch, agency, or banking subsidiary in the United States is subject to essentially the same requirements under the USA PATRIOT Act and U.S. economic sanctions laws in respect of those operations as apply to a U.S. domestic bank. Because many foreign banks also operate through additional forms of financial subsidiary in the United States, such as a broker/dealer, futures commission merchant, or investment adviser subsidiary, the discussion also refers to the USA PATRIOT Act anti-money laundering requirements applicable to the other principal forms of financial institutions in the United States.

[2] Economic Sanctions Laws

The U.S. economic and trade sanctions laws are broad-based measures that derive from U.S. foreign policy and national security concerns. These measures are principally administered by the Office of Foreign Assets Control (OFAC) in the U.S. Department of the Treasury. Under the applicable statutory authorities, economic sanctions have been imposed upon targeted foreign countries and persons in such countries, terrorists, international narcotics traffickers, and persons engaged in activities related to the proliferation of weapons of mass destruction. The U.S. economic and trade sanctions laws and regulations are separate and distinct from the U.S. anti-money laundering laws although they overlap in their concerns and objectives. The U.S. economic and trade sanctions laws generally apply to any United States person, which includes any U.S. branch, agency, or other office of a foreign bank and any U.S. subsidiary of a foreign bank. A number of high profile enforcement actions in the last several years have also extended the reach of the sanctions laws to the non-U.S. offices of foreign banks that clear U.S. dollar transactions through U.S. banking entities. As a general matter, U.S. financial institutions treat compliance with OFAC rules as related and connected to compliance with U.S. anti-money laundering requirements. This Chapter includes a discussion of the U.S. economic and trade sanctions laws with a specific focus on how they apply to the U.S. operations and U.S. dollar clearing activities of a foreign bank.

§ 13:2 Overview of U.S. Anti-Money Laundering Statutes

[1] Bank Secrecy Act

The historical core for anti-money laundering requirements in

the United States is the BSA.⁷ The BSA was enacted in 1970 in response to growing concerns over the use of domestic and foreign bank accounts to launder the proceeds of illegal activities and to evade taxes. Congress sought to address these concerns by requiring financial institutions to maintain “certain reports or records where such reports or records have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.”⁸ The BSA has been amended and expanded many times over the years with the most recent expansion effected by the USA PATRIOT Act.

The principal provisions of the BSA are codified at 31 U.S.C.A. §§ 5311 to 5332. The original provisions of the BSA established requirements for record-keeping and reporting by individuals and financial institutions. The term “financial institution” is broadly defined in the BSA to include not just banks and depository institutions but also a wide range of other entities.⁹ The BSA was originally designed to help to identify the source, volume, and movement of currency and other monetary instruments transported or transmitted into or out of the United States or deposited with financial institutions.¹⁰ The BSA sought to meet this objective by requiring financial institutions to file currency reports, to identify persons conducting transactions, and to maintain records of financial transactions. These reports and records are used by law-enforcement and regulatory agencies to pursue investigations of criminal, tax, and regulatory violations, including money-laundering and other financial crimes.

The BSA has been implemented by a series of regulations issued by the U.S. Department of the Treasury (the Treasury).¹¹ For example, the regulations require financial institutions to file

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⁷Pub. L. No. 91-508, 84 Stat. 1114 (1970) (codified as amended at 12 U.S.C.A. §§ 1829b and 1951 to 1959 and 31 U.S.C.A. §§ 5311 to 5332).

⁸Pub. L. No. 91-508, § 202, 84 Stat. at 1118. For a detailed discussion of the BSA, see John K. Villa, *Banking Crimes: Fraud, Money Laundering & Embezzlement* § 6 (1987).

⁹See 31 U.S.C.A. § 5312(a)(2) for the definition of “financial institution” for purposes of the BSA.

¹⁰31 U.S.C.A. §§ 5313 to 5316.

¹¹The regulations implementing the provisions of the BSA were recently reorganized and transferred to 31 C.F.R. Ch. X from 31 C.F.R. Pt. 301. See *Transfer and Reorganization of Bank Secrecy Act Regulations*, 75 Fed. Reg. 65,806 (Oct. 26, 2010) (the effective date for the transfer and reorganization was March 1, 2011). In this Chapter, all citations to the regulations implementing the BSA are to the regulations as now codified at 31 C.F.R. Ch. X.

a currency transaction report for each deposit, withdrawal, or exchange of currency by, through, or to the financial institution that involves more than \$10,000 in currency.¹² The regulations also require financial institutions to maintain specified information about a customer with respect to transactions involving the purchase or sale of monetary instruments.¹³ The regulations also require banks to maintain certain records with respect to funds transfers of \$3,000 or more.¹⁴

Many of the provisions of Title III of the USA PATRIOT Act were added as amendments to the BSA and have been implemented by the Treasury through rules issued thereunder as discussed in further detail in this Chapter.

[2] Money Laundering Control Act of 1986

A significant development in the criminal prosecution of money-laundering occurred with the enactment of the Anti-Drug Abuse Act of 1986. Title I of that Act, known as the “Money Laundering Control Act of 1986,” contained new criminal offenses for money-laundering and new civil and criminal forfeiture provisions directed at money-laundering as well as certain amendments to the BSA.¹⁵

Section 1352 of the Money Laundering Control Act of 1986, codified as amended in 18 U.S.C.A. §§ 1956 and 1957, created new criminal offenses relating to the laundering of monetary instruments. In its current form, 18 U.S.C.A. § 1956(a)(1) provides for a punishment of up to \$500,000 or twice the value of the property involved (whichever is greater) and a term of imprisonment of up to 20 years for whoever: (i) knowing that property involved in a financial transaction¹⁶ represents the

¹²31 C.F.R. § 1010.311.

¹³31 C.F.R. § 1010.415.

¹⁴31 C.F.R. § 1010.410.

¹⁵Pub. L. No. 99-570, 100 Stat. 3207 to 3218 (1986). For a detailed discussion of the money-laundering criminal statutes, see John K. Villa, *Banking Crimes: Fraud, Money Laundering & Embezzlement* § 6 (1987).

¹⁶The term “financial transaction” is broadly defined as a transaction that in any way or degree affects interstate or foreign commerce involving the movement of funds by wire or other means or involving one or more monetary instruments or involving the transfer of title to any real property, vehicle, vessel, or aircraft or a transaction involving a financial institution that is engaged in or affects interstate or foreign commerce in any degree. 18 U.S.C.A. § 1956(c)(4).

proceeds of some form of unlawful activity,¹⁷ (ii) conducts or attempts to conduct such a financial transaction that, (iii) in fact involves proceeds of specified unlawful activity, (a) with the intent to promote the carrying on of specified unlawful activity or (b) knowing that the transaction is designed in whole or in part (1) to conceal or disguise the nature, location, source, ownership, or control of the proceeds of specified unlawful activity or (2) to avoid a transaction reporting requirement under state or federal law.¹⁸ The term “specified unlawful activity” includes numerous specified felonies and the list of crimes that constitute a “specified unlawful activity” has grown substantially with various amendments to Section 1956.¹⁹ Section 1956(a)(1) requires actual knowledge that the property involved constitutes proceeds of unlawful activity, but the knowledge requirement may be established by a showing of willful blindness, which is generally defined as the conscious avoidance of knowledge.²⁰

18 U.S.C.A. § 1956(a)(2) provides for an identical penalty for whoever: (i) transports, transmits, or transfers, or attempts to transport, transmit, or transfer a monetary instrument or funds either into or out of the United States, (a) with the intent to promote the carrying on of a specified unlawful activity, or (b) knowing that the monetary instrument or funds involved in the transportation represent the proceeds of some form of unlawful activity and (1) knowing that such transportation is designed in

¹⁷The term “knowing that the property involved in a financial transaction represents the proceeds of some form of unlawful activity” does not mean that the person involved must know which form of unlawful activity the proceeds were from but only that the person involved knew the proceeds were from some form of activity that constitutes a felony under state, federal, or foreign law. 18 U.S.C.A. § 1956(c)(1). The term “proceeds” has been held to mean “profits” as opposed to “receipts” where there is no legislative history to the contrary. *U.S. v. Santos*, 553 U.S. 507, 128 S. Ct. 2020, 170 L. Ed. 2d 912, R.I.C.O. Bus. Disp. Guide (CCH) P 12062 (2008).

¹⁸18 U.S.C.A. § 1956(a)(1).

¹⁹18 U.S.C.A. § 1956(c)(7). Section 315 of the USA PATRIOT Act, for example, added foreign corruption offenses to the definition of “specified unlawful activity.” Pub. L. No. 107-56, § 315, 115 Stat. at 308 (codified at 18 U.S.C.A. § 1956(c)(7)(iv) to (vi)).

²⁰*See* *U.S. v. Finkelstein*, 229 F.3d 90, 95 (2d Cir. 2000); *U.S. v. Long*, 977 F.2d 1264, 1271 (8th Cir. 1992); *U.S. v. Campbell*, 977 F.2d 854, 857–59 (4th Cir. 1992); *U.S. v. Antzoulatos*, 962 F.2d 720, 724 (7th Cir. 1992), as amended on denial of reh’g, (May 29, 1992). *See also* *U.S. v. Santos*, 553 U.S. 507, 128 S. Ct. 2020, 170 L. Ed. 2d 912, R.I.C.O. Bus. Disp. Guide (CCH) P 12062 (2008) (noting that a “willful blindness instruction” is appropriate when a professional money launderer is “aware of a high probability that the laundered funds were profits, [and] deliberately avoids learning the truth about them”).

whole or in part to conceal or disguise the nature, location, source, ownership, or control of the proceeds of specified unlawful activity or (2) knowing that such transportation is designed in whole or in part to avoid a transaction reporting requirement under state or federal law.²¹

Subsequent to the passage of the Money Laundering Control Act of 1986, Congress passed the Anti-Drug Abuse Act of 1988, which created a new money-laundering offense codified in 18 U.S.C.A. § 1956(a)(3), which was intended to address law-enforcement concerns regarding the requirement in Section 1956(a)(1) that the property laundered actually be proceeds of a specified unlawful activity as opposed to property provided by undercover law-enforcement officers. Section 1956(a)(3) provides that whoever, with the intent (i) to promote the carrying on of a specified unlawful activity; (ii) to conceal or disguise the nature, location, source, ownership, or control of the property believed to be the proceeds of specified unlawful activity; or (iii) to avoid a transaction reporting requirement under state or federal law, conducts, or attempts to conduct a financial transaction involving property represented to be the proceeds of specified unlawful activity, or property used to conduct or facilitate specified unlawful activity shall be fined and imprisoned for up to 20 years.²²

18 U.S.C.A. § 1957 provides for a penalty of a fine and up to 10 years for whoever: (i) knowingly engages or attempts to engage in a monetary transaction²³ (ii) in criminally derived property (iii) of a value greater than \$10,000 and (iv) that is derived from specified unlawful activity.²⁴ Under 18 U.S.C.A. § 1957, the government need not prove that the defendant knew that the offense from which the property was derived was specified unlawful activity.²⁵

Subsequent to the enactment of the Money Laundering Control

²¹18 U.S.C.A. § 1956(a)(2). *See also* Regalado Cuellar v. U.S., 553 U.S. 550, 128 S. Ct. 1994, 170 L. Ed. 2d 942 (2008) (holding that the government must prove that the purpose of the transport was to conceal or disguise one of the listed attributes, not just that defendant “concealed the funds during their transport”).

²²18 U.S.C.A. § 1956(a)(3).

²³The term “monetary transaction” is defined as the deposit, withdrawal, transfer, or exchange, in or affecting interstate or foreign commerce, of funds or a monetary instrument by, through, or to a financial institution, but such term does not include any transaction necessary to preserve a person’s right to representation as guaranteed by the Sixth Amendment to the Constitution. 18 U.S.C.A. § 1957(f)(1) (2006).

²⁴18 U.S.C.A. § 1957(a).

²⁵18 U.S.C.A. § 1957(c).

Act of 1986, the Annunzio-Wylie Anti-Money Laundering Act amended Section 1956 to provide that any person who conspires to commit any offense defined in Section 1956 or Section 1957 shall be subject to the same penalties as those prescribed for the underlying offense that was the object of the conspiracy.²⁶

In addition to creating the money-laundering crimes described in this Section, the Money Laundering Control Act of 1986 also added 18 U.S.C.A. §§ 981 and 982, which provide for civil and criminal forfeiture of property obtained by a person as a result of a violation of Sections 1956 and 1957, certain violations of the BSA and certain other specified offenses. In its current form, 18 U.S.C.A. § 981 deals with civil forfeiture and provides that any property, real or personal, involved in a transaction or attempted transaction in violation of Section 1956 or Section 1957, or any property that is traceable to such property, is subject to forfeiture to the United States.²⁷

The Money Laundering Control Act of 1986 also added 18 U.S.C.A. § 982, which deals with criminal forfeiture and currently provides that a court in sentencing an individual convicted of an offense under 18 U.S.C.A. § 1956 or § 1957 must order that such person forfeit any real or personal property that was involved in or which is traceable to such offense.²⁸

Finally, in addition to creating the money-laundering offenses and civil and criminal forfeiture provisions, the Money Laundering Control Act of 1986 also made several amendments to the BSA. The provisions of the Money Laundering Control Act of 1986 that amended the BSA include Section 1354, which added a new provision to the BSA that prohibits structuring transactions to evade the reporting requirements of Chapter 2 of Title II of the BSA.²⁹ Also, the maximum civil fines under Title II of the BSA for a willful violation were raised from \$1,000 to the greater of the amount involved in the transaction (not to exceed \$100,000) and \$25,000 and a maximum fine of \$500 could now be imposed for a negligent violation.³⁰

²⁶Pub. L. No. 102-550, § 1530, 106 Stat. 4044, 4066 (1982) (codified as amended at 18 U.S.C.A. § 1956(h)).

²⁷18 U.S.C.A. § 981(a)(1)(A).

²⁸18 U.S.C.A. § 982(a)(1).

²⁹Pub. L. No. 99-570, § 1354, 100 Stat. at 3207 to 3222 (codified as amended at 31 U.S.C.A. § 5324).

³⁰Pub. L. No. 99-570, § 1357, 100 Stat. at 3207 to 3225 (codified as amended at 31 U.S.C.A. § 5321(a)).

[3] Annunzio-Wylie Anti-Money Laundering Act

In 1992, the Annunzio-Wylie Anti-Money Laundering Act, which amended both the BSA and provisions of the Money Laundering Control Act of 1986, was signed into law. A prominent aspect of the Annunzio-Wylie Anti-Money Laundering Act was a new provision that provided that a bank that is convicted of either a money-laundering offense or certain offenses under the BSA could lose its charter or insured status. Specifically, Section 1502 of the Annunzio-Wylie Anti-Money Laundering Act, codified in relevant part, as amended, in 12 U.S.C.A. § 93, states that if a national bank, a federal branch or federal agency is convicted of a criminal offense under 18 U.S.C.A. § 1956 or § 1957, the Comptroller of the Currency shall issue to the national bank, federal branch, or federal agency a notice of the Comptroller's intention to terminate all rights, privileges, and franchises of the bank, federal branch, or federal agency and schedule a pretermination hearing.³¹ If a national bank, federal branch, or federal agency is convicted of any criminal offense under 31 U.S.C.A. § 5322 or § 5324, the Comptroller of the Currency may issue a notice of intention to terminate rights, privileges, and franchises. In determining whether a franchise should be revoked, the Comptroller of the Currency must take into account: (i) the extent to which directors or other senior executive officers were involved in the commission of the money-laundering offense; (ii) the extent to which the offense occurred despite the existence of policies and procedures within the bank designed to prevent the occurrence of any such offense; (iii) the extent to which the bank cooperated with law-enforcement authorities; (iv) the extent to which the bank has implemented additional internal controls since the commission of the offense; and (v) the extent to which the interest of the local community in having adequate deposit and credit services available would be threatened by the forfeiture of the franchise.³² The Annunzio-Wylie Anti-Money Laundering Act also contained similar provisions that apply to state-licensed branches and agencies of foreign banks, federal savings associations, federal credit unions, insured state depository institutions, and insured state credit unions.³³

Additionally, the Annunzio-Wylie Anti-Money Laundering Act

³¹Pub. L. No. 102-550, § 1502, 106 Stat. 4044, 4045 (1992) (codified as amended at 12 U.S.C.A. § 93(d)(1)(A)).

³²Pub. L. No. 102-550, § 1502, 106 Stat. at 4045 to 4046 (codified as amended at 12 U.S.C.A. § 93(d)(2)).

³³Pub. L. No. 102-550, §§ 1502 to 1503, 106 Stat. at 4046 to 4051 (codified as amended at 12 U.S.C.A. §§ 3105(i) (state-licensed branches and agencies),

made several important amendments to the BSA, including provisions that authorized the Secretary of the Treasury (i) to issue regulations requiring any financial institution, and any director, officer, employee, or agent thereof, to report any suspicious transaction relevant to a possible violation of law or regulation and (ii) to issue regulations requiring financial institutions to carry out minimum anti-money laundering programs.³⁴

[4] Money Laundering Suppression Act of 1994

The Money Laundering Suppression Act of 1994 made several amendments to the BSA and added a provision requiring the federal registration of money transmitting businesses. Congress found that money transmitting businesses were largely unregulated and frequently used in sophisticated schemes to transfer large amounts of proceeds from unlawful enterprises and to evade the requirements of the Internal Revenue Code and other laws.³⁵ To address these concerns, any person who owns a money transmitting business is required to register that business with the Secretary of the Treasury whether or not the business is licensed as a money transmitting business in any state.³⁶ A money transmitting business is defined as a business that (i) provides check cashing, currency exchange, or money transmitting or remittance services, or issues or redeems money orders, travelers' checks, and other similar instruments; (ii) is subject to the reporting requirements of Section 5313 of the BSA; and (iii) is not a depository institution as defined in Section 5313 of the BSA.³⁷

In addition to the new registration requirements for money transmitting businesses, the Money Laundering Suppression Act of 1994 made various amendments to the BSA, including a provi-

1464 (federal savings associations), 1772(d) (federal credit unions), 1818 (insured state depository institutions), and 1786(v) (insured state credit unions)). See Board of Governors of the Federal Reserve System, *In the Matter of Bancamer, S.A., and Banca Serfin, S.A.*, Determination Not To Conduct A Termination Proceeding (Dec. 12, 2000), available at <http://www.federalreserve.gov/boarddocs/press/enforcement/2000/20001212/attachment.pdf>.

³⁴Pub. L. No. 102-550, § 1517, 106 Stat. at 4059 to 4060 (codified as amended at 31 U.S.C.A. § 5318(g) and (h)).

³⁵Pub. L. No. 103-325, § 408, 108 Stat. 2243, 2249 to 2250 (1994).

³⁶Pub. L. No. 103-325, § 408, 108 Stat. 2243, 2249 to 2250 (1994) (codified as amended at 31 U.S.C.A. § 5330(a)).

³⁷Pub. L. No. 103-325, § 408, 108 Stat. at 2251 (codified as amended at 31 U.S.C.A. § 5330(d)(1)). The USA PATRIOT Act amended the definition of money transmitting business to add "any other person who engages as a business in the transmission of funds, including any person who engages as a business in an informal money transfer system" Pub. L. No. 107-56, § 359(b), 115 Stat. at 328 (amending 31 U.S.C.A. § 5330(d)(1)(A)).

sion adding a criminal penalty of a maximum of five years imprisonment for structuring transactions to evade certain reporting requirements under the BSA.³⁸

[5] Money Laundering and Financial Crimes Strategy Act of 1998

The Money Laundering and Financial Crimes Strategy Act of 1998 added several provisions aimed at requiring the Executive Branch of the government to develop effective strategies for combating money-laundering. Specifically, the Act required the President, acting through the Secretary of the Treasury and in consultation with the Attorney General, to develop a national strategy for combating money-laundering and related financial crimes and to submit a report on the national strategy to Congress for each of years from 1999 through 2003.³⁹ The Act outlined specific goals, such as the coordination of prevention and enforcement efforts by various federal regulatory agencies and the enhancement of the role of the private financial sector, including by providing incentives to strengthen internal controls and to adopt on an industry wide basis more effective policies.⁴⁰ Additionally, the Secretary of the Treasury was directed to submit as part of the report on the national strategy an evaluation of the effectiveness of existing policies to combat money-laundering.⁴¹ Finally, the Act listed criteria for the Secretary of the Treasury to use in designating certain areas as high-risk money-laundering and financial crime areas as well as criteria for issuing grants to state and local authorities to combat money-laundering.⁴²

[6] USA PATRIOT Act

The USA PATRIOT Act represents a comprehensive legislative enactment directed at the interception and obstruction of

³⁸Pub. L. No. 103-325, § 411, 108 Stat. at 2253 (codified as amended at 31 U.S.C.A. § 5324(d)).

³⁹Pub. L. No. 105-310, § 2, 112 Stat. 2941, 2942 (1998) (codified as amended at 31 U.S.C.A. § 5341(a)).

⁴⁰Pub. L. No. 105-310, § 2, 112 Stat. 2941, 2942 (1998) (codified as amended at 31 U.S.C.A. § 5341(b) and (d)).

⁴¹Pub. L. No. 105-310, § 2, 112 Stat. 2941, 2942 (1998) (codified as amended at 31 U.S.C.A. § 5341(c)). A National Money Laundering Strategy Report was submitted to Congress by the Secretary of the Treasury and the Attorney General for each of the years 1999 through 2003 and for the year 2007. In 2005, the Treasury, the DOJ and several other federal agencies issued a subsequent report, entitled U.S. Money Laundering Threat Assessment, *available at* <http://www.treasury.gov/resource-center/terrorist-illicit-finance/Documents/mlta.pdf>.

⁴²Pub. L. No. 105-310, 112 Stat. at 2944 to 2948 (codified as amended at 31 U.S.C.A. §§ 5342 and 5351 to 5354).

terrorism. Among its many high-profile provisions are those that provide expanded surveillance and investigative powers to the federal government.⁴³ It also contains a set of broad ranging requirements imposed on financial institutions. Title III of the USA PATRIOT Act is specifically directed at strengthening anti-money laundering and counterterrorist financing measures in the financial institutions sector. Section 302 of the USA PATRIOT Act sets forth an extensive list of findings and purposes that underlie the provisions of Title III, all of which share in the common theme of increasing “the strength of United States measures to prevent, detect, and prosecute international money laundering and the financing of terrorism.”⁴⁴ Title III contains provisions that amended and expanded the preexisting provisions in the BSA and other anti-money laundering laws. It also added numerous new provisions to the BSA that impose significant requirements on banks and other financial institutions.

The new requirements added to the BSA by Title III include Section 311, authorizing the Secretary of the Treasury to adopt special measures for foreign jurisdictions, financial institutions, or types of accounts of primary money-laundering concern; Section 312, requiring due diligence and enhanced due diligence in respect to foreign correspondent accounts and private banking accounts; Section 313, prohibiting certain financial institutions from dealing with foreign shell banks; Section 314, providing procedures for cooperation and information sharing by financial institutions relating to terrorist financing; Section 319, providing certain record-keeping requirements for foreign bank correspondent accounts; Section 326, requiring financial institutions to establish customer identification programs; and Section 352, requiring financial institutions to establish anti-money laundering programs.

The Treasury acting through its bureau of the Financial Crimes Enforcement Network (FinCEN) has issued an extensive series of regulations to implement the various requirements of Title III. The following sections of this Chapter discuss in detail the principal provisions added to the BSA by the USA PATRIOT Act and the implementing regulations thereunder.

⁴³For a discussion of these surveillance and investigative provisions, *see* American Bar Association Standing Committee on Law and National Security, *Patriot Debates: Experts Debate the USA PATRIOT Act* (Stewart A. Baker and John Kavanagh eds. 2005).

⁴⁴Pub. L. No. 107-56 § 302(b)(1), 115 Stat. at 279.

§ 13:3 Anti-money laundering program requirement**[1] Statutory Provisions**

As discussed in Section 13:2[1], the historical base for anti-money laundering requirements applicable to U.S. financial institutions has been the BSA.⁴⁵ The legal foundation upon which the U.S. anti-money laundering regime rests is the basic requirement contained in Section 5318(h)(1) of the BSA, which as amended by the USA PATRIOT Act, provides that:

[i]n order to guard against money laundering through financial institutions, each financial institution shall establish anti-money laundering programs, including, at a minimum

- [i] the development of internal policies, procedures, and controls;
- [ii] the designation of a compliance officer;
- [iii] an ongoing employee training program; and
- [iv] an independent audit function to test the programs.⁴⁶

Section 5318(h)(1) of the BSA was amended by Section 352(a) of the USA PATRIOT Act to require each financial institution to establish anti-money laundering programs. Notwithstanding the self-executing nature of the amendment made by Section 352(a), Section 352(c) of the USA PATRIOT Act directed the Secretary of the Treasury to prescribe regulations that “consider the extent to which the requirements imposed under this section are commensurate with the size, location, and activities of the financial

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⁴⁵As originally enacted in 1970, the purpose of the BSA was to require financial institutions to maintain records and file reports that had a “high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.” This section of the BSA was expanded by the USA PATRIOT Act to include reports and records that have a high degree of usefulness “in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.” Pub. L. No. 91-508, § 202, 84 Stat. at 1118, Pub. L. No. 107-56, § 358(a), 115 Stat. at 326 (codified at 31 U.S.C.A. § 5311 (2006)). For purposes of convenience in this Chapter, the relevant sections of subchapter II in Chapter 53 of Title 31 of the U.S. Code will be referred to as sections of the BSA.

⁴⁶31 U.S.C.A. § 5318(h)(1). Prior to its amendment by the Section 352(a) of the USA Patriot Act, § 5318(h)(1) provided the Secretary of the Treasury with the authority to require financial institutions to carry out anti-money laundering programs. However, prior to the enactment of the USA PATRIOT Act, the Secretary of the Treasury had not used this authority with one exception to impose anti-money laundering program requirements on financial institutions. The effect of the amendment made by Section 352(a) was to make the requirement in § 5318(h)(1) self-executing.

institutions to which such regulations apply.”⁴⁷ Section 352(a)(2) also provided that the Secretary of the Treasury, after consulting with the appropriate federal functional regulator, could prescribe minimum standards for the required programs and could exempt financial institutions that were not otherwise subject to the general rules implementing the BSA.⁴⁸

The self-executing nature of the anti-money laundering program requirement in Section 5318(h)(1) presented a significant challenge for the Treasury and the financial industry because the BSA contains a very broad definition of the term “financial institution.” The definition encompasses a wide spectrum of institutions, ranging from traditional depository institutions to broker-dealers and investment companies, to travel agencies and persons involved in real estate closings.⁴⁹ With respect to banking and other depository institutions, the statutory definition of “financial institution” in the BSA expressly includes:

- (i) an insured bank (as defined in Section 3(h) of the Federal Deposit Insurance Act (FDI Act));
- (ii) a commercial bank or trust company;
- (iii) a private banker;
- (iv) an agency or branch of a foreign bank in the United States;
- (v) a credit union; and
- (vi) a thrift institution.⁵⁰

⁴⁷Pub. L. No. 107-56, § 352(c), 115 Stat. at 322.

⁴⁸Pub. L. No. 107-56, § 352(a)(2), 115 Stat. at 322. Section 352(a)(2) of the USA PATRIOT Act incorporates the definition of the term “Federal functional regulator” from § 509 of the Gramm-Leach-Bliley Act (GLB Act) to mean:

- (i) the Board of Governors of the Federal Reserve System;
- (ii) the Office of the Comptroller of the Currency;
- (iii) the Board of Directors of the Federal Deposit Insurance Corporation;
- (iv) the Director of the Office of Thrift Supervision;
- (v) the National Credit Union Administration Board; and
- (vi) the Securities and Exchange Commission.

Pub. L. No. 106-102, § 509, 113 Stat. 1338, 1443 (1999). Section 326 of the USA PATRIOT Act also treats the Commodity Futures Trading Commission as a federal functional regulator. Pub. L. No. 107-56, § 326, 115 Stat. at 318.

⁴⁹31 U.S.C.A. § 5312(a)(2). The BSA definition of the term “financial institution” was further expanded by the amendments made by the USA PATRIOT Act to include futures commission merchants, commodity trading advisors, and commodity pool operations. Pub. L. No. 107-56, § 321(a), 115 Stat. at 315 (codified at 31 U.S.C.A. § 5312(c)(1)).

⁵⁰31 U.S.C.A. § 5312(a)(2)(A) to (F).

Prior to the enactment of the USA PATRIOT Act, most of the categories of the institutions falling within the definition of “financial institution” (other than banking or depository institutions) had not been subject to an anti-money laundering program requirement from any federal regulator.

[2] Regulatory Provisions

[a] FinCEN Regulations

At the time of the enactment of the USA PATRIOT Act, federally regulated depository institutions were required under long-standing regulations issued by the federal banking agencies to establish and maintain anti-money laundering programs.⁵¹ These regulations required federally regulated depository institutions to establish programs with the same four minimum elements as provided in Section 5318(h)(1). Indeed, the regulations of the federal banking agencies were the source for the program requirements reflected in the language of Section 5318(h)(1).⁵² Prior to the passage of the USA PATRIOT Act, the Treasury had used its rule-making authority to extend the program requirements to only one category of institution—casinos.⁵³

At the time of passage of the USA PATRIOT Act, the other types of financial institutions falling within the BSA definition were not required to establish anti-money laundering programs although some institutions had as a matter of prudent risk management adopted their own anti-money laundering programs. In the aftermath of the USA PATRIOT Act, the Securities and Exchange Commission (the SEC) spearheaded an effort with the self-regulatory organizations for the securities industry to adopt rules requiring their member firms to implement anti-money

⁵¹See 12 C.F.R. §§ 21.21, 208.63, and 326.8. *See also* Anti-Money Laundering Programs for Financial Institutions, 67 Fed. Reg. 21,110, 21,111 (Apr. 29, 2002).

⁵²The federal banking agencies originally adopted their anti-money laundering program regulations in 1987. *See* Procedures for Monitoring Bank Secrecy Act Compliance, 52 Fed. Reg. 2858 (Jan. 27, 1987). In 1992, Congress amended the BSA by adding a new provision relating to antimoney programs codified at § 5318(h)(1). Pub. L. No. 102-550, § 1517(b), 106 Stat. 3672, 4060 (1992).

⁵³See 31 C.F.R. § 1021.210. The program requirement for casinos was adopted by the Treasury in 1993. *See* Amendments to the Bank Secrecy Act; Regulations Regarding Reporting and Record-keeping Requirements by Casinos, 58 Fed. Reg. 13,538 (Mar. 12, 1993).

laundering programs.⁵⁴ The Commodity Futures Trading Commission (the CFTC) played a similar role with the principal self-regulatory organization for the futures industry.⁵⁵ As a result of these actions, by April 2002, registered broker-dealers and registered futures commission merchants and introducing brokers were subject to a regulatory requirement from their federal functional regulators and their self-regulatory organizations to implement anti-money laundering programs in conformity with the requirements of Section 352.

In April 2002, the Treasury and FinCEN issued an interim final rule implementing the anti-money laundering program requirements of Section 5318(h)(1) for certain categories of financial institutions and temporarily exempting other categories of financial institutions from the anti-money laundering program requirement.⁵⁶ The interim final rule provided that a financial institution (which for this purpose includes any agency or branch of a foreign bank) with a federal banking agency as its federal functional regulator would be deemed to satisfy the requirements of Section 5318(h)(1) if it implements and maintains an anti-money laundering program that complies with the regulation of its federal functional regulator governing such programs.⁵⁷ The Treasury and FinCEN indicated that examination of these financial institutions by their federal functional regulator, *i.e.*, their federal banking agency regulator, would continue for compliance purposes.⁵⁸ The interim final rule further provided that a financial institution regulated by a self-regulatory organization (as that term is defined in the Securities Exchange Act of

⁵⁴See Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Anti-Money Laundering Compliance Programs, 67 Fed. Reg. 8565 (Feb. 25, 2002); Notice of Filing of Proposed Rule Change by the New York Stock Exchange, Inc. to Adopt NYSE Rule 445, Anti-Money Laundering Compliance Program, 67 Fed. Reg. 10,463 (Mar. 7, 2002). See also Exch. Act Release No. 34-45798 (Apr. 22, 2002) (approving the proposed rules).

⁵⁵See National Futures Association Notice to Members I-02-09: NFA Adopts Amendment to NFA Compliance Rule 2-9 and a Related Interpretive Notice Requiring FCMs and IBs to Implement an Anti-Money Laundering Compliance Program (Apr. 23, 2002), available at <http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=261>.

⁵⁶See Anti-Money Laundering Programs for Financial Institutions, 67 Fed. Reg. 21,110 (Apr. 29, 2000) (now codified at 31 C.F.R. § 1010.205).

⁵⁷See Anti-Money Laundering Programs for Financial Institutions, 67 Fed. Reg. 21,110, 21,113 (Apr. 29, 2000) (now codified at 31 C.F.R. § 1020.210).

⁵⁸See Anti-Money Laundering Programs for Financial Institutions, 67 Fed. Reg. 21,110, 21,111 (Apr. 29, 2000). For a further discussion of the examination process, see § 13:3[3].

1934 (Exchange Act)) would be deemed to satisfy the requirements of Section 5318(h)(1) if the financial institution implements and maintains an anti-money laundering program that complies with the rules or regulations of its self-regulatory organization governing such programs (which have been approved, if required, by the appropriate federal functional regulator) and with any applicable regulation of the federal functional regulator governing such programs.⁵⁹ The Treasury and FinCEN stated that the self-regulatory organizations would examine the member institutions for compliance with these requirements and would take appropriate enforcement action in cases of noncompliance.⁶⁰

At the same time in April 2002, the Treasury and FinCEN adopted interim final rules requiring money services businesses, mutual funds, and operators of credit card systems to implement anti-money laundering programs.⁶¹ Each of these interim final rules incorporated the four minimum program elements from Section 352, but in the case of money services businesses and operators of credit card systems, the rules also included additional specificity for certain of the program elements as applied to those particular categories of financial institutions.⁶²

In the April 2002 action, the Treasury and FinCEN also exempted temporarily all other categories of financial institutions from the requirement of establishing an anti-money laundering program, pending further study and action by the Treasury and FinCEN in promulgating anti-money laundering requirements for specific categories of financial institutions.⁶³ In the period subsequent to April 2002, the Treasury and FinCEN adopted

⁵⁹See Anti-Money Laundering Programs for Financial Institutions, 67 Fed. Reg. 21,110, 21,113 (Apr. 29, 2000) (now codified at 31 C.F.R. § 1023.210(a)).

⁶⁰See Anti-Money Laundering Programs for Financial Institutions, 67 Fed. Reg. 21,110, 21,111 (Apr. 29, 2000). The Treasury noted that the SEC also has authority to examine registered broker-dealers for compliance with the anti-money laundering rules adopted by the self-regulatory organizations.

⁶¹See Anti-Money Laundering Programs for Money Services Businesses, 67 Fed. Reg. 21,114 (Apr. 29, 2002) (now codified at 31 C.F.R. § 1022.210); Anti-Money Laundering Programs for Mutual Funds, 67 Fed. Reg. 21,117 (Apr. 29, 2002) (now codified at 31 C.F.R. § 1024.210); Anti-Money Laundering Programs for Operators of a Credit Card System, 67 Fed. Reg. 21,121 (Apr. 29, 2002) (now codified at 31 C.F.R. § 1028.210).

⁶²Compare 31 C.F.R. § 1024.210 (mutual funds) with 31 C.F.R. §§ 1022.210 (money services businesses) and 1028.210 (operators of credit card system).

⁶³See Anti-Money Laundering Programs for Financial Institutions, 67 Fed. Reg. 21,111 (now codified at 31 C.F.R. § 1010.205) (deferring the application of such requirements for all other financial institutions); Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Financial Institutions, 67

regulations requiring anti-money laundering programs for several additional categories of financial institutions, including certain insurance companies and dealers in precious metals, stones, or jewels,⁶⁴ and proposed regulations for other categories of financial institutions such as unregistered investment companies and investment advisors and commodities trading advisors.⁶⁵ Based on these rule-making processes by the Treasury and FinCEN, there are currently FinCEN regulations in place requiring anti-money laundering programs for the following categories of financial institutions: (i) banks and other depository institutions that are regulated by a federal functional regulator, (ii) brokers or dealers that are regulated by the SEC and futures commission merchants and introducing brokers that are regulated by the CFTC, (iii) open-end investment companies (mutual funds), (iv) money services businesses (as that term is defined in the BSA regulations), (v) operators of credit card systems, (vi) certain insurance companies (as specified in the BSA regulations), (vii) dealers in precious metals, stones, or jewels, and (viii) residential mortgage lenders and originators. Other categories of institutions that fall within the definition of “financial institution” in Section 5312(a)(2) and (c)(1) continue to be exempt from the requirements of Section 5318(h)(1) although, as noted previously in this Section, many of these institutions have adopted anti-money laundering policies and procedures as a matter of prudent risk management.

[b] Federal Banking Agency Regulations

Prior to enactment of the USA PATRIOT Act, each of the federal banking agencies had adopted a regulation requiring their regulated institutions to establish and maintain an anti-money laundering program that included as a minimum the four

Fed. Reg. 67,547 (Nov. 6, 2002) (further deferring the application of such requirements).

⁶⁴See Anti-Money Laundering Programs for Insurance Companies, 70 Fed. Reg. 66,754 (Nov. 3, 2005) (now codified at 31 C.F.R. § 1025.210); Anti-Money Laundering Programs for Dealers in Precious Metals, Stones or Jewels, 70 Fed. Reg. 33,702 (June 9, 2005) (now codified at 31 C.F.R. § 1027.210).

⁶⁵See Anti-Money Laundering Programs for Unregistered Investment Companies, 67 Fed. Reg. 60,617 (Sept. 26, 2002) (proposed rule); Anti-Money Laundering Program for Commodity Trading Advisors, 68 Fed. Reg. 23,640 (May 5, 2003) (proposed rule); Anti-Money Laundering Program for Investment Advisers, 68 Fed. Reg. 23,646 (May 5, 2003) (proposed rule). These proposed rules were withdrawn by FinCEN in October 2008.

program elements specified in Section 5318(h)(1).⁶⁶ The provisions of the federal banking agency regulations are essentially identical. The Office of the Comptroller of the Currency (the OCC), the federal banking agency that charters national banks and licenses federal branches and agencies of foreign banks, has implemented its anti-money laundering program requirement in Section 21.21 of its regulations.⁶⁷ Section 21.21 requires that each national bank develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with the record-keeping and reporting requirements of the BSA and its implementing regulations.⁶⁸ The compliance program must be written, approved by the bank's board of directors, and reflected in the minutes.⁶⁹ The regulation further states that the compliance program shall at a minimum:

- (i) provide for a system of internal controls to assure ongoing compliance;
- (ii) provide for independent testing for compliance to be conducted by bank personnel or by an outside party;
- (iii) designate an individual or individuals responsible for coordinating and monitoring day-to-day compliance; and
- (iv) provide training for appropriate personnel.⁷⁰

Elsewhere in its regulations, the OCC provides that the operations of a foreign bank at a federal branch or agency (*i.e.*, at a branch or agency that has been licensed by the OCC) shall be conducted subject to the same duties, restrictions, conditions, and limitations that would apply if the federal branch or agency were a national bank.⁷¹ On this basis, a federal branch or agency of a foreign bank is subject to the same requirements under Section 21.21 with respect to the establishment and maintenance of an anti-money laundering program as a national bank would be.

The Federal Deposit Insurance Corporation (the FDIC), the federal banking agency that insures deposits in banks chartered under federal or state banking laws (and deposits in grandfa-

⁶⁶12 C.F.R. §§ 21.21, 208.63, and 326.8. *See also* Procedures for Monitoring Bank Secrecy Act Compliance, 52 Fed. Reg. 2858 (Jan. 27, 1987) (adopting regulations requiring a program to monitor compliance with the BSA).

⁶⁷12 C.F.R. § 21.21.

⁶⁸12 C.F.R. § 21.21(b).

⁶⁹12 C.F.R. § 21.21(b).

⁷⁰12 C.F.R. § 21.21(c).

⁷¹12 C.F.R. § 28.13(a). For a general discussion of the various legal and regulatory requirements applicable to a federal branch or agency of a foreign bank, *see* §§ 1:1 et seq.

thered branches of foreign banks), has implemented its anti-money laundering program requirement in Section 326.8 of its regulations.⁷² The anti-money laundering program requirements in Section 326.8 are identical to those in the OCC regulation. Section 326.8 applies to all insured nonmember banks (*i.e.*, state-chartered banks that are not members of the Federal Reserve System). State-licensed branches of foreign banks that are insured by the FDIC are subject to the provisions of Section 326.8.⁷³

The Board of Governors of the Federal Reserve System (the Federal Reserve Board), the federal banking agency that regulates bank holding companies, state-chartered banks that are members of the Federal Reserve System (state member banks), and state-licensed branches, agencies, and representative offices of foreign banks, has implemented its anti-money laundering program requirements in two regulations. Regulation H of the Federal Reserve Board, which relates to the operations of state member banks, imposes anti-money laundering program requirements on state member banks in terms that are substantially identical to those of the OCC and FDIC regulations.⁷⁴ Unlike the comparable regulations of the OCC and the FDIC, however, Regulation H by its terms does not apply to a branch or agency of a foreign bank that is subject to Federal Reserve Board regulation and supervision. Instead, in 2006, the Federal Reserve Board separately added to Regulation K, which governs the foreign operations of U.S. banks and the U.S. operations of foreign banks, a provision incorporating the anti-money laundering program requirements of Regulation H.⁷⁵ The relevant provision of Regulation K now requires each branch, agency, or representative office of a foreign bank operating in the United States (other than a branch or agency licensed by the OCC or a state branch insured by the FDIC) to develop and provide for an anti-money laundering program in accordance with the provisions of Regula-

⁷²12 C.F.R. § 326.8. For a general discussion of the various legal and regulatory requirements applicable to insured branches of foreign banks, see §§ 9:1 et seq.

⁷³12 C.F.R. § 326.8 n.3 (stating that the program and procedures requirements of § 326.8 apply to an insured state branch of a foreign bank).

⁷⁴See 12 C.F.R. § 208.63.

⁷⁵See International Banking Operations, 71 Fed. Reg. 13,934, 13,936 (Mar. 20, 2006) (codified at 12 C.F.R. § 211.24(j)(1)).

tion H.⁷⁶ The relevant provision in Regulation K also specifies that the board of directors' approval requirement in Regulation H may be met in the case of a U.S. branch, agency, or representative office of a foreign bank either by approval by the board of the foreign bank itself or by a delegate acting under express authority from the board to approve the compliance program.⁷⁷

This provision in Regulation K completes a triad of federal banking agency regulations imposing anti-money laundering program requirements on the U.S. branches and agencies of foreign banks. Another provision in Regulation K provides that each Edge corporation or agreement corporation is also required to develop and provide for an anti-money laundering program in accordance with the provisions of Regulation H.⁷⁸ As noted in Section 13:3[2][a], compliance with these federal banking agency regulations by a U.S. branch, agency, or representative office or by a U.S. bank subsidiary or Edge Act subsidiary of a foreign bank satisfies the requirements of Section 5318(h)(1) of the BSA, based on Section 1020.100 of the FinCEN regulations.

[3] Supervisory and Examination Process

The language of Section 5318(h)(1) as well as the implementing regulation of FinCEN and the preexisting regulations of the federal banking agencies provide only the most generic guidance on the requirements for an anti-money laundering program. More precise requirements have been developed in practice over a number of years through the bank supervisory and examination process and more recently through the regulatory-enforcement process. Several guidance documents issued by the federal banking agencies over the years have provided a partial source of learning and an indication of expectations that the federal banking agencies have brought to the process of assessing anti-money

⁷⁶In adopting this amendment to Regulation K, the Federal Reserve Board stated that it was merely codifying what had been its longstanding supervisory practice of expecting U.S. branches, agencies and representative offices to develop BSA compliance programs that are risk-based. *See* International Banking Operations, 71 Fed. Reg. 13,934, 13,935 (Mar. 20, 2006). The scope of a risk-based program for a representative office would presumably be less extensive than for a branch or agency because of the limited nature of a representative office's permissible activities. *See* 12 C.F.R. § 211.24(d)(1) of Regulation K (describing the limited range of activities permissible to a representative office).

⁷⁷*See* International Banking Operations, 71 Fed. Reg. at 13,936 (codified at 12 C.F.R. § 211.24(j)(1)).

⁷⁸*See* International Banking Operations, 71 Fed. Reg. 13,936 (codified at 12 C.F.R. § 211.5(m)(1)). For a general discussion of the activities of Edge corporations and agreement corporations, *see* §§ 15:1 et seq.

laundering programs.⁷⁹ The examination manuals used by the federal banking agencies have also historically been an important source of information and guidance on supervisory requirements and expectations.⁸⁰ With a regulation that does no more than state general program requirements, guidance in any form from the regulators was a welcomed aid.

From the banking industry's perspective, however, the existing regulatory guidance and examination manuals were incomplete and in some critical areas out of date. Moreover, the regulatory and enforcement environment in the United States was significantly altered by the events of September 11, 2001, and the consequent enactment of the USA PATRIOT Act. The pace of enforcement actions relating to anti-money laundering and BSA matters had already accelerated and a number of prominent enforcement actions were taken against the domestic and foreign banks operating in the United States prior to September 11, 2001.⁸¹ Nonetheless, the events of September 11, 2001 and the more specific requirements of the USA PATRIOT Act led to an

⁷⁹*See, e.g.*, Board of Governors of the Federal Reserve System, Division of Banking Supervision and Regulation, Supervisory Letter SR 97-19 (SUP) (Jan. 30, 1997): Private Banking Activities, *available at* <http://www.federalreserve.gov/BoardDocs/SRLetters/1997/SR9719.HTM>; Supervisory Letter SR 01-03 (SUP) (Jan. 16, 2001): Guidance on Enhanced Scrutiny for Transactions That May Involve the Proceeds of Foreign Official Corruption, *available at* <http://www.federalreserve.gov/boarddocs/srletters/2001/SR0103.htm>.

⁸⁰*See, e.g.*, Comptroller's Handbook, Bank Secrecy Act/Anti-Money Laundering (Sept. 2000), *available at* <http://www.occ.gov/static/publications/handbook/bsa.pdf>; Federal Reserve Board, Bank Secrecy Act Examination Manual (Sept. 1997), *available at* <http://www.federalreserve.gov/boarddocs/SupManual/bsa/7-00bsaman.pdf>.

⁸¹*See, e.g.*, Board of Governors of the Federal Reserve System and Superintendent of Banks of the State of New York, *In the Matter of U.S. Trust Corporation*, Order to Cease and Desist and Order of Assessment of Civil Money Penalty and Monetary Payment Issued Upon Consent (July 12, 2001), *available at* <http://www.federalreserve.gov/boarddocs/press/enforcement/2001/20010713/Attachment.pdf> (citing *inter alia* apparent violations of the BSA and FinCEN regulations & §§ 208.62 and 208.63 of Regulation H); Board of Governors of the Federal Reserve System, *In the Matter of Bancamer, S.A.*, Cease and Desist Order Upon Consent (Dec. 12, 2000), *available at* <http://www.federalreserve.gov/boarddocs/press/Enforcement/2000/20001212/attachment.pdf> (requiring a written program to ensure compliance with the record-keeping and reporting requirements of the BSA and FinCEN regulations and an enhanced customer due diligence program to ensure compliance with requirements of §§ 208.62 and 208.63 of Regulation H); Written Agreement by and among Banco Industrial de Venezuela and Federal Reserve Bank of Atlanta (Dec. 12, 2000), *available at* <http://www.federalreserve.gov/boarddocs/press/enforcement/2000/20001212/attachment.pdf> (requiring a written program to ensure compliance with the record-keeping and reporting requirements of the BSA and FinCEN regulations and an enhanced

examination focus and enforcement process that was dominated by anti-money laundering and terrorist financing concerns. A series of high profile regulatory and law-enforcement actions were taken against domestic and foreign banking organizations in the United States.⁸² In some cases, these actions were directed at failures or alleged failures to implement the basic requirements of an anti-money laundering program and a suspicious activity reporting program.⁸³ In other cases, the actions were also directed at more specific requirements imposed by the USA PATRIOT Act.⁸⁴

These public enforcement actions as well as mounting criticisms of banks in the private examination process produced widespread concerns in the banking industry. Among the concerns were a perceived lack of consistency in the examination process, a lack of detailed guidance on the requirements for an acceptable anti-money laundering program, and a growing sense that the

customer due diligence report to ensure compliance with the requirements of §§ 208.62 and 208.63 of Regulation H); Written Agreement by and among Banco Bilbao Vizcaya Argentaria, S.A., Federal Reserve Bank of Atlanta, Federal Reserve Bank of New York, New York State Banking Department, and State of Florida Department of Banking and Finance (June 12, 2000), *available at* <http://www.federalreserve.gov/boarddocs/Press/enforcement/2000/20000623/attachment.pdf> (requiring *inter alia* enhanced customer due diligence program to ensure compliance with suspicious activity reporting requirements of Regulation K); Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, California Department of Financial Institutions, Illinois Office of Banks and Real Estate, New York State Banking Department, and Washington Department of Financial Institutions, *In the Matter of Korea Exchange Bank*, Order Issued Upon Consent (May 16, 2000), *available at* <http://www.federalreserve.gov/boarddocs/press/enforcement/2000/20000518/attachment.pdf> (requiring *inter alia* a written program to ensure compliance with the record-keeping and reporting requirements of the BSA and FinCEN regulations and an enhanced customer due diligence program to ensure compliance with the requirements of §§ 208.62 and 208.63 of Regulation H); Written Agreement by and between Banco Popular de Puerto Rico and Federal Reserve Bank of New York (Mar. 9, 2000), *available at* <http://www.federalreserve.gov/boarddocs/press/enforcement/2000/20000309/attachment.pdf> (requiring *inter alia* a written program to ensure compliance with the record-keeping and reporting requirements of the BSA and FinCEN regulations and an enhanced customer due diligence program to ensure compliance with the requirements of §§ 208.62 and 208.63 of Regulation H); and Written Agreement by and among Bank of New York, Federal Reserve Bank of New York, and New York State Banking Department (Feb. 8, 2000), *available at* <http://www.federalreserve.gov/boarddocs/press/enforcement/2000/20000208/attachment.pdf> (requiring *inter alia* an enhanced customer due diligence program to ensure compliance with the requirements of § 208.62 of Regulation H).

⁸²See § 13:3[4].

⁸³See §§ 13:3[4] and 13:4[4].

⁸⁴See §§ 13:10[4] and 13:11[4].

regulators or at the least their examination staff were adopting a “zero tolerance” policy for anti-money laundering deficiencies.⁸⁵ One of the intended consequences of the high-profile enforcement actions was to raise the general awareness among financial institutions to the need for more robust procedures and sophisticated systems for compliance with the BSA. One of the unintended consequences of the high-profile enforcement actions was a rising tide of “defensive” suspicious activity report filings that FinCEN itself concluded threatened to swamp its data warehouse and analytical systems.⁸⁶ In response to these concerns, the federal banking agencies undertook the task of creating a document that could be used by bank examiners and regulated entities alike as a guide to anti-money laundering and BSA compliance requirements. In June 2005, the federal banking agencies, through the medium of the Federal Financial Institutions Examination Council, working together with FinCEN, issued the Bank Secrecy Act Anti-Money Laundering Examination Manual (the FFIEC Manual). With over 400 pages of text and appendices, the FFIEC Manual is comprehensive, covering virtually all areas of anti-money laundering concern as well as OFAC requirements relating to terrorist and economic sanctions laws. It is detailed, providing specific guidance in many areas of anti-money laundering requirements. The FFIEC Manual provides the details of the policies, procedures, and controls that are lacking in the general language of Section 5318(h)(1) and the implementing regulations. The statutory requirement articulated in the phrase “internal policies, procedures and controls” has been translated into more than 400 pages of textual guidance. Finally, the FFIEC Manual is timely, replacing earlier examination manuals that were incomplete and out of date. The importance of timely guidance, particularly as best practices evolve and regulatory expectations expand, has been embraced by the regulatory authorities who have indicated that they intend to update the FFIEC Manual on a regular basis. The FFIEC Manual was most recently revised and updated in April 2010.⁸⁷

The FFIEC Manual provides the roadmap for developing the

⁸⁵See, e.g., Letter from the American Bankers Association *et al.* to the Federal Deposit Insurance Corporation, Federal Reserve Board, Office of the Comptroller of the Currency, Office of Thrift Supervision, Department of the Treasury, and FinCEN (Jan. 10, 2005).

⁸⁶See FinCEN, The SAR Activity Review, Trends, Tips & Issues (Apr. 2005) at 3, available at http://www.fincen.gov/newsroom/rp/files/sar_tti_08.pdf.

⁸⁷Federal Financial Institutions Examination Council, Bank Secrecy Act Anti-Money Laundering Examination Manual (2010), available at <http://www.ff>

internal policies, procedures, and controls necessary to satisfy the first element of an anti-money laundering program as required by Section 5318(h)(1). The examination procedures sections of the FFIEC Manual also provide a reference for the work plan and procedures for the internal (or external) audit function to test an institution's anti-money laundering program to satisfy the testing element of an anti-money laundering program as required by Section 5318(h)(1). The FFIEC Manual should be the starting point for the development of expanded internal audit procedures for banking institutions in the anti-money laundering and BSA areas.

The FFIEC Manual is the principal source of guidance for domestic and foreign banking institutions in designing and implementing an effective anti-money laundering program. The periodic updates to the FFIEC Manual provide insight to developing issues that the federal regulators have identified either through their examination process or through law-enforcement activities. The 2010 update, for example, included new or updated sections on bulk currency shipments, remote deposit capture, and payment processor relationships as requiring attention.⁸⁸ In addition to the FFIEC Manual, the federal banking agencies and FinCEN have issued a series of guidance documents on issues or questions arising under the various requirements of the USA PATRIOT Act.⁸⁹ These guidance documents provide more detailed information on specific issues than is contained in the FFIEC Manual and are necessary reading for parties designing an anti-money laundering program.

FinCEN holds the delegated authority from the Secretary of the Treasury to administer the BSA, including the power to examine financial institutions for compliance with the BSA.⁹⁰ By regulation, however, the Treasury has delegated the examination authority under the BSA to the federal functional regulator for the categories of financial institutions that are subject to federal

[iec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2010.pdf](http://www.ffc.gov/bsa_aml_infobase/documents/BSA_AML_Man_2010.pdf). (FFIEC Manual).

⁸⁸Press Release, The 2010 Version of the Bank Secrecy Act/Anti-Money Laundering Examination Manual (Apr. 29, 2010), *available at* <http://www.fincen.gov/newsroom/nr/html/20100429.html>.

⁸⁹The individual guidance documents issued by FinCEN are *available at* http://www.fincen.gov/statutes_regs/guidance/.

⁹⁰*See* 31 U.S.C.A. § 5318(a)(1) and (3) & Treas. Dep't Order No. 180-01 (Mar. 24, 2003), *available at* <http://www.treasury.gov/about/role-of-treasury/orders-directives/Pages/to180-01.aspx>.

functional regulation.⁹¹ Thus, domestic banking institutions and foreign banking institutions operating in the United States are examined for BSA compliance in the first instance by the federal banking agency primarily responsible for their general supervision. FinCEN retains to itself, however, enforcement authority under the BSA, including enforcement authority against banking institutions.⁹² The relationship between the federal banking agencies and FinCEN with respect to the examination process has been further formalized by the execution in 2004 of a memorandum of understanding among FinCEN and the federal banking agencies.⁹³ The memorandum of understanding contains a detailed set of procedures for the sharing of information between FinCEN and the federal banking agencies. One of the most important provisions in the memorandum of understanding requires the federal banking agencies to notify FinCEN promptly of any “significant BSA violations or deficiencies” that are identified as part of the bank examination process.⁹⁴ The purpose of the memorandum of understanding is to facilitate closer coordination of BSA supervision and enforcement with respect to banking institutions.⁹⁵ As noted in the following Section, joint enforcement actions by the federal banking agencies and

⁹¹31 C.F.R. § 1010.810(b).

⁹²See 31 C.F.R. § 1010.810(d). The federal banking agencies also have separate authority under the FDI Act, 12 U.S.C.A. § 1818(s), to enforce the requirement that depository institutions establish procedures for assuring compliance with the BSA. See Pub. L. No. 99-570, § 1359(a)(1), 100 Stat. 3207 (1986) (codified at 12 U.S.C.A. § 1818(s)).

⁹³See Memorandum of Understanding among the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Financial Crimes Enforcement Network, the Office of the Comptroller of the Currency and the Office of Thrift Supervision (Sept. 2004), available at http://www.ffiec.gov/bsa_aml_infobase/documents/FinCEN_DOCs/Memo_Understand_Sept04.pdf.

⁹⁴See Memorandum of Understanding among the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Financial Crimes Enforcement Network, the Office of the Comptroller of the Currency and the Office of Thrift Supervision (Sept. 2004) at § II.E, available at http://www.ffiec.gov/bsa_aml_infobase/documents/FinCEN_DOCs/Memo_Understand_Sept04.pdf.

⁹⁵FinCEN has entered into similar memoranda of understanding with many state banking authorities. See, e.g., FinCEN News, Financial Crimes Enforcement Network Signs Information Sharing Agreement with State Banking Agencies (June 2, 2005), available at <http://www.fincen.gov/newsroom/nr/html/20050602.html>. FinCEN and the SEC have also entered into a memorandum of understanding under which the SEC will provide FinCEN with detailed information on a quarterly basis regarding the SEC and the self-regulatory organizations' examination and enforcement activities in the anti-

FinCEN have become a prominent feature in the BSA area.

[4] Enforcement Actions

In addition to formal guidance documents and examination manuals, regulatory and law-enforcement actions in the anti-money laundering and BSA areas have been important sources of guidance for banks and other financial institutions in assessing the breadth and depth of compliance programs. Enforcement orders in the form of written agreements or cease and desist orders (frequently issued with the consent of the banking institution that neither admits nor denies the charges in the order) issued by the federal and state bank regulatory agencies include relatively detailed remedial steps that are required to address the deficiencies that are the subject of the enforcement order. Although the staff of the federal banking agencies generally aver that an enforcement order is specific to the institution involved and is not intended to be used for the purpose of setting policy, the specific actions required to be taken in an individual enforcement order may provide insights into the general requirements or expectations of the regulator. FinCEN also issues civil money penalties against banks and other financial institutions for violations of the BSA. Even more important, federal and state law-enforcement actions provide a further indication of the range of fact patterns that may translate not only into civil fines and remedial orders but also into criminal fines and nonprosecution, deferred prosecution, or plea agreements with federal and state law-enforcement authorities.

The most prominent enforcement actions in the anti-money laundering area have involved a combination of bank regulatory-enforcement orders, FinCEN fines, and criminal fines under plea agreements, deferred prosecution agreements, or nonprosecution agreements. A leading example of this combined enforcement approach was the case of Riggs Bank, N.A. (Riggs), which was the subject of multiple enforcement actions between 2003 and 2005 from the OCC and FinCEN. In a series of enforcement actions, the OCC and FinCEN cited Riggs for violations of the anti-money laundering program requirements of the BSA and the suspicious activity reporting requirement of the BSA and imposed a \$25

money laundering area. See Joint Release, SEC and FinCEN Sign Information Sharing Agreement (Dec. 21, 2006), available at <http://www.fincen.gov/newsroom/nr/html/20061221.html>.

million civil money penalty on Riggs.⁹⁶ The enforcement actions stated that the Riggs anti-money laundering program was deficient in all four elements required by Section 5318(h)(1).⁹⁷ The enforcement orders cited specific failures to identify and monitor accounts relating to “politically exposed persons” from several foreign countries.⁹⁸ These regulatory investigations ultimately lead to an investigation by the U.S. Department of Justice (DOJ) and the entry of a criminal plea agreement by Riggs in January 2005 pursuant to which Riggs pled guilty to a charge of failing to file timely or accurate suspicious activity reports for the period of March 1999 through December 2003 and paid a fine of \$16 million.⁹⁹

⁹⁶*In the Matter of Riggs Bank National Association*, Consent Order No. 2003-79 (July 16, 2003), available at <http://www.occ.gov/static/enforcement-actions/ea2003-79.pdf>; *In the Matter of Riggs Bank N.A.*, Consent Order of Civil Money Penalty No. 2004-44 (May 13, 2004), available at <http://www.occ.gov/static/news-issuances/news-releases/2004/nr-occ-2004-34-consent-order-44.pdf>; *In the Matter of Riggs Bank N.A.*, Consent Order No. 2004-43 (May 13, 2004), available at <http://www.occ.gov/static/news-issuances/news-releases/2004/nr-occ-2004-34-consent-order-43.pdf>; *In the Matter of Riggs Bank, N.A.*, Assessment of Civil Money Penalty No. 2004-01 (May 13, 2004), available at http://www.fince.n.gov/news_room/ea/files/riggsassessment3.pdf.

⁹⁷*In the Matter of Riggs Bank National Association*, Consent Order No. 2003-79 (July 16, 2003), available at <http://www.occ.gov/static/enforcement-actions/ea2003-79.pdf>; *In the Matter of Riggs Bank N.A.*, Consent Order of Civil Money Penalty No. 2004-44 (May 13, 2004), available at <http://www.occ.gov/static/news-issuances/news-releases/2004/nr-occ-2004-34-consent-order-44.pdf>; *In the Matter of Riggs Bank N.A.*, Consent Order No. 2004-43 (May 13, 2004), available at <http://www.occ.gov/static/news-issuances/news-releases/2004/nr-occ-2004-34-consent-order-43.pdf>; *In the Matter of Riggs Bank, N.A.*, Assessment of Civil Money Penalty No. 2004-01 (May 13, 2004), available at http://www.fince.n.gov/news_room/ea/files/riggsassessment3.pdf.

⁹⁸The 2004 OCC Consent Order for Civil Money Penalty cited the fact that Riggs had, through a lack of information on its foreign private banking accounts, failed to identify almost one-third of the accounts related to the country of Saudi Arabia and a high number of accounts related to the country of Equatorial Guinea. *In the Matter of Riggs Bank N.A.*, Consent Order of Civil Money Penalty No. 2004-44, 4 (May 13, 2004). The Consent Order also stated that Riggs had failed to identify or monitor potentially suspicious activity involving millions of dollars in cash withdrawals from accounts related to the Saudi Arabian embassy. *In the Matter of Riggs Bank N.A.*, Consent Order of Civil Money Penalty No. 2004-44, 5-6 (May 13, 2004). The 2004 OCC Consent Order required Riggs *inter alia* to conduct a “look-back” review covering the period from January 3, 2001, through April 30, 2004, of all accounts in its Embassy and International Private Banking areas that were identified as high risk. *In the Matter of Riggs Bank N.A.*, Consent Order No. 2004-43, 2-5 (May 13, 2004).

⁹⁹Press Release, DOJ, Riggs Bank Enters Guilty Plea and Will Pay \$16 Million Fine for Criminal Failure to Report Numerous Suspicious Transactions

Deferred prosecution agreements accompanied by FinCEN or bank regulatory assessment of significant fines have been used against other domestic and foreign banking institutions. For example, in December 2005, the New York County District Attorney's Office together with the New York State Banking Department (NYSBD) and the FDIC announced a joint settlement with Israel Discount Bank of New York (IDBNY), a New York state-chartered banking subsidiary of Israel Discount Bank Limited, relating to deficiencies in its anti-money laundering policies and procedures.¹⁰⁰ The settlement consisted of a settlement and cooperation agreement with the District Attorney's Office and cease and desist orders issued by the NYSBD and the FDIC. As part of the settlement, IDBNY agreed to pay \$8.5 million to the District Attorney's Office. The cease and desist orders issued by the NYSBD and the FDIC required detailed remedial actions with respect to each of the four basic elements of an anti-money laundering program as well as a third-party "look-back" review of account and transaction activity, covering the period from January 1, 2003, through December 15, 2005.¹⁰¹ The purpose of a "look-back" review is to determine whether suspicious activity was properly identified and reported in accordance with the suspicious activity reporting requirements under the BSA. Enforcement actions in the BSA area frequently include a requirement for such a "look-back" review. In the IDBNY case, the outcome of the "look-back" review was another round of regulatory fines. In October 2006, FinCEN, the NYSBD, and the FDIC assessed civil money penalties against IDBNY in the amount of \$12 million.¹⁰²

In August 2007, American Express Bank International (AEBI),

(Jan. 27, 2005), available at <http://www.justice.gov/tax/usaopress/2005/txdv050530.html>. The press release describes various suspicious transactions by or on behalf of Augusto Pinochet, the former President of Chile, and similar suspicious transactions for senior political figures from Equatorial Guinea.

¹⁰⁰Press Release, New York State Banking Department, Banking Department Joins Manhattan District Attorney in Announcing Joint Settlement with Israel Discount Bank (Dec. 16, 2005).

¹⁰¹*In the Matter of Israel Discount Bank of New York*, Order to Cease and Desist FDIC-05-232b (Dec. 15, 2005), available at <http://www.fdic.gov/bank/individual/enforcement/12506.html>; *In the Matter of Israel Discount Bank of New York*, Order to Cease and Desist Pursuant to Section 39 of the New York Banking Law Issued Upon Consent (Dec. 15, 2005), available at <http://www.banking.state.ny.us/ea051216.pdf>.

¹⁰²*In the Matter of Israel Discount Bank of New York*, Assessment of Civil Money Penalty No. 2006-7 (Oct. 31, 2006), available at http://www.fincen.gov/news_room/ea/files/fincen_assessment_of_civil_money_penalty.pdf; *In the Matter of Israel Discount Bank of New York*, Order of Assessment of Civil Monetary Penalty Upon Consent (Oct. 20, 2006), available at <http://www.bankin>

an Edge Act subsidiary of American Express Bank Ltd., entered into a deferred prosecution agreement with the DOJ with respect to the charge that it had failed to maintain an effective anti-money laundering program as required by Section 5318(h)(1) of the BSA.¹⁰³ Pursuant to the deferred prosecution agreement, AEBI made a forfeiture payment of \$55 million to the DOJ. The Factual Statement accompanying the deferred prosecution agreement indicates that there were certain foreign private banking accounts at AEBI that the DOJ believed were used to launder drug proceeds through the Black Market Peso Exchange.¹⁰⁴ As part of the resolution of the DOJ investigation, the Federal Reserve Board issued a consent cease and desist order and a civil money penalty in the amount of \$20 million against AEBI, which was deemed satisfied by AEBI's payment to the DOJ.¹⁰⁵ FinCEN also issued a civil money penalty against AEBI for an additional \$10 million.¹⁰⁶ At the same time, American Express Bank Ltd. entered into a written agreement with the NYSBD under which American Express Bank Ltd. agreed to implement various enhancements and remedial measures relating to its anti-money laundering program.¹⁰⁷

In September 2007, the DOJ took action against Union Bank of California, N.A., an indirect majority-owned subsidiary of Mitsubishi UFJ Financial Group. Union Bank of California entered into a deferred prosecution agreement with the DOJ and agreed to forfeit \$21.6 million relating to a charge that it failed to maintain an effective anti-money laundering program in violation

[g.state.ny.us/ea061020.pdf](http://www.g.state.ny.us/ea061020.pdf); *In the Matter of Israel Discount Bank of New York*, Order to Pay FDIC-06-099k (Oct. 31, 2006), available at <http://www.fdic.gov/bank/individual/enforcement/2006-10-00.pdf>.

¹⁰³*United States of America v. American Express Bank International* No. 07-20602 (S.D. Fla. Aug. 6, 2007) (Deferred Prosecution Agreement), available at http://www.justice.gov/dea/pubs/states/newsrel/wdo080607__attachment.pdf.

¹⁰⁴*United States of America v. American Express Bank International*, Factual Statement, ¶ 4.

¹⁰⁵*In the Matter of American Express Bank International*, Cease and Desist Order and Order of Assessment of a Civil Money Penalty Upon Consent, Dkt. No. 07-017-B-EC (Aug. 3, 2007), available at <http://www.federalreserve.gov/newsevents/press/enforcement/enf20070806a1.pdf>.

¹⁰⁶*In the Matter of American Express Bank International and American Express Travel Related Services Company, Inc.*, Assessment of Civil Money Penalty No. 2007-1 (Aug. 3, 2007), available at http://www.fincen.gov/fincen__amex.pdf.

¹⁰⁷Written Agreement Between American Express Bank Ltd. and New York State Banking Department (Aug. 6, 2007), available at <http://www.banking.state.ny.us/ea070806.htm>.

of Section 5318(h)(1) of the BSA.¹⁰⁸ The OCC and FinCEN also issued an additional \$10 million civil money penalty against Union Bank of California for violations of the BSA.¹⁰⁹ These enforcement orders focused principally on the failure by Union Bank of California to monitor transactions in correspondent accounts for Mexican currency exchange houses, *casas de cambio*.

Another high profile example of combined law-enforcement and regulatory actions against a bank for failure to maintain an effective anti-money laundering program involved Wachovia Bank, N.A. In March 2010, Wachovia Bank entered into a deferred prosecution agreement with the DOJ on a charge of failing to maintain an anti-money laundering program in violation of Section 5318(h)(1) of the BSA.¹¹⁰ As part of the deferred prosecution agreement, Wachovia Bank agreed to make a forfeiture payment of \$110 million to the DOJ. In a simultaneous action, FinCEN assessed a civil money penalty of \$110 million against Wachovia, which was satisfied by the \$110 million forfeiture payment to the DOJ.¹¹¹ FinCEN noted that this assessment was the largest penalty ever assessed by FinCEN against a financial institution. The OCC assessed a separate \$50 million civil money penalty against Wachovia Bank.¹¹² The principal focus of these actions was Wachovia's correspondent banking relationships with various Mexican currency exchange houses and other foreign correspondent customers.¹¹³ The enforcement orders recited that Wachovia failed to implement adequate policies, procedures, and monitoring controls over the repatriation of U.S. dollar bulk cash from high-risk *casas de cambio*, monetary instruments flowing

¹⁰⁸Press Release, DOJ, Union Bank of California Enters Into Deferred Prosecution Agreement and Forfeits \$21.6 Million To Resolve Bank Secrecy Act Violations (Sept. 17, 2007), available at http://www.justice.gov/opa/pr/2007/September/07_crm_726.html.

¹⁰⁹Joint Release, FinCEN and OCC Assess Civil Money Penalties Against Union Bank of California (Sept. 17, 2007), available at <http://www.occ.gov/news-issuances/news-releases/2007/nr-ia-2007-95.html>.

¹¹⁰Press Release, DOJ, Wachovia Enters Into Deferred Prosecution Agreement (Mar. 17, 2010), available at <http://www.justice.gov/usao/fls/PressReleases/100317-02.html>.

¹¹¹Press Release, FinCEN, Civil Money Penalty Assessed Against Wachovia Bank (Mar. 17, 2010), available at <http://www.fincen.gov/bsaviolations.html>.

¹¹²OCC, News Release, OCC Assesses Civil Money Penalty Against Wachovia (Mar. 17, 2010), available at <http://www.occ.gov/news-issuances/news-releases/2010/nr-occ-2010-30.html>.

¹¹³*In the Matter of Wachovia Bank*, Consent Order No. 2010-037 (Mar. 12, 2010), available at <http://www.occ.gov/news-issuances/news-releases/2010/nr-oc-2010-30b.pdf>.

through correspondent accounts in the form of “remote deposit capture” products, and traveler’s checks.¹¹⁴ After a voluntary lookback, Wachovia had filed over 4,300 suspicious activity reports involving transactions conducted through Wachovia by *casas de cambio* and other foreign correspondent customers.¹¹⁵

FinCEN and the bank regulators have assessed large civil money penalties against other foreign banking operations in the United States for failure to maintain an adequate anti-money laundering program in instances even where no law-enforcement action has been taken. In August 2005, FinCEN and the OCC assessed a \$24 million civil money penalty against the New York branch of Arab Bank PLC for deficiencies in its anti-money laundering program relating to its international funds transfer and correspondent banking business.¹¹⁶ In October 2005, FinCEN and the OCC assessed a \$3 million civil money penalty against the New York Branch of Banco de Chile for violations of anti-money laundering program and suspicious activity reporting requirements of the BSA.¹¹⁷ In December 2005, FinCEN, OFAC, and bank regulatory authorities assessed an aggregate of \$75 million in penalties against ABN AMRO Bank N.V. (ABN AMRO) and its New York branch, arising out of its correspondent banking operations.¹¹⁸

The federal banking agencies also take enforcement actions against banking institutions in cases that do not involve law-enforcement action or a FinCEN assessment of civil money penalties. These bank regulatory-enforcement actions may take the form of an informal commitment letter or memorandum of understanding or a formal written agreement, cease and desist order, or civil money penalty.¹¹⁹ A formal written agreement or cease and desist order will typically provide specific remedial ac-

¹¹⁴*In the Matter of Wachovia Bank*, Consent Order No. 2010-037 (Mar. 12, 2010), available at <http://www.occ.gov/news-issuances/news-releases/2010/nr-occ-2010-30b.pdf>.

¹¹⁵*In the Matter of Wachovia Bank*, Consent Order No. 2010-037 (Mar. 12, 2010), available at <http://www.occ.gov/news-issuances/news-releases/2010/nr-occ-2010-30b.pdf>.

¹¹⁶See § 13:10[4] for further discussion of this enforcement action.

¹¹⁷See § 13:5[4] for a further discussion of this enforcement order.

¹¹⁸See § 13:10[4] for further discussion of this enforcement action.

¹¹⁹In July 2007, the federal banking agencies issued an *Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements*, providing general guidance on the circumstances in which the agencies will issue a cease and desist order to address noncompliance with the anti-money laundering program requirements of the BSA. See Joint Release, Federal

tions that must be taken to correct the deficiencies underlying the enforcement action. The federal banking agencies have used written agreements, consent cease and desist orders, and civil money penalties extensively to address deficiencies in anti-money laundering programs. Such enforcement actions have been taken against U.S. branches and agencies of foreign banks as well as against U.S. bank subsidiaries of foreign banks. Additional discussion of regulatory enforcement actions involving foreign banks can be found in the other sections of this Chapter, especially Sections 13:4[4], 13:10[4], and 13:11[4].

The continuing importance that the federal banking agencies and the law enforcement authorities attach to the enforcement of anti-money laundering program requirements is emphasized by other recent comprehensive enforcement actions taken by the federal and state banking and law-enforcement authorities against foreign bank operations in the United States. The most prominent of these actions, including the highest monetary penalty ever assessed for anti-money laundering and OFAC sanctions violations, involved HSBC Holdings plc (HSBC Group), and its U.S. subsidiaries, HSBC North America Holdings, Inc. (HNAH), and HSBC Bank U.S.A., N.A. (HBUS). In October 2010 the Federal Reserve Board issued a consent cease and desist to HNAH, requiring a comprehensive review and enhancement of compliance risk management with a special focus on BSA compliance.¹²⁰ At the same time, the OCC issued an even more detailed consent cease and desist order to HBUS, requiring it to take comprehensive corrective actions to improve its BSA compliance program.¹²¹ The OCC found that the bank's BSA compliance program had deficiencies with respect to suspicious activity reporting, monitoring of bulk cash purchases and international funds transfers, customer due diligence concerning its foreign af-

Financial Regulatory Agencies Issue Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements (July 19, 2007), available at <http://www.occ.gov/news-issuances/news-releases/2007/pub-other-state-2007-76.pdf>. For a discussion of the enforcement actions generally available to the federal banking agencies, see OCC, Policies & Procedures Manual PPM 5310-3 (Rev): Bank Supervision Operations: Enforcement Action Policy (July 30, 2001), available at <http://www.occ.gov/static/publications/ppm-5310-3.pdf>.

¹²⁰*In the Matter of HSBC North America Holdings, Inc.*, Cease and Desist Order Issued Upon Consent, Dkt. No. 10-202-B-HC (Oct. 4, 2010), available at <http://www.federalreserve.gov/newsevents/press/enforcement/enf20101007c1.pdf>.

¹²¹*In the Matter of HSBC Bank USA, N.A.*, Consent Order No. 2010-199 (Oct. 6, 2010), available at <http://www.occ.gov/news-issuances/news-releases/2010/nr-occ-2010-121a.pdf>.

filiates, and risk assessment with respect to politically exposed persons and their associates. The OCC said that these deficiencies resulted in violations by HBUS of the statutory and regulatory requirements to maintain an adequate BSA compliance program, file suspicious activity reports, and conduct appropriate due diligence on foreign correspondent accounts.¹²² The OCC also specifically noted that the issuance of the consent cease and desist order did not preclude the OCC from assessing a civil money penalty against HBUS at a later time for the matters underlying the cease and desist order.¹²³ As is often the case in BSA enforcement actions, the OCC cease and desist order required a third-party conducted “look-back” review of activity in foreign correspondent accounts at HBUS. HSBC Group also disclosed that various HSBC Group companies were the subject of multiple investigations not only by the U.S. banking authorities, but also by the DOJ and the New York County District Attorney’s Office.¹²⁴

The full extent of the issues at HSBC Group, HNAH, and HBUS became apparent in July 2012 when the U.S. Senate Permanent Subcommittee on Investigations released a 355 page report, detailing alleged compliance failures at HBUS and other subsidiaries of HSBC Group, including in particular HSBC Mexico, HSBC Bank plc, and HSBC Bank Middle East.¹²⁵ These alleged failures related both to anti-money laundering programs and practices and to OFAC sanctions requirements. The outcome of the various investigations was the issuance of the most extensive set of regulatory and law-enforcement actions against a banking institution in U.S. history. In December 2012 HSBC Group and HBUS entered into deferred prosecution agreements with the DOJ and the New York County District Attorney’s Office and various consent agreements and settlement orders with OFAC, FinCEN, the OCC and the Federal Reserve Board, providing for the payment in the aggregate of \$1.92 billion in fines and

¹²²See Press Release, OCC, OCC Issues Cease and Desist Order Against HSBC Bank USA, N.A. (Oct. 7, 2010), available at <http://www.occ.gov/news-issuances/news-releases/2010/nr-occ-2010-121.html>.

¹²³See Press Release, OCC, OCC Issues Cease and Desist Order Against HSBC Bank USA, N.A. (Oct. 7, 2010), available at <http://www.occ.gov/news-issuances/news-releases/2010/nr-occ-2010-121.html>.

¹²⁴See HSBC Holdings plc, *Form 20-F for the fiscal year ended December 31, 2010* (82), available at http://www.hsbc.com/1/content/assets/investor_relations/hsbc201020f.pdf.

¹²⁵Senate Comm. on Homeland Security and Governmental Affairs, Permanent Subcomm. on Investigations, U.S. Vulnerabilities to Money Laundering, Drugs and Terrorist Financing: HSBC Case History (2012), available at <http://www.hsgac.senate.gov/download/?id=2a76c00f-7c3a-44c8-902e-3d9b5dbd0083>.

penalties by HSBC Group¹²⁶ The criminal charges against HSBC Group under the deferred prosecution agreement were that (i) HBUS failed to maintain an effective anti-money laundering program as required by the BSA; (ii) HBUS failed to conduct due diligence on correspondent bank accounts involving foreign persons as required by the BSA; (iii) HSBC Group facilitated transactions with sanctioned entities in Iran, Libya, Sudan and Burma in violation of U.S. sanctions law; and (iv) HSBC Group facilitated transactions for sanctioned entities in Cuba in violation of U.S. sanctions law.¹²⁷

The deferred prosecution agreements include an extensive and detailed list of remedial steps taken or to be taken by HBUS and HSBC Group. These remedial steps include exiting various high risk correspondent relationships, remediating the “know your customer” (KYC) files of 155,500 customers at HBUS, and reviewing all customer KYC files across the entire HSBC Group. In addition, HSBC Group agreed to implement a single global anti-money laundering standard, with the result that all HSBC Group affiliates must adhere at a minimum to U.S. anti-money laundering standards. As a compensation matter, HSBC Group also agreed to defer a portion of the bonuses payable to its most senior officers.

The size of the penalties, the scope of the allegations relating to violations of the U.S. anti-money laundering requirements and U.S. sanctions law requirements, and the range of remedial steps required under these agreements are unprecedented in the banking industry. So too is the provision in the deferred prosecution agreement requiring HSBC Group to retain an independent

¹²⁶See, e.g., Press Release, HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement (Dec. 11, 2012), *available at* <http://www.justice.gov/opa/pr/2012/December/12-crm-1478.html>. See also Press Release, District Attorney Vance Announces \$375 Million Settlement with HSBC Bank (Dec. 11, 2012), *available at* <http://manhattanda.org/node/3444/print>; Press Release, Treasury Department Reaches Landmark Settlement with HSBC (Dec. 11, 2012), *available at* <http://www.treasury.gov/press-center/press-releases/Page%2Ftg1799.aspx>; *In the matter of HSBC Holdings PLC, Order to Cease and Desist Issued Upon Consent Pursuant to the FDI Act*, as amended, Dkt. No. 12-062-B-FB (Dec. 11, 2012), *available at* <http://www.federalreserve.gov/newsevents/press/enforcement/enf20121211a2.pdf>; Press Release, OCC Assesses \$500 Million Civil Money Penalty Against HSBC Bank USA, N.A. (Dec. 11, 2012), *available at* <http://occ.gov/news-issuances/news-releases/2012/nr-occ-2012-173.html>.

¹²⁷Press Release, HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement (Dec. 11, 2012), *available at* <http://www.justice.gov/opa/pr/2012/December/12-crm-1478.html>.

compliance monitor for five years to oversee compliance with the deferred prosecution agreement not only in its U.S. operations, but also in its foreign operations.¹²⁸ Many of the remedial steps under the deferred prosecution agreements extend to the worldwide operations of HSBC Group, such as a requirement for HSBC Group to review all customer KYC files across the entire HSBC Group and to implement U.S. anti-money laundering standards in all its affiliates worldwide.

The actions against HSBC Group signal a new era of enforcement measures with the scope of scrutiny and remedial steps extending to the worldwide operations of foreign banking entities with U.S. operations. At their most fundamental level, these actions also emphasize the inherently higher risk facing foreign banking entities with U.S. operations. The inherent risk arises from the predominantly cross-border nature of most foreign banking activities in the U.S., including U.S. dollar clearing activities. As a result, foreign banking entities will likely face higher risk in the anti-money laundering and economic sanctions areas than domestic U.S. banking institutions.

§ 13:4 Suspicious activity reporting requirement

[1] Statutory Provisions

When Congress amended the BSA in 1992 to provide the Secretary of the Treasury with the authority to require financial institutions to implement an anti-money laundering program, Congress also amended the BSA to provide the Secretary of the Treasury with authority to require financial institutions “to report any suspicious transaction relevant to a possible violation of law or regulation.”¹²⁹ This provision, known as the suspicious activity reporting requirement, is codified in Section 5318(g)(1) of the BSA. The suspicious activity reporting requirement is a key element of the overall anti-money laundering program of a financial institution and a key component in the larger law-enforcement effort directed at identifying suspicious activity relating to a broad range of criminal violations. The anti-money laundering program requirement of Section 5318(h)(1) and the

¹²⁸Press Release, HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement (Dec. 11, 2012), available at <http://www.justice.gov/opa/pr/2012/December/12-crm-1478.html>.

[Section 13:4]

¹²⁹Pub. L. No. 102-550, § 1517(b), 106 Stat. 3672, 4059 (1992) (codified as amended at 31 U.S.C.A. § 5318(g)).

suspicious activity reporting requirement of Section 5318(g)(1) are complementary and serve related functions. An effective suspicious activity reporting program is an integral element of an overall anti-money laundering program because it provides the means of alerting law-enforcement authorities to suspected money-laundering, terrorist, or other criminal activity. At the same time, a suspicious activity reporting program presupposes that an effective anti-money laundering program is in place because the ability to identify and analyze potentially suspicious activity will be dependent upon other elements of an anti-money laundering program such as appropriate customer due diligence and account monitoring.

Section 5318(g)(2) contains an important additional element of the suspicious activity reporting regime. It provides that if a financial institution reports a suspicious transaction to a government agency, neither the financial institution nor any director, officer, employee, or agent may notify any person involved in the transaction that the transaction has been reported.¹³⁰ As discussed in Section 13:4[2][b], the restrictions on disclosure have presented practical problems for the sharing of these reports within corporate structures.

Although the BSA had authorized the Secretary of the Treasury to require suspicious activity reporting for financial institutions since 1992, prior to enactment of the USA PATRIOT Act, the Treasury had not made extensive use of the power beyond the confines of the banking industry. In 1996, the Treasury used this rule-making authority for the first time when, in conjunction with the federal banking agencies, it issued a rule requiring banks to file suspicious activity reports.¹³¹ Prior to the passage of the USA PATRIOT Act, the Treasury and FinCEN had adopted a rule requiring suspicious activity reporting for only one other category of financial institution—certain money services

¹³⁰See 31 U.S.C.A. § 5318(g)(2).

¹³¹See Amendment to the Bank Secrecy Act Regulations—Requirement to Report Suspicious Transactions, 61 Fed. Reg. 4326 (Feb. 5, 1996) (Treasury) (codified at 31 C.F.R. § 1020.320); Minimum Security Devices and Procedures, Reports of Suspicious Activities, and Bank Secrecy Act Compliance Program, 61 Fed. Reg. 4332 (Feb. 5, 1996) (OCC) (codified at 12 C.F.R. § 21.11); Membership of State Banking Institutions in the Federal Reserve System; International Banking Operations; Bank Holding Companies and Change of Control; Reports of Suspicious Activities Under Bank Secrecy Act, 61 Fed. Reg. 4338 (Feb. 5, 1996) (Federal Reserve Board) (codified at 12 C.F.R. § 208.62); Suspicious Activity Reports, 61 Fed. Reg. 6095 (Feb. 16, 1996) (FDIC) (codified at 12 C.F.R. § 353.3).

businesses.¹³²

Although the USA PATRIOT Act did not directly expand the authority of the Treasury to issue rules requiring suspicious activity reporting, the USA PATRIOT Act did expand the range of institutions potentially subject to a suspicious activity reporting requirement by adding additional categories of institutions such as futures commission merchants, commodity trading advisors, and commodity pool operators, to the definition of “financial institution.”¹³³ Section 356(b) of the USA PATRIOT Act specifically provided that the Secretary of the Treasury in consultation with the CFTC could prescribe suspicious activity reporting requirements for futures commission merchants, commodity trading advisors, and commodity pool operators.¹³⁴ The general spirit animating the authors of the USA PATRIOT Act was clearly reflected in Section 356(a) of the USA PATRIOT Act, which directed the Secretary of the Treasury to propose by no later than January 1, 2002, and adopt by no later than July 1, 2002, suspicious activity reporting requirements for broker-dealers.¹³⁵ Section 356(c) also directed the Treasury, the Federal Reserve Board, and the SEC to submit a report to Congress with recommendations for applying the requirements of the BSA to investment companies.¹³⁶ The Treasury and FinCEN in short order after the enactment of the USA PATRIOT Act began rule-making

¹³²See Amendments to the Bank Secrecy Act Regulations—Requirements That Money Transmitters and Money Order and Traveler’s Check Issuers, Sellers, and Redeemers Report Suspicious Transactions, 65 Fed. Reg. 13,683 (March 14, 2000) (codified at 31 C.F.R. § 1022.320) (effective Dec. 31, 2001). These money services businesses were made subject to a suspicious activity reporting requirement under FinCEN rules prior to their being made subject to an anti-money laundering program requirement. As a general matter, an effective anti-money laundering program would be a predicate for an effective suspicious activity reporting system. FinCEN has generally imposed a suspicious activity reporting requirement on an industry only after imposing an anti-money laundering program requirement on it.

¹³³Pub. L. No. 107-56, § 321, 115 Stat. at 315 (codified at 31 U.S.C.A. § 5312(a)(2) and (c)(1)). The USA PATRIOT Act also enhanced the suspicious activity reporting provision generally by expanding the protection from civil liability afforded to institutions and individuals involved in filing SARs on a voluntary basis. Pub. L. No. 107-56, § 351(a), 115 Stat. at 320 (codified at 31 U.S.C.A. § 5318(g)(3)).

¹³⁴Pub. L. No. 107-56, § 356(b), 115 Stat. at 324.

¹³⁵Pub. L. No. 107-56, § 356(a), 115 Stat. at 324.

¹³⁶Pub. L. No. 107-56, § 356(c), 115 Stat. at 324. In the joint report submitted to Congress pursuant to § 356, the Treasury ultimately recommended that mutual funds be required to file SARs. The Treasury also recommended that unregistered investment companies be required to establish anti-money laundering programs and customer identification programs but made no specific men-

processes to impose suspicious activity reporting requirements on a broader range of financial institutions.

[2] Regulatory Provisions

[a] FinCEN Regulations

[i] Banks

As discussed earlier in this Section, the Treasury and FinCEN inaugurated the current suspicious activity reporting system in 1996 when they adopted Section 103.21 (now Section 1020.320) of the BSA regulations. Section 1020.320(a)(1) requires every bank, to the extent provided by the section, to file a report of any suspicious transaction relevant to a possible violation of law or regulation.¹³⁷ A transaction must be reported under Section 1020.320(a)(2) if it is conducted or attempted “by, at, or through” a bank and involves or aggregates at least \$5,000 in funds or other assets and if the bank knows, suspects, or has reason to suspect that:

- (i) [t]he transaction involves funds derived from illegal activities or is intended or conducted to hide or disguise funds or assets derived from illegal activities (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any federal law or regulation or to

tion of a suspicious activity reporting requirement for these companies. *See* A Report to Congress In Accordance with § 356(c) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act), 37–38 (Dec. 31, 2002), *available at* <http://www.fincen.gov/356report.pdf>.

¹³⁷31 C.F.R. § 1020.320(a)(1). The term “bank” is defined in § 1010.100(d) of the BSA regulations to mean:

[e]ach agent, agency, branch or office within the United States of any person doing business in one or more of the capacities listed below:

- (1) A commercial bank or trust company organized under the laws of any State or of the United States;
- (2) A private bank;
- (3) A savings and loan association or a building and loan association organized under the laws of any State or of the United States;
- (4) An insured institution as defined in Section 401 of the National Housing Act;
- (5) A savings bank, industrial bank or other thrift institution;
- (6) A credit union organized under the law of any State or of the United States;
- (7) Any other organization (except a money services business) chartered under the banking laws of any state and subject to the supervision of the bank supervisory authorities of a State;
- (8) A bank organized under foreign law;
- (9) Any national banking association or corporation acting under the provisions of Section 25(a) of [the Federal Reserve Act].

31 C.F.R. § 1010.100(d).

- avoid any reporting requirement under federal law or regulation;
- (ii) [t]he transaction is designed to evade any requirements of [the BSA rules]; or
 - (iii) [t]he transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage and the bank knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.¹³⁸

The reporting requirements of Section 1020.320 are broad, particularly as they relate to a transaction that has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage. This requirement in the suspicious activity reporting regime inferentially requires customer due diligence policies and procedures to establish at a minimum the purpose, type, frequency, and size of transactions in which a customer would normally be expected to engage and policies and procedures for account monitoring. In adopting this provision as part of the original suspicious activity reporting requirement, the Treasury stated that the extent to which a bank would be required to track or monitor certain transactions would be addressed in “know your customer” rules that were expected to be issued as an adjunct to the suspicious activity reporting rule.¹³⁹ The Treasury further stated that the language “knows, suspects, or has reason to know” was intended

¹³⁸31 C.F.R. § 1020.320(a)(2).

¹³⁹See Amendments to the Bank Secrecy Act; Requirement To Report Suspicious Transactions, 61 Fed. Reg. 4326, 4327 (Feb. 5, 1996). The federal banking agencies proposed “know your customer” rules in 1998, but subsequently withdrew the proposal in 1999. See, e.g., “Know Your Customer” Requirements, 63 Fed. Reg. 67,524 (Dec. 7, 1998) (OCC proposed rule). See Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, Joint Statement on Proposed “Know Your Customer” Rule (Mar. 23, 1999), available at <http://www.federalreserve.gov/boarddocs/press/boardacts/1999/19990323/statement.htm> (announcing the withdrawal of the proposed rules). In March 2012 Treasury and FinCEN published an advance notice of proposed rulemaking to solicit comments on a wide range of questions pertaining to the development of a customer due diligence regulation for financial institutions. See Customer Due Diligence Requirements for Financial Institutions, 77 Fed. Reg. 13,046 (Mar. 5, 2012). In the advance notice FinCEN observed that the requirement that a financial institution “know its customer” is basic and fundamental to an effective BSA/AML compliance program. FinCEN further indicated that while a customer due diligence is an implicit obligation in the existing BSA rules for suspicious activity reporting, FinCEN believes that it may be necessary to adopt an express and comprehensive customer due diligence regulation. This proposed regulation

in any event to introduce a concept of due diligence into the reporting requirements.¹⁴⁰ The Treasury also indicated that certain actions were badges of suspicious activity, *e.g.*, a refusal by a customer to provide information, the provision of false information by a customer, or a request by a customer to change or cancel a transaction after the customer is questioned on the transaction.¹⁴¹ In subsequent enforcement actions, FinCEN has stated that Section 1020.320 requires a bank to have systems in place to identify the kinds of transactions that may present a high risk of money-laundering or that exhibit other indicia of suspicious activity, taking into account the types of products and services it offers and the nature of its customers.¹⁴²

Section 1020.320(b)(1) provides that a suspicious transaction shall be reported by completing a Suspicious Activity Report (SAR), which requires both a summary characterization of the suspicious activity and a detailed explanation or description of the suspicious activity.¹⁴³ Each SAR is filed with FinCEN as the central filing location within the federal government. Section 1020.320(b)(3) prescribes the timing requirements for the filing of a SAR. An institution is required to file a SAR no later than 30 calendar days after the date of initial detection by the institution of facts that may constitute a basis for the filing; if no suspect is identified on the date of initial detection of the incident, an institution may delay filing the SAR for an additional 30 calendar days to identify a suspect. In situations involving ongoing violations that require immediate attention such as ongoing money-laundering or criminal or a possible terrorist financing scheme,

would “clarify, consolidate, and strengthen existing CDD regulatory requirements and supervisory expectations, and establish a categorical requirement for financial institutions to identify beneficial ownership of their accountholders.” 77 Fed. Reg. 13,046.

¹⁴⁰See Amendments to the Bank Secrecy Act; Requirement to Report Suspicious Transactions, 61 Fed. Reg. 4328.

¹⁴¹See Amendments to the Bank Secrecy Act; Requirement to Report Suspicious Transactions, 61 Fed. Reg. 4329.

¹⁴²See, *e.g.*, *In the Matter of Korea Exchange Bank*, Assessment of Civil Money Penalty No. 2003-04 (June 24, 2003), available at <http://www.fincen.gov/newsroom/ea/files/koreaexchangeassessment.pdf>.

¹⁴³31 C.F.R. § 1020.320(b)(1). Prior to July 1, 2012, FinCEN used industry-specific paper forms for SAR filings. Effective July 1, 2012, FinCEN substituted a single electronic form for SAR filings. See Agency Information Collection and Reporting Activities; Electronic Filing of Bank Secrecy Act (BSA) Reports, Final Notice, 77 Fed. Reg. 12,367 (Feb. 29, 2012). See also FinCEN, Guidance, Filing FinCEN’s new Currency Transaction Report and Suspicious Activities Report, FIN-2012-G002 (Mar. 29, 2012), available at http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2012-G002.pdf.

an institution is required to notify an appropriate law-enforcement authority immediately.¹⁴⁴ A reporting bank is required to maintain a copy of any SAR filed and an original or business record equivalent of any supporting documentation for five years from the date of filing.¹⁴⁵

Section 1020.320(e) incorporates the confidentiality and nondisclosure requirements of Section 5318(g)(2) and clarifies their application to subpoenas or other requests for information served on a bank. Section 1020.320(e) provides that a SAR and any information that would reveal the existence of a SAR are confidential and may not be disclosed except as authorized under the section. Section 1020.320(e) also specifically provides that no bank and no officer, director, employee, or agent of any bank may disclose a SAR or any information that would reveal the existence of a SAR.¹⁴⁶ Section 1020.320(e) further provides that if a person is subpoenaed or otherwise requested to disclose a SAR or the information that would reveal the existence of a SAR, that person must decline to produce the SAR or such information and must notify FinCEN of the request and response. As discussed in Section 13:4[2][b], the confidentiality requirements applicable to the filing of a SAR have received significant attention, particularly as they relate to the sharing of SARs among affiliated reporting institutions.¹⁴⁷

Section 1020.320(e) also incorporates the limitation of liability

¹⁴⁴31 C.F.R. § 1020.320(b)(3). FinCEN has provided additional guidance on the question of when the 30-day time period to file a SAR begins. *See* FinCEN, *The SAR Activity Review—Trends, Tips & Issues* (May 2006), available at http://www.fincen.gov/newsroom/rp/files/sar_tti_10.pdf. FinCEN has stated that:

The phrase “initial detection” should not be interpreted as meaning the moment a transaction is highlighted for review. There are a variety of legitimate transactions that could raise a red flag simply because they are inconsistent with an account holder’s normal account activity The institution’s automated account monitoring system or initial discovery of information, such as system-generated reports, may flag the transaction; however, this should not be considered initial detection of potential suspicious activity. The 30-day (or 60-day) period does not begin until an appropriate review is conducted and a determination is made that the transaction under review is “suspicious” within the meaning of the SAR regulations.

A review must begin promptly upon the identification of unusual activity that warrants investigation and the review must be completed within a “reasonable period of time.” FinCEN, *The SAR Activity Review—Trends, Tips & Issues*, 45 (May 2006).

¹⁴⁵31 C.F.R. § 1020.320(d).

¹⁴⁶31 C.F.R. § 1020.320(e).

¹⁴⁷In December 2010, FinCEN amended the confidentiality and nondisclosure provisions of its SAR reporting requirements to clarify their application to certain instances of sharing within a corporate organization. *See* Confidentiality

(or safe harbor) provision in Section 5318(g)(3) of the BSA. Section 1020.320(f) provides that a bank and any director, officer, employee, or agent that makes a SAR filing (whether the SAR is required or filed voluntarily) shall be protected from liability for any disclosure contained therein or for the failure to disclose the fact of the report or both.¹⁴⁸ Finally, Section 1020.320(g) provides that compliance with the section will be audited by FinCEN or its delegates under the terms of the BSA.

Section 1010.810(b) of the BSA regulations contains a standing delegation of authority by the Treasury to the federal banking agencies to examine their regulated institutions for compliance with the BSA regulations.¹⁴⁹

Section 1020.320 established the template for suspicious activity reporting by banks and for other categories of financial institutions that would subsequently be made subject to suspicious activity reporting requirements. In connection with the adoption by FinCEN of a suspicious activity reporting requirement for banks in 1996, the federal banking agencies adopted suspicious activity reporting requirements in their own regulations. The federal banking agency regulations are discussed in Section 13:4[2][b].

[ii] Broker-Dealers and Other Financial Institutions

At the time of enactment of the USA PATRIOT Act, FinCEN had adopted suspicious activity reporting requirements for only two categories of financial institutions: banks and certain money services businesses. In the aftermath of the USA PATRIOT Act, FinCEN moved promptly to extend suspicious activity reporting requirements to other categories of financial institutions. In response to the direction contained in Section 356(a) of the USA PATRIOT Act, FinCEN adopted a regulation, now codified in Section 1023.320 of the BSA rules, imposing suspicious activity reporting requirements on brokers or dealers in securities within the United States.¹⁵⁰ The basic suspicious activity reporting requirements contained in Section 1023.320 for broker-dealers

of Suspicious Activity Reports, 75 Fed. Reg. 75,593 (Dec. 3, 2010), for these amendments and a detailed discussion of the confidentiality and nondisclosure requirements applicable to SARs.

¹⁴⁸31 C.F.R. § 1020.320(f).

¹⁴⁹31 C.F.R. § 1010.810(b)(1) to (5). *See also* § 13:3.

¹⁵⁰*See* Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations—Requirement That Brokers or Dealers in Securities Report Suspicious Transactions, 67 Fed. Reg. 44,048 (July 1, 2002) (now codified at 31 C.F.R. § 1023.320).

parallel the requirements contained in the FinCEN regulation for banks with several modifications and exceptions to reflect the specialized nature of existing broker-dealer regulation. Section 1023.320(b)(1) provides for the reporting of a suspicious transaction by completing a Suspicious Activity Report by the Securities and Futures Industry (SAR-SF).¹⁵¹ The FinCEN regulation for broker-dealers clarifies one point that is implicit in the suspicious activity reporting requirement already established for banks. In the list of transactions subject to reporting, Section 1023.320(a)(2)(iv) adds a fourth category: a transaction that involves the use of the broker-dealer to facilitate criminal activity. In adopting the regulation for broker-dealers, the Treasury stated that this additional category was added to ensure that transactions involving legally derived funds that broker-dealer suspects are being used for a criminal purpose, such as funding terrorist activity, are reported.¹⁵² The Treasury treated this addition as a clarification because, as the Treasury noted, the reporting requirement relating to a transaction that “has no business or apparent lawful purpose” should be interpreted to cover such transactions in any event.¹⁵³

The suspicious activity reporting requirements of Section 1023.320 became applicable to broker-dealers for transactions occurring after December 30, 2002.¹⁵⁴ Broker-dealers that were subsidiaries of banks or bank holding companies were already subject to the suspicious activity reporting requirements contained in the applicable federal banking agency regulations (discussed in Section 13:4[2][b]). In connection with the adoption of Section 1023.320, the Treasury indicated that a broker-dealer affiliate or subsidiary of a bank or bank holding company (BHC) would be subject to Section 1023.320 (rather than rules applicable to banks under Section 1020.320) and that it had requested the federal banking agencies to amend their regulations to exempt affiliated broker-dealers from the suspicious activity reporting requirement of the federal banking agency regulations so that these broker-dealers

¹⁵¹31 C.F.R. § 1023.320(b)(1). As discussed in footnote 144, prior to July 1, 2012, FINCEN used industry-specific paper forms for SAR filings. Effective July 1, 2012, FinCEN substituted a single electronic form for SAR filings.

¹⁵²See Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations—Requirement That Brokers or Dealers in Securities Report Suspicious Transactions, 67 Fed. Reg. 44,050 to 44,051.

¹⁵³See Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations—Requirement That Brokers or Dealers in Securities Report Suspicious Transactions, 67 Fed. Reg. 44,050 to 44,051.

¹⁵⁴31 C.F.R. § 1023.320(h).

would be subject only to the single FinCEN reporting requirement.¹⁵⁵

FinCEN has adopted suspicious activity reporting requirements for several other categories of financial institutions. In March 2000, FinCEN adopted a regulation requiring money transmitters and issuers, sellers, and redeemers of money orders and traveler's checks to report suspicious transactions.¹⁵⁶ In February 2003, FinCEN expanded the group of institutions covered by the regulation to include currency dealers and exchangers.¹⁵⁷ In November 2003, FinCEN also adopted a suspicious activity reporting requirement applicable to futures commission merchants and introducing brokers in commodities.¹⁵⁸ FinCEN further extended the categories of financial institutions subject to suspicious activity reporting requirements by adopting reporting requirements in 2005 for certain insurance companies,¹⁵⁹ in 2006

¹⁵⁵See Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations—Requirement That Brokers or Dealers in Securities Report Suspicious Transactions, 67 Fed. Reg. 44,052. The Federal Reserve Board originally stated that a nonbank subsidiary of a BHC or a state member bank would satisfy the requirements of the Federal Reserve Board's suspicious activity reporting provisions in Regulations H, K, and Y by complying with any applicable FinCEN regulation. See Division of Banking Supervision and Regulation, Supervisory Letter SR 02-24: Suspicious Activity Report Filing Requirements for Nonbank Subsidiaries of Bank Holding Companies and State Member Banks (Dec. 24, 2002), available at http://www.ffiec.gov/bsa_aml_infobase/documents/FRB_DOCS/SR_02_24.pdf. In April 2010, the Federal Reserve Board issued revised guidance on SAR filings by nonbank subsidiaries of a BHC. See Division of Banking Supervision and Regulation, Supervisory Letter SR 10-8: Suspicious Activity Report Filing Requirements for Banking Organizations Supervised by the Federal Reserve (Apr. 27, 2010), available at <http://www.federalreserve.gov/boarddocs/srletters/2010/sr1008.htm>.

¹⁵⁶See Amendments to Bank Secrecy Act Regulations—Requirement That Money Transmitters and Money Order and Traveler's Check Issuers, Sellers and Redeemers Report Suspicious Transactions, 65 Fed. Reg. 13,683 (March 14, 2000) (now codified at 31 C.F.R. § 1022.320).

¹⁵⁷See Amendment to the Bank Secrecy Act Regulations—Requirement That Currency Dealers and Exchangers Report Suspicious Transactions, 68 Fed. Reg. 6613 (Feb. 10, 2003).

¹⁵⁸See Amendment to the Bank Secrecy Act Regulations; Definition of Futures Commission Merchants and Introducing Brokers in Commodities as Financial Institutions; Requirement that Futures Commission Merchants and Introducing Brokers in Commodities Report Suspicious Transactions, 68 Fed. Reg. 65,392 (Nov. 30, 2003) (now codified at 31 C.F.R. § 1026.320).

¹⁵⁹See Amendment to the Bank Secrecy Act Regulations—Requirement that Insurance Companies Report Suspicious Transactions, 70 Fed. Reg. 66,761 (Nov. 3, 2005) (now codified at 31 C.F.R. § 1025.320) (the requirement applies only to insurance companies engaged in the business of issuing or underwriting

for mutual funds,¹⁶⁰ and in 2012 for residential mortgage lenders and originators.¹⁶¹

[b] Federal Banking Agency Regulations

At the time that the Treasury and FinCEN adopted their original suspicious activity reporting requirement for banks in 1996, the federal banking agencies simultaneously adopted their own individual regulations, imposing suspicious activity reporting requirements on their regulated banking institutions. The principal purpose of the federal banking agency regulations was to combine and coordinate the prior criminal referral reporting rules of the agencies with the new uniform suspicious activity reporting form, the SAR, provided for under the FinCEN regulation. The federal banking agency regulations, which are substantially identical among themselves, generally parallel the FinCEN suspicious activity reporting regulation but differ from the FinCEN regulation in setting different thresholds for reporting of certain categories of transactions and in establishing an additional category of reportable transactions.¹⁶² The federal banking agency regulations specify four categories of transactions requiring the filing of a SAR. The fourth category of transactions, described as “[t]ransactions aggregating \$5,000 or more that involve potential money laundering or violations of the Bank Secrecy Act,” requires the filing of a SAR for transactions in terms substantially identical to those in Section 1020.320(a)(2) of the FinCEN regulation.¹⁶³ The first category of transactions in the federal banking agency regulations, described as “[i]nsider abuse involving any amount,” requires the filing of a SAR whenever a bank detects:

any known or suspected Federal criminal violation, or pattern of criminal violations, committed or attempted against the bank or involving a transaction or transactions conducted through the bank, where the bank believes that it was either an actual or potential victim of a criminal violation, or series of criminal violations, or that the bank was used to facilitate a criminal transaction, and the

permanent life insurance, annuities, or other insurance products with cash value or investment features).

¹⁶⁰See Amendments to Bank Secrecy Act Regulations—Requirement That Mutual Funds Report Suspicious Transactions, 71 Fed. Reg. 26,213 (May 4, 2006) (now codified at 31 C.F.R. § 1024.320).

¹⁶¹See Anti-Money Laundering and Suspicious Activities Report Filing Requirements for Residential Mortgage Lenders and Originators, 77 Fed. Reg. 8148 (Feb. 14, 2012) (codified at 31 C.F.R. § 1029.320).

¹⁶²12 C.F.R. §§ 21.11 (OCC), § 208.62 (Federal Reserve Board), 353.3 (FDIC).

¹⁶³12 C.F.R. §§ 21.11(c)(4), 208.62(c)(4), 353.3(a)(4).

bank has a substantial basis for identifying one of its directors, officers, employees, agents or other institution-affiliated parties as having committed or aided in the commission of a criminal act, regardless of the amount involved in the violation.¹⁶⁴

Because there is no threshold provision for this category, the federal banking agency regulations would require the filing of a SAR for transactions involving less than \$5,000 in situations where no filing would be required under the FinCEN regulation. The second category of transactions, described as “[v]iolations aggregating \$5,000 or more where a suspect can be identified,” requires the filing of a SAR where the bank believes that it was either an actual or potential victim of a criminal violation or it was used to facilitate a criminal transaction and the bank has a substantial basis for identifying a possible suspect or group of suspects.¹⁶⁵ Transactions falling within the second category under the federal banking agency regulations would also fall under the general reporting requirement contained in the FinCEN regulation, which also sets a threshold amount of \$5,000 or more for reporting. The third category of transactions, described as “[v]iolations aggregating \$25,000 or more regardless of a potential suspect,” requires the filing of a SAR for transactions involving or aggregating \$25,000 or more even though the bank has no substantial basis for identifying a possible suspect or group of suspects.¹⁶⁶ Transactions falling within that third category under the federal banking agency regulations will likely fall within the general reporting requirement contained in the FinCEN regulation, which sets the lower threshold amount of \$5,000 or more. Accordingly, a bank should report a transaction involving less than \$25,000 even though no suspect was identified to assure itself that it is in compliance with the FinCEN regulation.

In other respects, the federal banking agency regulations generally parallel the provisions of the FinCEN regulation, including the provisions on the timing of filing, retention of records, confidentiality, and limitation on liability. The federal banking agency regulations include at least one requirement not contained in the FinCEN regulation. The federal banking agency regulations require the management of a bank to notify the board of directors or a committee thereof promptly of any SAR filed pursuant to the regulations.¹⁶⁷ The federal banking agency regulations applicable to state-chartered or state-licensed banks also encour-

¹⁶⁴12 C.F.R. §§ 21.11(c)(1), 208.62(c)(1), 353.3(a)(1).

¹⁶⁵12 C.F.R. §§ 21.11(c)(2), 208.62(c)(2), 353.3(a)(2).

¹⁶⁶12 C.F.R. §§ 21.11(c)(3), 208.62(c)(3), 353.3(a)(3).

¹⁶⁷12 C.F.R. §§ 21.11(h), 208.62(h), 353.3(f).

age those banks to file a copy of any SAR with state and local law-enforcement agencies where appropriate. State-chartered and state-licensed banks may also be subject to separate reporting requirements under state law.

The federal banking agency regulations by their terms specifically apply to branches and agencies of foreign banks licensed in the United States. The suspicious activity reporting regulation of the OCC specifically states that it applies to all national banks as well as any federal branch or agency of a foreign bank licensed by the OCC.¹⁶⁸ The suspicious activity reporting regulation of the FDIC likewise states that it applies to all insured state nonmember banks as well as any insured, state-licensed branches of foreign banks.¹⁶⁹ The suspicious activity reporting requirements of the Federal Reserve Board are to be found in three regulations. Regulation H of the Federal Reserve Board contains the basic suspicious activity reporting requirement applicable to state member banks.¹⁷⁰ Regulation H by its terms does not apply to a branch or agency of a foreign bank. Regulation K, the regulation of the Federal Reserve Board that contains the principal provisions applicable to foreign banks operating in the United States, provides that a branch, agency, or representative office of a foreign bank operating in the United States (other than a federal branch or agency or an FDIC-insured state-licensed branch) shall file a SAR in accordance with the provisions of Regulation H.¹⁷¹ As noted in Section 13:3[2][b] in the discussion of the Regulation K provision requiring the establishment of anti-money laundering programs, these provisions of Regulation K apply not only to a branch or agency of a foreign bank but also to a representative office.¹⁷² Regulation Y of the Federal Reserve Board also requires a BHC and any nonbank subsidiary thereof and a foreign bank that is subject to the Bank Holding Company Act of 1956 (BHC Act) and any nonbank subsidiary of such a foreign bank operating in the United States to file a SAR in accordance with the provisions of Regulation H.¹⁷³ Pursuant to the provisions of the International Banking Act of 1978, a foreign bank operating through a branch, agency, or a commercial lending company is subject to the BHC Act and thus under this provision of Regula-

¹⁶⁸12 C.F.R. § 21.11(a).

¹⁶⁹12 C.F.R. § 353.1.

¹⁷⁰12 C.F.R. § 208.62.

¹⁷¹12 C.F.R. § 211.24(f).

¹⁷²See § 13:3[2][b].

¹⁷³12 C.F.R. § 225.4(f).

tion Y each of its nonbank subsidiaries operating in the United States would be subject to the suspicious activity reporting requirements of Regulation H.

The application of the FinCEN regulation and the federal banking agency regulations to foreign banks operating in the United States present a number of sensitive issues for those foreign banks. One of the most important issues relates to the ability of a branch or agency to share SARs that are filed in the United States with its head office or with controlling companies, particularly outside the United States. The source of the issue is the prohibition contained in the BSA against the reporting financial institution (or any director, officer, employee, or agent thereof) notifying any person involved in the transaction that the transaction has been reported. This statutory prohibition is implemented through Section 1020.320(e) of the FinCEN regulation that requires any person subpoenaed or otherwise requested to disclose a SAR or information contained in a SAR to decline to produce the SAR or any information that would disclose that a SAR has been prepared or filed.¹⁷⁴ The federal banking agency regulations contain a similar provision and specifically state that SARs are confidential.¹⁷⁵ FinCEN has interpreted the BSA prohibition broadly to apply to disclosures to any third party because of the risk of indirect disclosure by that third party to the party involved in the transaction. FinCEN has been particularly concerned about disclosure to foreign head offices or foreign holding companies because of the possibility that the foreign head office or company would be subject to foreign judicial process that might require disclosure of the SAR in the possession of the foreign office. On the other hand, as discussed earlier in this Section, the federal banking agency regulations appear on their face to require prompt reporting of the filing of a SAR to the board of directors of the foreign bank in the case of a filing by a branch, agency, or representative office. Sound risk management procedures also seem to argue in favor of sharing of the SAR with the head office as part of the foreign bank's global anti-money laundering efforts.

After an interlude of uncertainty, FinCEN and the federal banking agencies in 2006 published a guidance document that clarified that a U.S. branch or agency of a foreign bank may share a SAR with its head office outside the United States and that a U.S. bank or savings association may share a SAR with its con-

¹⁷⁴31 C.F.R. § 1020.320(e).

¹⁷⁵12 C.F.R. §§ 21.11(k), 208.62(j), 353.3(g).

trolling company or companies whether domestic or foreign.¹⁷⁶ The guidance indicated that because there are circumstances under which an institution may be liable for the direct or indirect disclosure by its controlling company or its head office of a SAR, the institution must have a written confidentiality agreement or arrangement, specifying that the controlling company or head office must protect the confidentiality of the SAR through appropriate internal controls and addressing the process for responding to requests for disclosure that are subject to foreign law.¹⁷⁷ The guidance further indicates that the recipient head office may not disclose the SAR or the fact that a SAR has been filed but may disclose underlying information about the customer or the transaction that does not otherwise reveal that a SAR has been filed. FinCEN published similar guidance for broker-dealers, futures commission merchants, and introducing brokers, permitting them to share SARs with parent entities, whether domestic or foreign.¹⁷⁸ In both guidance documents, FinCEN indicated that it had not yet made any determination about the permissibility of sharing SARs with affiliates other than controlling companies or head offices whether domestic or foreign. Until further guidance was issued by FinCEN, institutions were directed not to share SARs with affiliates other than controlling companies or head offices.¹⁷⁹ In November 2010, FinCEN issued additional guidance stating that a depository institution that has filed a SAR may share the SAR or any information that would disclose the existence of the SAR with any affiliate provided that the affiliate is itself subject to a SAR regulation.¹⁸⁰

¹⁷⁶See Interagency Guidance on Sharing Suspicious Activity Reports with Head Offices and Controlling Companies (Jan. 20, 2006), available at http://www.fincen.gov/statutes_regs/guidance/pdf/sarsharingguidance01122006.pdf.

¹⁷⁷See Interagency Guidance on Sharing Suspicious Activity Reports with Head Offices and Controlling Companies (Jan. 20, 2006), available at http://www.fincen.gov/statutes_regs/guidance/pdf/sarsharingguidance01122006.pdf.

¹⁷⁸See Guidance on Sharing Suspicious Activity Reports by Securities Broker-Dealers, Futures Commission Merchants, and Introducing Brokers in Commodities (Jan. 20, 2006), available at http://www.fincen.gov/statutes_regs/guidance/pdf/sarsharingguidance01202006.pdf.

¹⁷⁹See Guidance on Sharing Suspicious Activity Reports by Securities Broker-Dealers, Futures Commission Merchants, and Introducing Brokers in Commodities (Jan. 20, 2006), available at http://www.fincen.gov/statutes_regs/guidance/pdf/sarsharingguidance01202006.pdf.

¹⁸⁰See FinCEN, Guidance: Sharing Suspicious Activity Reports by Depository Institutions with Certain U.S. Affiliates (Nov. 23, 2010), available at http://www.fincen.gov/statutes_regs/guidance/html/fin-2010-g006.html. See also Notice of Availability of Final Interpretive Guidance-Sharing Suspicious Activ-

[3] Supervisory and Examination Process

Like the anti-money laundering program requirement, the suspicious activity reporting requirement applied to banks before the enactment of the USA PATRIOT Act and like the anti-money laundering program requirement, the suspicious activity reporting requirement for banks has been subject to markedly increased scrutiny after the enactment of the USA PATRIOT Act. Even as FinCEN began the process of instituting suspicious activity reporting requirements for new categories of financial institutions, such as broker-dealers and mutual funds, the federal banking agencies made scrutiny of the existing suspicious activity reporting procedures one of their top priorities in their examination of banking institutions. Heightened scrutiny led to a series of enforcement actions against domestic and foreign banking organizations by the federal banking authorities and in several high profile cases by federal and state law-enforcement authorities.¹⁸¹

Although the suspicious activity reporting requirement and its predecessor criminal referral reporting requirement had been in place for a number of years, there was relatively little official guidance on the specific policies and procedures that an institution should have in place to satisfy the requirements of the regulations. The OCC Handbook on Bank Secrecy Act/Anti-Money Laundering provided a list of examples of potentially suspicious activities, under categories such as activities inconsistent with a customer's business, attempts to avoid reporting or record-keeping requirements, wire-transfer activities, and insufficient or suspicious information from a customer.¹⁸² The Federal Reserve Board's Bank Secrecy Act Examination Manual also included a list of examples of potentially suspicious transactions, under categories such as money-laundering, offshore transactions, and linked financing or brokered transactions.¹⁸³ In addition, in 2000, FinCEN began publishing regular reports, such as *The SAR*

ity Reports by Depository Institutions and Securities Broker-Dealers, Mutual Funds, Futures Commission Merchants, or Introducing Brokers in Commodities with Certain U.S. Affiliates, 75 Fed. Reg. 75,607 (Dec. 3, 2010).

¹⁸¹See § 13:4[4].

¹⁸²See, e.g., Comptroller's Handbook, Bank Secrecy Act/Anti-Money Laundering (Sept. 2000), available at <http://www.occ.gov/static/publications/handbook/bsa.pdf>; Federal Reserve Board, Bank Secrecy Act Examination Manual (Sept. 1997), available at <http://www.federalreserve.gov/boarddocs/SupManual/bsa/7-00bsaman.pdf>.

¹⁸³See, e.g., Comptroller's Handbook, Bank Secrecy Act/Anti-Money Laundering (Sept. 2000), available at <http://www.occ.gov/static/publications/handbook/bsa.pdf>; Federal Reserve Board, Bank Secrecy

Activity Review—Trends, Tips & Issues and *The SAR Activity Review—By the Numbers*, to provide current information to the industry on trends in suspicious activity and in suspicious activity reporting.¹⁸⁴ *The SAR Activity Review—Trends, Tips & Issues* has become an increasingly important source of guidance from FinCEN on suspicious activity reporting issues. In November 2003, FinCEN in consultation with the federal banking agencies also issued a guidance package for preparing a SAR with textual examples.¹⁸⁵ FinCEN also issues guidance and advisories on specific issues relating to SAR filings.¹⁸⁶

Notwithstanding these efforts, the banking industry, as noted in Section 13:3[3], continued to express concerns about the consistency of the application of existing guidance in the examination process and the lack of additional guidance on the specific procedures required to implement an acceptable suspicious activity reporting program. The FFIEC Manual, issued in June 2005 and revised most recently in April 2010, represents in part the regulators' response to these calls for comprehensive and detailed guidance.¹⁸⁷ Examination procedures for compliance with the suspicious activity reporting requirements have a prominent place in the FFIEC Manual.¹⁸⁸ Examiners are directed to focus on a bank's policies, procedures, and processes to identify, research, and report suspicious activity. The federal banking agencies will expect detailed front to back procedures and processes for identifying, tracking, and reporting suspicious activity. Beyond appropriate front-end procedures and monitoring processes, the federal banking agencies will also expect detailed procedures for referring suspicious or unusual activity from all business lines to

Act Examination Manual (Sept. 1997), available at <http://www.federalreserve.gov/boarddocs/SupManual/bsa/7-00bsaman.pdf>.

¹⁸⁴These reports are available at http://www.fincen.gov/news_room/rp/sar_tti.html.

¹⁸⁵The narrative guidance document is available at http://www.fincen.gov/news_room/rp/files/sar_tti_06.pdf.

¹⁸⁶See, e.g., Advisory to Financial Institutions on Filing Suspicious Activity Reports regarding Trade-Based Money Laundering, FIN-2010-A001 (Feb. 18, 2010), available at http://www.fincen.gov/statutes_regs/guidance/pdf/fin-2010-a001.pdf; Guidance to Financial Institutions on Filing Suspicious Activity Reports regarding the Proceeds of Foreign Corruption, FIN 2008-G-005 (Apr. 17, 2008), available at http://www.fincen.gov/statutes_regs/guidance/html/fin-2008-g005.html.

¹⁸⁷FFIEC Manual, available at http://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2010.pdf. (FFIEC Manual).

¹⁸⁸See FFIEC Manual at 79–80.

the personnel or department responsible for evaluating the activity and determining whether a SAR should be filed.¹⁸⁹

The existence of appropriate written policies, procedures, and processes, however, is not sufficient. The examiners are directed to test the policies, procedures, and processes to determine whether they have been effectively implemented and whether they are in fact functioning in accordance with their design.¹⁹⁰ In effect, all of the procedures and processes must be auditable and on an appropriate basis audited by an independent internal or external audit function.

[4] Enforcement Actions

As noted in Section 13:3[4], a number of prominent regulatory and law-enforcement actions have been taken against banking institutions, particularly since the time of the enactment of the USA PATRIOT Act, for the failure to implement adequate anti-money laundering programs. Many of these actions involve underlying claims that the banking institution failed to implement an effective anti-money laundering program and as a result failed to identify suspicious transactions and to file SARs. In the Riggs case, the institution pled guilty to a criminal charge of violating Section 5318(g) by failure to file timely or accurate SARs.¹⁹¹

Other law-enforcement actions have also been taken against banking institutions for the failure to comply with the suspicious activity reporting requirements. In January 2003, Banco Popular de Puerto Rico entered into a deferred prosecution agreement with the DOJ on a criminal charge of failing to file SARs in a timely and complete manner in violation of Section 5318(g)(1) and made a \$21.6 million forfeiture payment to the DOJ; FinCEN concurrently assessed a \$20 million civil money penalty that was satisfied by the \$21.6 million payment to the DOJ.¹⁹² In October 2004, AmSouth entered into a deferred prosecution agreement with the U.S. Attorney's Office for the Southern District of Mississippi in connection with the charge that it had failed to file SARs in a timely, complete, and accurate manner in violation of Section 5318(g)(1) and paid a \$40 million fine; at the same time, FinCEN and the Federal Reserve Board issued a civil money

¹⁸⁹See FFIEC Manual at 75–76.

¹⁹⁰See FFIEC Manual at 83–85.

¹⁹¹For a further discussion of the Riggs case, see § 13:3[4].

¹⁹²*United States v. Banco Popular de Puerto Rico*, Deferred Prosecution Agreement Including Civil Money Penalty Assessment (Jan. 16, 2003), available at <http://www.fincen.gov/newsroom/ea/files/bancopopular.pdf>.

penalty against AmSouth for an additional \$10 million.¹⁹³ In November 2005, The Bank of New York entered into a nonprosecution agreement with the U.S. Attorney's Offices for the Eastern and Southern Districts of New York relating to allegations that The Bank of New York had failed to file timely and complete SARs with respect to a former customer and with respect to certain funds transfer activities to and from Russia from 1996 through 1999.¹⁹⁴ As part of the agreement, The Bank of New York made a forfeiture payment to the government of \$38 million.

The law-enforcement and regulatory actions against IDBNY in December 2005 discussed in Section 13:3[4] involved deficiencies both in the implementation of an effective anti-money laundering program and in the reporting of suspicious activity. The cease and desist orders issued by the FDIC and NYSBD required a third-party "look-back" review of account and transaction activity to determine whether suspicious activity was properly identified and reported in accordance with the applicable suspicious activity reporting requirements.¹⁹⁵ Such "look-back" or "transaction" reviews are common features of remedial orders or agreements in cases where the banking agencies determine that a banking institution has not implemented an effective anti-money laundering program. As a result of the look-back review, IDBNY filed numerous SARs on a late basis. Many of the SARs related to high-risk wire transfers, including from unlicensed money transmitters in South America. The result of this review and of the late filing of numerous SARs was the subsequent assessment in October 2006 by FinCEN, the FDIC, and the NYSBD of a \$12 million civil money penalty against IDBNY.¹⁹⁶

The FinCEN orders assessing civil money penalties against

¹⁹³*United States v. AmSouth Bancorporation and AmSouth Bank*, Deferred Prosecution Agreement (Oct. 12, 2004), available at http://www.sec.gov/Archives/edgar/data/3133/000089183604000358/ex_99-2.htm; *In the Matter of AmSouth Bank*, Assessment of Civil Money Penalty No. 2004-2 (Oct. 12, 2004), available at <http://www.fincen.gov/newsroom/ea/files/amsouthassessmentcivilmoney.pdf>; *In the Matter of AmSouth Bancorporation and AmSouth Bank*, Cease and Desist Order and Order of Assessment of a Civil Money Penalty Issued Upon Consent Pursuant to the FDI Act (Oct. 12, 2004), available at <http://www.federalreserve.gov/boarddocs/press/Enforcement/2004/20041012/attachment.pdf>.

¹⁹⁴Press Release, United States Attorney's Office for the Eastern District of New York, The Bank of New York Resolves Parallel Criminal Investigations Through Non-Prosecution Agreement with the United States (Nov. 8, 2005), available at <http://www.justice.gov/usao/nye/pr/2005/2005nov08.html>.

¹⁹⁵For a further discussion of the IDBNY case, see § 13:3[4].

¹⁹⁶*In the Matter of Israel Discount Bank of New York*, Assessment of Civil Money Penalty No. 2006-7 (Oct. 31, 2006), available at http://www.fincen.gov/newsroom/ea/files/fincen_assessment_of_civil_money_penalty.pdf; *In the*

Banco de Chile, ABN AMRO and Arab Bank discussed in Section 13:3[4] rested on dual findings that the banking institution failed to implement an adequate anti-money laundering program as required by Section 5318(h) and as a result failed to report suspicious transactions as required by Section 5318(g).¹⁹⁷ As discussed in Section 13:3[4], the most recent and significant enforcement action taken against a banking institution for failure to file SARs involved the deferred prosecution agreement and other regulatory orders with Wachovia Bank. In connection with those actions, Wachovia Bank forfeited \$110 million to the DOJ and paid an additional \$50 million in civil money penalties to the OCC.

§ 13:5 Customer identification program requirement

[1] Statutory Provisions

The anti-money laundering program requirement of Section 5318(h)(1) of the BSA and the suspicious activity reporting requirement of Section 5318(g)(1) of the BSA are the pillars upon which the U.S. anti-money laundering regime rests. The USA PATRIOT Act strengthened these pillars by adding specific requirements that must now be included in the general anti-money laundering programs. One such requirement was added by Section 326 of the USA PATRIOT Act, which as codified in Section 5318(l) of the BSA, requires financial institutions to implement a customer identification program.¹⁹⁸ Section 5318(l)(1) directs the Secretary of the Treasury to prescribe regulations setting forth the minimum standards regarding the identity of a customer that will apply in connection with the opening of an account at a financial institution.¹⁹⁹ Section 5318(l)(2) provides certain minimum requirements to be included in the regulations. These minimum requirements mandate that financial institutions implement reasonable procedures for:

- (i) verifying the identity of any person seeking to open an account to the extent reasonable and practicable;

Matter of Israel Discount Bank of New York, Order to Pay FDIC-06-099k (Oct. 31, 2006), available at <http://www.fdic.gov/bank/individual/enforcement/2006-10-00.pdf>; *In the Matter of Israel Discount Bank of New York*, Order of Assessment of Civil Monetary Penalty Upon Consent (Oct. 20, 2006), available at <http://www.banking.state.ny.us/ea061020.pdf>.

¹⁹⁷For a further discussion of these cases, see §§ 13:5[4] and 13:10[4].

[Section 13:5]

¹⁹⁸Pub. L. No. 107-56, § 326, 115 Stat. at 317 (codified at 31 U.S.C.A. § 5318(l)).

¹⁹⁹31 U.S.C.A. § 5318(l)(1).

- (ii) maintaining records of the information used to verify a person's identity, including name, address, and other identifying information; and
- (iii) consulting lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency to determine whether a person seeking to open an account appears on any such list.²⁰⁰

Section 5318(l)(3) requires the Secretary of the Treasury in prescribing regulations to take into account the various types of accounts maintained by the types of financial institutions, the various methods of opening accounts, and the various types of identifying information available.²⁰¹ Section 5318(l)(4) provides that, in the case of financial institutions that are subject to regulation by a federal functional regulator, the customer identification program regulation is to be issued jointly by the Treasury and the relevant federal functional regulator.²⁰²

The customer identification and verification requirements added by Section 326 of the USA PATRIOT Act both reinforced and further refined a key component of an anti-money laundering program for financial institutions. Elements of the new requirement were already implicit in the anti-money laundering program requirements applicable to federally regulated banking institutions under the general anti-money laundering regulations issued by the federal banking agencies and under the supervisory expectation that these institutions would have an appropriate "know your customer" policy.²⁰³ Broker-dealers and futures commission merchants and introducing brokers were also subject to

²⁰⁰31 U.S.C.A. § 5318(l)(2).

²⁰¹31 U.S.C.A. § 5318(l)(3).

²⁰²31 U.S.C.A. § 5318(l)(4).

²⁰³*See, e.g.*, Comptrollers' Handbook, Bank Secrecy Act/Anti-Money Laundering (Sept. 2000) at 19–21 (discussing identification standards that should be established by banks); Federal Reserve Board, Bank Secrecy Act Examination Manual (Sept. 1997), § 601 Know Your Customer. As further discussed in footnote 139, in March 2012 the Treasury and FinCEN published an advance notice of proposed rulemaking to solicit comments on a wide range of questions relating to the development of a general customer due diligence regulation for financial institutions. The proposal for a general customer due diligence rule would include among its various elements a customer identification requirement. *See* 77 Fed. Reg. 13,046, 13,050 (Mar. 5, 2012). The advance notice discusses the relationship between the proposed customer due diligence rule and the existing CIP rule. The effect of the proposal contained in the advance notice would appear to be to extend elements of the CIP rule to various types of financial institutions not currently subject to the CIP rule.

separate requirements from their federal functional regulators and self-regulatory organizations that they implement “know your customer” and record-keeping programs that included information relating to the identity of their customers.²⁰⁴ Nonetheless, Section 326 and its implementing regulations impose additional requirements, particularly relating to the verification of customer identity, on banks and broker-dealers, that go beyond the identification requirements previously imposed by their federal functional regulators. Moreover, Section 326 imposes customer identification and verification requirements on other types of financial institutions, such as mutual funds, that were not previously subject to a customer identification rule from their federal functional regulator.

[2] Regulatory Provisions

Pursuant to the direction contained in Section 326 of the USA PATRIOT Act, the Treasury and FinCEN have adopted regulations, jointly with the applicable federal functional regulator, specifying the requirements of a customer identification program (CIP) for the following types of financial institutions:

- (i) banks;
- (ii) broker-dealers;
- (iii) mutual funds; and
- (iv) futures commission merchants and introducing brokers.²⁰⁵

In each case, the regulation states that the CIP must be part of the institution’s anti-money laundering program required under the FinCEN regulations implementing Section 5318(h)(1). As part of the joint issuance with the Treasury of the CIP rule for banks, each of the federal banking agencies also amended its own anti-money laundering program regulations to provide that their

²⁰⁴See, e.g., 17 C.F.R. § 240.17a-3(a)(9) (requiring broker-dealers to obtain basic identifying information for each beneficial owner of a cash or margin account); New York Stock Exchange Rule 405 (requiring member firms to use due diligence to learn the essential facts relative to every customer); NASD Rule 3110 (requiring member firms to obtain various items of information relating to customers).

²⁰⁵See Customer Identification Programs for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks, 68 Fed. Reg. 25,090 (May 9, 2003) (now codified at 31 C.F.R. § 1020.100); Customer Identification Programs for Broker-Dealers, 68 Fed. Reg. 25,113 (May 9, 2003) (now codified at 31 C.F.R. § 1023.100); Customer Identification Programs for Mutual Funds, 68 Fed. Reg. 25,131 (now codified at 31 C.F.R. § 1024.100); Customer Identification Programs for Futures Commission Merchants and Introducing Brokers, 68 Fed. Reg. 25,149 (now codified at 31 C.F.R. § 1026.100).

regulated institutions were required to implement a CIP as part of their compliance program required by the banking agency regulation.²⁰⁶

The CIP regulation that applies to banks is codified in Section 1020.220 of the BSA rules. The term “bank” for purposes of Section 1020.220 is defined generally by cross-reference to the definition of the term “bank” in Section 1010.100(d) of the BSA rules.²⁰⁷ Section 1010.100(d) defines the term “bank” broadly. It includes specifically “[e]ach agent, agency, branch or office within the United States of . . . [a] bank organized under foreign law[.]”²⁰⁸ In adopting the CIP regulation for banks, the Treasury also addressed the threshold question of the meaning of the terms “account” and “customer” for purposes of the regulation. In the case of the term “account,” the Treasury based the definition in the CIP regulation on the definition of that term contained in Section 311 of the USA PATRIOT Act. Section 311 amended the BSA by adding a new section codified at Section 5318A, which provides authority to the Treasury to require special measures for jurisdictions, financial institutions, or international transactions of primary money-laundering concern.²⁰⁹ Section 5318A(e)(1)(A) provides that the term “account” with respect to a bank:

- (i) means a formal banking or business relationship established to provide regular services, dealings, and other financial transactions; and
- (ii) includes a demand deposit, savings deposit, or other transaction or asset account and a credit account or other extension of credit.²¹⁰

Section 1020.100(a)(1) of the CIP regulation defines the term “account” to mean:

a formal banking relationship established to provide or engage in services, dealings, or other financial transactions including a deposit account, a transaction or asset account, a credit account, or other extension of credit.²¹¹

The term also includes a relationship established to provide other

²⁰⁶See 12 C.F.R. §§ 21.21, 208.63(b), 211.5(m), 211.24 (j), 326.8(b), 563.177(b).

²⁰⁷31 C.F.R. § 1020.100(b). See § 13:4[2][a][i] for a list of entities encompassed within the definition of the term “bank” contained in § 1010.100(d).

²⁰⁸31 C.F.R. § 1010.100(d)(8).

²⁰⁹See § 13:9[1] for a discussion of the special measures provisions of Section 5318A.

²¹⁰31 U.S.C.A. § 5318A(e)(1)(A).

²¹¹31 C.F.R. § 1020.100(a)(1).

financial services such as safekeeping, cash management, custodian, or trust services. Section 1020.100(a)(2) provides several exclusions from the defined term, including for a product or service where a formal banking relationship is not established with a person such as check-cashing, wire transfer, or sale of a check or money order, and for an account that a bank acquires through an acquisition, merger or purchase of assets.²¹²

Section 1020.100(c)(1) defines the term “customer” broadly to mean “[a] person that opens a new account.”²¹³ Section 1020.220(a)(1) provides the basic CIP requirement. It requires a bank to implement a CIP that is appropriate for its size and type of business and that at a minimum includes each of four specified components described in the following paragraph. Section 1020.220(a)(1) further provides that if a bank is required to have an anti-money laundering compliance program under Section 5318(h) or under federal banking law (as all federally regulated banks are), then the CIP must be made part of the anti-money laundering compliance program.²¹⁴ This means that the CIP must be incorporated into each of the four basic elements of the bank’s anti-money laundering program.²¹⁵

The CIP regulation prescribes four minimum components of a CIP. First, the CIP must include risk-based procedures for verify-

²¹²31 C.F.R. § 1020.100(a)(2).

²¹³31 C.F.R. § 1020.100(c)(1). Section 1020.100(c)(2) provides three general exclusions from the term “customer.” The first exclusion is for a financial institution regulated by a federal functional regulator or a bank regulated by a state bank regulator. The second exclusion is for federal and state agencies and any entity whose common stock or analogous equity interests are traded on the New York Stock Exchange or the American Stock Exchange or whose common stock or analogous equity interests have been designated as a NASDAQ National Market Security (other than those listed as NASDAQ Small Cap Issues) and any subsidiary of any listed entity if it is organized under the laws of the United States or any state and at least 51% of its common stock or analogous equity interest is owned by the listed company. The second exclusion applies only to the extent of the domestic operation of these excluded entities. Foreign offices, affiliates, or subsidiaries of these entities do not qualify for the exclusion from the definition of customer. The third exclusion is for a person who has an existing account with the bank provided that the bank has a reasonable belief that it knows the true identity of the customer. This final exclusion was added to the rule by the Treasury to reduce the burden on banks of having to document and verify the identity of existing customers who propose to open additional accounts. *See* Customer Identification Programs for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks, 68 Fed. Reg. 25,090, 25,094 (May 9, 2003).

²¹⁴31 C.F.R. § 1020.220(a)(1).

²¹⁵*See* Customer Identification Programs for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks, 68 Fed. Reg. 25,095.

ing the identity of each customer to the extent reasonable and practicable. These procedures must be designed to enable the bank to form a reasonable belief that it knows the true identity of a customer. In designing its procedures, a bank must take into account its size, location, and customer base as well as the risks presented by the various types of accounts maintained by the bank, the various methods of opening accounts, and the various types of identifying information available. These procedures must at a minimum include procedures to obtain certain specified information about the customer and procedures to verify the information obtained about the customer. The items of information required to be obtained from a customer are:

- (i) name;
- (ii) date of birth for an individual;
- (iii) address for an individual, which will generally be a residential or business street address, and for a person other than an individual (such as a corporation, partnership, or trust), a principal place of business, local office, or other physical location; and
- (iv) identification number, which for a U.S. person will be a taxpayer identification number, and for a non-U.S. person, one or more of the following: a taxpayer identification number; passport number and country of issuance; alien identification card number; or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.²¹⁶

A foreign business or enterprise may not have a taxpayer identification number. When opening an account for such a foreign entity without a taxpayer identification number, a bank must obtain an alternative government-issued document, certifying to the existence of the business or enterprise.²¹⁷ The CIP procedures may also provide for the opening of an account for a customer that has applied for, but not yet received, a taxpayer identification number. The CIP must include procedures to confirm that the application for a taxpayer identification number has been filed and to obtain the number within a reasonable time after the account is opened.²¹⁸

The CIP must also include procedures for verifying the identity of the customer, using the information obtained about the

²¹⁶31 C.F.R. § 1020.220(a)(2)(i).

²¹⁷31 C.F.R. § 1020.220(a)(2)(i).

²¹⁸31 C.F.R. § 1020.220(a)(2)(i)(A)(4)(ii).

customer under the CIP procedures. This verification must be done within a reasonable period of time after the account is opened. The procedures for verification may rely on verification through documents or verification through nondocumentary methods or a combination of both.²¹⁹ The procedures for verification through documents may rely on the use of the following documents:

- (i) for an individual, unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard such as a driver's license or passport; and
- (ii) for a person other than an individual (such as a corporation, partnership, or trust), documents showing the existence of the entity such as certified articles of incorporation, a government-issued business license, a partnership agreement, or trust instrument.²²⁰

The procedures for verification through nondocumentary methods may rely on a broader range of verification techniques such as independently verifying the customer's identity through the comparison of information provided by the customer with information obtained from a consumer reporting agency, public database, or other source; checking references with other financial institutions; and obtaining a financial statement.²²¹ The procedures for verification through nondocumentary methods must address situations where verification through documents is not feasible such as where an individual is unable to present an unexpired government-issued identification document that bears a photograph, where the bank is not familiar with the documents presented, or where the customer opens the account without appearing in person at the bank.²²² Verification through nondocumentary methods is also encouraged by the Treasury and the federal banking agencies even when a customer provides identification documentation because of the rising incidence of identity theft and fraudulent documentation.²²³

Additional verification procedures may be required for corporate accounts and other nonindividual accounts. Section 1020.220(a)

²¹⁹31 C.F.R. § 1020.220(a)(2)(ii).

²²⁰31 C.F.R. § 1020.220(a)(2)(ii)(A).

²²¹31 C.F.R. § 1020.220(a)(2)(ii)(B)(1).

²²²31 C.F.R. § 1020.220(a)(2)(ii)(B)(2).

²²³See Customer Identification Programs for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks, 68 Fed. Reg. 25,090, 25,100 (May 9, 2003).

(2)(ii)(C) requires that a CIP cover situations where, based on the bank's risk assessment of a new account that is opened by a customer that is not an individual, the bank will obtain information about the individuals with authority or control over the account including signatories.²²⁴ A CIP must also include specific procedures for responding to circumstances where a bank cannot form a reasonable belief about the identity of a customer, including procedures where a bank should not open an account, should close an account or should file a SAR.²²⁵

The second element of a CIP is the requirement for record-keeping. Section 1020.220(a)(3) requires that a CIP include procedures for making and keeping a record of information obtained under the required identity verification procedures. The records must include all identifying information obtained about a customer under Section 1020.220(a)(2)(i) and a description and specified details of any document that was relied upon under Section 1020.220(a)(2)(ii)(A) for verification through a documentary process. The records must also include a description and specified details of the methods and results of any measures undertaken to verify the identity of a customer under a verification through nondocumentary methods or under the additional requirements for corporate or other nonindividual accounts as well as a description of the resolution of any substantive discrepancy discovered as part of the verification process.²²⁶ A bank must retain all identifying information about a customer for five years after the date the account is closed and all other information required under the CIP rule for five years after the record is made.²²⁷

The third element of a CIP is the requirement that it include procedures for determining whether a customer appears on any list of known or suspected terrorists or terrorist organizations published by any federal governmental agency and designated as

²²⁴31 C.F.R. § 1020.220(a)(2)(ii)(C). In its original proposed rule, the Treasury would have required identification and verification of each signatory on an account, including corporate accounts. Most commenters on the proposed rule objected to this requirement as overly burdensome. *See* Customer Identification Programs for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks, 68 Fed. Reg. 25,090, 25,100 (May 9, 2003). In response to these comments, in the final CIP rule the Treasury added the provisions in Section 1020.220(a)(2)(ii)(C) to create a risk-based approach to the identification and verification requirements for signatories on corporate accounts.

²²⁵31 C.F.R. § 1020.220(a)(2)(iii).

²²⁶31 C.F.R. § 1020.220(a)(3)(i).

²²⁷31 C.F.R. § 1020.220(a)(3)(ii).

such by the Treasury in consultation with the federal functional regulators.²²⁸ This determination must be made within a reasonable time after the account is opened or earlier (*i.e.*, at the time the account is opened) if required by other federal law or regulation. Currently, there are no designated government lists to verify specifically for purposes of the CIP rule.²²⁹ There are, however, other separate legal requirements under OFAC rules that prohibit the opening of accounts or the providing of services to Specially Designated Nationals or to other nationals or entities of certain sanctioned countries.²³⁰ Financial institutions are prohibited under the OFAC rules from dealing with such persons or entities and accordingly must check the identity of potential customers against the OFAC list independent of any requirement imposed under the CIP rule. In addition, FinCEN distributes Section 314(a) subject lists, which financial institutions are required to use to search their records for any accounts or transactions involving any subjects on the list.²³¹ This requirement is independent of any requirement imposed under the CIP rule.

The fourth element of a CIP is a requirement for customer notice. Section 1020.220(a)(5) requires that a CIP include procedures for providing bank customers with adequate notice that the bank is requesting information to verify their identity. A sample form of notice is provided in the CIP rule. Depending upon the way an account is opened, the notice may be posted in a lobby on a Web site or through any other form of written or oral notice.²³²

An important point in administering a CIP is the ability of a bank to rely on the performance by another financial institution (including an affiliate) of certain of the CIP procedures to avoid duplicative efforts. Section 1020.220(a)(6) specifically provides that a bank may rely on another financial institution that is subject to a FinCEN rule implementing Section 5318(h) and is regulated by a federal functional regulator to perform CIP

²²⁸31 C.F.R. § 1020.220(b)(4).

²²⁹See FFIEC Manual at 57.

²³⁰See § 13:12 for a discussion of the OFAC rules.

²³¹See § 13:8[2] for a discussion of § 314(a) of the USA PATRIOT Act and § 314(a) subject lists.

²³²31 C.F.R. § 1020.220(a)(5).

procedures for it.²³³ The significance of the reliance provision is that the bank will not be held responsible for any failure of the other financial institution to fulfill adequately the bank's CIP responsibilities so long as the bank satisfies the conditions for reliance in the CIP rule. Under the CIP rule, a bank may also contract with a servicer or other party to perform CIP services on its behalf. In contrast to the reliance provision, however, a bank would remain fully responsible for the third party's compliance with the requirements of the CIP rule.

As discussed earlier in this Section, the Treasury, in consultation with the SEC and the CFTC, has adopted regulations, imposing CIP requirements on broker-dealers, mutual funds, and futures commission merchants and introducing brokers. These regulations are substantially identical to the provisions of Section 1020.220 applicable to banks. The differences among the regulations relate principally to the definition of the term "account," which varies in each regulation to reflect the different services provided by these entities. In each case, however, the definition of the term "account" continues to have a broad application. The CIP regulation for broker-dealers is codified at Section 1023.100 of the BSA rules. Section 1023.100(a) defines the term "account" for the broker-dealer CIP rule to mean:

a formal relationship with a broker-dealer established to effect transactions in securities, including, but not limited to, the purchase or sale of securities and securities loaned and borrowed activity, and to hold securities or other assets for safekeeping or as collateral.²³⁴

In adopting the rule, the Treasury and SEC noted that the term "account" would include cash accounts, margin accounts, prime brokerage accounts, and accounts to engage securities repurchase transactions and that these examples were not intended to be an exhaustive listing of the types of accounts that would fall within

²³³31 C.F.R. § 1020.220(a)(6). To qualify for the reliance provision, the other financial institution must have or be opening an account for the customer and the other financial institution must enter into a contract with the bank under which it will certify annually that it has implemented an anti-money laundering program and that it will perform the specified requirements of the bank's CIP. In addition, the reliance must be reasonable under the circumstances. Presumably, reliance would not be reasonable if, for example, the other financial institution had recently been cited by a regulatory authority for deficiencies in its anti-money laundering programs.

²³⁴31 C.F.R. § 1023.100(a)(1).

the defined term “account.”²³⁵

The CIP regulation for futures commission merchants and introducing brokers is codified at Section 1026.100 of the BSA rules. Section 1026.100(a)(1) defines the term “account” to mean:

a formal relationship with a futures commission merchant, including but not limited to, those established to effect transactions in contracts of sale of a commodity for future delivery, options on any contract of sale of a commodity for future delivery, or options on a commodity.²³⁶

In adopting the rule, the Treasury and CFTC made it clear that the definition is intended to cover the provision of financial services broadly, including the provision of any guarantee or clearing service and the provision of financial services involving any foreign currency futures contract, option on any foreign currency futures contract, or option on a foreign currency that occurs on an off-exchange basis.²³⁷

The CIP regulation for mutual funds is codified at Section 1024.100 of the BSA rules. Section 1024.100(a)(1) defines the term “account” to mean:

any contractual or other business relationship between a person and a mutual fund established to effect transactions in securities issued by the mutual fund, including the purchase or sale of securities.²³⁸

The definition of the term “customer” in the other CIP rules closely tracks the definition of the term in the bank CIP rule. Nonetheless, questions on the scope of the definition of the term “customer” have arisen with respect to other CIP rules as they have with the bank CIP rule.²³⁹ For example, in adopting the final rule, the Treasury and SEC noted that a broker-dealer would treat the named accountholder opening a trust or escrow account as the “customer” for purposes of the CIP rule and not the benefi-

²³⁵See Customer Identification Programs for Broker-Dealers, 68 Fed. Reg. 25,113, 25,115 (May 9, 2003).

²³⁶31 C.F.R. § 1026.100(a)(1).

²³⁷See Customer Identification Programs for Futures Commission Merchants and Introducing Brokers, 68 Fed. Reg. 25,149, 25,150 n.16 (May 9, 2003).

²³⁸31 C.F.R. § 1024.100(a)(1).

²³⁹The Treasury and the federal banking agencies have issued a succession of guidance documents for the CIP rule, including guidance on the meaning of the term “customer.” See, e.g., Interagency Interpretive Guidance on Customer Identification Program Requirements under Section 326 of the USA PATRIOT Act (Apr. 28, 2005), available at http://www.fincen.gov/statutes_regs/guidance/pdf/faqsfinalciprule.pdf.

ciaries of a trust or escrow account.²⁴⁰ Likewise, with respect to an omnibus account, a broker-dealer would not be required to look through the intermediary to the underlying beneficial owners if the intermediary was identified as the accountholder.²⁴¹ Other applicable rules, however, may require a broker-dealer to determine the identity of the beneficial owners of certain accounts.²⁴²

The basic identification and verification requirements in each of the other CIP rules are substantially identical to the bank CIP rule. The other CIP rules also contain the same provision for reliance on procedures undertaken by other qualifying financial institutions. This provision was particularly important to the securities and mutual fund businesses. In its original proposed CIP rule for broker-dealers, for example, the Treasury appeared to suggest that reliance might be limited to situations involving an account subject to a carrying or clearing agreement under NYSE or NASD rules and even in those situations it was not clear whether complete reliance would be permitted.²⁴³ The final CIP rule for broker-dealers incorporates the broader reliance provision found in the bank CIP rule. In issuing the final rule, the Treasury emphasized that a broker-dealer must be able to demonstrate that the other qualifying financial institution has agreed to perform the requirements of the broker-dealer's CIP and that the contract and certification requirement in the rule applies equally to an affiliate or a nonaffiliate performing the

²⁴⁰See Customer Identification Programs for Broker-Dealers, 68 Fed. Reg. 25,113.

²⁴¹See Customer Identification Programs for Broker-Dealers, 68 Fed. Reg. 25,113. FinCEN has confirmed this interpretation in a guidance document discussing omnibus accounts at futures commission merchants. See FinCEN Guidance, Frequently Asked Questions regarding Customer Identification Programs for Futures Commission Merchants and Introducing Brokers, FIN-2006-G004 (Feb. 14, 2006), available at http://www.fincen.gov/statutes_regs/guidance/html/futures_omnibus_account_qa_final.html. See also FinCEN Guidance, Application of the Customer Identification Program Rule to Future Commission Merchants Operating as Executing and Clearing Brokers in Give-Up Arrangements, FIN-2007-G001 (Apr. 20, 2007), available at http://www.fincen.gov/statutes_regs/guidance/html/cftc_fincen_guidance.html.

²⁴²See Customer Identification Programs for Broker-Dealers, 68 Fed. Reg. 25,113, 25,116 n.30 & n.31 (May 9, 2003).

²⁴³See Customer Identification Programs for Broker-Dealers, 68 Fed. Reg. 25,113, 25,122 (May 9, 2003). See also Customer Identification Programs for Broker-Dealers, 67 Fed. Reg. 48,306, 48,308 (July 23, 2002).

procedures.²⁴⁴ The Treasury made a similar observation with respect to the reliance provision in the CIP rule for mutual funds and futures commission merchants and introducing brokers.²⁴⁵

[3] Supervisory and Examination Process

The CIP rules for banks, broker-dealers, futures commission merchants and introducing brokers, and mutual funds each require that the CIP be made part of the anti-money laundering program required of these institutions under the applicable FinCEN regulation implementing Section 5318(h). As Treasury and FinCEN have stated with respect to the regulations implementing Section 5318(h), examination of these financial institutions for compliance with the FinCEN regulations will be done by their federal functional regulator and for those institutions with a self-regulatory organization by their self-regulatory organization.²⁴⁶ The Treasury and FinCEN have made a standing delegation of authority to the federal banking agencies, the SEC, and the CFTC to examine their regulated institutions for compliance with the BSA regulations.²⁴⁷ FinCEN and the federal functional regulators work closely in implementing these regulations, and have also issued a series of detailed guidance documents, discussed earlier in this Section, interpreting the requirements of the CIP rules for various categories of financial institutions. These FinCEN documents are the principal source of guidance on the CIP rules for financial institutions.

For banking institutions, the FFIEC Manual is an additional source of guidance on the supervisory requirements with respect to a CIP. The FFIEC Manual provides guidance on the regulatory expectations of the scope of application of the CIP requirement.²⁴⁸ The FFIEC Manual is perhaps most helpful in providing a list of examination procedures that the examiners will be expected to perform to determine compliance with the statutory and regulatory requirements for a CIP. This list provides banking institutions with the baseline for their own

²⁴⁴See Customer Identification Programs for Broker-Dealers, 68 Fed. Reg. 25,123 n.134.

²⁴⁵See Customer Identification Programs for Mutual Funds, 68 Fed. Reg. 25,131, 25,141 n.121 (May 9, 2003) (mutual funds); Customer Identification Programs For Futures Commission Merchants and Introducing Brokers, 68 Fed. Reg. 25,149, 25,158 n.87 (May 9, 2003) (futures commission merchants) (also noting that foreign affiliates are not eligible for use under the reliance provision).

²⁴⁶See discussion in § 13:3[2].

²⁴⁷31 C.F.R. § 1010.810(b)(1) to (9).

²⁴⁸FFIEC Manual at 52–62.

program design and audit procedures.²⁴⁹

[4] Enforcement Actions

A number of the regulatory and law-enforcement actions that have been taken against banking institutions for a failure to implement an effective anti-money laundering program have subsumed a failure to have an effective CIP. In some cases the enforcement actions have expressly cited the failure to have an effective CIP. For example, the regulatory actions taken against Riggs and its affiliates and against the New York branch of Banco de Chile involved deficiencies in their CIPs.²⁵⁰ A consent order issued by the OCC to the New York branch of Banco de Chile in February 2005 required extensive remedial actions in respect of the anti-money laundering and BSA compliance programs of the New York branch including the development of operating procedures for the opening of new accounts and a prohibition on opening accounts in the name of anyone other than the true owner or accounts held in the name of a custodian or fiduciary for which the branch has done appropriate due diligence.²⁵¹ In October 2005, the OCC imposed a \$3 million civil money penalty against the New York branch for the matters underlying the February consent order.²⁵² At the same time, FinCEN assessed a concurrent \$3 million civil money penalty against Banco de Chile and provided more details on the deficiencies at the New York

²⁴⁹FFIEC Manual at 59–62.

²⁵⁰For a further discussion of the Riggs case, see § 13:3[4].

²⁵¹*In the Matter of Banco de Chile, New York Branch*, Consent Order No. 2005-2 (Feb. 1, 2005), available at <http://www.occ.gov/static/enforcement-actions/ea2005-11a.pdf>. The OCC took this action after discovering that former branch personnel had concealed accounts of Augusto Pinochet under the names of nominees. The OCC also found that the branch generally failed to classify or monitor accounts of “politically exposed persons” and opened accounts without determining the source of funds. See Press Release, OCC, OCC Issues Cease and Desist Order Against New York Branch of Banco De Chile (Feb. 2, 2005), available at <http://www.occ.gov/news-issuances/news-releases/2005/nr-occ-2005-11.html>.

²⁵²*In the Matter of Banco de Chile, New York Branch*, Consent Order for Civil Money Penalty No. 2005-140 (Oct. 11, 2005), available at <http://www.occ.gov/static/enforcement-actions/ea2005-140.pdf>. The OCC consent order for civil money penalty contained general findings, including that the personnel of the New York branch had executed transactions that allowed certain customers to mask the true beneficiaries of transactions, approved transactions without conducting adequate due diligence on the source of funds used to open accounts, failed to monitor or identify the suspicious nature of deposit and loan accounts, and made misleading, inaccurate, and false statements to bank examiners.

branch, including specifically deficiencies in its CIP.²⁵³

§ 13:6 Shell bank prohibition

[1] Statutory Provisions

Section 313 of the USA PATRIOT Act added a new provision to the BSA, codified at Section 5318(j), which prohibits the provision of banking services to foreign shell banks.²⁵⁴ The purpose of Section 313 is to deny foreign shell banks both direct and indirect access to the U.S. banking system and thus to bring added pressure for their closure worldwide.²⁵⁵

Section 5318(j)(1) provides that a financial institution described in subparagraphs (A) through (G) of Section 5312(a)(2)

“shall not establish, maintain, administer, or manage a correspondent account in the United States for, or on behalf of, a foreign bank that does not have a physical presence in any country.”²⁵⁶

The term “physical presence” is defined in Section 5318(j)(4)(B) to mean a place of business that:

- (i) is maintained by a foreign bank;
- (ii) is located at a fixed address (other than solely an

²⁵³*In the Matter of the New York Branch of Banco de Chile and the Miami Branch of Banco de Chile*, Assessment of Civil Money Penalty No. 2005-03, 2-4 (Oct. 12, 2005), available at <http://www.fincen.gov/newsroom/ea/files/bancodechile.pdf>. Among the general findings recited in the FinCEN order were that the New York branch failed to establish an adequate system of internal controls, failed to designate a person adequate to ensure compliance with the BSA, and failed to conduct adequate independent testing. Among the specific findings were that the failure by the New York branch to implement adequate controls allowed a “prominent Chilean politically exposed person” and his family members and close associates to engage in suspicious transactions dating back as far as November 1997. FinCEN further found that personnel of the New York branch authorized transactions by, for or, on behalf of a “high profile Chilean politically exposed person” that allowed that person to engage in apparent money-laundering and then obstructed the OCC examination process by concealing information.

[Section 13:6]

²⁵⁴Pub. L. No. 107-56, § 313, 115 Stat. at 306 (codified at 31 U.S.C.A. § 5318(j)).

²⁵⁵For a discussion of risks that Congress determined were presented by foreign shell banks, see *Role of U.S. Correspondent Banking in International Money Laundering: Hearings Before Permanent Subcomm. on Investigations of the Senate Comm. on Governmental Affairs*, 107th Cong. (2001) (2001 Congressional Hearing); Minority Staff of S. Comm. on Investigations, 107th Cong., Report on Correspondent Banking: A Gateway to Money Laundering (2001) (2001 Congressional Report).

²⁵⁶31 U.S.C.A. § 5318(j)(1).

electronic address) in a country in which the foreign bank is authorized to conduct banking activities, at which location the foreign bank—

- (I) employs 1 or more individuals on a full-time basis and;
- (II) maintains operating records related to its banking activities; and
- (III) is subject to inspection by the banking authority which licensed the foreign bank to conduct banking activities.²⁵⁷

Section 5318(j) itself does not use the term “foreign shell bank.” Rather, it provides a functional definition of foreign shell bank by referring to a foreign bank that does not have a physical presence in any country. However, in their regulation implementing Section 5318(j) discussed in Section 13:6[2], the Treasury and FinCEN have included a definition of the term “foreign shell bank.”²⁵⁸ The term is defined to mean a foreign bank without a physical presence in any country.

The other critical definition for purposes of Section 5318(j) is the definition of the term “correspondent account.” Section 5318(j) does not contain a definition of the term “correspondent account.” However, Section 311 of the USA PATRIOT Act, which provides for special measures for jurisdictions, financial institutions, or international transactions of primary money-laundering concern and that is codified as a new provision of the BSA in Section 5318A, contains a definition of the term “correspondent account” that applies by its terms not only to Section 5318A but also to Section 5318(i) and Section 5318(j).²⁵⁹ The term “correspondent account” is defined in Section 5318A to mean “an account established to receive deposits from, make payments on behalf of a foreign financial institution, or handle other financial transactions related to such institution.”²⁶⁰ As discussed in the following subsection dealing with the rulemaking process under Section 5318(j), the definition of “correspondent account” contained in Section 5318A is substantially broader than the conventional understanding of a correspondent account in banking circles.

The categories of financial institutions that are subject to the prohibition in Section 5318(j) are those specified in paragraphs (A) through (G) of Section 5312(a)(2), which contains the definition of the term “financial institution” for purposes of the BSA.

²⁵⁷31 U.S.C.A. § 5318(j)(4)(B).

²⁵⁸31 C.F.R. § 1010.605(g).

²⁵⁹Pub. L. No. 107-56, § 311(a), 115 Stat. at 298 (codified at 31 U.S.C.A. § 5318(A)(e)).

²⁶⁰31 U.S.C.A. § 5318(A)(e)(1)(B).

The institutions covered by paragraphs (A) through (G), which include an agency or branch of a foreign bank in the United States, are referred to as a “covered financial institution” in Section 5318(j)(1).

Section 5318(j)(1) prohibits a covered financial institution from maintaining a correspondent account in the United States for or on behalf of a foreign shell bank. This provision is intended to deny a foreign shell bank direct access to the U.S. banking system. Section 5318(j)(2) is intended to deny a foreign shell bank indirect access to the U.S. banking system. Section 5318(j)(2) provides that a covered financial institution must take reasonable steps to ensure that a correspondent account established, maintained, administered, or managed by a covered financial institution in the United States for any foreign bank is not being used indirectly by that foreign bank to provide banking services to a foreign shell bank.²⁶¹ The scope of Section 5318(j)(2) is much broader than the scope of Section 5318(j)(1) and is clearly intended to put pressure on the foreign banking community at large to cease dealing with foreign shell banks on a global basis. Section 5318(j)(3) provides an important exception to the prohibitions contained in Section 5318(j)(1) and (2). A covered financial institution is not prohibited from providing a correspondent account to a foreign bank without a physical presence if the foreign bank:

- (i) is an affiliate of a depository institution, credit union, or foreign bank that maintains a physical presence in the United States or a foreign country; and
- (ii) is subject to supervision by a banking authority in the country regulating the affiliated depository institution, credit union, or foreign bank.²⁶²

The scope of the prohibitions contained in Section 5318(j)(1) and (2) as well as the scope of the exception contained in Section 5318(j)(3) were further delineated in regulations issued by the Treasury and FinCEN to implement Section 5318(j). Section 5318(j) became effective 60 days after the enactment of the USA PATRIOT Act.²⁶³

[2] Regulatory Provisions

As one of the first provisions in Title III of the USA PATRIOT Act to become effective, Section 313 and its implementing regula-

²⁶¹31 U.S.C.A. § 5318(j)(2).

²⁶²31 U.S.C.A. § 5318(j)(3).

²⁶³Pub. L. No. 107-56, § 313(b), 115 Stat. at 307.

tions were the subject of intense scrutiny by the banking industry. To assist the banking industry in meeting its compliance requirements under the early effective date, the Treasury issued interim guidance in November 2001 and anticipated several of the important interpretive issues that would arise in implementing the provisions of Section 313 and the related provisions of Section 319 (discussed in Section 13:7).²⁶⁴ As a procedural matter, the interim guidance adopted an important mechanism to facilitate compliance, the use of a certification process by foreign bank holders of correspondent accounts.²⁶⁵ The ability of covered financial institutions to rely on a certificate from a foreign bank confirming that it was not a foreign shell bank and that it would not use any correspondent account to provide banking services to a foreign shell bank significantly eased the overall burden of the rule although the identification of all the necessary recipients and the tracking of individual certifications constituted a substantial administrative and operational undertaking in the early days of the new regime. In the interim guidance, the Treasury signaled its view that the implementation of Section 5318(j) would be based on the broad definition of the term “correspondent account” contained in Section 5318(A).²⁶⁶ In its notice of proposed rulemaking issued a month later in December 2001, the Treasury carried forward the basic premises reflected in the interim guidance and applied these same premises to broker-dealers who were not covered by the interim guidance although they were subject to Section 5318(j) as “covered financial institutions.”²⁶⁷ The proposed rule carried forward from the interim guidance the use of a certification process for purposes of

²⁶⁴See Interim Guidance Concerning Compliance by Covered U.S. Financial Institutions With New Statutory Anti-Money Laundering Requirements Regarding Correspondent Accounts Established or Maintained for Foreign Banking Institutions, 66 Fed. Reg. 59,342 (Nov. 27, 2001) (providing interim guidance on the requirements of §§ 313(a) and 319(b) of the USA PATRIOT Act).

²⁶⁵See Interim Guidance Concerning Compliance by Covered U.S. Financial Institutions With New Statutory Anti-Money Laundering Requirements Regarding Correspondent Accounts Established or Maintained for Foreign Banking Institutions, 66 Fed. Reg. 59,342, 59,346 (Nov. 27, 2001) (attaching form of certification that could be used for purposes of §§ 313(a) and 319(b)).

²⁶⁶See Interim Guidance Concerning Compliance by Covered U.S. Financial Institutions With New Statutory Anti-Money Laundering Requirements Regarding Correspondent Accounts Established or Maintained for Foreign Banking Institutions, 66 Fed. Reg. 59,342, 59,343 (Nov. 27, 2001) (attaching form of certification that could be used for purposes of §§ 313(a) and 319(b)).

²⁶⁷See Counter Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 66 Fed. Reg. 67,460 (Dec. 28, 2001).

meeting the compliance requirements of Section 5318(j) and Section 5318(k) and included an express safe harbor provision for institutions using the model form of certification attached as an appendix to the rule.²⁶⁸ In the notice of proposed rule-making, the Treasury also adhered to the same approach as in the interim guidance with respect to the broad definition of “correspondent account.” Indeed, in its discussion of the proposed rule, the Treasury stated that the statutory definition of “correspondent account” in Section 5318A was broad and was not limited to any particular type of account.²⁶⁹ It would include clearing and settlement accounts, fiduciary accounts, custody and escrow accounts, and accounts for engaging in transactions in securities, derivatives, repurchase agreements, and foreign exchange. In the proposed rule, the Treasury indicated that it intended to apply the same broad definition of “correspondent account” to broker-dealers as to banks under the provisions of Section 5318(j) as “covered financial institutions.”²⁷⁰

In September 2002, the Treasury and FinCEN adopted a final rule implementing Section 5318(j) and Section 5318(k).²⁷¹ The final rule consists of a definitional section, now codified at Section 1010.100 of the BSA rules, and an operative section, now codified at Section 1010.630 of the BSA rules.²⁷² Notwithstanding many critical comments relating to the definition of a “correspondent account,” the Treasury determined in the final rule to retain the use of the statutory definition with only technical changes to the language. The Treasury attempted to address certain of the concerns raised in the comment process by specifically incorporating into the definition of “correspondent account” the definition of “account” from Section 5318A of the BSA. The term “account” as defined in Section 5318A:

- (i) means a formal banking or business relationship estab-

²⁶⁸See Counter Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 66 Fed. Reg. 67,460, 67,460 to 67,461 (Dec. 28, 2001).

²⁶⁹See Counter Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 66 Fed. Reg. 67,460, 67,461 (Dec. 28, 2001).

²⁷⁰See Counter Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 66 Fed. Reg. 67,460, 67,461 (Dec. 28, 2001).

²⁷¹See Anti-Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 67 Fed. Reg. 60,562 (Sept. 26, 2002).

²⁷²31 C.F.R. § 1010.100 (2010); 31 C.F.R. § 1010.630.

- lished to provide regular services, dealings, and other financial transactions; and
- (ii) includes a demand deposit, savings deposit, or other transaction or asset account and a credit account or other extension of credit.²⁷³

In its discussion of the final rule, the Treasury said that the inclusion of the word “regular” in the definition of the term “account” would have the effect generally of excluding infrequent or occasional transactions from the definition of “account.”²⁷⁴

The other provision of the proposed rule that prompted significant comment was the proposed inclusion of foreign branches of U.S. banks within the definition of “covered financial institutions.” The Treasury decided to exclude foreign branches of U.S. banks from the definition of “covered financial institutions” for purposes of the final rules under Section 313 and Section 319. This means that a correspondent account for a foreign bank that is maintained and managed only at a foreign branch of a U.S. bank would not be subject to the rule. On the other hand, if the correspondent account, even though nominally maintained at a foreign branch of a U.S. bank, is actually administered or managed in the United States, the rule would apply.²⁷⁵ This approach was in fact consistent with the existing definitions in the BSA regulations.²⁷⁶ This approach means that other covered financial institutions must treat the foreign branch of a U.S. bank as a “foreign bank” for purposes of compliance with the certification and other requirements of Section 313 and Section 319. In the final rule, Treasury also decided to apply the existing definition of “foreign bank” in the BSA regulations to the certification and other requirements of Section 313 and Section 319.²⁷⁷

In adopting the final rule, the Treasury tightened the require-

²⁷³Pub. L. No. 107-56, § 311(a), 115 Stat. at 303 (codified at 31 U.S.C.A. § 5318A(e)(1)(A)).

²⁷⁴See Anti-Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 67 Fed. Reg. 60,564.

²⁷⁵See Anti-Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 67 Fed. Reg. 60,564.

²⁷⁶See Anti-Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 67 Fed. Reg. 60,564. Compare 31 C.F.R. § 1010.100(u) (definition of foreign bank) with 31 C.F.R. § 1010.100(d) (definition of bank).

²⁷⁷The term “foreign bank” is defined in the BSA rules to mean a bank organized under foreign law. The definition specifically excludes any agent,

ments for the exception for correspondent accounts of a foreign shell bank that is an affiliate of a depository institution with a physical presence and that is subject to supervision by the banking authority that regulates the depository institution. Section 5318(j)(4) defines the term “affiliate” to mean a foreign bank that is controlled by or under common control with a depository institution, credit union, or foreign bank. In the proposed rule, the Treasury included the defined term “regulated affiliate” and for purposes of determining whether a foreign shell bank is a regulated affiliate of another depository institution, credit union, or foreign bank, defined “control” to mean ownership or control of 25% or more of any class of voting security or control in any manner of the election of a majority of the directors of another company.²⁷⁸ In response to a congressional comment on the proposed rule, the Treasury revised the definition of “control” in the final rule to increase the percentage test from 25% to 50%.²⁷⁹

The operative requirements of Section 5318(j) relating to foreign shell banks are included in Section 1010.630(a)(1) of the final rule. Section 1010.630(b) of the final rule continues the basic certification and safe-harbor approach reflected in the proposed rule and in the original interim guidance.²⁸⁰ For accounts existing on October 28, 2002, the covered financial institution was required to have obtained the certification from the foreign bank on or before March 31, 2003, and a recertification from the foreign bank at least once every three years thereafter.²⁸¹ For accounts established after October 28, 2002, the covered

agency, branch, or office within the United States of a bank organized under foreign law. 31 C.F.R. § 1010.100(u). An agent, agency, branch, or office within the United States of a foreign bank is included within the definition of “bank” in the BSA rules. 31 C.F.R. § 1010.100(d).

²⁷⁸See Counter Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 66 Fed. Reg. 67,460, 67,466 (Dec. 28, 2001).

²⁷⁹See Anti-Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 67 Fed. Reg. 60,567.

²⁸⁰31 C.F.R. § 1010.630(b). In the final rule, the Treasury expanded the certification form to provide for a global certification that would be applicable to all correspondent accounts maintained for the foreign bank by all covered financial institutions. See Anti-Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 67 Fed. Reg. 60,568.

²⁸¹31 C.F.R. § 1010.630(d)(1). FinCEN has published a guidance document on the recertification process, indicating that the recertification must be obtained on or before the three-year anniversary of the execution of the initial certification. See FinCEN Guidance, Frequently Asked Questions—Foreign

financial institution must obtain the certification within 30 calendar days after the date the account is established and a recertification at least once every three years thereafter.²⁸² If the covered financial institution does not obtain the certification or recertification within the specified time period, it must close all the correspondent accounts of the foreign bank within a commercially reasonable time.²⁸³ The final rule also provides that a covered financial institution will not be liable to any person in any court or arbitration proceeding for terminating an account in accordance with the rule.²⁸⁴ In adopting the final rule, the Treasury also clarified the obligation on a covered financial institution in accepting a certification form. The Treasury stated that it expects a covered financial institution to review the form of certification to determine that it is complete and internally consistent.²⁸⁵ If a covered financial institution knows, suspects, or has reason to suspect that any information in a certification or recertification is no longer correct, the covered financial institution must request the foreign bank to verify or correct the information within 90 calendar days.²⁸⁶

[3] Supervisory and Examination Process

The FFIEC Manual contains an extended discussion of the various requirements of the USA PATRIOT Act applicable to the maintenance of correspondent accounts for foreign banks.²⁸⁷ The discussion specifically covers the requirements of Section 5318(j) relating to foreign shell banks as well as the other sections of the USA PATRIOT Act applicable to correspondent accounts.²⁸⁸ It also includes examination procedures for evaluating compliance by the bank with the foreign shell bank prohibition.²⁸⁹

Bank Recertifications under 31 C.F.R. § 103.177, FIN-2006-G003 (Feb. 3, 2006), available at http://www.fincen.gov/statutes_regs/guidance/html/faqsguidance.html.

²⁸²31 C.F.R. § 1010.630(d)(2).

²⁸³31 C.F.R. § 1010.630(d)(1) and (2).

²⁸⁴31 C.F.R. § 1010.630(d)(5).

²⁸⁵See Anti-Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 67 Fed. Reg. 60,562, 60,568 to 60,569 (Sept. 26, 2002).

²⁸⁶31 C.F.R. § 1010.630(c).

²⁸⁷See FFIEC Manual at 117–129.

²⁸⁸See FFIEC Manual at 117–18.

²⁸⁹See FFIEC Manual at 125.

[4] Enforcement Actions

The regulatory authorities have taken a large number of enforcement actions against domestic and foreign banks based on their correspondent banking operations. The enforcement orders or written agreements in these actions typically require the banking institution to adopt improved procedures and internal controls for its correspondent banking activities. Among the standard provisions in these orders or written agreements is the requirement for improved controls to ensure compliance with all requirements relating to correspondent accounts for non-U.S. persons, including but not limited to the prohibition on correspondent accounts for foreign shell banks. These orders and written agreements are discussed in further detail in Section 13:10[4].

§ 13:7 Record-keeping for foreign correspondent accounts**[1] Statutory Provisions**

Section 319(b) of the USA PATRIOT Act added several new requirements to the BSA, which are codified at Section 5318(k). These provisions became effective at the same time as the foreign shell bank prohibition and they were implemented initially through the same interim guidance document and then through the same rule-making process as the foreign shell bank prohibition.²⁹⁰ The provisions of Section 319(b), however, have application to a much larger group of foreign banks than do the provisions of Section 313 (which relate only to foreign shell banks) because the provisions of Section 319(b) apply to all foreign banks maintaining a correspondent account in the United States.

The provisions of Section 319(b) as codified at Section 5318(k) deal with access to information by federal banking agencies and federal law-enforcement authorities relating to anti-money laundering compliance by a covered financial institution or its customers and with record-keeping requirements for correspondent accounts maintained in the United States for foreign banks. Section 5318(k)(2) contains a requirement that not later than 120 hours after receiving a request by an appropriate federal banking agency for information related to the anti-money laundering compliance by a covered financial institution or a customer of the institution, the covered financial institution must provide information, including account documentation, for any account opened, maintained, administered, or managed in the United States by

[Section 13:7]

²⁹⁰See § 13:6[2].

the covered financial institution.²⁹¹ Unlike Section 5318(j), Section 5318(k) does not contain a definition of the term “covered financial institution.” In its rule-making process under Section 5318(j) and Section 5318(k), the Treasury determined that the term “covered financial institution” in Section 5318(k) should be given the same meaning as in Section 5318(j), namely, banks, and other depository institutions and broker-dealers.²⁹²

Section 5318(k)(3) provides (i) additional authority for the Secretary of the Treasury or the Attorney General to access records of a foreign bank maintaining a correspondent account in the United States, and (ii) an additional record-keeping requirement on covered financial institutions to facilitate the authority of the Secretary of the Treasury and the Attorney General to access the records of foreign banks. Section 5318(k)(3)(A)(i) provides that the Secretary of the Treasury or the Attorney General may issue a summons or subpoena to any foreign bank that maintains a correspondent account in the United States for records related to the account, “including records maintained outside of the United States relating to the deposit of funds with the foreign bank.”²⁹³ Thus, under Section 5318(k)(3)(A)(i), the maintenance by a foreign bank of a correspondent account in the United States provides the basis for the Secretary of the Treasury or the Attorney General to subpoena records outside the United States relating to the deposit of funds into the foreign bank outside the United States.

This extraterritorial expansion of the subpoena power is of a piece with the expansion of the forfeiture power provided for in Section 319(a) of the USA PATRIOT Act. Section 319(a) amended the forfeiture provisions of the United States criminal code to provide that for purposes of forfeiture under Section 981 of title 18 or Section 801 of title 21 of the U.S. Code, funds deposited into a foreign bank that has an “interbank” account in the United States with a covered financial institution (as defined in Section 5318(j)) shall be deemed to have been deposited into the “interbank” account in the United States. The result is that funds in the interbank account are subject to restraint and seizure up

²⁹¹31 U.S.C.A. § 5318(k)(2).

²⁹²*See* Counter Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 66 Fed. Reg. 67,460, 67,463 (Dec. 28, 2001).

²⁹³31 U.S.C.A. § 5318(k)(3)(A)(i). For purposes of § 5318(k), the term “correspondent account” has the same meaning as in § 5318A(e)(1)(B). 31 U.S.C.A. § 5318(k)(1)(B).

to the amount of the funds deposited in the foreign bank.²⁹⁴ Unlike other forfeiture provisions in Section 981, in the new forfeiture provision there is no requirement that the funds in the interbank account be directly traceable to the funds deposited in the foreign bank.²⁹⁵ The amendments made by Section 319(a) to the forfeiture provisions of the criminal code provide that the Attorney General in consultation with the Secretary of the Treasury may suspend or terminate a forfeiture order under the new section if the Attorney General determines that a conflict of law exists between the laws of the jurisdiction where the foreign bank is located and the laws of the United States and if the suspension or termination is in the interest of justice and would not harm the national interests of the United States.²⁹⁶

Section 5318(k)(3)(A)(ii) further provides that a summons or subpoena from the Secretary of the Treasury or the Attorney General on a foreign bank with a correspondent account in the United States may be served on the foreign bank in the United States if the foreign bank has a representative in the United States or on the foreign bank in a foreign country pursuant to any mutual legal assistance treaty, multilateral agreement, or other request for international law-enforcement assistance.²⁹⁷

²⁹⁴Pub. L. No. 107-56, § 319(a), 115 Stat. at 311 (codified at 18 U.S.C.A. § 981(k)(1)(A)).

²⁹⁵Pub. L. No. 107-56, § 319(a), 115 Stat. at 311 (codified at 18 U.S.C.A. § 981(k)(2)).

²⁹⁶Pub. L. No. 107-56, § 319(a), 115 Stat. at 311 (codified at 18 U.S.C.A. § 981(k)(1)(B)).

²⁹⁷31 U.S.C.A. § 5318(k)(3)(A)(ii). Section 5318(k)(3)(B)(i) establishes a new standing mechanism for satisfying the first alternative above, *i.e.*, a foreign bank having a representative in the United States. Section 5318(k)(3)(B)(i) requires any covered financial institution that maintains a correspondent account in the United States for a foreign bank to maintain records in the United States identifying (i) the owners of the foreign bank and (ii) the name and address of a person who resides in the United States and is authorized to accept service of legal process for records regarding the correspondent account. Section 5318(k)(3)(B)(ii) further provides that upon receipt of a written request for the information required to be maintained under the subsection from a federal law-enforcement officer, the covered financial institution must provide the information not later than seven days after receipt of the request. An indirect enforcement mechanism is also provided in Section 5318(k)(3)(C). A covered financial institution is required to terminate any correspondent relationship with a foreign bank not later than 10 business days after receipt of written notice from the Secretary of the Treasury or the Attorney General that the foreign bank has failed either to comply with a summons or subpoena issued under the section or to initiate proceedings in a United States court to contest the summons or subpoena. 31 U.S.C.A. § 5318(k)(3)(C)(i). This closure requirement comes with a

[2] Regulatory Provisions

As discussed in Section 13:6[2], the Treasury adopted a broad definition of the term “correspondent account” for purposes of both Section 313 and Section 319(b) in its interim guidance, which was subsequently adopted in the final rules implementing Section 313 and Section 319(b).²⁹⁸ The final rule implementing the record-keeping requirements of Section 319(b) consists of a definitional section codified at Section 1010.605 of the BSA rules and an operative section codified at Section 1010.630(a)(2) of the BSA rules. The final rule implementing the summons and subpoena response requirements of Section 319(b) is codified at Section 1010.670 of the BSA rules. In adopting the final rules, the Treasury found that there was no clear basis to differentiate the definition of “correspondent account” for purposes of Section 313 and Section 319(b).²⁹⁹ It noted that the principal argument for adopting a more restrictive definition for purposes of Section 319(b) was to reduce the compliance burden of applying a broad definition against a much larger universe of foreign banks (as opposed to Section 313 that applied only to foreign shell banks). In response to that observation, the Treasury noted that covered financial institutions would have the ability to rely on the same certification process for purposes of Section 313 and Section 319(b) and that the incremental burden of responding to Section 319(b) requirements in the certification process would not be substantial.³⁰⁰ The implications of the adoption of a broad definition of the term “correspondent account” for purposes of Section 319(b) were twofold. First, a large set of foreign banks would have to appoint an agent for service of legal process in the United

limitation of liability provision. A covered financial institution will not be liable to any person in any court or arbitration proceeding for terminating a correspondent relationship in accordance with the requirements of the section. 31 U.S.C.A. § 5318(k)(3)(C)(ii).

²⁹⁸See Interim Guidance Concerning Compliance by Covered U.S. Financial Institutions With New Statutory Anti-Money Laundering Requirements Regarding Correspondent Accounts Established or Maintained for Foreign Banking Institutions, 66 Fed. Reg. 59,342, 59,343 (Nov. 27, 2001).

²⁹⁹See Anti-Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 67 Fed. Reg. 60,562, 60,564 (Sept. 26, 2002). Indeed, § 5318(k)(1)(B) provides that the definition of the term “correspondent account” in § 5318(A)(e)(1)(B) applies to § 5318(k).

³⁰⁰See Anti-Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 67 Fed. Reg. 60,562, 60,564 (Sept. 26, 2002). Indeed, § 5318(k)(1)(B) provides that the definition of the term “correspondent account” in § 5318(A)(e)(1)(B) applies to § 5318(k).

States in order to maintain their various account relationships in the United States. Second, U.S. covered financial institutions would need to identify from their customer base a large set of foreign banks holding such accounts and then would have to obtain the necessary ownership information in addition to legal process information from this large set of foreign banks.

The Treasury was required to address another definitional issue with respect to Section 319(b) in its interim guidance and subsequent regulations. Section 5318(k)(3) (B)(i) requires a covered financial institution to maintain records identifying the “owners” of any foreign bank maintaining a correspondent account in the United States.³⁰¹ Section 5318(k)(3) contains no definition of the term “owners.” In its interim guidance and in its proposed rule under Section 319(b), the Treasury proposed a complex definitional taxonomy comprised of “large direct owners,” “indirect owners,” and “small direct owners.”³⁰² Confusion over the proposed taxonomy abounded even in U.S. banking circles; and the prospect of thousands of foreign banks trying to apply the complex rules was a daunting one to many observers.

In its final rule adopted in September 2002, the Treasury dropped the complex definitional approach and replaced it with a relatively straightforward definition based on control concepts from federal banking law.³⁰³ The final rule also specifies how “ownership” is determined in a family context.³⁰⁴ The final rule also included two categories of exceptions from the requirement to identify the owners of a foreign bank. First, a covered financial

³⁰¹31 U.S.C.A. § 5318(i)(3)(B)(i).

³⁰²See Interim Guidance Concerning Compliance by Covered U.S. Financial Institutions With New Statutory Anti-Money Laundering Requirements Regarding Correspondent Accounts Established or Maintained for Foreign Banking Institutions, 66 Fed. Reg. at 59343 to 59344; Counter Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 66 Fed. Reg. 67,460, 67,463 to 67,464 (Dec. 28, 2001).

³⁰³See Anti-Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, 67 Fed. Reg. 60,562, 60,566 (Sept. 26, 2002); see 31 C.F.R. § 1010.605(j)(1) (defining the term “owner” as meaning a person who directly or indirectly owns, controls, or has the power to vote 25% or more of any class of voting securities or other voting interests or who controls in any manner the election of a majority of directors of the foreign bank).

³⁰⁴31 C.F.R. § 1010.605(j)(2) (2010). Members of the same family are treated as one person. The term “same family” is defined broadly to mean “parents, spouses, children, siblings, uncles, aunts, grandparents, grandchildren, first cousins, stepchildren, stepsiblings, parents-in-law, and spouses of any of the foregoing.” 31 C.F.R. § 1010.605(j)(2).

institution is not required to maintain records of the owners of any foreign bank that is required to file an annual report on Form FRÿ-7 with the Federal Reserve Board that identifies current owners as required by the Form.³⁰⁵ Second, a covered financial institution is not required to maintain records of the owners of any foreign bank the shares of which are publicly traded. For purposes of this rule, “publicly traded” means shares that are traded on an exchange or on an organized over-the-counter market that is regulated by a foreign securities authority (as defined in Section 3(a)(50) of the Exchange Act).³⁰⁶

As noted in Section 13:6[2], the rule adopted under Section 319(b) permits covered financial institutions to rely on a certification by the foreign bank to satisfy the requirements of Section 319(b) with respect to ownership information and information relating to the process agent.³⁰⁷ The forms of certification and recertification are available on the FinCEN Web site. The rule provides a safe harbor for a covered financial institution that uses the appended form of certification and recertification with its foreign bank customers or counterparties. The safe-harbor provision is subject to the qualification that if any time a covered financial institution knows, suspects, or has reason to suspect that any information contained in a certification provided by a foreign bank is no longer correct, the covered financial institution must request the foreign bank to rectify or correct the information.³⁰⁸ If the covered financial institution does not obtain from the foreign bank or other source verification of the information or corrected information within 90 calendar days, the covered financial institution is required to close all correspondent accounts of that foreign bank within a commercially reasonable time and may not permit the foreign bank to establish new positions or execute any transactions through the accounts other than transactions necessary to close the accounts.³⁰⁹ The final rule also includes a limitation of liability provision for a covered financial institution that terminates an account in accordance with the requirements of the rule.³¹⁰ The final rule requires a financial institution to retain the original of any document provided by a foreign bank or the original or a copy of any other

³⁰⁵31 C.F.R. § 1010.630(a)(2)(ii).

³⁰⁶31 C.F.R. § 1010.630(a)(2)(iii).

³⁰⁷31 C.F.R. §§ 1010.605(b) and 1010.630(b).

³⁰⁸31 C.F.R. § 1010.630(c).

³⁰⁹31 C.F.R. § 1010.630(d)(3).

³¹⁰31 C.F.R. § 1010.630(d)(5).

document relied upon for purposes of the rule for at least five years after the date that the covered financial institution no longer maintains any correspondent account for the foreign bank.³¹¹

Section 1010.670 of the BSA rules implements, and generally tracks the language of, the provisions of Section 5318(k)(3)(A) and (B) relating to summons and subpoenas served by the Secretary of the Treasury or the Attorney General on a foreign bank maintaining a correspondent account in the United States.³¹² Section 1010.670 also incorporates the language from Section 5318(k)(3) relating to the required closure of accounts, the limitation of liability for such closure, and the civil money penalty for failure to effect the required closure.³¹³

[3] Supervisory and Examination Process

The FFIEC Manual contains guidance and examination procedures with respect to the requirements of the regulations implementing Section 319(b). The certification and closure processes under Section 1010.630 and Section 1010.670 are outlined.³¹⁴ More importantly, the FFIEC Manual sets out testing procedures for use by examiners.³¹⁵ The internal audit department of a banking institution should at a minimum apply the same testing procedures as part of its internal audit programs both to identify possible deficiencies in internal processes and procedures and to satisfy the independent testing requirement of the anti-money laundering program regulation.

§ 13:8 Sharing of information

[1] Statutory Provisions

Section 314 of the USA PATRIOT Act contains two general information sharing procedures. Section 314(a) directs the Secretary of the Treasury to adopt regulations to encourage further cooperation among financial institutions, regulatory authorities, and law-enforcement authorities with the specific purpose of encouraging those authorities to share with the financial institutions information regarding individuals or entities suspected of

³¹¹31 C.F.R. § 1010.630(e).

³¹²31 C.F.R. § 1010.670(b) and (c).

³¹³31 C.F.R. § 1010.670(d), (e), and (f).

³¹⁴See FFIEC Manual at 118–119.

³¹⁵See FFIEC Manual at 125–129.

being engaged in terrorist acts or money-laundering activities.³¹⁶ The regulations adopted pursuant to this section may require a financial institution to designate one or more individuals to receive the information and may establish procedures for the protection of the shared information.³¹⁷

Section 314(b) provides that upon notice to the Secretary of the Treasury two or more financial institutions or an association of financial institutions may share information with one another regarding individuals, entities, or countries suspected of possible terrorist or money-laundering activities.³¹⁸ Section 314(b) further provides that a financial institution sharing such information shall not be liable to any person under any law or regulation of the United States or any constitution, law, or regulation of any state or political subdivision or under any contract or other legally enforceable agreement for such disclosure or for any failure to provide notice of such disclosure to any person who is the subject of the disclosure except for actions that violate Section 314(b) or any regulations promulgated thereunder.³¹⁹ In addition, under the terms of Section 314(c), the sharing of information under Section 314(b) will not constitute a violation of the privacy provisions of title V of the Gramm-Leach-Bliley Act of 1999 (GLB Act) relating to the protection of nonpublic personal information.³²⁰

[2] Regulatory Provisions

The Treasury and FinCEN have adopted regulations implementing the information sharing provisions of Section 314(a) and Section 314(b).³²¹ Section 1010.520(b)(1) provides that a federal law-enforcement agency investigating terrorist activity or money-laundering may request FinCEN to solicit information from a financial institution or group of financial institutions.³²² In making the request, the federal law-enforcement agency must certify

[Section 13:8]

³¹⁶Pub. L. No. 107-56, § 314(a)(1), 115 Stat. at 307.

³¹⁷Pub. L. No. 107-56, § 314(a)(3), 115 Stat. at 307.

³¹⁸Pub. L. No. 107-56, § 314(b), 115 Stat. at 308.

³¹⁹Pub. L. No. 107-56, § 314(b), 115 Stat. at 308.

³²⁰Pub. L. No. 107-56, § 314(c), 115 Stat. at 308. The privacy provisions of the GLB Act are codified at 15 U.S.C.A. §§ 6801 et seq. (2006).

³²¹See Special Information Sharing Procedures To Deter Money Laundering and Terrorist Financing, 67 Fed. Reg. 60,579 (Sept. 26, 2002) (now codified at 31 C.F.R. §§ 1010.505, 1010.520, and 1010.540).

³²²31 C.F.R. § 1010.520(b)(1). Section 1010.520(a)(1) defines the term “financial institution” as meaning any financial institution described in § 5312(a)(2) of the BSA.

to FinCEN that the individual or entity about which the law-enforcement agency is seeking information is engaged in or reasonably suspected based on credible evidence of engaging in terrorist activity or money-laundering. Upon receiving the certification, FinCEN may require a financial institution to search its records to determine whether it maintains or has maintained an account for, or has engaged in transactions with, any specified individual or entity.³²³ A financial institution receiving such a request from FinCEN must expeditiously search its records for certain items, including any account maintained for a named suspect during the preceding 12 months and any transaction or transmittal of funds involving the named suspect during the preceding six months.³²⁴ If a financial institution identifies an account or transaction relating to the individual or entity named in the request, the financial institution must report certain specified information relating to the account or transaction to FinCEN in the manner and within the time frame specified in the FinCEN request.³²⁵ A financial institution must also designate one person to be the point of contact to receive these requests from FinCEN.³²⁶

Section 1010.520(b)(3) specifies that a financial institution may not use the information provided by FinCEN in its request for any purpose other than certain specified purposes.³²⁷ A financial institution may not disclose to any person other than FinCEN or the other federal law-enforcement agency on whose behalf FinCEN has requested the information the fact that a request has been made.³²⁸ Under the special information sharing provisions of Section 1010.540, a financial institution may share information concerning an individual or entity named in a FinCEN request for information with other authorized financial institutions but not the fact that FinCEN has requested information

³²³31 C.F.R. § 1010.520(b)(1).

³²⁴31 C.F.R. § 1010.520(b)(3)(i). The terms “transaction” and “transmittal of funds” have the meanings generally provided in 31 C.F.R. § 1010.100.

³²⁵31 C.F.R. § 1010.520(b)(3)(i). The information that may be required to be reported includes the name of the individual or entity; the number of the account; the date and type of the transaction; and any Social Security number, taxpayer identification number, date of birth, address, or other similar identifying information.

³²⁶31 C.F.R. § 1010.520(b)(3)(iii).

³²⁷The specified purposes are: (i) reporting to FinCEN as provided in the section; (ii) determining whether to establish or maintain an account or to engage in a transaction; or (iii) assisting the financial institution in complying with any requirement of the BSA regulations. 31 C.F.R. § 1010.520(b)(3)(iv)(A).

³²⁸31 C.F.R. § 1010.520(b)(3)(iv)(B)(1).

about the individual or entity.³²⁹

A financial institution is required to maintain adequate procedures to protect the security and confidentiality of requests from FinCEN under this Section, and the requirement will be deemed satisfied to the extent that a financial institution applies the same procedures that it has established to satisfy the requirements of Section 501 of the GLB Act relating to the protection of customer nonpublic personal information.³³⁰ Section 1010.520(b)(4) provides that information that a financial institution is required to report under this Section shall be treated as information required to be reported in accordance with a federal statute for purposes of the relevant exceptions in Section 3413(d) of the Right to Financial Privacy Act and Section 502(e)(8) of the GLB Act.³³¹

After adopting the implementing regulation in September 2002, FinCEN began processing Section 314(a) requests from other federal law-enforcement agencies in November 2002 but shortly thereafter placed a brief moratorium on the process. FinCEN reinstated the process in February 2003 with various revisions.³³² Under the revised process, FinCEN now sends requests to the designated individuals at more than 22,000 financial institutions every two weeks through a secure Web site.³³³ The financial institutions have two weeks from the transmission date of the request to respond. Unless otherwise noted, the requirement upon the financial institution is for a one-time search of relevant records. The Section 314(a) request process operates as a means of providing a “lead” to the law-enforcement authorities. It does not substitute for a subpoena or other legal process.³³⁴ To obtain financial records from a financial institution that has reported a match pursuant to a Section 314(a) request, the law-enforcement agency must meet the legal standards that otherwise apply to

³²⁹31 C.F.R. § 1010.520(b)(3)(iv)(B)(2). Section 314(a) subject lists or requests, however, may not be shared with any foreign office, branch, or affiliate unless the FinCEN request specifically states otherwise. See FFIEC Manual at 99–100.

³³⁰31 C.F.R. § 1010.520(b)(3)(iv)(C).

³³¹31 C.F.R. § 1010.520(b)(4).

³³²See FinCEN News, FinCEN to Reinstate USA PATRIOT Act Section 314(a) Information Requests (Feb. 6, 2003), available at http://www.fincen.gov/news_room/nr/html/20030206.html.

³³³See FinCEN’s 314(a) Fact Sheet, available at http://www.fincen.gov/statutes_regs/patriot/pdf/314afactsheet.pdf.

³³⁴See FinCEN’s 314(a) Fact Sheet, available at http://www.fincen.gov/statutes_regs/patriot/pdf/314afactsheet.pdf.

the investigative tool such as a subpoena that it chooses to use to obtain the records themselves.

Section 1010.540 governs the voluntary sharing of information among financial institutions and associations of financial institutions as authorized by Section 314(b). Section 1010.540(a)(1) defines the term “financial institution” for purposes of voluntary sharing of information more narrowly than does Section 1010.520(a)(1) for purposes of responding to federal government requests.³³⁵ The term “association of financial institutions” is defined to mean an association comprised entirely of such financial institutions.³³⁶

Section 1010.540(b) authorizes a financial institution or an association of financial institutions to transmit, receive, or otherwise share information with any other financial institution or association of financial institutions for the purpose of identifying and reporting activities that the financial institution or association suspects may involve possible terrorist activity or money-laundering.³³⁷ To avail itself of this authority, a financial institution must submit a notice to FinCEN on an annual basis.³³⁸

Section 1010.540(b) provides that the information shared may not be used for any purpose beyond certain specified purposes.³³⁹ Section 1010.540(b) also requires any financial institution or association sharing information to maintain adequate procedures to protect the security and confidentiality of the information. If a financial institution or association complies with the requirements of Section 501 of the GLB Act or the regulations thereun-

³³⁵31 C.F.R. § 1010.540(a)(1). A “financial institution” eligible to share information is limited to a financial institution that is required to establish anti-money laundering programs under FinCEN regulations. *See* § 13:3[2][a] for a discussion of the FinCEN regulations imposing anti-money laundering program requirements.

³³⁶31 C.F.R. § 1010.540(a)(2). FinCEN has issued guidance indicating that the information sharing under Section 314(b) covers a broad array of fraudulent and other criminal activities in addition to possible terrorist activity. *See* FinCEN, Guidance on the Scope of Permissible Information Sharing Covered by Section 314(b) Safe Harbor of the USA PATRIOT Act, FIN-2009-G002 (June 16, 2009), available at http://www.fincen.gov/statutes_regs/guidance/html/fin-2009-g002.html.

³³⁷31 C.F.R. § 1010.540(b)(1).

³³⁸31 C.F.R. § 1010.540(b)(2).

³³⁹The specified purposes are: (i) identifying and, where appropriate, reporting on money-laundering or terrorist activities; (ii) determining whether to establish or maintain an account or to engage in a transaction; or (iii) assisting the financial institution in complying with any requirement of the BSA regulations. 31 C.F.R. § 1010.540(b)(4).

der requirements, then it will be entitled to the safe harbor from liability provided in Section 314(b) in connection with the sharing of such information.³⁴⁰ Finally, Section 1010.540(c) confirms that if as a result of information shared pursuant to this section, a financial institution knows, suspects, or has reason to suspect that an individual or entity is involved in terrorist activity or money-laundering, the financial institution must file a SAR in accordance with any regulations applicable to it.³⁴¹

[3] Supervisory and Examination Process

The FFIEC Manual contains detailed directions to the staffs of the federal banking agencies on the examination procedures relating to the information sharing requirements of Section 314(a) and Section 314(b).³⁴² FinCEN also makes available to financial institutions on the secure Web site a set of general instructions and frequently asked questions with respect to Section 314(a) requests. Unless otherwise indicated in the request, financial institutions must search the records specified in the General Instructions.³⁴³ The FFIEC Manual further explains that a financial institution must report to FinCEN that it has a match but that no further details should be provided.³⁴⁴ Generally, the FFIEC Manual states that financial institutions should develop and implement comprehensive policies, procedures, and processes for responding to Section 314(a) requests.³⁴⁵

The FFIEC Manual notes that FinCEN strongly discourages financial institutions from using the fact of a Section 314(a) request as the sole factor in making a decision whether to open or close an account (unless the request specifically states otherwise) or in making the decision whether to file a SAR.³⁴⁶ A financial institution may not disclose to any person, other than

³⁴⁰31 C.F.R. § 1010.540(b)(5).

³⁴¹31 C.F.R. § 1010.540(c).

³⁴²See FFIEC Manual at 97–105.

³⁴³The General Instructions are not generally available to the public. The FFIEC Manual, however, discusses one example of the search process required by the General Instructions. The General Instructions state that unless the instructions to a specific 314(a) request state otherwise, a bank must search funds transfer records maintained pursuant to § 1010.410 of the BSA rules to determine whether the named suspect was the originator/transmitter of a funds transfer for which the bank was the originator/transmitter's financial institution or a beneficiary/recipient of a funds transfer for which the bank was the beneficiary/recipient's financial institution. See FFIEC Manual at 98 n. 87.

³⁴⁴See FFIEC Manual at 98.

³⁴⁵See FFIEC Manual at 99.

³⁴⁶See FFIEC Manual at 99.

FinCEN, its primary banking regulator, or the requesting federal law-enforcement authority, the fact that FinCEN has requested information. A financial institution will be expected to maintain a log and other supporting documentation of all Section 314(a) requests received and of all positive matches identified and reported to FinCEN, subject to appropriate security procedures.³⁴⁷ A financial institution must also maintain documentation that demonstrates that all required searches were performed.

The FFIEC Manual also contains guidance on the voluntary sharing of information among financial institutions pursuant to Section 314(b).³⁴⁸ It specifically indicates that Section 314(b) does not authorize a financial institution to share a SAR or to disclose the existence or nonexistence of a SAR and also does not extend to sharing information across international borders.³⁴⁹ If a financial institution shares information under Section 314(b) about a subject of a SAR, the information shared must be limited to the underlying transaction and customer information.

[4] Enforcement Actions

FinCEN and the bank regulatory authorities have taken at least one enforcement action against a banking institution for failure to comply with requests under Section 314(a).³⁵⁰ FinCEN and the bank regulatory authorities found that the institution had failed to implement an adequate anti-money laundering program.³⁵¹ In the press release announcing the civil money penalty, FinCEN and the bank regulators placed special emphasis

³⁴⁷See FFIEC Manual at 100.

³⁴⁸See FFIEC Manual at 101–102.

³⁴⁹See FFIEC Manual at 102.

³⁵⁰Joint Press Release, Financial Crimes Enforcement Network, Federal Deposit Insurance Corporation, and New York State Banking Department Assess Civil Money Penalties Against Liberty Bank of New York (May 19, 2006), available at <http://www.fincen.gov/newsroom/nr/pdf/20060519.pdf>. See also *In the Matter of Liberty Bank of New York*, Assessment of Civil Money Penalty No. 2006-5 (May 18, 2006), available at http://www.fincen.gov/newsroom/ea/files/liberty_assessment.pdf; *In the Matter of Liberty Bank of New York*, Order to Pay FDIC-06-083k (May 18, 2006), available at <http://www.fdic.gov/bank/individual/enforcement/12599.html>; *In the Matter of Liberty Bank of New York*, Order of Assessment of Civil Monetary Penalty Upon Consent (May 18, 2006), available at <http://www.banking.state.ny.us/ea060518.pdf>.

³⁵¹*In the Matter of Liberty Bank of New York*, Assessment of Civil Money Penalty No. 2006-5, footnote 354, at 3. The FinCEN order assessing the civil money penalty noted that Liberty Bank had filed a substantial number of SARs in response to earlier cease and desist orders issued by the FDIC and the NYSBD in 2004. The cease and desist orders required remedial actions across a broad range of compliance areas. See *In the Matter of Liberty Bank of New York*,

on the fact that they also had found systemic defects in the banking institution's procedures for complying with information requests under Section 314(a).³⁵²

§ 13:9 Special measures for jurisdictions, financial institutions, or international transactions of primary money-laundering concern

[1] Statutory Provision

Section 311 of the USA PATRIOT Act added another new provision to the BSA, codified at Section 5318A, which is both more targeted and more detailed than many of the other provisions contained in Title III.³⁵³ Section 5318A(a)(1) provides that the Secretary of the Treasury may require domestic financial institutions and domestic financial agencies to take one or more special measures described in the section if the Secretary finds that there are reasonable grounds to conclude that a jurisdiction outside the United States, or one or more financial institutions operating outside the United States, or a class of transactions within or involving a jurisdiction outside the United States, or one or more types of accounts is of primary money-laundering concern.³⁵⁴ The remaining provisions of Section 5318A contain detailed procedures for making the determination that a jurisdiction, financial institution, class of transaction, or type of account is of primary money-laundering concern and for selecting the special measures to be imposed. In selecting which special measure to impose, the Secretary of the Treasury is required to consult with the Chairman of the Federal Reserve Board, any other appropriate federal banking agencies, the Secretary of State, the SEC, the CFTC,

Order to Cease and Desist FDIC-04-253b (Nov. 30, 2004), available at <http://www.fdic.gov/bank/individual/enforcement/12331.html>; *In the Matter of Liberty Bank of New York*, Order to Cease and Desist Issued Upon Consent (Nov. 30, 2004), available at <http://www.banking.state.ny.us/ea041130.htm>.

³⁵²Joint Press Release, Financial Crimes Enforcement Network, Federal Deposit Insurance Corporation, and New York State Banking Department Assess Civil Money Penalties Against Liberty Bank of New York.

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³⁵³Pub. L. No. 107-56, § 311, 115 Stat. at 298 (codified at 31 U.S.C.A. § 5318A).

³⁵⁴31 U.S.C.A. § 5318A(a)(1). The terms "domestic financial institution" and "domestic financial agency" are defined in 31 U.S.C.A. § 5312(b)(1) to apply to an action within the United States of a financial agency or a financial institution. The term "financial institution" as defined in 31 U.S.C.A. § 5312(a)(1)(D) includes among other institutions an agency or branch of a foreign bank in the United States.

and the National Credit Union Administration Board.³⁵⁵ The Secretary of the Treasury is also required to consider factors specified in Section 5318A such as whether similar action is being taken by other nations or multilateral groups; whether the special measure would create a significant competitive disadvantage for U.S. financial institutions; whether the special measure would have a significant adverse systemic impact on the international payment, clearance, and settlement system; and what effect the special measure would have on U.S. national security and foreign policy.³⁵⁶ The special measures that are authorized under Section 5318A range in severity, the most severe being a prohibition on maintaining a correspondent account for a banking institution from the designated country or on maintaining a correspondent account that indirectly provides services to a banking institution from the designated country.³⁵⁷

As a predicate to the imposition of any special measure under Section 5318A, the Secretary of the Treasury must first make a determination that there is a reasonable ground for concluding that the foreign jurisdiction, financial institution, class of transaction, or type of account is of primary money-laundering concern. In making this determination, Section 5318A requires the Secretary of the Treasury to consult with the Secretary of State and the Attorney General.³⁵⁸ Section 5318A contains a set of potentially relevant factors with respect to a determination relating to a jurisdiction and a set of potentially relevant factors with respect to a determination relating to an institution, a class of transaction, or a type of account that must be considered by the Secretary of the Treasury.³⁵⁹

³⁵⁵31 U.S.C.A. § 5318A(a)(4)(A). Section 5318A(b)(5) requires the Secretary of the Treasury to consult the Chairman of the Federal Reserve Board, the Attorney General, and the Secretary of State in connection with the special measure specified in § 5318A(b)(5).

³⁵⁶31 U.S.C.A. § 5318A(a)(4)(B).

³⁵⁷31 U.S.C.A. § 5318A(b)(1) to (5).

³⁵⁸31 U.S.C.A. § 5318A(c)(1).

³⁵⁹31 U.S.C.A. § 5318A(c)(2). The potentially relevant factors applicable to a determination for a jurisdiction include evidence that organized criminal groups or terrorists transact business in the jurisdiction, the extent to which the jurisdiction offers bank secrecy and special regulatory advantages to nonresidents, the substance and quality of bank supervision and anti-money laundering laws in the jurisdiction, the relationship between the volume of financial transactions in the jurisdiction and the size of the economy of the jurisdiction, the extent to which the jurisdiction is characterized as an offshore banking or secrecy haven, and the extent to which the jurisdiction is characterized by high levels of official

[2] Regulatory Provisions

The Treasury has used the authority granted under Section 5318A to impose special measures in several instances. The Treasury has also used the authority under Section 5318A to designate certain jurisdictions and financial institutions as being of primary money-laundering concern and has proposed imposing special measures with the expectation that the initial finding would be sufficient to discourage most institutions from dealing with the jurisdiction or the financial institution and would thus obviate the need to go to the second step and formally impose special measures with respect to the jurisdiction or the institution.³⁶⁰

In November 2003, the Treasury and FinCEN published notice that the Treasury had designated Burma (Myanmar) as a jurisdiction of primary money-laundering concern and proposed to impose special measures against Burma.³⁶¹ The designation of primary money-laundering concern was based among other factors on the Financial Action Task Force's (FATF) designation of Burma as a noncooperative country and FATF's call upon its members to impose countermeasures on Burma. In April 2004, the Treasury and FinCEN adopted a final rule imposing the special measures on Burma largely as proposed.³⁶² The special measures against Burma are now codified at Section 1010.651 of the BSA rules. Burma is the only jurisdiction subject to special

corruption. The potentially relevant factors to a determination for an institution, class of transactions, or type of account include the extent to which the institution, class of transactions, or type of account is used to facilitate money-laundering and the extent to which the institution is used for legitimate purposes. 31 U.S.C.A. § 5318A(c)(2).

³⁶⁰See Departmental Offices Designation of Nauru and Ukraine as Primary Money Laundering Concerns, 67 Fed. Reg. 78,859 (Dec. 26, 2002); 67 Fed. Reg. 78,860, 78,862. See also Revocation of Designation of Ukraine as Primary Money Laundering Concern (Apr. 15, 2003), available at <http://www.treasury.gov/resource-center/terrorist-illicit-finance/Terrorist-Finance-Tracking/Documents/js1931.pdf>; Imposition of Special Measures Against the Country of Nauru, 68 Fed. Reg. 18,917 (Apr. 17, 2003) (proposed rule); Withdrawal of the Notice of Proposed Rulemaking Against the Republic of Nauru, 76 Fed. Reg. 21,179 (Apr. 8, 2008); Withdrawal of Notice of the Finding of the Republic of Nauru as a Primary Money Laundering Concern, 76 Fed. Reg. 21,178 (Apr. 18, 2008).

³⁶¹See Imposition of Special Measures Against Burma as a Jurisdiction of Primary Money Laundering Concern, 68 Fed. Reg. 66,299 (Nov. 25, 2003) (proposed rule). The proposed special measures for Burma required a covered financial institution to terminate any correspondent account maintained in the United States for or on behalf of a Burmese financial institution.

³⁶²See Imposition of Special Measures Against Burma, 69 Fed. Reg. 19,093 (Apr. 12, 2004). The proposed special measure would have applied to any

measures under Section 311 of the USA PATRIOT Act. However, in March 2011, the Treasury and FinCEN made a finding that the Islamic Republic of Iran is a jurisdiction of primary money laundering concern.³⁶³ At the time the Treasury and FinCEN did not propose any special measures with respect to Iran or entities in Iran presumably because dealings with Iran or entities in Iran are already prohibited for U.S. persons under various sanction laws as discussed in Section 13:12.

At the time of adoption the special measures for the country of Burma, the Treasury and FinCEN also adopted special measures specifically for two Burmese banking institutions, Myanmar Mayflower Bank and Asia Wealth Bank.³⁶⁴ These special measures were formerly codified at Section 1010.652 of the BSA rules and were similar to the special measures applicable to other Burmese banking institutions under Section 1010.651. These measures were repealed in October 2012 because FinCEN determined that the Government of Burma had withdrawn the licenses of the two institutions in 2005 and that neither of the institutions currently existed.³⁶⁵

The Treasury and FinCEN have imposed special measures on several other foreign banking institutions. The Treasury found the Commercial Bank of Syria and its subsidiary, Syrian Lebanese Commercial Bank (together CBS), which are Syrian government controlled institutions, to be of primary money-laundering concern and proposed, and subsequently adopted, a special measure requiring a covered financial institution to terminate any correspondent account for CBS.³⁶⁶ The special measure applicable to CBS differed from the special measure ap-

“Burmese financial institution.” The final special measure applies to any “Burmese banking institution.”

³⁶³See Finding That the Islamic Republic of Iran is a Jurisdiction of Primary Money Laundering Concern, 76 Fed. Reg. 72,756 (Nov. 25, 2011).

³⁶⁴See Imposition of Special Measures Against Myanmar Mayflower Bank and Asia Wealth Bank, 69 Fed. Reg. 19,098 (Apr. 12, 2004).

³⁶⁵See Repeal of the Final Rule Imposing Special Measures and Withdrawal of the Findings of Primary Money Laundering Concern Against Myanmar Mayflower Bank and Asia Wealth Bank, 77 Fed. Reg. 59,747 (Oct. 1, 2012).

³⁶⁶See Amendment to the Bank Secrecy Act Regulations—Imposition of a Special Measure Against Commercial Bank of Syria, including its Subsidiary, Syrian Lebanese Commercial Bank, as a Financial Institution of Primary Money Laundering Concern, 69 Fed. Reg. 28,098 (May 18, 2004); Amendment to the Bank Secrecy Act Regulations—Imposition of Special Measure Against Commercial Bank of Syria, including its Subsidiary, Syrian Lebanese Commercial Bank, as a Financial Institution of Primary Money Laundering Concern, 71 Fed. Reg. 13,260 (Mar. 15, 2006).

plicable to the Burmese banking institutions in its approach to indirect access to the U.S. banking systems, which assumed greater importance because of the fact that CBS no longer maintained any direct access to the U.S. banking system. The special measure applicable to CBS requires a covered financial institution to apply specified due diligence procedures to its correspondent accounts to guard against their indirect use by CBS.³⁶⁷ In adopting the final rule, the Treasury stated that the notice requirement would be satisfied by a one-time notice to correspondent account holders.³⁶⁸ With respect to the requirement that a covered financial institution take ongoing steps to identify indirect use of its correspondent accounts by CBS, the Treasury noted that a covered institution would be expected to apply an appropriate screening mechanism to identify a funds transfer order that on its face lists CBS as the originator's or beneficiary's financial institution.³⁶⁹

The Treasury and FinCEN followed a similar approach in imposing a special measure against VEF Banka, a Latvian bank. The Treasury and FinCEN published a notice of a determination that VEF Banka was a financial institution of primary money-laundering concern and a rule was proposed, and subsequently adopted, imposing a prohibition on direct or indirect access by VEF Banka to correspondent accounts in the United States.³⁷⁰ The provisions of the special measure against VEF Banka were essentially identical to the provisions of the special measure against CBS. The special measures against VEF Banka were rescinded by FinCEN in August 2011 after the Latvian regula-

³⁶⁷31 C.F.R. § 1010.653(b)(2)(i).

³⁶⁸*See* Amendment to the Bank Secrecy Act Regulations—Imposition of Special Measure Against Commercial Bank of Syria, Including Its Subsidiary, Syrian Lebanese Commercial Bank, as a Financial Institution of Primary Money Laundering Concern, 71 Fed. Reg. 13,260, 13,265 (Mar. 15, 2006).

³⁶⁹*See* Amendment to the Bank Secrecy Act Regulations—Imposition of Special Measure Against Commercial Bank of Syria, Including Its Subsidiary, Syrian Lebanese Commercial Bank, as a Financial Institution of Primary Money Laundering Concern, 71 Fed. Reg. 13,260, 13,266 (Mar. 15, 2006).

³⁷⁰*See* Amendment to the Bank Secrecy Act Regulations—Imposition of Special Measure Against VEF Banka, 70 Fed. Reg. 21,369 (Apr. 26, 2005); Amendment to the Bank Secrecy Act Regulations—Imposition of Special Measure Against VEF Banka, as a Financial Institution of Primary Money Laundering Concern, 71 Fed. Reg. 39,554 (July 13, 2006).

tory authorities revoked VEF Banka's license.³⁷¹

The Treasury and FinCEN have imposed special measures against another foreign institution, Banco Delta Asia SARL (Banco Delta Asia), codified at Section 1010.655 of the BSA rules.³⁷² The Treasury and FinCEN initially in 2005 made a finding that there were reasonable grounds to conclude that Banco Delta Asia was a financial institution of primary money-laundering concern and proposed to impose special measures on it.³⁷³ The subsequent financial difficulties experienced by Banco Delta Asia suggest that a finding of primary money-laundering concern may be enough to curtail the availability of direct or indirect access to U.S. banking system in advance of the actual adoption of special measures.³⁷⁴ The Treasury ultimately adopted a final rule imposing special measures on Banco Delta Asia in 2007.³⁷⁵

The Treasury and FinCEN also used the authority under Section 311 in February 2011 to make a finding of primary money-laundering concern with respect to Lebanese Canadian Bank SAL (LCB) and to propose special measures against LCB.³⁷⁶ The special measures proposed against LCB were generally similar to

³⁷¹See Repeal of the Final Rule and Withdrawal of the Finding of Primary Money Laundering Concern Against VEF Banka, 76 Fed. Reg. 45,689 (Aug. 1, 2011).

³⁷²See Imposition of Special Measure Against Banco Delta Asia, including its Subsidiaries Delta Asia Credit Limited and Delta Asia Insurance Limited, as a Financial Institution of Primary Money Laundering Concern, 72 Fed. Reg. 12,730 (Mar. 19, 2007). In its final rule, the Treasury and FinCEN described in detail the background of the special problems at Delta Bank Asia.

³⁷³See Finding That Banco Delta Asia SARL is a Financial Institution of Primary Money Laundering Concern, 70 Fed. Reg. 55,214 (Sept. 20, 2005); Amendment to Bank Secrecy Act Regulations—Imposition of Special Measure Against Banco Delta Asia SARL, 70 Fed. Reg. 55,217 (Sept. 20, 2005) (proposed rule). The finding of primary money-laundering concern was based among other concerns on the fact that Banco Delta Asia had provided financial services for many years to North Korean government agencies and front companies.

³⁷⁴See Joel Brinkley, *U.S. Squeezes North Korea's Money Flow*, N.Y. Times, Mar. 10, 2006, at A12 (discussing the significant financial effects that the finding of primary money-laundering concern had on the operations of Banco Delta Asia).

³⁷⁵See Imposition of Special Measure Against Banco Delta Asia, Including Its Subsidiaries Delta Asia Credit Limited and Delta Asia Insurance Limited, as a Financial Institution of Primary Money Laundering Concern, 72 Fed. Reg. 12,730 (Mar. 19, 2007).

³⁷⁶See Finding That the Lebanese Canadian Bank SAL is a Financial Institution of Primary Money Laundering Concern, 76 Fed. Reg. 9403 (Feb. 17, 2011); Imposition of Special Measure Against the Lebanese Canadian Bank

those previously imposed against Delta Bank Asia, VEF Banka, and CBS.

In May 2012 the Treasury and FinCEN made a finding that JSC CredexBank, located in the Republic of Belarus, was a financial institution of primary money laundering concern and proposed to impose special measures against it.³⁷⁷ The special measures proposed with respect to JSC CredexBank were similar to the special measures previously imposed against Delta Bank Asia, VEF Banka, and CBS, but with the additional requirement that a covered financial institution take reasonable steps to collect and report to FinCEN information about the participants in any transaction or attempted transaction involving JSC CredexBank.

[3] Supervisory and Examination Process

The FFIEC Manual contains a section addressing special measures under Section 311, but the section provides only a broad overview of the special measures provisions of Section 311 and little specific guidance.³⁷⁸ FinCEN has provided guidance of its own on specific issues relating to the scope of the special measures under Section 311.³⁷⁹

§ 13:10 Due diligence requirement for foreign correspondent accounts

[1] Statutory Provisions

Section 312(a) of the USA PATRIOT Act added a new provision to the BSA, codified at Section 5318(i), which requires specific due diligence policies, procedures, and controls for foreign correspondent banking accounts and foreign private banking

SAL as a Financial Institution of Primary Money Laundering Concern, 76 Fed. Reg. 9268 (Feb. 17, 2011).

³⁷⁷See Finding That JSC CredexBank is a Financial Institution of Primary Money Laundering Concern, 77 Fed. Reg. 31,434 (May 25, 2012); Imposition of Special Measure Against JSC CredexBank as a Financial Institution of Primary Money Laundering Concern, 77 Fed. Reg. 31,794 (May 30, 2012).

³⁷⁸See FFIEC Manual at 138–140.

³⁷⁹See FinCEN Ruling, Application of a Section 311 Special Measure to the payment of current and future potential obligations of a U.S. customer, FIN-2010-R002 (Apr. 29, 2009), available at http://www.fincen.gov/statutes_regs/guidance/html/fin-2010-r002.html; FinCEN Ruling, Application of a Section 311 Special Measure to Payments under a Stand-By Letter of Credit, FIN-2010-R001 (Jan. 16, 2009), available at http://www.fincen.gov/statutes_regs/guidance/html/fin-2010-r001.html.

accounts.³⁸⁰ Section 312 represents one of the most important and far-reaching requirements of the regime of heightened scrutiny imposed by the USA PATRIOT Act. The basic requirement imposed by Section 5318(i)(1) is that:

[e]ach financial institution that establishes, maintains, administers, or manages a private banking account or a correspondent account in the United States for a non-United States person, including a foreign individual visiting the United States, or a representative of a non-United States person[,] shall establish appropriate, specific, and, where necessary, enhanced, due diligence policies, procedures, and controls that are reasonably designed to detect and report instances of money laundering through those accounts.³⁸¹

In addition to this basic requirement, Section 5318(i)(2)(A) imposes additional requirements for correspondent accounts requested or maintained by or on behalf of a foreign bank operating under an offshore banking license or under a banking license issued by a foreign country that has been designated as noncooperative with international anti-money laundering principles.³⁸² For correspondent accounts of these latter categories of higher risk foreign banks, certain enhanced due diligence policies, procedures, and controls are required.³⁸³ Section 5318(i)(4) contains a definition of the term “offshore banking license.”³⁸⁴ Section 5318(i) does not contain a definition of the term “correspondent account,” but as discussed in Section 13:6[1], Section 311 of the USA PATRIOT Act contains a broad definition of the term “correspondent account” and specifically provides that the definition of “correspondent account” applies to Section 5318(i) as well.

Section 312(b)(1) of the USA PATRIOT Act directed the Secretary of the Treasury in consultation with the appropriate federal functional regulators to further delineate by regulation the due diligence policies, procedures, and controls required by Section 312(a) within 180 days from the date of enactment of the USA

[Section 13:10]

³⁸⁰Pub. L. No. 107-56, § 312(a), 115 Stat. at 304 (codified at 31 U.S.C.A. § 5318(i)).

³⁸¹31 U.S.C.A. § 5318(i)(1).

³⁸²31 U.S.C.A. § 5318(j)(2)(A).

³⁸³31 U.S.C.A. § 5318(i)(2)(B).

³⁸⁴The term is defined to mean “a license to conduct banking activities which, as a condition of the license, prohibits the licensed entity from conducting banking activities with the citizens of, or with the local currency of, the country which issued the license.” 31 U.S.C.A. § 5318(i)(4)(A).

PATRIOT Act.³⁸⁵ Section 312(b)(2) further provided that Section 312(a) would take effect 270 days after the date of enactment whether or not the regulations required under Section 312(b)(1) were issued.³⁸⁶ Section 312(b)(2) also provided that the requirements of Section 312(a) would apply to accounts opened before, on, or after the date of enactment of the USA PATRIOT Act.³⁸⁷

[2] Regulatory Provisions

Correspondent banking accounts had been the source of congressional scrutiny and concern even before the heightened concern for the possible transmission of terrorist funding occasioned by the events of September 11, 2001.³⁸⁸ Because the correspondent banking system is a fundamental feature of the international payments system, the prospect of additional regulation of the correspondent banking system was a matter of concern to many of the participants in the international payments system. In May 2002, the Treasury and FinCEN issued a proposed rule to implement the provisions of Section 312 relating to the due diligence and enhanced due diligence requirements for foreign correspondent accounts.³⁸⁹ The Treasury and FinCEN received numerous comments from the financial industry, many of whom were critical of various approaches contained in the proposed rule.

The proposed rule—at least in the form published in May 2002—was never finalized. Instead, in July 2002, the Treasury and FinCEN issued an interim final rule, the purpose of which was to defer temporarily for most categories of financial institutions the application of the requirements of Section 5318(i) and to provide guidance pending the issuance of a final rule for those categories of financial institutions for which compliance with the requirements was not deferred.³⁹⁰ The volume and complexity of the comments that had been received from the domestic and foreign banking community on the proposed rule convinced the

³⁸⁵Pub. L. No. 107-56, § 312(b)(1), 115 Stat. at 305.

³⁸⁶Pub. L. No. 107-56, § 312(b)(2), 115 Stat. at 306.

³⁸⁷Pub. L. No. 107-56, § 312(b)(2), 115 Stat. at 306.

³⁸⁸*See, e.g., Role of U.S. Correspondent Banking in International Money Laundering: Hearings Before Permanent Subcomm. on Investigations of the Senate Comm. on Governmental Affairs, 107th Cong. (2001);* Minority Staff of S. Comm. on Investigations, 107th Cong., Report on Correspondent Banking: A Gateway to Money Laundering (2001).

³⁸⁹Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts, 67 Fed. Reg. 37,736 (May 30, 2002).

³⁹⁰Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 67 Fed. Reg. 48, 348 (July 23, 2002).

Treasury that further study of various critical assumptions in the proposed rule was necessary.

Hence, there was a need for a more circumscribed approach in the interim final rule implementing Section 5318(i). The more circumscribed approach adopted in the interim final rule consisted of applying the Section 5318(i) requirements relating to correspondent accounts only to banks and other depository institutions and the Section 5318(i) requirements relating to private banking accounts only to banks and other depository institutions and broker-dealers, futures commission merchants, and introducing brokers.³⁹¹ By the terms of the interim final rule, all other categories of financial institutions were exempted from the requirements of Section 5318(i).³⁹²

The interim final rule itself provided no delineation of the due diligence policies, procedures, and controls required under Section 5318(i). Indeed, the interim final rule said nothing more than that the requirements of Section 5318(i) would apply effective July 23, 2002, to specified categories of banks and depository institutions and that the requirements of Section 5318(i) relating to due diligence and enhanced due diligence for private banking accounts would apply effective July 23, 2002, to broker-dealers, futures commission merchants, and introducing brokers. The discussion in the supplementary information section of the Federal Register notice of the interim final rule, however, provided certain high-level guidance on the requirements applicable to these accounts pending the issuance of a final rule. The Treasury stated that pending issuance of a final rule, it would expect compliance with the requirements of Section 5318(i) on the basis set forth in the supplementary information section of

³⁹¹Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 67 Fed. Reg. 48,348, 48,351 (July 23, 2002). By the terms of the interim final rule, the requirements of Section 5318(i) relating to corresponding accounts and private banking accounts became applicable on July 23, 2002, to the following categories of banks and depository institutions: (a) an insured bank (as defined in Section 3(h) of the FDI Act); (b) a commercial bank; (c) an agency or branch of a foreign bank in the United States; (d) a federally insured credit union; (e) a thrift institution; and (f) a corporation acting under Section 25A of the Federal Reserve Act. By the terms of the interim final rule, the requirements of Section 5318(i) relating to private banking accounts became applicable on July 23, 2002, to a broker-dealer registered or required to register with the SEC under the Exchange Act and to a futures commission merchant or introducing broker registered or required to be registered with the CFTC under the Commodities Exchange Act.

³⁹²Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 67 Fed. Reg. 48,348, 48,352 (July 23, 2002).

the Federal Register.³⁹³

After a relatively long interlude, in January 2006, FinCEN published a final rule, which is codified at Section 1010.610 of the BSA rules, implementing the correspondent account provisions of Section 312.³⁹⁴ Certain definitions used in the rule are codified at Section 1010.605 of the BSA rules.³⁹⁵ In the final rule, FinCEN determined to retain the definition of “correspondent account” as

³⁹³Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 67 Fed. Reg. 48,348, 48,350 (July 23, 2002). With respect to correspondent accounts, the discussion in the supplementary information section noted that Section 5318(i) requires policies, procedures and controls “reasonably” designed to detect and report money-laundering. The discussion stated that in the Treasury’s view a due diligence program would be reasonable if it focused compliance efforts on correspondent accounts that pose a high risk of money-laundering, based on an overall assessment of the risks posed by the foreign correspondent institution. Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 67 Fed. Reg. 48,348, 48,350 (July 23, 2002). The discussion further indicated that a bank should accord a priority to conducting due diligence on high-risk foreign banks with correspondent deposit accounts or their equivalents and on the foreign correspondent accounts used to provide services for third parties. The priority on correspondent deposit accounts and on accounts used to provide services for third parties reflected the judgment that, within the broad definition of correspondent account, the subset of accounts that would generally pose a higher risk would be accounts that are used to receive deposits or make payments for third parties, *i.e.*, for customers of the foreign financial institution. Priority was also to be accorded other high-risk foreign correspondent accounts, such as accounts of money transmitters. Pending the issuance of a final rule, the Treasury indicated that reasonable due diligence policies and procedures should comport with existing best practice standards for foreign correspondent accounts, citing as specific examples The New York Clearing House Association guidelines for correspondent accounts issued in March 2002 and the Basel Committee on Banking Supervision guidance on customer due diligence for banks issued in October 2001. Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 67 Fed. Reg. 48,348, 48,350 n.8 (July 23, 2002). *See also* The New York Clearing House Association L.L.C., Guidelines for Counter Money Laundering Policies and Procedures in Correspondent Banking (Mar. 2002), available at <http://www.theclearinghouse.org/docs/000592.pdf>; Basel Committee on Banking Supervision, Customer Due Diligence for Banks (Oct. 2001), available at <http://www.bis.org/press/p011004.htm>. The Treasury stated that a due diligence program that did not adopt “all of the best practices and standards described in industry and other available guidance” could still be considered reasonable if there were a justifiable basis for not adopting a particular best practice or standard based on the particular type of account held by the institution. Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 67 Fed. Reg. 48,350 n.8.

³⁹⁴Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 496 (Jan. 4, 2006).

³⁹⁵31 C.F.R. § 1010.605.

taken from Section 311 of the USA PATRIOT Act and as already in use under Section 313 and Section 319 of the USA PATRIOT Act.³⁹⁶ FinCEN concluded that it would be better to retain the statutory definition of the term to ensure a broad application of the rule while modifying the due diligence requirements of the rule to incorporate a more risk-based approach and thus provide more flexibility in the application of the requirements.³⁹⁷

The difficulties presented by the breadth of the definition of “correspondent account” extended beyond the banking industry to other nonbank financial institutions covered by the rule. As FinCEN has recognized, there is greater uncertainty as to the meaning of the term “correspondent account” when that term is used in reference to nonbank financial institutions.³⁹⁸ This issue came to the fore because the final rule, unlike the interim final rule, applied the correspondent account requirements to certain categories of nonbank financial institutions, namely, broker-dealers, futures commission merchants, and introducing brokers, and mutual funds. To address the concern of the application of the term “correspondent account” to these categories of nonbank financial institutions, FinCEN included in the final rule a definition of the term “account,” taken largely from the existing CIP rules for these same nonbank financial institutions.³⁹⁹

³⁹⁶See Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 497. FinCEN made several technical amendments to the definition to conform the definition for purposes of the new rule with the definition in effect for purposes of the rules implementing §§ 313 and 319. Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 497 n.8.

³⁹⁷See Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 497 to 498.

³⁹⁸See Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 497 to 498.

³⁹⁹See Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 512 (now codified at 31 C.F.R. § 1010.605(d)(2)). In a series of subsequent rulings, FinCEN has dealt with the application of the Section 312 requirements to U.S. clearing broker-dealers in their relationships with foreign financial institutions. See FinCEN Ruling, Bank Secrecy Act Obligations of a U.S. Clearing Broker-Dealer Establishing a Fully Disclosed Clearing Relationship with a Foreign Financial Institution, FIN 2008-R008 (June 3, 2008), available at <http://www.fincen.gov/st>

The discussion in the supplementary information section of the Federal Register notice relating to the scope of the term “correspondent account” for futures commission merchants and introducing brokers is similar to that for broker-dealers.⁴⁰⁰ With respect to mutual funds, the discussion in the supplementary information section merely notes that mutual funds maintain accounts for foreign financial institutions in which those institutions may hold investments in the funds as principal or for their customers and that may be used by those institutions to make payments or to handle other financial transactions.⁴⁰¹

In the final rule, FinCEN decided to take a more circumscribed approach to the definition of “covered financial institution” than it had in the proposed rule. It decided to remove foreign branches of U.S. depository institutions from the definition.⁴⁰² For purposes of the rule implementing Section 312, a foreign branch of a U.S. depository institution is treated as a “foreign bank” rather than a “covered financial institution.” This is the same treatment provided to a foreign branch of a U.S. depository institution under the regulations implementing Sections 319 and 319 of the USA PATRIOT Act. FinCEN also decided to include only three categories of nondepository financial institutions in the definition of “covered financial institution”: (i) brokers-dealers; (ii) future commission merchants and introducing brokers; and (iii) mutual funds.⁴⁰³

Just as FinCEN had decided to limit the scope of the defined term “covered financial institution” in the final rule, so too, FinCEN decided to limit the scope of the defined term “foreign financial institution” in the final rule. Responding to concerns about the difficulty of applying U.S. terminology and licensing concepts to foreign entities, FinCEN attempted in the final rule to specify more precisely the foreign entities that would fall

[atutes_regs/guidance/html/fin-2008-r008.html](http://www.fincen.gov/statutes_regs/guidance/html/312securities_futures_guidance.html); FinCEN Guidance, Application of the Regulations Requiring Special Due Diligence Programs for Certain Foreign Accounts to the Securities and Futures Industries, FIN-2006-G009 (May 10, 2006), available at http://www.fincen.gov/statutes_regs/guidance/html/312securities_futures_guidance.html.

⁴⁰⁰Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 499.

⁴⁰¹Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 499.

⁴⁰²Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 498.

⁴⁰³Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 498.

within the definition of a “foreign financial institution.” FinCEN defined the term “foreign financial institution” in the final rule to mean: (i) a foreign bank; (ii) any office located outside the United States of any other “covered financial institution”; (iii) any person organized under foreign law that, if located in the United States, would be a broker-dealer, futures commission merchant or introducing broker, or mutual fund; and (iv) any person organized under foreign law that “is engaged in the business of, and is readily identifiable” as a currency dealer or exchanger or a money transmitter.⁴⁰⁴ On the basis of a comment in the supplementary information section of the Federal Register notice, it appears that for foreign broker-dealers or futures commission merchants or introducing brokers, the inclusion in the defined term “foreign financial institution” will be dependent on a functional analysis based on their primary activity and not on an analysis as to whether the chartering jurisdiction requires that they register as such.⁴⁰⁵

The most significant changes made by FinCEN in the final rule related to the general due diligence policies, procedures, and controls required under Section 5318(i)(1). FinCEN adopted changes in the rule that FinCEN said were intended “to incorporate a risk-based approach to the entire rule.”⁴⁰⁶ The general due diligence requirement, codified in Section 1010.610(a) of the BSA rules, requires a covered financial institution to establish “appropriate, specific, risk-based, and, where necessary, enhanced policies, procedures, and controls that are reasonably designed to enable the covered financial institution to detect and report, on an ongoing basis, any known or suspected money laundering activity conducted through or involving any correspondent account established, maintained, administered, or managed by such covered financial institution in the United States.”⁴⁰⁷

The final rule also specified two basic steps in the initial due

⁴⁰⁴Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 513 (now codified at 31 C.F.R. § 1010.605(f)).

⁴⁰⁵Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 502 n.37.

⁴⁰⁶Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 502 n.37.

⁴⁰⁷Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 514 (now codified at C.F.R. § 1010.610(a)).

diligence process.⁴⁰⁸ First, the covered financial institution must determine whether the correspondent account is maintained for a foreign bank that is subject to the requirements for enhanced due diligence under Section 5318(i)(2)(B) (*i.e.*, whether it is a high-risk foreign bank that operates under an offshore banking license or under a license from a jurisdiction designated as noncooperative with international anti-money laundering principles). Second, the covered financial institution must assess the money-laundering risk presented by the particular correspondent account based on all relevant factors, including certain specified risk factors.⁴⁰⁹

The final rule has also made express a due diligence procedure that FinCEN said was implicit in the proposed rule. Section 1010.610(a)(3) of the final rule requires that the general due diligence procedures include the application of risk-based procedures and controls to each correspondent account, including a periodic review of the correspondent account activity to determine consistency with the information obtained about the type, purpose, and anticipated activity of the account.⁴¹⁰ The requirement for “ongoing due diligence” was clarified at least in part in response to the request by key Senatorial authors of the USA PATRIOT Act who had commented on the proposed rule.⁴¹¹ The discussion in the supplementary information section of the Federal Register notice

⁴⁰⁸31 C.F.R. § 1010.610(a)(1) and (2).

⁴⁰⁹The specified risk factors are:

- (i) the nature of the foreign financial institution’s business and the markets it serves;
- (ii) the type, purpose, and anticipated activity of such correspondent account;
- (iii) the nature and duration of the covered financial institution’s relationship with the foreign financial institution (and any of its affiliates);
- (iv) the anti-money laundering and supervisory regime of the jurisdiction that issued the charter or license to the foreign financial institution, and, to the extent that information regarding such jurisdiction is reasonably available, of the jurisdiction in which any company that is an owner of the foreign financial institution is incorporated or chartered; and
- (v) information known or reasonably available to the covered financial institution about the foreign financial institution’s anti-money laundering record.

31 C.F.R. § 1010.610(a)(2)(i) to (v).

⁴¹⁰31 C.F.R. § 1010.610(a)(3).

⁴¹¹*See* Letter of Senators Charles E. Grassley, John Kerry & Carl Levin to FinCEN 12-13 (Oct. 11, 2002), *available at* http://www.fincen.gov/statutes_regs/frn/comment_letters/old_comment_files/grassley.pdf.

makes the point that ongoing due diligence does not “in the ordinary situation” mean scrutiny of every transaction, but it might involve monitoring against an “account profile” established by the institution to reflect how an account would be used and the volume of activity to be expected.⁴¹²

The discussion in the supplementary section of the Federal Register notice includes several items of additional guidance. In the discussion, FinCEN stated that a due diligence program should provide for a range of due diligence measures based on the individual risk assessment of a correspondent account performed by the covered financial institution.⁴¹³ The FFIEC Manual in fact anticipates that a banking institution will apply a comparable risk assessment approach to its entire BSA and anti-money laundering program. In the supplementary information discussion, FinCEN also observed that foreign correspondent bank accounts that a covered financial institution identifies as having a high risk of money-laundering may require increased due diligence even if they do not specifically fall within the statutory categories in Section 5318(i)(2)(A) for enhanced due diligence.⁴¹⁴

Finally, in the supplementary information discussion, FinCEN responded to one of the recurring private sector comments on the proposed rule. FinCEN noted that many commenters had requested clarification on the question of reliance on due diligence conducted by reputable foreign intermediaries on their own customers.⁴¹⁵ FinCEN stated that these commenters misunderstood the requirements of Section 5318(i) and the rule. FinCEN stated that “[t]he due diligence requirement under [Section 5318(i)] generally requires an assessment of the money-laundering risks presented by the foreign financial institution for which the correspondent account is maintained, and not for the customers of that institution.”⁴¹⁶ FinCEN’s statement may seem at odds with the statements contained in certain FinCEN enforcement actions that have been taken against banking institutions

⁴¹²Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 496, 503 (Jan. 4, 2006).

⁴¹³Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 496, 503 (Jan. 4, 2006).

⁴¹⁴Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 496, 503 (Jan. 4, 2006).

⁴¹⁵Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 496, 503 (Jan. 4, 2006).

⁴¹⁶Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 496, 503 (Jan. 4, 2006).

for not identifying suspicious activity in a correspondent account attributable to customers of the foreign institution.⁴¹⁷ In partial reconciliation of these statements, FinCEN noted, however, that if a covered financial institution's review of an account identifies activities inconsistent with what would be expected, a covered financial institute would need to review the account more carefully.⁴¹⁸

Simultaneously with the publication of the final rule implementing Section 5318(i)(1), FinCEN published a revised proposed rule to implement the enhanced due diligence requirement of Section 5318(i)(2) for certain foreign banks.⁴¹⁹ This rule was finally adopted in August 2007 and is codified in Section 1010.610 (b) of the BSA rules.⁴²⁰ Under the final rule, a covered financial institution is required to apply enhanced due diligence to a foreign bank operating under an offshore banking license or a banking license issued by a country that has been designated as noncooperative with international anti-money laundering principles or designated by the Secretary of the Treasury as warranting special measures due to money-laundering concerns.⁴²¹

The final rule provides that under the enhanced due diligence requirement a covered financial institution must at a minimum take steps in three areas. First, the covered financial institution must conduct "enhanced scrutiny" of a correspondent account for such a foreign bank that "shall reflect the risk assessment of the

⁴¹⁷See § 13:10[4].

⁴¹⁸Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 503. A comment letter from key Senatorial authors of the USA PATRIOT Act adopted a similar reading of the statutory requirement:

We believe Section 312, which requires U.S. financial institutions to apply "appropriate" due diligence to guard against money-laundering, requires U.S. financial institutions to focus their reviews on their own client, the foreign bank, not the clients of their client. However, that review, depending upon the nature of the foreign bank, the number and nature of its clients, and other relevant factors, may necessitate some degree of inquiry into the bank's own customers. But that review would not require a U.S. financial institution to conduct systematic, comprehensive, detailed, or ongoing due diligence reviews of the clients of its client.

Letter of Senators Charles E. Grassley, John Kerry & Carl Levin to FinCEN 12-13 (Oct. 11, 2002), available at http://www.fincen.gov/statutes_regs/frn/comment_letters/old_comment_files/grassley.pdf.

⁴¹⁹Anti-Money Laundering Programs: Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 516 (Jan. 4, 2006) (proposed rule).

⁴²⁰Anti-Money Laundering Programs: Special Due Diligence Programs for Certain Foreign Accounts, 72 Fed. Reg. 44,768 (Aug. 9, 2007) (now codified at 31 C.F.R. § 1010.610(b)).

⁴²¹31 C.F.R. § 1010.610(c).

account” and “shall include, as appropriate” certain specified steps, including obtaining information relating to the foreign bank’s anti-money laundering program, monitoring transactions in the account, and obtaining information on the identity of any person with authority to direct transactions through any “payable-through” correspondent account.⁴²²

Second, a covered financial institution must take reasonable steps to determine whether the foreign correspondent bank in turn maintains correspondent accounts for other foreign banks that use the correspondent account at the covered financial institution and, if so, take reasonable steps to obtain information to assess and mitigate the money-laundering risks associated with the foreign bank’s correspondent accounts for the other foreign banks, including as appropriate the identity of those foreign banks.⁴²³ This element of enhanced due diligence is aimed at the issue of “nested accounts.”⁴²⁴

Third, a covered financial institution must take reasonable steps to determine: (i) the identity of each owner of a foreign bank that is subject to the enhanced due diligence requirement and the shares of which are not publicly traded and (ii) the nature and extent of each owner’s ownership interest.⁴²⁵ The final rule defines “owner” to mean any person who directly owns, controls, or has the power to vote 10% or more of any class of securities of the foreign bank.⁴²⁶

[3] Supervisory and Examination Process

The FFIEC Manual contains a detailed section entitled “Foreign Correspondent Account Recordkeeping and Due Diligence—Overview” that outlines the due diligence and enhanced due diligence requirements of Section 1010.610.⁴²⁷ This section of the FFIEC Manual also incorporates the additional guidance given by FinCEN in the Federal Register discussion of the final rules. For example, the FFIEC Manual discusses the ongoing monitoring responsibility for foreign correspondent accounts. It

⁴²²31 C.F.R. § 1010.610(b)(1). For a discussion of the special risks presented by payable-through accounts, *see* FFIEC Manual at 198-200.

⁴²³31 C.F.R. § 1010.610(b)(2).

⁴²⁴The risk of “nested accounts” being maintained without adequate due diligence was cited as a major vulnerability in the U.S. MONEY LAUNDERING THREAT ASSESSMENT 2-3 (Dec. 2005), *available at* <http://www.treasury.gov/resourc-center/terrorist-illicit-finance/Documents/mlta.pdf>.

⁴²⁵31 C.F.R. § 1010.610(b)(3)(i).

⁴²⁶31 C.F.R. § 1010.610(b)(3)(ii)(A).

⁴²⁷FFIEC Manual at 117-129.

offers the following general proposition:

As part of ongoing due diligence, banks should periodically review their foreign correspondent accounts. Monitoring will not, in the ordinary situation, involve scrutiny of every transaction taking place within the account, but instead, should involve a review of the account sufficient to ensure that the bank can determine whether the nature and volume of account activity is generally consistent with information regarding the purpose of the account and expected account activity and to ensure that the bank can adequately identify suspicious transactions.⁴²⁸

In fact, the monitoring of foreign correspondent accounts has become a particular focus of the examination staffs of the federal banking agencies. As discussed in the following Section, a number of prominent enforcement actions have been taken against domestic and foreign banking institutions for their failure to implement sufficiently robust monitoring systems for their correspondent banking business.

The FFIEC Manual also contains a discussion of the enhanced due diligence requirements under Section 1010.610(b). It includes the following advice:

In addition to those categories of foreign banks identified in the regulation as requiring EDD [enhanced due diligence], banks may find it appropriate to conduct additional due diligence measures on foreign financial institutions identified through application of the bank's general due diligence program as posing a high risk for money laundering. Such measures may include any or all of the elements of EDD set forth in the regulation, as appropriate for the risks posed by the specific foreign correspondent account.⁴²⁹

[4] Enforcement Actions

Correspondent banking operations of domestic and foreign banking institutions in the United States have been one of the principal areas of regulatory scrutiny and enforcement under the USA PATRIOT Act as well as under U.S. economic sanction laws. The provisions of Section 312 have formed the basis for a series of regulatory enforcement actions, taken by federal banking agencies and in some cases FinCEN against domestic and foreign

⁴²⁸FFIEC Manual at 121-122.

⁴²⁹FFIEC Manual at 123. As discussed in footnote 139, Treasury and FinCEN have recently issued an advance notice of proposed rulemaking to solicit comments on a comprehensive customer due diligence requirement, including a categorical requirement for financial institutions to identify beneficial ownership of their accountholders. *See* 77 Fed. Reg. 13,046 (Mar. 5, 2012). This proposal would extend the requirements of section 5318(i) relating to identifying the beneficial ownership of certain accounts to all accounts. 77 Fed. Reg. at 13,051.

banking institutions. State banking authorities have also joined in the enforcement actions against state-chartered or state-licensed banking institutions. In addition, in several prominent cases, the federal and state law-enforcement authorities have also initiated criminal enforcement actions against banking institutions.

In July 2004, the Federal Reserve Board together with the NYSBD and the Illinois Department of Financial and Professional Regulation required ABN AMRO and its New York branch to enter into a written agreement to address deficiencies relating to compliance with the BSA and the suspicious activity reporting requirements of Regulation K of the Federal Reserve Board with respect to its correspondent account business.⁴³⁰ In addition, the written agreement required ABN AMRO to engage an independent firm to conduct a transaction review of account and transaction activity at the New York branch for the period from July 23,

⁴³⁰Written Agreement by and among ABN AMRO Bank, N.V., ABN AMRO Bank, N.V., New York Branch, Federal Reserve Bank of Chicago, Federal Reserve Bank of New York, State of Illinois Department of Financial and Professional Regulation and New York State Banking Department, FRB Dkt. No. 04-014-WA/RB-FB & 04-014-WA/RB-FBR (July 23, 2004), available at <http://www.federalreserve.gov/boarddocs/press/enforcement/2004/20040726/attachment.pdf>. The written agreement required ABN AMRO to submit a plan to the regulators, covering *inter alia* procedures for ongoing compliance monitoring of the correspondent banking lines of business. Written Agreement by and among ABN AMRO Bank, N.V., ABN AMRO Bank, N.V., New York Branch, Federal Reserve Bank of Chicago, Federal Reserve Bank of New York, State of Illinois Department of Financial and Professional Regulation and New York State Banking Department at 3–4. The written agreement also required the New York branch of ABN AMRO to develop a customer due diligence program designed to reasonably ensure the identification and timely and accurate reporting of all known or suspected violations of law and other suspicious transactions under applicable regulations. The program was to include a methodology for assigning risk levels to the New York branch’s customer base, including correspondent account holders, and a risk-based assessment for those categories of customers that pose a heightened risk of illicit activities. The written agreement further specified that these procedures were to include: (i) obtaining appropriate information about the correspondent, its customers, and its anti-money laundering procedures, particularly with regard to its customer relationships that present a heightened risk of money-laundering; (ii) approval and ongoing review by appropriate levels of management of the correspondent banking services being provided by the New York branch; (iii) effective monitoring of customer accounts and transactions, including transactions conducted through the New York branch’s clearing operation, consistent with industry sound practices; and (iv) appropriate participation by senior management in the process of identifying, reviewing, and reporting suspicious activity.

2002, through April 30, 2004.⁴³¹ The purpose of a transaction review, which has now become a standard feature of enforcement actions under the BSA, is to determine whether suspicious activities in the correspondent accounts were properly identified and reported to the authorities. As part of a required transaction review, an institution will be expected to file SARs for transactions that are identified as being suspicious as a result of the review. This “late” filing of SARs may subsequently result in further sanctions from a federal banking agency or FinCEN.

In October 2004, Standard Chartered Bank (Standard Chartered) entered into a written agreement with the Federal Reserve Bank of New York and the NYSBD with respect to correspondent accounts that was similar in many respects to the written agreement with ABN AMRO.⁴³² Shortly after the issuance of the Standard Chartered agreement, the Federal Reserve Bank of New York announced a similar written agreement with Union Bank of California International, an Edge corporation subsidiary of Union Bank of California, N.A., that was focused on correspondent accounts.⁴³³

In October 2005, the Federal Reserve Bank of New York and the NYSBD announced a written agreement with Deutsche Bank Trust Company Americas (DBTC) in New York.⁴³⁴ The written agreement called for written revisions to, and updating of, the provisions of the DBTC anti-money laundering program that

⁴³¹Written Agreement by and among ABN AMRO Bank, N.V., ABN AMRO Bank, N.V., New York Branch, Federal Reserve Bank of Chicago, Federal Reserve Bank of New York, State of Illinois Department of Financial and Professional Regulation and New York State Banking Department, FRB Dkt. No. 04-014-WA/RB-FB & 04-014-WA/RB-FBR, 8 (July 23, 2004), *available at* <http://www.federalreserve.gov/boarddocs/press/enforcement/2004/20040726/attachment.pdf>.

⁴³²Written Agreement by and among Standard Chartered plc, Standard Chartered Bank, Standard Chartered Bank, New York Branch, Federal Reserve Bank of New York and New York State Banking Department, FRB Dkt. No. 04-024-WA/RB-FB & 04-024-WA/RB-FBR (Oct. 7, 2004), *available at* <http://www.federalreserve.gov/boarddocs/press/enforcement/2004/20041008/attachment.pdf>.

⁴³³Written Agreement by and between Union Bank of California International and Federal Reserve Bank of New York, FRB Dkt. No. 04-028-WA/RB-EC (Oct. 18, 2004), *available at* <http://www.federalreserve.gov/boarddocs/press/enforcement/2004/20041019/attachment.pdf>.

⁴³⁴Written Agreement by and among Deutsche Bank Trust Company Americas, Federal Reserve Bank of New York, and New York State Banking Department, FRB Dkt. No. 05-025-WA/RB-SMB (Oct. 12, 2005), *available at* <http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051014/attachment.pdf>.

cover correspondent accounts and funds transfer clearing activities. Reflecting the specific facts of the DBTC situation, the DBTC written agreement contained a provision requiring DBTC to submit a written plan for the full installation, testing, and activation of a proposed new transaction monitoring system.⁴³⁵

During this same time period the OCC, the federal bank regulator for federally licensed branches of foreign banks was taking enforcement actions against branches of foreign banks. The OCC took a series of enforcement actions against Arab Bank PLC, based principally on its international funds transfer activities. On February 8, 2005, the OCC entered into a consent cease and desist order with the New York branch of Arab Bank, requiring it to take immediate action to increase its capital equivalency deposit, to maintain its liquid assets and to cease from engaging in any funds transfer activities except to the extent specifically permitted by the order.⁴³⁶ On February 24, 2005, the OCC issued an even broader consent order with the branch, requiring the branch to cease deposit taking activities and convert its operation into an agency.⁴³⁷ In a news release issued in connection with the new consent order, the OCC stated that the new order replaced the February 8, 2005, interim order that had required the New York branch to preserve its assets and restrict its funds transfer activities until the broader action encompassed in the new order could be completed.⁴³⁸ The reason for these extraordinary directives was a finding by the OCC of significant control weaknesses in the international funds transfer operations of the branch.⁴³⁹ Regulatory scrutiny of the New York branch of Arab Bank

⁴³⁵Written Agreement by and among Deutsche Bank Trust Company Americas, Federal Reserve Bank of New York, and New York State Banking Department, FRB Dkt. No. 05-025-WA/RB-SMB, 8-9 (Oct. 12, 2005), available at <http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051014/attachment.pdf>. Pending the implementation of the new transaction monitoring system, DBTC was required by the written agreement to submit a plan for an interim transaction monitoring system.

⁴³⁶*In the Matter of the Federal Branch of Arab Bank PLC*, Consent Order No. 2005-13 (Feb. 8, 2005), available at <http://www.occ.gov/news-issuances/news-releases/2005/pub-consent-order-2005-13.pdf>.

⁴³⁷*In the Matter of the Federal Branch of Arab Bank PLC*, Consent Order No. 2005-14 (Feb. 24, 2005), available at <http://www.occ.gov/news-issuances/news-releases/2005/pub-consent-order-2005-14.pdf> (*Arab Bank Consent Order*).

⁴³⁸OCC News Release, OCC Issues Order Against the Federal Branch of Arab Bank PLC (NR 2005-20) (Feb. 25, 2005), available at <http://www.occ.gov/news-issuances/news-releases/2005/nr-occ-2005-20.html>.

⁴³⁹OCC News Release, OCC Issues Order Against the Federal Branch of Arab Bank PLC (NR 2005-20) (Feb. 25, 2005), available at <http://www.occ.gov/news-issuances/news-releases/2005/nr-occ-2005-20.html>.

continued and in August 2005 the OCC and FinCEN assessed a concurrent \$24 million civil money penalty against the New York branch for these violations of the BSA.⁴⁴⁰

In December 2005, the federal and state regulatory authorities took another and more significant enforcement action against ABN AMRO arising from its international funds transfer operations. In a joint order, the Federal Reserve Board and OFAC assessed a \$40 million penalty, the NYSBD a \$20 million penalty, and the Illinois Department of Financial and Professional Regulation a \$15 million penalty against ABN AMRO.⁴⁴¹ The joint assessment order stated that, after the execution of the 2004 written agreement with the regulators and in response to its requirements, ABN AMRO discovered additional information regarding a pattern of previously undisclosed violations of OFAC

⁴⁴⁰FinCEN & OCC Joint Release, FinCEN and OCC Assess \$24 Million Penalty Against Arab Bank Branch (NR 2005-80) (Aug. 17, 2005), available at <http://www.occ.gov/news-issuances/news-releases/2005/nr-ia-2005-80.html>. In *the Matter of the Federal Branch of Arab Bank PLC*, Consent Order for Civil Money Penalty No. 2005-101 (Aug. 17, 2005), available at <http://www.occ.treas.gov/news-issuances/news-releases/2005/nr-ia-2005-80a.pdf>. See *In the Matter of the Federal Branch of Arab Bank PLC*, Assessment of Civil Money Penalty No. 2005-2 (Aug. 17, 2005), available at http://www.fincen.gov/newsroom/ea/files/a_rab081705.pdf. The FinCEN assessment order provided additional details on the issues at the Arab Bank New York branch. Among other issues, the FinCEN order specifically cited as a failure of internal control the fact that the New York branch focused its transaction monitoring and review only on the direct customers of the New York branch as opposed to the originators or beneficiaries of the transfers effected through the clearing accounts at the New York branch. The FinCEN order observed that the Arab Bank Group and a number of its correspondent institutions operated in countries that posed heightened risks of money-laundering and terrorist financing and that the New York branch's monitoring was ineffective. In addition, the FinCEN order noted that the New York branch failed to implement procedures for obtaining information from other members of the Arab Bank Group or other correspondent institutions on the potentially suspicious nature of funds transfers cleared by the New York branch and failed to implement procedures for reviewing publicly available data, such as congressional testimony, indictments in U.S. courts, and well-publicized research and media reports that would help in identifying high-risk originators or beneficiaries. In the few instances where manual review of records led to the detection of unusual transactions and the New York branch requested information from another member of the Arab Bank Group, the New York branch accepted an insufficient generic reply that merely stated that the member entity knew its customers.

⁴⁴¹*In the Matter of ABN AMRO Bank N.V. et al.*, Order of Assessment of a Civil Money Penalty, Monetary Payment and Order to File Reports Issued Upon Consent, FRB Dkt. No. 05-035-CMP-FB (Dec. 19, 2005), available at <http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/>.

sanction regulations involving Iran and Libya.⁴⁴² The information related to the practices of an ABN AMRO overseas branch that implemented “special procedures” to circumvent the OFAC compliance systems established by the U.S. branches of ABN AMRO. The New York branch of ABN AMRO processed wire transfers for Bank Melli Iran under circumstances in which the payment instructions had been modified by the ABN AMRO overseas branch to remove any reference to Bank Melli Iran. Likewise, the U.S. branches of ABN AMRO advised a number of letters of credit issued by Bank Melli Iran that had been reissued by an ABN AMRO overseas branch to delete any reference to Bank Melli Iran.⁴⁴³

The Federal Reserve Board, De Nederlandsche Bank (the home country supervisor of ABN AMRO), and the New York and Illinois banking authorities also issued a consent cease and desist order that imposed a detailed set of compliance and governance requirements upon ABN AMRO with respect to its U.S. operations and mandated a wide range of compliance actions.⁴⁴⁴ Among others, actions were required to ensure that non-U.S. offices did not engage in practices aimed at evading compliance programs and controls in the United States, and ABN AMRO was required to submit an acceptable written plan to ensure that issues relating to OFAC compliance were properly escalated to management, that any violations or apparent violations were reported, and that there was training for both U.S. and non-U.S. employees in OFAC issues appropriate to the employee’s job responsibilities.⁴⁴⁵ Concurrent with the enforcement actions of the other regulatory authorities, FinCEN assessed a penalty of \$30 million against the New York branch of ABN AMRO for violations of the BSA

⁴⁴²*In the Matter of ABN AMRO Bank N.V. et al.*, Order of Assessment of a Civil Money Penalty, Monetary Payment and Order to File Reports Issued Upon Consent, FRB Dkt. No. 05-035-CMP-FB, 3 (Dec. 19, 2005), available at <http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/>.

⁴⁴³*In the Matter of ABN AMRO Bank N.V. et al.*, Order of Assessment of a Civil Money Penalty, Monetary Payment and Order to File Reports Issued Upon Consent, FRB Dkt. No. 05-035-CMP-FB, 5 (Dec. 19, 2005), available at <http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/>.

⁴⁴⁴*In the Matter of ABN AMRO Bank N.V.*, Order to Issue a Direction; Order to Cease and Desist Issued Upon Consent, FRB Dkt. No. 05-035-B-FB (Dec. 19, 2005), available at <http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/121905attachment1.pdf>.

⁴⁴⁵*In the Matter of ABN AMRO Bank N.V.*, Order to Issue a Direction; Order to Cease and Desist Issued Upon Consent, FRB Dkt. No. 05-035-B-FB, 9-18 (Dec. 19, 2005), available at <http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/121905attachment1.pdf>.

and FinCEN implementing regulations.⁴⁴⁶

⁴⁴⁶*In the Matter of the New York Branch ABN AMRO Bank N.V.*, Assessment of Civil Money Penalty No. 2005-5 (Dec. 19, 2005), available at http://www.fincen.gov/newsroom/ea/files/abn_assessment.pdf. The FinCEN assessment order provides further background on the non-OFAC related issues underlying these enforcement actions. The FinCEN assessment order was based on a general finding that the New York branch of ABN AMRO had violated the requirements of the BSA and FinCEN regulations by failing to establish an adequate BSA compliance or anti-money laundering program and had violated the requirements of the BSA and FinCEN regulations by failing to file suspicious activity reports. The FinCEN assessment order provided a summary of the more specific findings that led to these conclusions. It noted that the New York branch through its North American Regional Clearing Center unit had provided funds transfer services to more than 400 correspondent institutions, including numerous small- and mid-sized financial institutions in Russia. *In the Matter of the New York Branch ABN AMRO Bank N.V.*, Assessment of Civil Money Penalty No. 2005-5, 2 (Dec. 19, 2005). The majority of these Russian institutions had no other relationship with the New York branch or the ABN AMRO network other than the correspondent account. FinCEN concluded that the New York branch of ABN AMRO had failed to implement internal controls appropriate to the substantial risk of money-laundering posed by the location, number, and size of the financial institutions holding correspondent accounts with the North America Regional Clearing Center and that the New York branch was inadequately staffed to monitor day-to-day compliance with the BSA. *In the Matter of the New York Branch ABN AMRO Bank N.V.*, Assessment of Civil Money Penalty No. 2005-5, 4 (Dec. 19, 2005). In support of this conclusion, FinCEN cited, among other things, an internal ABN AMRO review that indicated that as of January 26, 2003 the New York branch lacked complete documentation for institutions holding 50% of all its correspondent accounts. *In the Matter of the New York Branch ABN AMRO Bank N.V.*, Assessment of Civil Money Penalty No. 2005-5, 2 (Dec. 19, 2005). FinCEN also noted that prior to February 2002, the New York branch relied solely on sporadic manual transaction monitoring by a single employee. When the New York branch did implement an automated transaction monitoring system in February 2002, the lack of complete documentation for many of the correspondent institutions prevented the incorporation of an accurate risk assessment into the monitoring system. *In the Matter of the New York Branch ABN AMRO Bank N.V.*, Assessment of Civil Money Penalty No. 2005-5, 4-5 (Dec. 19, 2005). FinCEN also cited as an additional high-risk activity the New York branch's extensive clearing activity for "shell companies" that served as originators or beneficiaries for transactions with parties in Russia or other former Republics of the Soviet Union. FinCEN noted that only after "strong urging from regulators" did the New York branch commence an analysis of this activity. *In the Matter of the New York Branch ABN AMRO Bank N.V.*, Assessment of Civil Money Penalty No. 2005-5, 5 (Dec. 19, 2005). FinCEN also noted that the New York branch failed to investigate numerous alerts generated by its new automated monitoring system apparently because, until July 2002, only three individuals coordinated and monitored day-to-day BSA compliance, a staffing level that FinCEN said was clearly inadequate in light of the volume of activities and alerts at the New York branch. *In the Matter of the New York Branch ABN AMRO Bank N.V.*, Assessment of Civil Money Penalty No. 2005-5, 5 (Dec. 19, 2005). Finally, FinCEN cited the New

In December 2005, law-enforcement and regulatory actions were taken against IDBNY, arising out of its correspondent banking operations.⁴⁴⁷ The cease and desist orders issued by the NYSBD and the FDIC specifically cited IDBNY for operating in violation of Section 5318(i) by failing to adopt appropriate policies and procedures for identifying and monitoring high-risk correspondent accounts, including for accounts of its subsidiary correspondent bank in Latin America.⁴⁴⁸ The remedial actions required by the cease and desist orders included detailed requirements for identifying and monitoring high-risk accounts. In October 2006, FinCEN, the NYSBD, and the FDIC imposed an additional civil money penalty on IDBNY for the matters underlying the earlier enforcement actions.⁴⁴⁹ The FinCEN order discusses particular areas of concern, including correspondent relationships with money transmitters and currency exchangers in Latin America.⁴⁵⁰ As a result of the “look-back” review required under the earlier cease and desist orders issued by the NYSBD and the FDIC, IDBNY filed a significant number of SARs on cross-border funds transfers for these relationships, but these SARs were not filed on a timely basis.⁴⁵¹ The FinCEN orders issued against Arab Bank, ABN AMRO, and IDBNY emphasize

York branch for violations of the suspicious activity reporting requirements of the BSA. FinCEN noted that the New York branch had filed only 12 suspicious activity reports for the period from 1996 through 2001. After scrutiny from the regulators starting in 2002, the New York branch filed escalating numbers of suspicious activity reports, including a substantial number of delinquent reports for substantial dollar amounts. *In the Matter of the New York Branch ABN AMRO Bank N.V.*, Assessment of Civil Money Penalty No. 2005-5, 7 (Dec. 19, 2005).

⁴⁴⁷See §§ 13:3[4] and 13:4[4] for a further discussion of the IDBNY enforcement actions.

⁴⁴⁸*In the Matter of Israel Discount Bank of New York*, Order to Cease and Desist FDIC-05-232b, footnote 101, at 2; *In the Matter of Israel Discount Bank of New York*, Order to Cease and Desist Pursuant to Section 39 of the New York Banking Law Issued Upon Consent, footnote 101, at 1.

⁴⁴⁹Press Release, Financial Crimes Enforcement Network, Federal Deposit Insurance Corporation, and New York State Banking Department Assess Civil Money Penalty Against Israel Discount Bank of New York (Oct. 31, 2006), available at <http://www.banking.state.ny.us/pr061031.htm>.

⁴⁵⁰*In the Matter of Israel Discount Bank of New York*, Assessment of Civil Penalty No. 2006-7, footnote 102, at 4.

⁴⁵¹*In the Matter of Israel Discount Bank of New York*, Assessment of Civil Penalty No. 2006-7, footnote 102, at 4. In addition, FinCEN found that IDBNY had failed to implement adequate due diligence procedures and controls with respect to the correspondent account of its subsidiary bank in Uruguay. FinCEN noted that the correspondent account of the Uruguay subsidiary bank posed a high risk of money-laundering because the transactions in the account involved

the point that the correspondent accounts for other branches, subsidiaries, or affiliates of a foreign bank are correspondent accounts subject to the requirements of Section 5318(i) of the BSA and Section 1010.610 of the BSA rules and thus require appropriate due diligence and monitoring.

The regulatory focus on correspondent banking has been highlighted by subsequent regulatory enforcement actions. In December 2006, the Federal Reserve Board, the FDIC and the NYSBD took coordinated enforcement actions against Mitsubishi UFJ Financial Group Inc. (MUFG), its subsidiary bank, The Bank of Tokyo-Mitsubishi UFJ, Ltd. (BTMUFJ), and certain of its U.S. operations.⁴⁵² The FDIC and the NYSBD issued a joint cease and desist order against the Bank of Tokyo-Mitsubishi UFJ Trust Company, a New York State-chartered banking corporation, for a failure to implement adequate BSA and anti-money laundering compliance programs.⁴⁵³ The Federal Reserve Board, through the Federal Reserve Bank of San Francisco and the Federal Reserve Bank of New York, with the NYSBD, simultaneously entered into a written agreement with MUFG, BTMUFJ, and the New York branch of BTMUFJ.⁴⁵⁴ The principal focus of the written agreement was on the correspondent banking operations of the New York branch of BTMUFJ, including in particular the correspondent services provided to non-U.S. banks and to BTMUFJ's

such customers as foreign nonbank financial institutions and private banking customers with code names or pseudonyms. *In the Matter of Israel Discount Bank of New York*, Assessment of Civil Penalty No. 2006-7, footnote 102, at 5. FinCEN stated that IDBNY relied solely on its subsidiary for due diligence purposes and did not apply independent due diligence to the transactions and the transactors in the correspondent account of its subsidiary bank. *In the Matter of Israel Discount Bank of New York*, Assessment of Civil Penalty No. 2006-7 at 5.

⁴⁵²Press Release, Federal Deposit Insurance Corporation, Federal Reserve Board, and New York State Banking Department Announce Separate But Coordinated Enforcement Actions Regarding The Bank of Tokyo-Mitsubishi UFJ, Ltd. (Dec. 18, 2006), available at <http://www.federalreserve.gov/newsevents/press/enforcement/20061218a.htm>.

⁴⁵³*In the Matter of Bank of Tokyo-Mitsubishi UFJ Trust Company*, Order to Cease and Desist FDIC-06-184b (Dec. 18, 2006), available at <http://www.fdic.gov/bank/individual/enforcement/2006-12-00.pdf>.

⁴⁵⁴Written Agreement By and Among Mitsubishi UFJ Financial Group, Inc., The Bank of Tokyo-Mitsubishi UFJ, Ltd., The Bank of Tokyo-Mitsubishi UFJ, Ltd. New York Branch, Federal Reserve Bank of San Francisco, Federal Reserve Bank of New York, and New York State Banking Department, Dkt. Nos. 06-028-WA/RB-FH, 06-028-WA/RB-FB, 06-028-WA/RB-FBR (Dec. 18, 2006), available at <http://www.federalreserve.gov/newsevents/press/enforcement/enf20061218a2.pdf>.

non-U.S. branches and affiliates.⁴⁵⁵ The Federal Reserve Board together with various state banking authorities have entered into written agreements with a number of other foreign banks focused on their correspondent and funds transfer operations.⁴⁵⁶

In other cases presenting more serious concerns, the federal banking agencies have used consent cease and orders against foreign banking entities. In November 2008, the Federal Reserve Board and the NYSBD entered into a consent cease and desist order with the New York branch of Dresdner Bank, focused on the branch's correspondent services to non-U.S. branches and affiliates of Dresdner Bank and U.S. dollar funds transfer clearing

⁴⁵⁵Written Agreement By and Among Mitsubishi UFJ Financial Group, Inc., The Bank of Tokyo-Mitsubishi UFJ, Ltd., The Bank of Tokyo-Mitsubishi UFJ, Ltd. New York Branch, Federal Reserve Bank of San Francisco, Federal Reserve Bank of New York, and New York State Banking Department, Dkt. Nos. 06-028-WA/RB-FH, 06-028-WA/RB-FB, 06-028-WA/RB-FBR (Dec. 18, 2006), *available at* <http://www.federalreserve.gov/newsevents/press/enforcement/enf20061218a2.pdf>.

⁴⁵⁶*See* Written Agreement by and among Habib Bank Limited, Habib Bank Limited New York Branch, Federal Reserve Bank of New York, and New York State Banking Department (Dec. 19, 2006), *available at* <http://www.federalreserve.gov/newsevents/press/enforcement/enf20061221a1.pdf>; Written Agreement by and among Sumitomo Mitsui Banking Corporation, Sumitomo Mitsui Banking Corporation New York Branch, Federal Reserve Bank of New York, and New York State Banking Department (Jan. 22, 2007), *available at* <http://www.federalreserve.gov/newsevents/press/enforcement/enf20070124a1.pdf>; Written Agreement by and among Banco La Nacion Argentina, Banco La Nacion Argentina New York Branch, Federal Reserve Bank of New York, and New York State Banking Department (Mar. 2, 2007), *available at* <http://www.federalreserve.gov/newsevents/press/enforcement/enf20070306a1.pdf>; Written Agreement by and among Intesa Sanpaolo S.p.a., Intesa Sanpaolo S.p.a. New York Branch, Federal Reserve Bank of New York and New York State Banking Department (Mar. 2, 2007), *available at* <http://www.federalreserve.gov/newsevents/press/enforcement/enf20070313a1.pdf>; Written Agreement by and among Societe Generale, Societe Generale New York Branch, Federal Reserve Bank of New York and New York State Banking Department (Mar. 4, 2009), *available at* <http://www.federalreserve.gov/newsevents/press/enforcement/enf20090317a1.pdf>; Written Agreement by and among Philippine National Bank, Philippine National Bank New York Branch, Federal Reserve Bank of San Francisco, Federal Reserve Bank of New York, and New York State Banking Department (May 8, 2009), *available at* <http://www.federalreserve.gov/newsevents/press/enforcement/enf20090520a1.pdf>. *See also* Written Agreement by and among Bank Hapoalim, B.M., Bank Hapoalim, B.M. Miami Branch, Federal Reserve Bank of New York, Federal Reserve Bank of Atlanta, and State of Florida Office of Financial Regulation (July 8, 2009), *available at* <http://www.federalreserve.gov/newsevents/press/enforcement/enf20090728a1.pdf>.

for other corporate clients.⁴⁵⁷ In July 2011, the Federal Reserve Board and various state banking authorities entered into a consent cease and desist order with the Royal Bank of Scotland Group (RBS Group) and certain of its bank subsidiaries and their U.S. branches relating to broad areas of BSA/AML and OFAC compliance in its U.S. branches.⁴⁵⁸ Among the provisions of the consent order was a requirement that the board of directors of the RBS Group strengthen board and management oversight of the U.S. operations on an enterprise-wide and business line basis, including but not limited to compliance with BSA/AML and OFAC

⁴⁵⁷*In the Matter of Dresdner Bank AG and Dresdner Bank AG New York Branch, Cease and Desist Order Issued Upon Consent Pursuant to the FDI Act*, as amended, Dkt. Nos. 08-031-B-FB and 08-031-B-FBR (Nov. 7, 2008), available at <http://www.federalreserve.gov/newsevents/press/enforcement/enf20081113a1.pdf>.

⁴⁵⁸*In the Matter of The Royal Bank of Scotland Group PLC, The Royal Bank of Scotland PLC, The Royal Bank of Scotland N.V., The Royal Bank of Scotland PLC New York Branch, The Royal Bank of Scotland PLC Connecticut Branch, The Royal Bank of Scotland N.V. New York Branch, and The Royal Bank of Scotland N.V. Chicago Branch, Cease and Desist Order Issued Upon Consent Pursuant to the FDI Act*, as amended, Dkt. Nos. 11-074-B-FB1, 11-074-B-FB2, 11-074-B-FB3, 11-074-B-FBR1, 11-074-B-FBR2, 11-074-B-FBR3, 11-074-B-FBR4, and 2011-DB-35 (July 26, 2011), available at <http://www.federalreserve.gov/newsevents/press/enforcement/enf20110727a1.pdf>.

FinCEN has likewise focused its enforcement efforts on correspondent and other foreign accounts. In February 2011, FinCEN assessed an \$8 million civil money penalty against Zions First National Bank in Salt Lake City, Utah, arising from its foreign correspondent account business. *See In the Matter of Zions First National Bank*, Assessment of Civil Money Penalty No. 2011-011 (Feb. 10, 2011), available at <http://www.fincen.gov/newsroom/ea/files/ZionsAssessment.pdf>. FinCEN found *inter alia* that Zions had maintained numerous accounts for casas de cambio, casas de bolsa (securities firms), and foreign banks primarily in Latin America and had not complied with the due diligence and monitoring requirements of Section 5318(i) of the BSA. The FinCEN assessment order contains a relatively extensive discussion of the Section 5318(i) due diligence and monitoring requirements. *See In the Matter of Zions First National Bank*, Assessment of Civil Money Penalty No. 2011-011, 5-8 (Feb. 10, 2011), available at <http://www.fincen.gov/newsroom/ea/files/ZionsAssessment.pdf>. In March 2011, FinCEN assessed a \$7 million civil money penalty against Pacific National Bank in Miami (PNB). *See In the Matter of Pacific National Bank*, Assessment of Civil Money Penalty No. 2011-5 (Mar. 24, 2011), available at <http://www.fincen.gov/newsroom/ea/files/PacificNationalBankASSESSMENT.pdf>. PNB is a subsidiary of Banco del Pacifico S.A. (BPE), which is owned by the Central Bank of Ecuador. Among the findings by FinCEN was that PNB did not have appropriate due diligence information on its customers, including more than half of its direct customer base in Ecuador, and did not adequately monitor transactions in two correspondent accounts for its parent bank BPE. *See In the Matter of Pacific National Bank*, Assessment of Civil Money Penalty No. 2011-5, 3-4 (Mar. 24, 2011), available at <http://www.fincen.gov/newsroom/ea/files/PacificNationalBankASSESSMENT.pdf>.

requirements.⁴⁵⁹

The initial regulatory actions in 2010 taken by the Federal Reserve Board and the OCC against HNAH and HBUS, discussed in Section 13:3[4], confirmed the continuing focus of the federal banking agencies on foreign correspondent accounts. The OCC consent order specifically cited HBUS for violations of the BSA anti-money laundering program requirement, suspicious activity reporting requirement, and the Section 5318(i) due diligence requirement with respect to correspondent bank accounts.⁴⁶⁰

In December 2012 the federal banking agencies and the law enforcement authorities took even more dramatic action by entering into deferred prosecution agreements and other settlement agreements with HSBC Group and HBUS. These actions resulted in an aggregate fine of \$1.92 billion and in requirements for a broad range of remedial actions by HSBC Group and HBUS. The additional regulatory and law enforcement actions focused prominently on HBUS practices with regard to its correspondent banking business, including the failure by HBUS to obtain due diligence or KYC information on its foreign affiliates in violation of Section 5318(i).⁴⁶¹ As part of the deferred prosecution agreements, HSBC Group and HBUS agreed to a broad range of remedial steps, including steps relating to its correspondent banking business, such as exiting high risk correspondent relationships, remediating the KYC files of 155,500 customers of HBUS, and reviewing all customer KYC files across the entire HSBC group.⁴⁶² The regulatory and law enforcement actions against HSBC Group and HBUS are the most sweeping in the history of the U.S. bank-

⁴⁵⁹*In the Matter of The Royal Bank of Scotland Group PLC, The Royal Bank of Scotland PLC, The Royal Bank of Scotland N.V., The Royal Bank of Scotland PLC New York Branch, The Royal Bank of Scotland PLC Connecticut Branch, The Royal Bank of Scotland N.V. New York Branch, and The Royal Bank of Scotland N.V. Chicago Branch, Cease and Desist Order Issued Upon Consent Pursuant to the FDI Act*, as amended, Dkt. Nos. 11-074-B-FB1, 11-074-B-FB2, 11-074-B-FB3, 11-074-B-FBR1, 11-074-B-FBR2, 11-074-B-FBR3, 11-074-B-FBR4, and 2011-DB-35 (July 26, 2011), available at <http://www.federalreserve.gov/newsevents/press/enforcement/enf20110727a1.pdf>.

⁴⁶⁰See discussion in Section 13:3[4].

⁴⁶¹Press Release, HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement (Dec. 11, 2012), available at <http://www.justice.gov/opa/pr/2012/December/12-crm-1478.html>.

⁴⁶²Press Release, HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement (Dec. 11, 2012), available at <http://www.justice.gov/opa/pr/2012/December/12-crm-1478.html>.

ing industry. As discussed in Section 13:3[4], the implications extend far beyond the U.S. operations of HSBC Group and encompass the worldwide operations of HSBC Group.

The regulatory and law enforcement actions against HSBC Group involved violations of U.S. sanctions law as well as U.S. anti-money laundering laws. The exposure of foreign financial institutions like HSBC Group and its affiliates to U.S. sanctions law has become a prominent and pervasive issue for the international banking community. The law enforcement actions against HSBC Group based on OFAC and sanctions law requirements follows a pattern that was set several years ago. In January 2009, the DOJ and the New York County District Attorney's Office entered into deferred prosecution agreements with Lloyds TSB Bank plc (Lloyds) pursuant to which Lloyds forfeited \$350 million for violations of U.S. sanctions law and New York state bank fraud law.⁴⁶³ The charge in the deferred prosecution agreements was that beginning as early as 1995 and continuing through January 2007 Lloyds personnel in the United Kingdom and Dubai falsified outgoing U.S. dollar wire transfers involving countries and persons on U.S. sanctions lists, including Iran, Sudan, and Libya. The charge recited that Lloyds personnel had deliberately "stripped" or removed information, such as customer names, bank names, and addresses, from U.S. dollar SWIFT payment messages for Iranian banks so that the wire transfers would pass undetected through filters at U.S. financial institutions.⁴⁶⁴ Perhaps the most significant aspect of the law enforcement action was its extraterritorial application because the underlying "stripping" actions of Lloyds occurred outside the United States. None of the U.S. dollar payments processed for Lloyds on behalf of OFAC-sanctioned parties was processed by either the New York or the Miami branches of Lloyds. Instead, the payments were processed through Lloyds clearing accounts at other U.S. banks. The processing of the U.S. dollar payments at other banks in the United States, however, was sufficient to establish the jurisdictional basis for the criminal enforcement action against Lloyds. Lloyds entered into a settlement agreement with OFAC covering the same pattern of conduct as the deferred prosecution

⁴⁶³Press Release, DOJ, Lloyds TSB Bank Plc Agrees to Forfeit \$350 Million in Connection with Violations of the International Emergency Economic Powers Act (Jan. 9, 2009), *available at* <http://www.justice.gov/opa/pr/2009/January/09-cr-m-023.html>.

⁴⁶⁴Press Release, DOJ, Lloyds TSB Bank Plc Agrees to Forfeit \$350 Million in Connection with Violations of the International Emergency Economic Powers Act (Jan. 9, 2009), *available at* <http://www.justice.gov/opa/pr/2009/January/09-cr-m-023.html>.

agreement.⁴⁶⁵

In December 2009, the DOJ and the New York County District Attorney's Office entered into similar deferred prosecution agreements with Credit Suisse AG in connection with its U.S. dollar clearing activities on behalf of OFAC-sanctioned parties, involving charges similar to those in the Lloyds case.⁴⁶⁶ The deferred prosecution agreement documents indicated that Credit Suisse stripped or removed information from SWIFT payment messages to conceal the involvement of sanctioned parties in the transactions and that Credit Suisse eventually moved to the use of "cover payments" to process most of its U.S. dollar clearing transactions for Iranian and other sanctioned parties as a means of avoiding the disclosure of the involvement of sanctioned entities.⁴⁶⁷ Credit Suisse forfeited \$536 million as part of the deferred prosecution agreement and a simultaneous settlement with OFAC. At the same time Credit Suisse entered into a consent cease and desist order with the Federal Reserve Board, requiring Credit Suisse to

⁴⁶⁵Press Release, U.S. Department of Treasury, U.S. Treasury Department Announces Settlement with Lloyds TSB Bank, PLC (Dec. 22, 2009), available at <http://www.treasury.gov/press-center/press-releases/Pages/tg458.aspx>.

⁴⁶⁶Press Release, DOJ, Credit Suisse Agrees to Forfeit \$536 Million in Connection with Violations of the International Emergency Economic Powers Act and New York State Law (Dec. 16, 2009), available at <http://www.justice.gov/opa/pr/2009/December/09-ag-1358.html>.

⁴⁶⁷In a report on cross-border wire transfers, FinCEN described the "cover payments" method as follows:

In examining these foreign location-to-foreign location funds transfers involving U.S.-based correspondent banks, there are two primary methods of payment: the "Serial" payment method and the "Cover" payment method.

In the serial payment method, one financial institution transmits the funds transfer instructions (i.e., a SWIFT MT 103 message) to the next financial institution in the overall "payment chain." Each institution in the communication chain receives the same level of detail about the transaction at each step.

In contrast, the "Cover" payment method divides the message into two parts. The originator's bank sends the detailed funds transfer instruction directly to the beneficiary's bank. In this case, no U.S. institution receives the instruction that identifies the originator and beneficiary of the transaction. The originator's bank also sends a second "cover" payment instruction (i.e., a SWIFT MT 202 message) that directs the transfer of the funds from the originator's bank to the beneficiary's bank as a financial institution-to-financial institution settlement payment. FinCEN, Feasibility of a Cross-Border Electronic Funds Transfer Reporting System under the Bank Secrecy Act (Oct. 2006) 67-68 available at http://www.fincen.gov/news_room/rp/files/cross_b_order.html.

The use of the "cover payments" method allowed the processing of U.S. dollar transfers without any identifying information relating to a sanctioned party as the originator or beneficiary on messages entering the U.S. As a result of the investigations and subsequent enforcement orders discussed in this section, SWIFT changed its procedures to require the disclosure of originator and beneficiary information on MT 202 COV payment messages.

improve its program for compliance with U.S. sanctions law on a global basis.⁴⁶⁸

Culminating its long saga of regulatory issues, the former ABN AMRO in May 2010 entered into a deferred prosecution agreement with the DOJ and forfeited \$500 million in connection with charges that it conspired to violate the U.S. sanctions laws, involving charges similar to those in the Lloyds case, and that it failed to maintain an adequate anti-money laundering program as required by Section 5318(h)(1) of the BSA.⁴⁶⁹

In August 2010, Barclays Bank PLC entered into deferred prosecution agreements with the DOJ and the New York County District Attorney's Office in connection with its U.S. dollar clearing activities on behalf of OFAC-sanctioned parties involving charges similar to those in the Lloyds, Credit Suisse, and ING cases.⁴⁷⁰ Barclays forfeited \$298 million as part of the deferred prosecution agreement and a simultaneous settlement with OFAC. Barclays also entered into a consent cease and desist order with the Federal Reserve Board and the NYSBD, requiring Barclays to improve its program for compliance with U.S. sanctions laws on a global basis.⁴⁷¹

In June 2012 ING Bank N.V. entered into deferred prosecution agreements with the DOJ and the New York County District Attorney's Office in connection with violations of U.S. sanctions laws.⁴⁷² ING Bank N.V. agreed to forfeit \$619 million as part of the deferred prosecution agreements and a simultaneous settle-

⁴⁶⁸Board of Governors of the Federal Reserve System, In the Matter of Credit Suisse AG, Order to Cease and Desist Issued Upon Consent (Dec. 16, 2009), available at <http://www.federalreserve.gov/newsevents/press/enforcement/enf20091216a1.pdf>.

⁴⁶⁹Press Release, DOJ, Former ABN Amro Bank N.V. Agrees to Forfeit \$500 Million in Connection with Conspiracy to Defraud the United States and with Violation of the Bank Secrecy Act (May 10, 2010), available at <http://www.justice.gov/opa/pr/2010/May/10-crm-548.html>.

⁴⁷⁰Press Release, DOJ, Barclays Bank PLC Agrees to Forfeit \$298 Million in Connection with Violations of the International Emergency Economic Powers Act and the Trading with the Enemy Act (Aug. 18, 2010), available at <http://www.justice.gov/opa/pr/2010/August/10-crm-933.html>.

⁴⁷¹*In the Matter of Barclays Bank PLC and Barclays Bank PLC New York Branch, Cease and Desist Order Issued Upon Consent Pursuant to the FDI Act*, as amended, Dkt. Nos. 10-165-B-FB and 10-165-B-FBR (Aug. 16, 2010), available at <http://www.federalreserve.gov/newsevents/press/enforcement/enf20100818b1.pdf>.

⁴⁷²Press Release, DOJ, ING Bank N.V. Agrees to Forfeit \$619 Million for Illegal Transactions with Cuban and Iranian Entities (June 12, 2012), available at <http://www.justice.gov/opa/pr/2012/June/12-crm-742.html>.

ment agreement with OFAC. The \$619 million forfeiture and fine constituted the largest OFAC settlement in history. The deferred prosecution agreements and OFAC settlement agreement stated that the prohibited transactions occurred with the knowledge and approval of senior corporate managers and legal and compliance departments of ING Bank N.V.⁴⁷³

Standard Chartered Bank recently became the object of regulatory and law enforcement actions based on the U.S. sanctions laws. In a high profile case the New York State Department of Financial Services (NYDFS), the successor to the NYSBD, on August 6, 2012, initiated an enforcement proceeding against Standard Chartered Bank (SCB), asserting that U.S. dollar clearing services provided by SCB to Iranian customers violated U.S. sanctions law and various provisions of New York law by concealing information relating to involvement of the Iranian customers.⁴⁷⁴ The order initiating the enforcement proceeding specifically referred to the possibility of revoking SCB's license to operate a branch in New York. Amid virtually unprecedented press coverage of the NYDFS enforcement action, SCB and the NYDFS quickly announced on August 14, 2012, that they had reached a settlement of the matter providing for SCB to pay a \$340 million civil penalty to the NYDFS.⁴⁷⁵ The settlement with the NYDFS was followed by an announcement on December 10, 2012, that SCB had entered into deferred prosecution agreements with the DOJ and the New York County District Attorney's Office for violating U.S. sanctions laws and New York law by clearing U.S. dollar transactions for Iranian, Sudanese, Libyan and Burmese entities.⁴⁷⁶ As part of the deferred prosecution agreements and a simultaneous settlement agreement with OFAC, SCB agreed to pay a \$227 million fine. In addition, the Federal Reserve Board entered into a consent cease and desist order with

⁴⁷³Press Release, DOJ, ING Bank N.V. Agrees to Forfeit \$619 Million for Illegal Transactions with Cuban and Iranian Entities (June 12, 2012), available at <http://www.justice.gov/opa/pr/2012/June/12-crm-742.html>.

⁴⁷⁴New York State Department of Financial Services, *In the Matter of Standard Chartered Bank, New York Branch, Order Pursuant to Banking Law § 39* (Aug. 6, 2012), available at <http://www.dfs.ny.gov/banking/ea120806.pdf>.

⁴⁷⁵Press Release, New York State Department of Financial Services, Statement from Benjamin M. Lawskey, Superintendent of Financial Services, Regarding Standard Chartered Bank (Aug. 14, 2012), available at <http://www.dfs.ny.gov/about/press/pr1208141.htm>.

⁴⁷⁶Press Release, DOJ, Standard Chartered Bank Agrees to Forfeit \$227 Million for Illegal Transactions with Iran, Sudan, Libya, and Burma (Dec. 10, 2012), available at <http://www.justice.gov/opa/pr/2012/December/12-crm-1467.html>.

SCB and imposed a separate \$100 million civil money penalty on SCB.⁴⁷⁷ The deferred prosecution agreements incorporated findings that the actions of SCB personnel in London and other locations in concealing information relating to the U.S. dollar transactions on behalf of sanctioned entities occurred with the knowledge and approval of senior corporate managers and the legal and compliance departments of SCB.⁴⁷⁸

The announcement of the SCB settlement with the DOJ and OFAC was followed one day later on December 11, 2012, by the announcement of the even broader ranging deferred prosecution agreements between HSBC Group and the DOJ and the New York County District Attorney's Office and a simultaneous settlement agreement with OFAC.⁴⁷⁹ The deferred prosecution agreements and OFAC settlement with HSBC Group included charges of violations of U.S. sanctions laws relating to Iran, Burma, Sudan, Libya and Cuba. The deferred prosecution agreements documents cited HSBC Group for the practice of stripping or amending payment messages for sanctioned customers and more generally for the use of "cover payments" to process U.S. dollar payments on behalf of sanctioned customers. The broad ranging implications of the enforcement actions against HSBC Group are discussed further in Section 13:3[4].

§ 13:11 Due diligence requirement for foreign private banking accounts

[1] Statutory Provisions

Like correspondent banking, foreign private banking operations had been identified by regulators and legislators as a high-

⁴⁷⁷*In the Matter of Standard Chartered PLC, Standard Chartered Bank, and Standard Chartered Bank New York Branch, Cease and Desist Order Issued Upon Consent Pursuant to the FDI Act*, as amended, Dkt. Nos. 12-069-B-FB and 12-069-B-FBR (Dec. 10, 2012), available at <http://www.federalreserve.gov/newsevents/press/enforcement/enf20121012a1.pdf>.

⁴⁷⁸Press Release, DOJ, Standard Chartered Bank Agrees to Forfeit \$227 Million for Illegal Transactions with Iran, Sudan, Libya, and Burma (Dec. 10, 2012), available at <http://www.justice.gov/opa/pr/2012/December/12-crm-1467.html>.

⁴⁷⁹Press Release, DOJ, HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement (Dec. 11, 2012), available at <http://www.justice.gov/opa/pr/2012/December/12-crm-1478.html>.

risk area for money-laundering during the 1990s.⁴⁸⁰ This scrutiny of foreign private banking led to the various legislative proposals to strengthen the anti-money laundering regime for foreign private banking. Those proposals were ultimately reflected in Section 312 of the USA PATRIOT Act. As indicated in Section 13:10, Section 312(a) of the USA PATRIOT Act added a provision to the BSA, codified at Section 5318(i), which provides due diligence requirements for private banking accounts for non-U.S. persons and for representatives of non-U.S. persons. Section 5318(i) (1) contains the general requirement that a financial institution must establish appropriate, specific, and when necessary, enhanced due diligence policies, procedures, and controls for a private banking account in the United States for a non-U.S. person or a representative of a non-U.S. person.⁴⁸¹ Section 5318(i) (3) provides the minimum due diligence requirements for a foreign private banking account. Section 5318(i)(3) provides that the due diligence policies, procedures, and controls required for such an account must include reasonable steps:

- (i) to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, such account as needed to guard against money laundering and report any suspicious transactions under [Section 5318](g); and
- (ii) to conduct enhanced scrutiny of any such account that is requested or maintained by, or on behalf of, a senior foreign political figure, or any immediate family member or close associate of a senior foreign political figure that is reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption.⁴⁸²

Section 5318(i)(4)(B) contains a specific definition of the term “private banking account” for purposes of Section 5318. The defi-

[Section 13:11]

⁴⁸⁰See, e.g., *Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities: Hearings Before the Permanent Subcomm. on Investigations of the Senate Comm. on Governmental Affairs*, 106th Cong. (1999).

⁴⁸¹31 U.S.C.A. § 5318(i)(1).

⁴⁸²31 U.S.C.A. § 5318(i)(3). As discussed in footnote 139, Treasury and Fin CEN have recently issued an advance notice of proposed rulemaking to solicit comments on a comprehensive customer due diligence requirement, including a categorical requirement for financial institutions to identify beneficial ownership of their accountholders. See 77 Fed. Reg. 13,046 (Mar. 5, 2012). This proposal would by regulation extend the basic requirements of Section 5318(i)(3) relating to identifying the beneficial ownership of accounts to all customers. 77 Fed. Reg. at 13051.

inition provides that the term “private banking account” means an account or any combination of accounts that:

- (i) requires a minimum aggregate deposits [sic] of funds or other assets of not less than \$1,000,000;
- (ii) is established on behalf of 1 or more individuals who have a direct or beneficial ownership interest in the account; and
- (iii) is assigned to, or is administered or managed by, in whole or in part, an officer, employee, or agent of a financial institution acting as a liaison between the financial institution and the direct or beneficial owner of the account.⁴⁸³

This definition, particularly with its threshold of \$1 million, may be narrower than the conventional usage of the term in banking circles. As with the provisions for foreign correspondent accounts discussed in Section 13:10[1], Section 312(b) of the USA PATRIOT Act provided for the issuance of regulations to further delineate the due diligence and enhanced scrutiny provisions of Section 5318(i) applicable to foreign private banking accounts.⁴⁸⁴

[2] Regulatory Provisions

In May 2002, as part of the general proposed rulemaking under Section 312, the Treasury and FinCEN issued a proposed rule to implement the provisions of Section 312 relating to foreign private banking accounts.⁴⁸⁵ The proposed rule specified the due diligence program’s minimum reasonable measures for a foreign private banking account.⁴⁸⁶

The proposed rule also included a “special” provision for ac-

⁴⁸³31 U.S.C.A. § 5318(i)(4)(B).

⁴⁸⁴Pub. L. No. 107-56, § 312(b), 115 Stat. at 305.

⁴⁸⁵Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts, 67 Fed. Reg. 37,736 (May 30, 2002).

⁴⁸⁶Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts, 67 Fed. Reg. 37,736, 37,744 (May 30, 2002).

Under the proposed rule the due diligence program would, at a minimum, have to include reasonable steps to:

- (i) ascertain the identity of all nominal holders and holders of any beneficial ownership interest in the account, including information on the holders’ lines of business and source of wealth;
- (ii) ascertain the source of funds deposited into the account;
- (iii) ascertain whether any holder might be a senior foreign political figure; and
- (iv) report any known or suspected violation of law conducted through or involving the account.

counts of senior foreign political figures, reflecting the requirement in Section 312 that financial institutions must conduct “enhanced scrutiny” of such accounts to detect and report transactions that may involve the proceeds of foreign corruption.⁴⁸⁷ The proposed rule included a definition of the term “senior foreign political figure,” based in significant part on the definition used in a 2001 guidance document issued jointly by the federal banking agencies, Treasury, and the Department of State.⁴⁸⁸ The proposed rule also included a definition of the term “proceeds of foreign corruption.”⁴⁸⁹ It did not, however, provide any greater specificity than a general statement as to “special” requirements for senior foreign political figures.⁴⁹⁰

⁴⁸⁷Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts, 67 Fed. Reg. 37,736, 37,744 (May 30, 2002).

⁴⁸⁸See Board of Governors of the Federal Reserve System, Division of Banking Supervision and Regulation, Supervisory Letter SR 01-03 (SUP) (Jan. 16, 2001): Guidance on Enhanced Scrutiny for Transactions That May Involve the Proceeds of Foreign Official Corruption, *available at* <http://www.federalreserve.gov/boarddocs/srletters/2001/sr0103.htm>. The definition of a “senior foreign political figure” contained in the proposed rule read as follows:

- (i) a current or former senior official in the executive, legislative, administrative, military, or judicial branches of a foreign government (whether elected or not), a senior official of a major foreign political party, or a senior executive of a foreign government-owned commercial enterprise; (ii) a corporation, business or other entity that has been formed by, or for the benefit of, any such individual; (iii) an immediate family member of any such individual; and (iv) a person who is widely and publicly known (or is actually known by the relevant covered financial institution) to maintain a close personal or professional relationship with any such individual.

Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts, 67 Fed. Reg. 37,743.

⁴⁸⁹The definition of “proceeds of foreign corruption” contained in the proposed rule (and adopted in the final rule with only minor changes) read as follows:

- assets or property that are acquired by, through, or on behalf of a senior foreign political figure through misappropriation, theft or embezzlement of public funds, or the unlawful conversion of property of a foreign government, or through acts of bribery or extortion, and shall include other property into which such assets have been transformed or converted.

Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts, 67 Fed. Reg. 37,743.

⁴⁹⁰The discussion in the supplementary information section of the Federal Register notice, however, did provide some additional guidance on the requirements. Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts, 67 Fed. Reg. 37,741. That discussion indicated that the decision to open an account for a senior foreign political figure should generally be approved by senior management, which simply reiterates a point made in the 2001 guidance document. The discussion also indicated that, although the proposed rule did not specify the extent to which transaction monitoring must take place, an effective due diligence program would dictate when risk factors,

As discussed in Section 13:10[2], the interim final rule issued by the Treasury and FinCEN in July 2002 applied the requirements of Section 5318(i) relating to private banking accounts to various categories of banks and depository institutions and to broker-dealers and futures commission merchants and introducing brokers.⁴⁹¹ The discussion in the supplemental information section of the Federal Register notice for the interim final rule also provided certain high-level guidance on the requirements applicable to private banking accounts pending the issuance of a final rule.⁴⁹²

In January 2006, FinCEN issued a final rule implementing the

such as those listed in the 2001 guidance document, would require transaction monitoring. Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts, 67 Fed. Reg. 37,741. The absence of any express provision in the proposed rule for monitoring accounts drew congressional reaction as part of the comment process.

⁴⁹¹See § 13:10[2].

⁴⁹²Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 67 Fed. Reg. 48,348, 48,350 (July 23, 2002). With respect to foreign private banking accounts, the discussion in the supplementary information section noted that the due diligence program under Section 5318(i) (1) and (3) must be “reasonably” designed to detect and report money-laundering and the existence of proceeds of foreign corruption. As with correspondent accounts, the discussion in the supplementary information section stated that in Treasury’s view, a due diligence program would be reasonable if it focused on those private banking accounts that presented a high risk of money-laundering. The discussion in the supplementary information section further stated that a program consistent with applicable government guidance on private banking accounts, such as the guidance on private banking activities issued by the Federal Reserve Board in 1997 and the guidance on transactions potentially involving the proceeds of foreign official corruption, issued jointly by the federal banking agencies, the Treasury and the State Department in 2001, would be reasonable so long as it incorporated the requirements of Section 5318(i)(3). See Board of Governors of the Federal Reserve System, Division of Banking Supervision and Regulation, Supervisory Letter SR 97-19 (SUP) (June 30, 1997): Private Banking Activities, *available at* <http://www.federalreserve.gov/boarddocs/srletters/1997/SR9719.HTM>; and Supervisory Letter SR 01-03 (SUP) (Jan. 16, 2001): Guidance on Enhanced Scrutiny for Transactions That May Involve the Proceeds of Foreign Official Corruption, *available at* <http://www.federalreserve.gov/boarddocs/srletters/2001/SR0103.htm>. The discussion also cited private sector guidance in the form of the Wolfsberg Group anti-money laundering guidelines for private banking. 67 Fed. Reg. 48,351 n.11. In reference to private banking accounts as with correspondent accounts, the discussion indicated that a bank’s program would not have to adopt all the best practices or standards outlined in government guidance if there was a justifiable basis for not adopting a particular best practice or standard based on the particular type of accounts held by the bank. Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 67 Fed. Reg. 48,351 n.11.

private banking account provisions of Section 5318(i).⁴⁹³ The final rule for private banking accounts is codified at Section 1010.620 of the BSA rules. Certain definitions used in the rule are codified at Section 1010.605. In adopting the final rule, FinCEN retained the definition of the term “private banking account” from the proposed rule with only minor changes. The definition in the proposed rule generally tracked the language of the definition contained in Section 5318(i)(4)(B). A comment letter from the Senatorial sponsors of the USA PATRIOT Act requested that the rule be clarified to include accounts that exceed \$1 million even if the deposit requirement is less than \$1 million.⁴⁹⁴ FinCEN concluded that the plain language of the statute required a test based on a minimum deposit requirement of not less than \$1 million and so retained that requirement in the definition.⁴⁹⁵ Nonetheless, FinCEN noted that a variety of private banking relationships may be available at a financial institution that do not meet the technical definition of a “private banking account” as contained in the rule and that these other private banking relationships should be given a higher level of due diligence under a risk-based anti-money laundering program than that given to retail customers.⁴⁹⁶ The FFIEC Manual clearly anticipates a higher level of due diligence for private banking relationships even in its general discussion of private banking.⁴⁹⁷ Under the FFIEC Manual, a bank would be expected to collect much the same information for its general private banking accounts as it would be required to collect under Section 5318(i)(3)(A) for a statutorily defined “private banking account.” Thus, in administering its anti-money laundering programs, a covered financial institution should not put undue weight on any specific limitation contained in the statutory definition of “private banking account.”

Many of the private sector comment letters on the proposed rule had raised concerns with the breadth of the definition of “beneficial ownership interest” contained in the proposed rule because of the attendant requirement that a covered financial

⁴⁹³Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 496 (Jan. 4, 2006).

⁴⁹⁴See Letter of Senators Charles E. Grassley, John Kerry & Carl Levin to FinCEN 8 (Oct. 11, 2002), available at http://www.fincen.gov/statutes_regs/frn/comment_letters/old_comment_files/grassley.pdf.

⁴⁹⁵Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 505.

⁴⁹⁶Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 505 n. 48.

⁴⁹⁷See FFIEC Manual at 279–283.

institution identify and perform due diligence on each holder of a beneficial ownership interest in a private banking account. FinCEN addressed these concerns in the final rule by substituting a new defined term, “beneficial owner,” for the proposed term “beneficial ownership interest.” The term “beneficial owner” is defined to mean “an individual who has a level of control over, or entitlement to, the funds or assets in the account that, as a practical matter, enables the individual, directly or indirectly, to control, manage, or direct the account.”⁴⁹⁸ The ability to fund the account or the entitlement to funds in the account standing alone without any corresponding authority to control or manage the account does not constitute the basis for a finding of beneficial ownership. In the supplementary information section of the Federal Register notice, FinCEN further explained that the intent of the definition is to apply to individuals and not to legal entities such as collective investment vehicles although a personal investment company or trust established for the benefit of an individual would be subject to the rule.⁴⁹⁹ While the breadth of the term “beneficial owner” has been limited to some degree, the obligation on the covered financial institution to identify and perform due diligence on each beneficial owner of a private banking account remains in place. FinCEN specifically declined to allow reliance on foreign intermediaries to satisfy any due diligence obligation under the rule. Covered financial institutions must conduct their own due diligence with respect to the beneficial owners of private banking accounts.⁵⁰⁰

The definition of the term “senior foreign political figure” in the proposed rule was taken in large measure from the 2001 government document *Guidance on Enhanced Scrutiny for Transactions*

⁴⁹⁸Financial Crimes Enforcement Network; Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 512 (now codified at 31 C.F.R. § 1010.605(a)).

⁴⁹⁹Financial Crimes Enforcement Network; Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 506 (now codified at 31 C.F.R. § 1010.605(a)).

⁵⁰⁰Financial Crimes Enforcement Network; Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 509 (now codified at 31 C.F.R. § 1010.605(a)).

FinCEN and various federal regulatory agencies have recently issued consolidated guidance on the requirements of beneficial ownership information. See Joint Release, *Guidance on Obtaining and Retaining Beneficial Ownership Information*, FIN-2010-G001 (Mar. 5, 2010), available at http://www.fincen.gov/statutes_regs/guidance/pdf/fin-2010-g001.pdf.

*That May Involve the Proceeds of Foreign Official Corruption.*⁵⁰¹ In the face of public comments that criticized various components of the defined term as difficult to implement, FinCEN chose to retain the definition, making only one substantive change. The proposed rule included in its definition of “senior foreign political figure” a person “who is widely and publicly known (or is actually known by the relevant covered financial institution) to maintain a close personal or professional relationship” with a senior foreign political figure.⁵⁰² In the final rule, FinCEN deleted the proposed reference to “close personal or professional relationship” and reverted to the statutory language, *i.e.*, a person known to be a “close associate” of such an individual.⁵⁰³

The discussion in the supplementary information section of the Federal Register provides some additional guidance on the required due diligence process for determining the status of a private banking account holder. In that discussion, FinCEN indicated that prior to accepting any private banking client, particularly one with a “high dollar” account, a covered financial institution should perform sufficient due diligence to ensure that it is comfortable with the prospective client and his or her source of funds.⁵⁰⁴ This standard due diligence process should provide the basis for determining whether a prospective client is a senior foreign political figure or for triggering additional inquiries to determine whether a particular position or title qualifies the individual as a senior official or executive.⁵⁰⁵ In connection with the requirement in the final rule that a covered financial institution must ascertain whether any nominal or beneficial owner of a private banking account is a senior foreign political figure, FinCEN said that a covered financial institution could and should build on its general due diligence processes for private banking

⁵⁰¹See footnote 79.

⁵⁰²Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts, 67 Fed. Reg. 37,736, 37,743 (May 30, 2002).

⁵⁰³Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 507 (now codified at 31 C.F.R. § 1010.605(p)(1)(iv)).

⁵⁰⁴Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 507 (now codified at 31 C.F.R. § 1010.605(p)(1)(iv)).

⁵⁰⁵Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 507 (now codified at 31 C.F.R. § 1010.605(p)(1)(iv)).

accounts.⁵⁰⁶ First, the institution should seek information directly from the individual regarding his or her possible status as a senior foreign political figure. Information about past and current employment history and sources of income, which is typically sought as part of a general due diligence process for private banking accounts, might be indicative of senior foreign political figure status. Second, references should be checked to determine whether the individual holds or held a senior political position or may be a close associate of such a person. Third, the institution should also make reasonable efforts to review public sources of information. FinCEN indicated that reasonable efforts to review public sources would involve, in virtually all cases, checking the name against U.S. government databases, major news publications, and commercial databases available on the Internet- and fee-based databases as appropriate.⁵⁰⁷

In the provision of the final rule relating to the minimum requirements of a due diligence program, FinCEN carried over the four elements from the proposed rule with several changes. First, in the final rule, a covered financial institution is required to take reasonable steps to ascertain the identity of all nominal and beneficial owners of a private banking account. As discussed earlier in this Section, the definition of “beneficial owner” in the final rule is narrower than the definition of “beneficial ownership interest” in the proposed rule. Second, in the final rule, a covered financial institution is required to take reasonable steps to ascertain whether any nominal or beneficial owner is a senior foreign political figure. Third, in the final rule, a covered financial institution is required to take reasonable steps to ascertain the source of funds deposited into the account and the purpose and expected use of the account. The proposed rule had referred to the source of funds deposited into the account but had not referred to the purpose and expected use of the account. The addition of a requirement for ascertaining the purpose and expected use of the account was fully to be expected. In this respect, the final rule does no more than reflect the current practice and regulatory expectation for private banking operations generally. Fourth, the final rule is more specific in its requirements that a covered financial institution take reasonable steps to report in ac-

⁵⁰⁶Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 510 (now codified at 31 C.F.R. § 1010.605(p)(1)(iv)).

⁵⁰⁷Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 510 (now codified at 31 C.F.R. § 1010.605(p)(1)(iv)).

cordance with applicable law and regulation any known or suspected violation of law conducted through or involving a private banking account by providing that a covered financial institution must “[r]eview the activity of the account to ensure that it is consistent with the information obtained about the client’s source of funds, and with the stated purpose and expected use of the account.”⁵⁰⁸

In the supplementary information section of the Federal Register notice, FinCEN noted in its discussion of the due diligence requirements of the private banking account rule that the final rule requires a risk-based due diligence program (although the language of Section 1010.620(a), unlike the language of Section 1010.610(a), does not expressly refer to risk-based policies, procedures and controls) and that the nature and extent of due diligence required by the final rule will vary with each client depending upon potential risk factors.⁵⁰⁹ Among the factors that would affect the nature and extent of due diligence would be whether the client is new to the institution, whether the client operates in or makes transfers from or to jurisdictions with weak anti-money laundering regimes and whether the client is involved with cash-based lines of business. The nature and extent of due diligence should also vary based on the size and level of activity in the account. FinCEN also provided guidance on some of the specific requirements for due diligence contained in the final rule. As to the requirement for ascertaining the nominal and beneficial owners of a private banking account, FinCEN stated that a covered financial institution would have to look through the nominal owner to determine who has effective control over the account. In this regard, FinCEN noted that when an account holder is a legal entity such as a private investment company, a financial institution should ensure that it has information about the structure of the entity, its directors, shareholders, and persons who have control over the account so that it can determine which individual or individuals constitute the beneficial owner as defined in the final rule. For a trust, the financial institution should determine which individual or individuals control the funds in the trust and should identify the source of the funds.⁵¹⁰

As with the due diligence requirements for correspondent ac-

⁵⁰⁸31 C.F.R. § 1010.620(b)(4).

⁵⁰⁹Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 496, 508 (Jan. 4, 2006).

⁵¹⁰Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 496, 508 to 509 (Jan. 4, 2006).

counts, FinCEN determined that the due diligence requirements for private banking accounts could not be met by reliance on due diligence conducted by foreign intermediaries. Citing the “unique vulnerabilities for money-laundering that exist in the private banking context,” FinCEN concluded that covered financial institutions must conduct their own due diligence with respect to the beneficial owners of private banking accounts.⁵¹¹

As to the requirement to ascertain the source of funds and the purpose and expected use of the account, FinCEN observed that it would not expect a financial institution to verify the source of every deposit into a private banking account. However, it would expect monitoring of an account to ensure that deposits were consistent with the information received about the client’s source of funds and the expected use of the account. A large deposit, if unusual, might warrant additional scrutiny as would a deposit from an unusual source such as a charitable fund or a government trust fund or aid grant.⁵¹²

As to the final requirement of a due diligence program, which was revised expressly to require review of activity in the account, FinCEN observed that if there is unusual activity in an account and the institution cannot obtain a satisfactory response from the client “and/or other sources,” the institution may be in a position to suspect that money-laundering or other activity with no apparent lawful purpose has occurred.⁵¹³ The final rule also expanded upon the proposed rule by specifically requiring review of activity in a private banking account to ensure its consistency with the information obtained about the client’s source of funds and purpose and use of the account.⁵¹⁴

FinCEN also revised the provisions in the final rule relating to the “special” requirements for senior foreign political figures. The “special” requirements provision of the proposed rule had simply stated that the due diligence program for private banking accounts must include policies and procedures reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption. The proposed rule did not expressly refer to

⁵¹¹Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 496, 509 (Jan. 4, 2006).

⁵¹²Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 496, 509 (Jan. 4, 2006).

⁵¹³Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 496, 511 (Jan. 4, 2006).

⁵¹⁴Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 515 (codified at 31 C.F.R. § 1010.620(b)(4)).

the statutory requirement for “enhanced scrutiny” of a private banking account for which a senior foreign political figure was a nominal or beneficial owner. This omission was noted by and criticized in a Congressional comment letter.⁵¹⁵ The language in Section 1010.620(c) of the final rule expressly incorporates the enhanced scrutiny language contained in Section 5318(i)(3)(B), but without providing any further specificity as to the meaning of “enhanced scrutiny.” The discussion in the supplementary information section of the Federal Register notice, however, provides some additional guidance on FinCEN’s views of what enhanced scrutiny might entail. FinCEN stated that as with the general due diligence requirements for private banking accounts under Section 1010.620(a), it would expect an enhanced scrutiny program under Section 1010.620(c) to be risk-based. FinCEN stated that reasonable steps as part of an enhanced scrutiny process might include an institution consulting publicly available information about the home country of the client; contacting its foreign branch, if any, in the home jurisdiction of the client to obtain further information; and conducting greater scrutiny of the client’s employment history and sources of wealth.⁵¹⁶ These steps appear to do no more than restate the general due diligence requirement applicable to identifying a senior foreign political figure. FinCEN further observed that when a client is a former senior foreign political figure, the risk-based program should weigh such factors as the length of time the client has been out of office and the size of the account.⁵¹⁷ The one “red flag” cited by FinCEN in its discussion of the final rule was the use of wire transfers from a government account to the personal account of a government official who has signature power over the government account.⁵¹⁸ A covered financial institution will undoubtedly want to incorporate the “red flags” identified in the 2001 *Guidance on Enhanced Scrutiny for Transactions That May Involve the Proceeds of Foreign Official Corruption* into its monitoring

⁵¹⁵See Letter of Senators Charles E. Grassley, John Kerry & Carl Levin to FinCEN 12-13 (Oct. 11, 2002), available at http://www.fincen.gov/statutes_regs/frn/comment_letters/old_comment_files/grassley.pdf.

⁵¹⁶Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 511.

⁵¹⁷Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 511.

⁵¹⁸Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 511.

process.⁵¹⁹ FinCEN reiterated the statements it had made at the time of the proposed rule that the decision to accept a senior foreign political figure as a customer should involve senior management and that the internal control procedures should make information on such accounts available for review not only by the relationship manager for the account but also by senior management.⁵²⁰

[3] Supervisory and Examination Process

The FFIEC Manual contains several sections that provide guidance on the statutory and regulatory requirements applicable to private banking accounts. The core examination overview section contains a section entitled “Private Banking Due Diligence Program (Non-U.S. Persons)—Overview.”⁵²¹ The expanded examination overview section includes a section entitled “Politically Exposed Persons—Overview.”⁵²²

The section of the FFIEC Manual discussing private banking accounts under Section 1010.620 notes (as FinCEN did in publishing the final rule) that the nature and extent of due diligence conducted on private banking accounts for non-U.S. persons will vary. More extensive due diligence, for example, will be appropriate for new clients, clients who operate in or whose funds are transmitted from or through jurisdictions with weak anti-money laundering controls, and clients whose lines of business are primarily currency based.⁵²³ This section of the FFIEC Manual also discusses the requirements of Section 1010.620 relating to “senior foreign political figures.”⁵²⁴

The section entitled “Private Banking—Overview” provides additional guidance on the requirements generally applicable to private banking operations, including those that do not meet the technical definition in Section 5318(i)(4)(B) of the BSA and Section

⁵¹⁹See Board of Governors of the Federal Reserve System, Division of Banking Supervision and Regulation, Supervisory Letter SR 01-03 (SUP) (Jan. 16, 2001): Guidance on Enhanced Scrutiny for Transactions That May Involve the Proceeds of Foreign Official Corruption, *available at* <http://www.federalreserve.gov/boarddocs/srletters/2001/sr0103.htm>.

⁵²⁰Financial Crimes Enforcement Network; Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 71 Fed. Reg. 511.

⁵²¹FFIEC Manual at 130–134.

⁵²²FFIEC Manual at 135–137, 297–300.

⁵²³FFIEC Manual at 132.

⁵²⁴FFIEC Manual at 132.

1010.605(m) of the BSA rules.⁵²⁵ This section contains a detailed discussion of the due diligence policies, procedures, and processes that banks should observe with respect to the range of products and relationships that they offer and maintain for private banking customers.⁵²⁶ There is a specific focus on offshore entities, such as private investment companies, international business corporations, and other shell entities, and the related use of bearer shares for such entities. This section also indicates that an institution should establish a risk profile for each private banking customer for prioritization of oversight resources and ongoing monitoring of relationship activities. Among the important points discussed in this section is the regulatory expectation that senior management and the board of directors of banking institutions will exercise active oversight of private banking operations.⁵²⁷ The FFIEC Manual also emphasizes the importance of thoroughly investigating the background of newly hired private banking relationship managers and of ongoing monitoring of their personal financial condition.⁵²⁸

The section entitled “Politically Exposed Persons—Overview” provides additional guidance on the requirements generally applicable to accounts for “politically exposed persons” and senior foreign political figures with respect to accounts or relationships that extend beyond the defined term “private banking account” as used in Section 1010.620.⁵²⁹ The discussion in the section is largely based upon the 2001 document *Guidance on Enhanced Scrutiny for Transactions That May Involve the Proceeds of Foreign Official Corruption*.⁵³⁰

FinCEN and the federal banking agencies have also issued other guidance documents that address specific issues relating to private banking accounts and accounts for “politically exposed

⁵²⁵FFIEC Manual at 279–283.

⁵²⁶FFIEC Manual at 132.

⁵²⁷FFIEC Manual at 283.

⁵²⁸FFIEC Manual at 283.

⁵²⁹FFIEC Manual at 297–300.

⁵³⁰*See, e.g.*, Board of Governors of Federal Reserve System, Division of Banking Supervision and Regulation, Supervisory Letter SR 97-19 (SUP) (Jan. 30, 1997): Private Banking Activities, *available at* <http://www.federalreserve.gov/BoardDocs/SRLetters/1997/SR9719.HTM>; Supervisory Letter SR 01–03 (SUP) (Jan. 16, 2001): Guidance on Enhanced Scrutiny for Transactions that May Involve the proceeds of Foreign Official Corruption, *available at* <http://www.federalreserve.gov/boarddocs/srletters/2001/SR0103.htm>.

persons.”⁵³¹ These guidance documents must also be considered in designing appropriate compliance systems.

[4] Enforcement Actions

Like foreign correspondent accounts, foreign private banking accounts have been a particular focus of law-enforcement and regulatory scrutiny. A number of the prominent law-enforcement actions in recent years have specifically been directed at private banking. The law-enforcement and the regulatory actions against Riggs involved the international private banking operations of Riggs.⁵³² The DOJ in its action stated that Riggs had failed to conduct sufficient due diligence on the accounts of “politically exposed persons,” including most prominently those related to Augusto Pinochet, former President of Chile.⁵³³ The DOJ recited various efforts by Riggs employees and by associates and family members of Augusto Pinochet to conceal the identity of the true owner of various accounts.⁵³⁴ Numerous suspicious transactions occurred in the accounts, including sequentially numbered cashier’s checks drawn on the accounts. The DOJ stated that officers and employees of Riggs knew or had reason to know that these transactions were suspicious but failed to file SARs on the transactions until after the bank regulatory authorities, a subcommittee of the U.S. Congress, or law-enforcement authorities discovered the transactions.⁵³⁵

The DOJ also recited that Riggs had opened numerous accounts

⁵³¹See, e.g., Interagency Advisory, Guidance on Accepting Accounts From Foreign Embassies, Consulates and Missions (Mar. 24, 2011), available at http://www.fincen.gov/statutes_regs/guidance/pdf/FFIEC_FinCEN_24_march.pdf; Interagency Advisory, Guidance on Accepting Accounts From Foreign Governments, Foreign Embassies and Foreign Political Figures (June 15, 2004), available at http://www.fincen.gov/statutes_regs/guidance/html/advis36.html. See also FinCEN Guidance, Potential Money Laundering Risks Related to Shell Companies, FIN-2006-G014 (Nov. 9, 2006), available at http://www.fincen.gov/statutes_regs/guidance/html/AdvisoryOnShells_FINAL.html.

⁵³²See Section 13:3[4] for a further discussion of the law-enforcement and regulatory actions against Riggs.

⁵³³Press Release, DOJ, Riggs Bank Enters Guilty Plea and Will Pay \$16 Million Fine for Criminal Failure to Report Numerous Suspicious Transactions (Jan. 27, 2005), available at <http://www.justice.gov/tax/usaopress/2005/txdv050530.html>.

⁵³⁴Press Release, DOJ, Riggs Bank Enters Guilty Plea and Will Pay \$16 Million Fine for Criminal Failure to Report Numerous Suspicious Transactions (Jan. 27, 2005), available at <http://www.justice.gov/tax/usaopress/2005/txdv050530.html>.

⁵³⁵Press Release, DOJ, Riggs Bank Enters Guilty Plea and Will Pay \$16 Million Fine for Criminal Failure to Report Numerous Suspicious Transactions

for the government of Equatorial Guinea, its senior government officials and its President and had assisted the President and his family in establishing offshore shell companies. By 2003, the accounts of the President and his family represented the largest banking relationship at Riggs.⁵³⁶ Large cash deposits and suspect wire transfers were made to these accounts over an extended period of time, and no new SARs were filed until after regulatory investigations had begun.⁵³⁷

Other law-enforcement actions have focused attention on the risks of foreign private banking accounts. The law-enforcement action against IDBNY also involved foreign private banking operations.⁵³⁸ The NYSBD and Manhattan District Attorney's press release in the IDBNY case described a pattern of activity that involved private banking customers of IDBNY bringing Brazilian currency to exchange houses in Brazil and then having the proceeds transferred to their private banking accounts at IDBNY for further transfer onto other parties.⁵³⁹ This process evaded Brazil's controls over foreign money transfers and allowed the foreign exchange houses to conduct a money transfer business in New York in violation of Brazilian law.⁵⁴⁰ The district attorney's press release stated that besides violating Brazilian law, this practice violated federal and New York banking regulations and money-laundering laws.

The deferred prosecution agreement for AEBI also dealt with foreign private banking operations.⁵⁴¹ The factual statement attached to the deferred prosecution agreement recited that federal investigators had identified specific private banking accounts at AEBI which the investigators believe were used to launder drug

(Jan. 27, 2005), available at <http://www.justice.gov/tax/usaopress/2005/txdv050530.html>.

⁵³⁶Press Release, DOJ, Riggs Bank Enters Guilty Plea and Will Pay \$16 Million Fine for Criminal Failure to Report Numerous Suspicious Transactions (Jan. 27, 2005), available at <http://www.justice.gov/tax/usaopress/2005/txdv050530.html>.

⁵³⁷Press Release, DOJ, Riggs Bank Enters Guilty Plea and Will Pay \$16 Million Fine for Criminal Failure to Report Numerous Suspicious Transactions (Jan. 27, 2005), available at <http://www.justice.gov/tax/usaopress/2005/txdv050530.html>.

⁵³⁸See Section 13:3[4] for a further discussion of the law-enforcement and regulatory actions against IDBNY.

⁵³⁹See Section 13:3[4].

⁵⁴⁰See Section 13:3[4].

⁵⁴¹See Section 13:3[4] for a further discussion of the law-enforcement and regulatory actions against AEBI.

proceeds through the Black Market Peso Exchange as well as other private banking accounts controlled by apparently legitimate South American businesses but held in the name of offshore shell companies and used to process “parallel currency exchange market” transactions.⁵⁴² Both types of accounts were characterized by suspicious incoming funds transfers such as multiple sources of incoming funds (typically wire transfers) from persons or entities unrelated to the account holders.⁵⁴³ In many cases, the financial transactions were inconsistent with the nature of the account holder’s business as understood by AEBI personnel. The factual statement focused specific attention on the use of bearer share corporations incorporated in offshore jurisdictions to hold private banking accounts. It concluded that there are few, if any, legitimate reasons for the use of bearer share companies and yet it states that law-enforcement has found that the presence of bearer share accounts is endemic to international private banking in the United States.⁵⁴⁴

There are signs of renewed regulatory focus on banking relationships with foreign “politically exposed persons.” The U.S. Senate Permanent Subcommittee on Investigations in February 2010 published a lengthy report discussing in depth four cases of penetration of the U.S. financial system by alleged corrupt foreign officials.⁵⁴⁵ This report came amid other international reports on the failure of global efforts to stem bribery and corruption.⁵⁴⁶ The thrust of these reports was that greater efforts must be made at stemming the flow of the proceeds of foreign corruption into international banking markets. A recent regulatory response to this issue can be found in the OCC enforcement action taken against HBUS in October 2010.⁵⁴⁷ Among the various deficiencies cited by the OCC in its consent cease and desist order was inadequate collection and analysis of due diligence information on politically exposed persons and inadequate monitoring. The order directed HBUS to develop appropriate enhanced due diligence

⁵⁴²See footnote 104, Factual Statement, ¶ 4.

⁵⁴³See footnote 104, Factual Statement, ¶ 13.

⁵⁴⁴See footnote 104, Factual Statement, ¶ 22.

⁵⁴⁵Senate Comm. on Homeland Security and Governmental Affairs, Permanent Subcomm. on Investigations, *Keeping Foreign Corruption Out of the United States: Four Case Histories* (2010), available at <http://www.hsgac.senate.gov/download/psi-staff-report-keeping-foreign-corruption-out-of-the-us>.

⁵⁴⁶See Paul L. Lee, *A Renewed Focus on Foreign Corruption and Politically Exposed Persons*, 127 *Banking L.J.* 813 (2010).

⁵⁴⁷See Section 13:3[4] for a further discussion of this regulatory action.

procedures for politically exposed persons.⁵⁴⁸ A report issued in July 2012 by the U.S. Senate Permanent Subcommittee on Investigations dealing with HSBC has detailed most recently the vulnerabilities of private banking operations to money laundering.⁵⁴⁹

§ 13:12 Foreign assets control and economic sanctions laws

[1] Legal Basis for Economic Sanctions

The United States has from time to time since the early 19th century imposed embargoes or sanctions against foreign nations seen as hostile to its interests.⁵⁵⁰ The present-day foreign assets control laws of the United States, sometimes referred to as economic sanctions laws or financial sanctions laws, evolved from wartime measures adopted during the First World War. In 1917, shortly after the United States' entry into that war, Congress enacted the Trading with the Enemy Act (TWEA).⁵⁵¹ TWEA, as amended, remains in force. In its current form, TWEA forbids any person subject to United States jurisdiction from trading with an enemy during a declared war without a license from the President of the United States.⁵⁵² "Trading," for these purposes, is defined broadly in a way that includes any transaction or transfer of property.⁵⁵³

In 1933, TWEA was amended to allow the President to impose restrictions on foreign governments with which the U.S. was not at war by declaring a "national emergency."⁵⁵⁴ As a result, TWEA was used during periods in the 20th century to impose embargoes on a number of Communist-controlled countries, notably the embargo against Cuba that was imposed in the early 1960s and

⁵⁴⁸See Section 13:3[4] for a further discussion of this regulatory action.

⁵⁴⁹See Senate Comm. on Homeland Security and Governmental Affairs, Permanent Subcomm. on Investigations, U.S. Vulnerabilities to Money Laundering, Drugs and Terrorist Financing: HSBC Case History (2012), available at <http://www.hsgac.senate.gov/download/?id=2a76c00f-7c3a-44c8-902e-3d9b5dbd0083>.

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⁵⁵⁰See, e.g., Embargo Act, ch. 5, 2 Stat. 451 (1807) (imposing an embargo on trade with Great Britain and France prior to the War of 1812).

⁵⁵¹Trading with the Enemy Act, Pub. L. No. 65-91, 40 Stat. 411 (1917) (codified as amended at 50 U.S.C.A. App. §§ 1 to 6, 7 to 39, and 41 to 44).

⁵⁵²50 U.S.C.A. App. § 3.

⁵⁵³50 U.S.C.A. App. § 2.

⁵⁵⁴Act of Mar. 9, 1933, Pub. L. No. 73-1, § 2, 48 Stat. 1, 1 to 2.

remains in effect today.⁵⁵⁵

In 1977, Congress enacted a new economic sanctions statute, the International Emergency Economic Powers Act (IEEPA),⁵⁵⁶ which governs economic sanctions other than in times of declared war. At the time IEEPA was enacted, TWEA was amended to restrict its future use to declared wars.⁵⁵⁷ Existing peacetime sanctions under TWEA, however, were allowed to remain in effect.⁵⁵⁸ Most of these TWEA sanctions were subsequently terminated, and only Cuba remains subject to sanctions under TWEA.⁵⁵⁹

Today, IEEPA and related statutes provide the legal basis for a wide variety of economic sanctions imposed by the United States. The United States imposed some of these sanctions programs unilaterally⁵⁶⁰ and imposed others in cooperation with the United Nations or other international organizations.⁵⁶¹ Many of these sanctions programs are directed at particular foreign governments that the United States wishes to isolate. Several of these countries are subject to sanctions that are sufficiently broad to prohibit most banking transactions by persons in the U.S. with persons in those countries.⁵⁶² Other countries are sanctioned under narrower programs, which restrict transactions with designated individuals or entities, and sometimes with the government itself, but not with persons in those countries

⁵⁵⁵Cuban Assets Control Regulations, 31 C.F.R. Pt. 515 (adopted 1963).

⁵⁵⁶International Emergency Economic Powers Act, Pub. L. No. 95-223, Title II, 91 Stat. 1625, 1626 to 1629 (1977) (codified as amended at 50 U.S.C.A. §§ 1701 to 1706).

⁵⁵⁷Pub. L. No. 95-223, § 101(a), 91 Stat. at 1625.

⁵⁵⁸Pub. L. No. 95-223, § 101(b), 91 Stat. at 1625 (reprinted at 50 U.S.C.A. App. § 5 note); *see* *Regan v. Wald*, 468 U.S. 222, 104 S. Ct. 3026, 82 L. Ed. 2d 171 (1984).

⁵⁵⁹*See* Cuban Assets Control Regulations, 31 C.F.R. Pt. 515; *see also, e.g.*, Presidential Proclamation 8271, 73 Fed. Reg. 36,785 (June 26, 2008) (terminating exercise of TWEA authority with respect to North Korea).

⁵⁶⁰*See, e.g.*, Cuban Assets Control Regulations, 31 C.F.R. Pt. 515.

⁵⁶¹*See, e.g.*, Exec. Order No. 13570, 76 Fed. Reg. 22,291 (Apr. 18, 2011) (implementing UN Security Council resolutions imposing sanctions against North Korea). Section 5 of the United Nations Participation Act (UNPA), 22 U.S.C. § 287c, authorizes the U.S. President to impose economic sanctions to implement UN Security Council resolutions. In implementing UN-mandated sanctions, the President typically invokes both UNPA and IEEPA.

⁵⁶²*See, e.g.*, Cuban Assets Control Regulations, 31 C.F.R. Pt. 515; Iranian Transactions and Sanctions Regulations, 31 C.F.R. Pt. 560, *as amended by* 77 C.F.R. 64664 (Oct. 22, 2012) *and* 77 C.F.R. 75845 (Dec. 26, 2012); Sudanese Sanctions Regulations, 31 C.F.R. Pt. 538.

generally.⁵⁶³ The United States also has adopted list-based sanctions programs that are not directed against foreign governments but at individuals or organizations believed to be involved in terrorism, drug trafficking, or the proliferation of weapons of mass destruction.⁵⁶⁴

Sanctions under IEEPA are imposed by executive order of the President of the United States and in most cases are implemented by regulations issued by the Secretary of the Treasury and administered by the Office of Foreign Assets Control (OFAC), an office within the U.S. Department of the Treasury. Each sanctions program, whether country-based or list-based, has its own set of regulations.⁵⁶⁵ The regulations for each program include substantive prohibitions, definitions of terms (which sometimes vary among the different sets of regulations), interpretive guidance, licenses and information about licensing policy, and cross-references to record-keeping, reporting, and penalty provisions.

Separately, the United States has adopted the Iran Sanctions Act of 1996 (ISA), a law that imposes sanctions on foreign financial institutions and other non-U.S. companies that conduct certain types of business with Iran.⁵⁶⁶ Four more recent laws—the Comprehensive Iran Sanctions and Disinvestment Act of 2010 (CISADA),⁵⁶⁷ the National Defense Authorization Act for Fiscal Year 2012 (NDAA),⁵⁶⁸ the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRSHRA),⁵⁶⁹ and the Iran Freedom

⁵⁶³See, e.g., Exec. Order No. 13,566, 76 Fed. Reg. 11,315 (Feb. 25, 2011) (blocking certain property and prohibiting certain transactions with respect to Libya); Belarus Sanctions Regulations, 31 C.F.R. Pt. 548; Zimbabwe Sanctions Regulations, 31 C.F.R. Pt. 541.

⁵⁶⁴See, e.g., 31 C.F.R. Pts. 536, 598 (narcotics-trafficking sanctions), 544 (weapons of mass destruction sanctions), 594 to 597 (terrorism sanctions).

⁵⁶⁵31 C.F.R. Pts. 515 to 598.

⁵⁶⁶Iran Sanctions Act of 1996, Pub. L. No. 104-172, 110 Stat. 1541 (1996) (ISA) (reprinted as amended at 50 U.S.C.A. § 1701 note).

⁵⁶⁷Comprehensive Iran Sanctions and Disinvestment Act of 2010, Pub. L. No. 111-195, 124 Stat. 1312 (2010) (CISADA) (codified as amended in scattered sections of U.S.C.A.).

⁵⁶⁸National Defense Authorization Act for Fiscal Year 2012, Pub. L. No. 112-81, § 1245, 125 Stat. 1298, 1647–1650 (2011) (NDAA) (codified at 22 U.S.C.A. § 8513a).

⁵⁶⁹Iran Threat Reduction and Syria Human Rights Act of 2012, Pub. L. No. 112-158, 126 Stat. 1214 (2012) (ITRSHRA) (codified in scattered sections of U.S.C.A.);

and Counter-Proliferation Act of 2012 (IFCPA)⁵⁷⁰—have added new sanctions with respect to Iran, either by amending the ISA or adding new provisions. If a foreign financial institution or other foreign company is sanctioned under the ISA or these related laws, financial institutions in the United States (including the U.S. branches of foreign banks) may be restricted from doing business with that foreign company (see Section 13:12[10]).

[2] Persons Required to Comply with U.S. Sanctions Laws

As a general matter, compliance with the U.S. sanctions laws is required of United States persons,⁵⁷¹ defined to mean companies organized under the laws of any U.S. jurisdiction (including their foreign offices or branches), individual U.S. citizens or permanent residents, and any person in the United States.⁵⁷²

Compliance with OFAC regulations is also required of offices, branches, or subsidiaries of foreign companies located in the United States, because any person within the United States meets the definition of “United States person.”⁵⁷³ Thus, a U.S. branch, agency, representative, or other office of a foreign bank is subject to the OFAC regulations, as is a U.S. subsidiary of a foreign bank.

Importantly, a foreign bank can also be held responsible for a violation of the OFAC regulations if the foreign bank acting from a non-U.S. office causes a U.S. bank or other U.S. person to engage in a transaction that is not permitted by the regulations (see Section 13:12[8]). This can occur if, for example, the foreign bank misrepresents or omits information about the parties to a transaction in order to induce a U.S. bank or other U.S. person to process the transaction.

⁵⁷⁰Iran Freedom and Counter-Proliferation Act of 2012, Subtitle XII(D) of the National Defense Authorization Act for Fiscal Year 2013, (IFCPA) Pub. L. No. 112–239, 126 Stat. 1632, 2004–2018 (2013) (codified in scattered sections of U.S.C.A.).

⁵⁷¹See, e.g., 31 C.F.R. §§ 560.206 (prohibiting U.S. persons from engaging in trade-related transactions involving Iran), 538.205 (prohibiting U.S. persons from exporting goods, services or technology from any country to Sudan).

⁵⁷²See, e.g., 31 C.F.R. §§ 560.314 (definition with respect to Iranian Transactions and Sanctions Regulations; similar definitions exist for other sanctions programs), 560.305 (the term “person” means an individual or entity).

⁵⁷³See, e.g., 31 C.F.R. §§ 515.329(b), 515.330(a)(2) (“person subject to the jurisdiction of the United States” under Cuban Asset Control Regulations includes, among others, any person “actually in the United States”), 560.314 (“United States person” under Iranian Assets Control Regulations includes, among others, any person “in the United States”).

With regard to the Cuba and Iran regulations, compliance obligations also are imposed on foreign companies “owned or controlled” by a United States person.⁵⁷⁴ This would include, for example, any foreign financial institution or other company that is a subsidiary of a U.S. company. With regard to the sanctions programs other than Iran and Cuba, the sanctions do not directly apply to foreign subsidiaries of U.S. companies located outside the United States so long as the U.S. parent company is not involved in the transaction, is not required to approve it and does not otherwise “facilitate” the transaction.⁵⁷⁵ However, the term “facilitate” is broadly defined in the OFAC regulations and so as a practical matter the prohibitions in most OFAC regulations will often extend to foreign subsidiaries of U.S. companies.⁵⁷⁶ In addition, the OFAC regulations apply to individual U.S. nationals or residents working for foreign companies overseas.⁵⁷⁷

Separately, the Iran Sanctions Act and related laws can impose sanctions on wholly foreign financial institutions and other foreign companies in response to actions that those companies take outside the United States (see Section 13:12[10]). Under these laws, the United States does not purport to exercise extraterritorial jurisdiction directly over the foreign company. Rather, the laws are framed as a prohibition or restriction against United States persons—including U.S. banks and U.S. branches of foreign financial institutions—doing business with the foreign banks or other companies that have been placed on the sanctions

⁵⁷⁴31 C.F.R. § 515.329(d) (for purposes of the Cuban Assets Control Regulations, defining “persons subject to the jurisdiction of the United States” to include any person “owned or controlled” by a U.S. person); 31 C.F.R. § 560.215, *as added by* 77 Fed. Reg. 75,845, 75,848 (Dec. 26, 2012) (replying persons “owned or controlled” by U.S. persons to comply with Iranian Transactions and Sanctions Regulations).

⁵⁷⁵*See, e.g.*, 31 C.F.R. § 538.206 (prohibiting U.S. persons from approving, financing, brokering, or otherwise facilitating Sudanese transactions by non-United States persons).

⁵⁷⁶*See, e.g.*, 31 C.F.R. § 538.407 (giving examples of activities by U.S. businesses that would constitute violation of prohibition on facilitation or approval of transactions by foreign affiliates with respect to Sudan).

⁵⁷⁷*See, e.g.*, 31 C.F.R. §§ 515.329(a) (“person subject to the jurisdiction of the United States” under Cuban Asset Control Regulations includes, among others, “any individual, wherever located, who is a citizen or permanent resident of the United States”), 560.314 (“United States person” under Iranian Assets Control Regulations includes, among others, “any United States citizen or permanent resident alien.”), 560.206 (prohibiting trade-related transactions involving Iran by a United States person “wherever located”).

list.⁵⁷⁸ The ability to deal with U.S. financial institutions directly or indirectly is important to the business of most foreign banks. Thus, as a practical matter, foreign banks and other financial institutions typically will treat these U.S. laws as prohibitions that apply to them directly.

[3] Summary of Current Sanctions Programs

United States sanctions programs change frequently in response to current events. Because sanctions regulations are understood to involve foreign affairs, the Treasury Department issues sanctions regulations without the notice and comment period that is required for most other regulations.⁵⁷⁹ For that reason, it is important to check the current status of the laws, orders and regulations administered by OFAC and not rely on summaries that may rapidly become obsolete. Nonetheless, certain features of the sanctions regulations have been fairly stable over a number of years.

Cuba has been subject to a comprehensive embargo since the early 1960s. The embargo took essentially its current form in 1963 when the Treasury Department promulgated the Cuban Assets Control Regulations.⁵⁸⁰ Under the Cuban Assets Control Regulations, property in which the government of Cuba or a Cuban national has an interest is “blocked.”⁵⁸¹ This means that persons subject to U.S. jurisdiction may not deal in or transfer the property or any interest in the property (*see* Section 13:12[5]). “Property” is defined broadly to include, among other things, money, securities, receivables, contracts, services, and all other

⁵⁷⁸*See, e.g.*, Exec. Order No. 13622, §§ 3 to 4, 77 C.F.R. 45897, 45898–45899 (July 30, 2012) (barring U.S. persons from certain transactions involving foreign persons engaging in certain types of dealings with Iran); 31 C.F.R. § 561.201, *as amended by* 77 C.F.R. 66918, 66919 (Nov. 8, 2012) (barring U.S. persons from certain transactions with foreign financial institutions sanctioned for dealing with certain Iranian banks).

⁵⁷⁹*See* 5 U.S.C.A. § 553(a)(1) (2006) (exempting rules relating to a “foreign affairs function” from notice and comment requirements); *see also, e.g.*, 76 Fed. Reg. 5072, 5074 (Jan. 28, 2011) (amending Cuban Asset Control Regulations without notice and comment in reliance on the foreign-affairs exception to 5 U.S.C.A. § 553).

⁵⁸⁰Cuban Assets Control Regulations, 28 Fed. Reg. 6974 (July 9, 1963) (codified as amended at 31 C.F.R. Pt. 515).

⁵⁸¹31 C.F.R. § 515.201(b) (prohibiting transfers of property in which a Cuban national has an interest); *see also* 31 C.F.R. § 515.319 (definition of “blocked account” as an account in which a Cuban national has an interest).

types of real, personal, or mixed property⁵⁸²—in effect, virtually anything that might be the subject of any kind of transaction by a bank or any other company.⁵⁸³ As a result, banks in the U.S. and other persons subject to U.S. jurisdiction generally may not engage in any transaction in which the Cuban government or a Cuban national has any direct or indirect interest.⁵⁸⁴

The Cuban Assets Control Regulations apply not only to U.S. companies, citizens and permanent residents and persons in the U.S. but also corporations, partnerships, or other organizations “owned or controlled” by them.⁵⁸⁵ This means that foreign subsidiaries of U.S. companies, including foreign banks owned by U.S. banking entities, are required to comply with the restrictions.

The Cuba sanctions are unique in that they include a ban on most travel-related transactions by persons subject to U.S. jurisdiction.⁵⁸⁶ Although IEEPA contains an exemption for travel-related transactions,⁵⁸⁷ the exemption does not apply to the Cuba embargo because it was established under TWEA.⁵⁸⁸

Some exceptions to the embargo exist. For example, property of individual Cuban nationals who have taken up residence in the United States have been unblocked⁵⁸⁹ and, subject to certain documentation requirements, so has property of individual Cuban nationals who have taken up residence in third countries.⁵⁹⁰ This means, for example, that a bank may open an account, and process transactions on an account, for an individual Cuban national habitually residing outside of Cuba without the need for specific permission from OFAC, as long as the individual supplies documentation of his or her residence as specified in the ap-

⁵⁸²31 C.F.R. § 515.311(a).

⁵⁸³See Office of Foreign Assets Control, *OFAC Regulations for the Financial Community 4* (May 6, 2011) (“Practically everything that banks do every day involves ‘property’ within the meaning of the regulations.”), available at <http://www.treasury.gov/resource-center/sanctions/Documents/facbk.pdf>.

⁵⁸⁴See 31 C.F.R. §§ 515.201(b) (prohibiting transfers of property in which a Cuban national has an interest), 515.310 (2010) (defining “transfer” to include any actual or purported act or transaction creating, surrendering, releasing, altering, or transferring any interest in property), 515.512 (defining “interest” in property to include any “direct or indirect” interests of any kind).

⁵⁸⁵31 C.F.R. §§ 515.329(d), 515.330(a)(4).

⁵⁸⁶31 C.F.R. §§ 515.415, 515.420.

⁵⁸⁷50 U.S.C.A. § 1702(b)(4).

⁵⁸⁸See 31 C.F.R. Pt. 515 (citing Trading with the Enemy Act, 50 U.S.C.A. App. §§ 1 et seq., as authority for regulations).

⁵⁸⁹31 C.F.R. § 515.505(a).

⁵⁹⁰31 C.F.R. § 515.505(b).

plicable regulation.⁵⁹¹

Iran has long been subject to a comprehensive U.S. trade embargo under IEEPA,⁵⁹² but the scope of the U.S. sanctions against Iran has recently undergone a dramatic expansion. Recently, the Iranian Transactions and Sanctions Regulations (ITSR) were expanded to apply to foreign companies “owned or controlled” by a U.S. person.⁵⁹³ In this respect, the Iran sanctions are now similar to the Cuba sanctions. In the event of a violation of the sanctions, the U.S. parent company as well as the subsidiary is liable for penalties.⁵⁹⁴ Although authorizations at one time existed under the predecessor to the ITSR that allowed U.S. banks to process “U-turn” transactions involving Iran, those authorizations have been rescinded, and U-turn transactions involving Iran are currently prohibited.⁵⁹⁵

In addition, executive orders and regulations adopted to implement the Comprehensive Iran Sanctions and Disinvestment Act of 2010⁵⁹⁶ and related laws authorize sanctions against non-U.S. banks that do certain types of business with Iranian banks. These provisions are discussed in detail in Section 13:12[10][b].

U.S. laws also prohibit most transactions by United States persons with Syria or the Republic of the Sudan (North Sudan).⁵⁹⁷

⁵⁹¹31 C.F.R. § 515.505(b).

⁵⁹²Iranian Transactions Regulations, 31 C.F.R. Pt. 560.

⁵⁹³Executive Order 13628, § 4, 77 C.F.R. 62139, 62141 (Oct. 12, 2012); 31 C.F.R. § 560.215, *as added by* 77 C.F.R. 75845, 75848 (Dec. 26, 2012); *see also* 22 U.S.C. § 8725(b) (ITRSHRA provision requiring adoption of this change).

⁵⁹⁴22 U.S.C.A. § 8725(c).

⁵⁹⁵73 Fed. Reg. 66,541 (Nov. 10, 2008) (amendment to Iranian Transactions Regulations revoking previous authorization for U-turn transactions). The U-turn provision authorized transactions in a U.S. dollar clearing account involving a transfer by order of a non-Iranian foreign bank from its own account in a domestic U.S. bank to an account held by a domestic U.S. bank for another non-Iranian foreign bank. In effect, a U-turn transaction was a transaction initiated outside the United States as a dollar-denominated transaction by order of a foreign bank to customers; it then became a transfer from a correspondent account held by a U.S. bank for a foreign bank to a correspondent account held by a U.S. bank for another foreign bank; and it ended up outside the United States as a transfer to a dollar-denominated account of the second foreign bank’s customer.

⁵⁹⁶Comprehensive Iran Sanctions and Disinvestment Act of 2010, Pub. L. No. 111-195, 124 Stat. 1312 (2010) (CISADA) (codified as amended in scattered sections of U.S.C.A.).

⁵⁹⁷Sudanese Sanctions Regulations, 31 C.F.R. Pt. 538 (prohibiting most transactions involving Sudan and blocking property of certain persons associ-

Burma (Myanmar) is subject to much more limited sanctions,⁵⁹⁸ and a previous ban on funds transfers and other financial services to persons in Burma⁵⁹⁹ has largely been lifted.⁶⁰⁰

With respect to certain other countries, the United States has restricted transactions with the government itself, with certain designated persons or with both.⁶⁰¹ The United States also has adopted list-based sanctions programs that are not directed to a particular government but instead are global sanctions against categories of parties such as terrorists and narcotics traffickers.⁶⁰² The individuals and entities designated under these programs are included on a master list of “Specially Designated Nationals” that OFAC regularly updates.⁶⁰³

Because of a statute commonly known as the “Berman Amendment,” transactions for the purchase and sale of books, films, recordings, photographs, and similar types of “information and informational material” are exempt from all of the sanctions programs administered by OFAC.⁶⁰⁴ Certain other types of transactions also are exempt or are authorized under a “general license,” or may be authorized by a “specific license” issued by OFAC in its discretion (see Section 13:12[4]).

ated with the Government of Sudan); Executive Order No. 13582, 76 Fed. Reg. 52,209 (Aug. 18, 2011) (prohibiting most transactions involving Syria and blocking property of the Government of Syria and certain other persons). For purposes of the Sudanese Sanctions Regulations, “Sudan” does not include the newly independent Republic of South Sudan. *See* 31 C.F.R. § 538.305, Note 1, *added by* 76 Fed. Reg. 76,617, 76,618 (Dec. 8, 2011).

⁵⁹⁸Burmese Sanctions Regulations, 31 C.F.R. Pt. 537.

⁵⁹⁹31 C.F.R. §§ 537.202, 537.305.

⁶⁰⁰Office of Foreign Assets Control, Burmese Sanctions Regulations General License No. 16 (July 11, 2012), *available at* <http://www.treasury.gov/resource-center/sanctions/Programs/Documents/burmagl16.pdf>. Transactions involving a designated blocked person remain forbidden, except that transactions involving an account of a blocked Burmese bank, other than an account on the books of a U.S. financial institution, are authorized.

⁶⁰¹*See, e.g.*, Exec. Order No. 13,566, 76 Fed. Reg. 11,315 (Feb. 25, 2011) (blocking certain property and prohibiting certain transactions with respect to Libya); Belarus Sanctions Regulations, 31 C.F.R. Pt. 548; Zimbabwe Sanctions Regulations, 31 C.F.R. Pt. 541.

⁶⁰²*See, e.g.*, 31 C.F.R. Pts. 536, 598 (counter-narcotics-trafficking sanctions); 31 C.F.R. Pts. 594 to 597 (counterterrorism sanctions).

⁶⁰³*See* Office of Foreign Assets Control, *Specially Designated Nationals and Blocked Persons* (updated frequently), *available at* <http://www.treasury.gov/resource-center/sanctions/SDN-List>.

⁶⁰⁴50 U.S.C.A. § 1705(b)(3) (IEEPA exemption); 50 U.S.C.A. App. § 5(b)(4) (TWEA exemption).

[4] General and Specific Licenses

“General licenses” and “specific licenses” are two key concepts found throughout the regulations and orders administered by OFAC. A “license,” for these purposes, means an authorization to engage in a transaction that otherwise would be prohibited by sanctions regulations.⁶⁰⁵ A general license is an authorization to that anyone may use, without the need to apply for it, which is normally set forth in the regulations themselves.⁶⁰⁶ Some general licenses, however, are published separately from the regulations and posted on OFAC’s Web site before they are formally incorporated into the regulations.⁶⁰⁷ Some general licenses are very broad, covering large categories of transactions that would otherwise be prohibited.⁶⁰⁸ Despite the name, however, other “general” licenses are very narrowly defined and apply only if certain detailed criteria are satisfied.⁶⁰⁹

In addition, OFAC accepts applications for specific licenses. A specific license normally authorizes a named person or persons to engage in particular transactions.⁶¹⁰ The issuance of a specific license is normally within OFAC’s discretion. In some cases, OFAC’s regulations contain guidance on the types of transactions that OFAC considers licensable.⁶¹¹ In a few instances, OFAC’s authority to issue specific licenses is limited by statute.⁶¹²

For some types of specific license applications, OFAC has

⁶⁰⁵See, e.g., 31 C.F.R. §§ 515.516, 560.310 (defining “license” for purposes of Cuban and Iranian sanctions; other regulations contain similar provisions).

⁶⁰⁶31 C.F.R. § 501.801(a).

⁶⁰⁷31 C.F.R. § 501.801(a).

⁶⁰⁸See, e.g., Office of Foreign Assets Control, Burmese Sanctions Regulations General License No. 18 (Nov. 16, 2012) (broadly authorizing importation of all Burmese products, other than jadeite or rubies, into the United States), available at <http://www.treasury.gov/resource-center/sanctions/Programs/Documents/burmag118.pdf>.

⁶⁰⁹See, e.g., 31 C.F.R. § 515.565 (setting out detailed criteria specifying when transactions related to educational travel to Cuba are permitted without a specific license).

⁶¹⁰31 C.F.R. § 501.801(b)(1).

⁶¹¹See, e.g., 31 C.F.R. § 515.560(a) and (b) (explaining which types of travel to Cuba are subject to general licenses or licensable under specific licenses).

⁶¹²See, e.g., 22 U.S.C.A. § 6005(a)(1) (prohibiting OFAC from licensing certain trade with Cuba by foreign subsidiaries of U.S. companies); Trade Sanctions Reform and Export Enhancement Act of 2000, Pub. L. No. 105-387, § 910(b), 114 Stat. 1549, 1549A-72 (2000) (prohibiting OFAC from licensing tourist travel to Cuba); Tom Lantos Block Burmese JADE (Junta’s Anti-Democratic Efforts) Act of 2008, Pub. L. No. 110-286, § 5(i), 122 Stat. 2632 (2008) (reprinted at 50 U.S.C.A. § 1701 note) (authorizing waiver of certain

prescribed the use of a particular form. For example, an application for a specific license to unblock funds that have been blocked by a bank or other financial institution (*see* Section 13:12[5]) requires the use of a barcoded application form available on OFAC's Web site.⁶¹³ A different online form may be used to request permission to travel to Cuba, but use of this form is voluntary.⁶¹⁴ Other types of license applications are made by letter⁶¹⁵ though in some cases OFAC has published guidance about the specific types of information that should be included.⁶¹⁶ The time required for OFAC to grant or deny a license application can vary greatly.

[5] Blocked and Rejected Transactions

“Blocking” is a key concept in many of the sanctions programs that OFAC administers. The regulations “block” property and interests in property belonging to nationals of Cuba, some designated foreign governments, and persons and entities that OFAC has listed as Specially Designated Nationals, to the extent that that property comes into the United States or into the possession or control of a United States person (or, in the case of Cuba or Iran, an entity owned or controlled by a United States person).⁶¹⁷ Blocked property must not be transferred or otherwise dealt with.⁶¹⁸

This means that if a bank in the United States receives instructions for a wire transfer to a blocked person, the bank may not simply reject the transfer. Rather, the bank must “block” the funds—that is, freeze them so that they cannot be withdrawn or transferred—and must notify OFAC that the funds have been

Burma sanctions only upon specific findings by President and report to Congress).

⁶¹³31 C.F.R. § 515.801(b)(2) (requiring use of form); Office of Foreign Assets Control, *Application for the Release of Blocked Funds*, available at <http://www.treasury.gov/resource-center/sanctions/Documents/license.pdf>.

⁶¹⁴Office of Foreign Assets Control, *License Application for Travel to Cuba*, available at <https://cubatravel.ofac.treas.gov/>.

⁶¹⁵31 C.F.R. § 501.801(b)(2).

⁶¹⁶*See, e.g.*, 31 C.F.R. § 501.801(b)(3) (describing required contents of all specific license applications); Office of Foreign Assets Control, *Sudanese Sanctions Regulations: Registration of Non-Governmental Organizations*, available at http://www.treasury.gov/resource-center/sanctions/Documents/ngo_guide.pdf (setting forth guidelines for certain types of license applications by NGOs).

⁶¹⁷*See, e.g.*, 31 C.F.R. § 515.201(b) (Cuba); 31 C.F.R. § 560.215, *as added by* 77 Fed. Reg. 75,845, 75,848 (Dec. 26, 2012) (Iran).

⁶¹⁸*See, e.g.*, 31 C.F.R. § 515.201(b).

blocked.⁶¹⁹ In most cases, the frozen funds must promptly be placed into an interest-bearing blocked account in the United States.⁶²⁰

For example, if a funds transfer comes from outside the United States and is being routed through a U.S. bank (or a U.S. office of a foreign bank) to an offshore bank and there is an OFAC-designated party on the transaction, it must be blocked. Funds must be blocked if a blocked person has any interest in the transaction. This means, for example, that a transfer from, to or through the U.S. must normally be blocked if the sender, the beneficiary, or any bank involved in the transaction is a blocked person, unless a general or specific license applies. If a U.S. bank (or a U.S. office of a foreign bank) receives instructions to make an unlicensed funds transfer involving a blocked person, it must execute the order by placing the funds into a blocked account.⁶²¹ A payment order involving a blocked person cannot be canceled or amended after it is received by a U.S. bank (or U.S. office of a foreign bank) except with an authorization from OFAC.

If 50% or more of the stock of a company is owned by a blocked person, then OFAC considers the blocked person to have an interest in all the company's assets so that the company itself must be treated as a blocked person.⁶²² The Cuban Asset Control Regulations also block any company if a "substantial part" of its equity or debt securities owned or controlled by a Cuban national;⁶²³ in that case, the 50% threshold would not apply. Some other sanctions regulations, such as those for Sudan or Iran, block any entity that is "owned or controlled" by a blocked person or entity;⁶²⁴ in that case, too, it is possible that something less than 50% ownership could amount to effective control in particular

⁶¹⁹See Office of Foreign Assets Control, *OFAC Regulations for the Financial Community* at 3 (May 6, 2011), available at <http://www.treasury.gov/resource-center/sanctions/Documents/facbk.pdf>; Office of Foreign Assets Control, *Frequently Asked Questions and Answers*, available at <http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx>.

⁶²⁰See, e.g., 31 C.F.R. § 515.205 (Cuba); 31 C.F.R. § 560.213, as added by 77 Fed. Reg. 64,664, 64,670–64,671 (Oct. 22, 2012) (Iran).

⁶²¹See, e.g., 31 C.F.R. § 515.205 (Cuba); 31 C.F.R. § 560.213, as added by 77 Fed. Reg. 64,664, 64,670–64,671 (Oct. 22, 2012) (Iran).

⁶²²Office of Foreign Assets Control, *Guidance on Entities Owned by Persons Whose Property and Interests in Property Are Blocked*, available at http://www.treasury.gov/resource-center/sanctions/Documents/licensing_guidance.pdf.

⁶²³31 C.F.R. § 515.302(a)(2)(iii).

⁶²⁴31 C.F.R. § 538.305(a)(3) (defining "Government of Sudan" to include "[a]ny entity owned or controlled by" the government of Sudan or one of its political subdivisions); 31 C.F.R. § 560.304 (defining "Government of Iran" to

circumstances. If a bank in the United States knows or has reason to believe that an entity is blocked by reason of being owned or controlled by a blocked person under these provisions, it may be required to block transactions involving that entity even if the entity has not been placed on the Specially Designated Nationals list. In doubtful cases, the bank should contact OFAC for guidance.

Not all of the OFAC sanctions regulations involve blocking. For example, the OFAC regulations prohibit transfers to persons in Sudan, or transfers in support of most transactions involving Sudan or Sudanese goods or services, but the funds are not blocked unless the transaction involves a person, bank or other entity on the Specially Designated Nationals list (or owned or controlled by a person on the list).⁶²⁵ Where no blocked person is involved, a prohibited transaction must be “rejected”—that is, not processed—and OFAC must be notified of the rejected transaction.⁶²⁶

The Iranian Transactions and Sanctions Regulations are similar to the Sudanese Sanctions Regulations in this regard.⁶²⁷ In practice, however, funds transfers to Iran must normally be blocked rather than rejected because substantially all Iranian financial institutions have been designated as blocked.⁶²⁸

[6] Reporting, Record-keeping and Screening Requirements

A bank or other financial institution, including a U.S. branch, agency, or other U.S. office of a foreign bank, that blocks or rejects a transaction under the sanctions regulations must report the

include “[a]ny person owned or controlled, directly or indirectly,” by the government of Iran or one of its political subdivisions).

⁶²⁵See Sudanese Sanctions Regulations, 31 C.F.R. Pt. 538; see also 31 C.F.R. § 501.604(a) and (b) (distinguishing blocked transactions from rejected transactions).

⁶²⁶See 31 C.F.R. § 501.604.

⁶²⁷See Iranian Transactions and Sanctions Regulations, 31 C.F.R. Pt. 560.

⁶²⁸See 22 U.S.C.A. § 8513a(c) (requiring blocking of Iranian financial institutions). In addition, Bank Saderat has been designated as blocked under the Global Terrorism Sanctions Regulations, 31 C.F.R. Pt. 594, and many other Iranian or Iran-affiliated banks have been designated as blocked under the Weapons of Mass Destruction Proliferators Sanctions Regulations, 31 C.F.R. Pt. 544. See Office of Foreign Assets Control, *Specially Designated Nationals and Blocked Persons List* (Dec. 21, 2012), available at <http://www.treasury.gov/ofac/downloads/t11sdn.pdf>.

transaction to OFAC within 10 business days.⁶²⁹ In addition, banks and other financial institutions holding blocked property must file with OFAC an annual report of blocked property.⁶³⁰

OFAC regulations require that records of all blocked or rejected transactions, as well as transactions that are permitted by an OFAC license, must be retained for at least five years from the date of the transaction.⁶³¹ In addition, financial institutions holding blocked funds or other blocked property must retain records of the blocked property for at least five years after the property is unblocked.⁶³² These requirements are in addition to any other record-keeping requirements that may apply under other laws.

OFAC itself does not prescribe any particular compliance procedures, but U.S. bank regulators require that the banks they regulate maintain effective procedures for detecting potential violations of the OFAC sanctions regulations.⁶³³ To minimize the risk of OFAC penalties, banks should have a well-defined OFAC compliance program with clearly defined lines of responsibility, sufficient levels of staffing, and appropriate and effective training and quality control.⁶³⁴ OFAC has issued enforcement guidelines that provide guidance on how it determines a course of enforcement action. These guidelines confirm that although the OFAC regime itself remains a strict liability regime, OFAC will consider an institution's risk-based compliance program as one of the factors in its enforcement calculus.⁶³⁵ For banking institutions, the FFIEC Manual provides additional guidance on the views of the federal banking agencies as to the requirements for a robust OFAC compliance program. In a section entitled "Office of Foreign Asset Control—Overview," there is a detailed discussion of the regulatory expectations for a compliance program based on a comprehensive risk assessment by the institution of its OFAC

⁶²⁹31 C.F.R. §§ 501.603(b)(1)(i) (blocked transactions), 501.604(c) (rejected transactions).

⁶³⁰31 C.F.R. § 501.603(b)(2).

⁶³¹31 C.F.R. § 501.601.

⁶³²31 C.F.R. § 501.601.

⁶³³See Office of Foreign Assets Control, *OFAC Regulations for the Financial Community* at 3 (May 6, 2011), available at <http://www.treasury.gov/resource-center/sanctions/Documents/facbk.pdf>.

⁶³⁴See 31 C.F.R. Pt. 501 App. A annex (OFAC risk matrix for financial institutions).

⁶³⁵Economic Sanctions Enforcement Guidelines, 31 C.F.R. Pt. 501, App. A.

risk profile.⁶³⁶ To identify potential OFAC violations, banks generally use commercially available interdiction software, which matches customer or beneficiary names against the OFAC Specially Designated Nationals list and other lists and by checks for references to embargoed countries. If a possible match or “hit” is found, the compliance program typically refers the transaction to one of the bank’s compliance officers for manual review. If bank personnel are unable to determine whether the hit is a true match, they may contact OFAC for guidance on whether the transaction must be blocked or rejected.⁶³⁷

[7] Penalties

Penalties for violation of sanctions regulations can be severe. In 2007 and 2010, respectively, IEEPA⁶³⁸ and TWEA⁶³⁹ were amended to increase the maximum penalties greatly.⁶⁴⁰ Under current law, OFAC may impose civil monetary penalties under IEEPA of up to \$250,000 per violation (subject to periodic adjustments for inflation) or twice the amount of the transaction in question, whichever is greater.⁶⁴¹ Under TWEA, the maximum civil monetary penalty per violation is \$65,000 (subject to periodic adjustments for inflation),⁶⁴² and the funds or property involved

⁶³⁶FFIEC Manual at 147–159.

⁶³⁷See Office of Foreign Assets Control, *Frequently Asked Questions and Answers*, available at <http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx>.

⁶³⁸International Emergency Economic Powers Act, Pub. L. No. 95-223, 91 Stat. 1626 (1977) (codified as amended at 50 U.S.C.A. §§ 1701 to 1706).

⁶³⁹Trading with the Enemy Act, Ch. 106, 40 Stat. 411 (1917) (codified as amended at 50 U.S.C.A. App. §§ 1 to 6, 7 to 39, and 41 to 44).

⁶⁴⁰International Emergency Economic Powers Enhancement Act, Pub. L. No. 110-96, § 2, 112 Stat. 1011, 1011 (2007) (increasing IEEPA civil and criminal penalties); Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, Pub. L. No. 111-195, § 107(a)(4), 124 Stat. 1312, 1337 (2010) (increasing criminal penalties under TWEA and other related statutes to match the criminal penalties under IEEPA).

⁶⁴¹50 U.S.C.A. § 1705(b) (establishing penalty amounts as \$250,000 or twice the amount of the violation); Federal Civil Penalties Inflation Adjustment Act of 1990, Pub. L. No. 101-410, 104 Stat. 890 (1990) (authorizing inflation adjustments) (reprinted at 28 U.S.C.A. § 2461 note).

⁶⁴²See 50 U.S.C.A. App. § 16(b)(1) (establishing maximum penalty as \$50,000 per violation); Federal Civil Penalties Inflation Adjustment Act of 1990, Pub. L. No. 101-410, 104 Stat. 890 (1990) (authorizing inflation adjustments) (reprinted at 28 U.S.C.A. § 2461 note); 31 C.F.R. § 501.701(a)(3) (stating that maximum amount has been adjusted to \$65,000 for inflation).

in the transaction may be forfeited to the government.⁶⁴³ Where a company has engaged in a pattern of repeated violations of OFAC's regulations, the maximum penalty for all violations in the aggregate can become very large, as each transaction constitutes a separate violation.

OFAC has the discretion to impose a civil monetary penalty, after a hearing, regardless of fault.⁶⁴⁴ In determining the amount of the civil monetary penalty, however, OFAC will consider whether the violation was willful or reckless.⁶⁴⁵ OFAC also has discretion to take no action, to issue a cautionary letter, or to make a finding of violation without imposing a civil penalty.⁶⁴⁶

OFAC has issued a detailed set of penalty guidelines that it uses to determine the amount of a civil penalty.⁶⁴⁷ Where the violation involves a prohibited transaction (rather than a failure to keep required records or file a required report), OFAC's civil penalty guidelines call for OFAC first to determine if it considers the violation "egregious" or "non-egregious."⁶⁴⁸ If the violation was egregious, the base amount for the penalty is the statutory maximum at the time of the violation;⁶⁴⁹ otherwise, the base amount is determined from a schedule depending on the value of the transaction but no more than the statutory maximum.⁶⁵⁰ If the violation came to OFAC's attention through voluntary disclosure by the respondent, however, the base amount is reduced by 50% or more.⁶⁵¹ OFAC then adjusts this amount up or down in its discretion, based on aggravating and mitigating circumstances, to arrive at the proposed penalty amount.⁶⁵² The circumstances that OFAC takes into account include such factors as willfulness, recklessness, concealment, cooperation with OFAC, involvement by senior management, existence of an effective compliance program, harm caused by the violation to the objectives of the sanctions program, and many other potentially rele-

⁶⁴³50 U.S.C.A. App. § 16(b)(2).

⁶⁴⁴*Compare* 50 U.S.C.A. § 1705(c) (imposing criminal liability on those who "willfully" violate the law) *with* 50 U.S.C.A. § 1705(a) and (b) (not including any intent requirement for civil penalties).

⁶⁴⁵31 C.F.R. Pt. 501, App. A, § III(A)(1) and (2).

⁶⁴⁶31 C.F.R. Pt. 501, App. A, § II.

⁶⁴⁷31 C.F.R. Pt. 501, App. A.

⁶⁴⁸31 C.F.R. Pt. 501, App. A, § V(B)(1).

⁶⁴⁹31 C.F.R. Pt. 501, App. A, § V(B)(2)(a)(iv).

⁶⁵⁰31 C.F.R. Pt. 501, App. A, § V(B)(2)(a)(ii).

⁶⁵¹31 C.F.R. Pt. 501, App. A, § V(B)(2)(a)(i), (iii).

⁶⁵²31 C.F.R. Pt. 501, App. A, § V(B)(2)(b).

vant considerations.⁶⁵³ OFAC has the authority to agree to a settlement with the subject of the proceeding.⁶⁵⁴

OFAC's penalty guidelines apply a different method of computation if the violation consists of a failure to file a required report or keep adequate records. Under the guidelines, failure to file a required report can result in a civil penalty of up to \$20,000, or up to \$50,000 if the report involves a transaction over \$500,000.⁶⁵⁵ Late filing of a required report can result in a civil penalty of up to \$2,500 if the report is less than 30 days late or \$5,000 if the report is more than 30 days late.⁶⁵⁶ If the report relates to blocked assets, an additional \$1,000 can be added for each additional 30 days the report is overdue, up to five years.⁶⁵⁷ Failure to maintain required records can result in a penalty up to \$50,000 under the guidelines.⁶⁵⁸ These penalties can be applied in addition to any penalties assessed for the underlying transaction.

If a violation of any of OFAC's regulations was "willful"—that is, was committed with knowledge that the conduct was unlawful—criminal prosecution is possible.⁶⁵⁹ Criminal prosecution of a company officer, director, or agent is possible if the individual knowingly participated in a violation by the company.⁶⁶⁰ On conviction under either IEEPA or TWEA, the maximum criminal penalty per violation is a fine of up to \$1 million for an individual or a corporation and, for an individual, imprisonment for up to 20 years.⁶⁶¹

[8] Application of United States Sanctions Regulations to Banks Outside the United States; Prohibitions on Evasion or Facilitation.

As discussed, the sanctions laws apply to U.S.-incorporated companies (and, in the case of Cuba and Iran, their subsidiaries), U.S. citizens, U.S. permanent residents, and persons in the

⁶⁵³31 C.F.R. Pt. 501, App. A, § III.

⁶⁵⁴31 C.F.R. Pt. 501, App. A, § V(B).

⁶⁵⁵31 C.F.R. Pt. 501, App. A, § IV(A).

⁶⁵⁶31 C.F.R. Pt. 501, App. A, § IV(B).

⁶⁵⁷31 C.F.R. Pt. 501, App. A, § IV(B).

⁶⁵⁸31 C.F.R. Pt. 501, App. A, § IV(C).

⁶⁵⁹50 U.S.C.A. § 1705(c); 50 U.S.C.A. App. § 16(a).

⁶⁶⁰50 U.S.C.A. App. § 16(a) (providing for criminal prosecution of officer, director or agent who knowingly participates in a TWEA offense); *see also* 50 U.S.C.A. § 1705(c) (imposing same penalty on person who conspires to commit an offense under IEEPA); 18 U.S.C.A. § 2(a) (person who aids or abets an offense can be charged as a principal).

⁶⁶¹50 U.S.C.A. § 1705(c) (IEEPA); 50 U.S.C.A. App. § 16(a) (TWEA).

United States (*see* Section 13:12[2]). The regulations, however, can also apply to foreign companies or individuals outside the United States, if the transaction involves property in the United States⁶⁶² or the transaction takes place in the United States.⁶⁶³ In addition, OFAC's sanctions regulations typically contain provisions prohibiting any transaction that has the intent or effect of evading compliance with the sanctions regulations.⁶⁶⁴

Foreign banks and other companies can also get caught up in U.S. sanctions laws to the extent that they have employees, officers, directors, or agents who are U.S. nationals or permanent residents or have parent companies, subsidiaries, or affiliates that are U.S. companies. Many of the sanctions regulations prohibit such U.S. persons from approving or facilitating transactions by a foreign person that would be forbidden to the U.S. persons themselves.⁶⁶⁵ This means, in effect, that U.S. individuals and entities are required to comply with U.S. sanctions laws even if they are acting outside the United States on behalf of a foreign entity and not on their own behalf.

[9] Enforcement Actions Against Foreign Banks

In a series of widely publicized cases in 2009, 2010, 2011 and 2012, foreign banks have been investigated and threatened with criminal prosecution for causing prohibited transactions to be processed in the United States. Most of these large cases involved allegations that the banks had willfully "stripped" details from wire transfer instructions in order to conceal the involvement of Iran or other sanctioned countries or persons in the transfers and to evade the OFAC regulations that forbid processing such transfers through financial institutions in the United States.

Many of these investigations were resolved by deferred prosecution agreements or settlement agreements requiring the banks to pay large fines and to take steps to ensure future compliance. For example, Lloyds TSB Bank plc, Credit Suisse AG, ABN AMRO Bank N.V., Barclays Bank PLC, ING Bank N.V., Standard Chartered Bank, and HSBC Holdings plc each agreed to forfeit hundreds of millions of dollars and to adopt new compliance measures as a result of OFAC violations. Details of these cases and others are described in Section 13:10[4].

⁶⁶²*See, e.g.*, 31 C.F.R. §§ 515.201(b)(2), 515.313 (Cuba).

⁶⁶³*See, e.g.*, 31 C.F.R. §§ 538.205 (Sudan), 560.203 (Iran).

⁶⁶⁴*See, e.g.*, 31 C.F.R. §§ 515.201(c) (Cuba), 538.211 (Sudan), 560.203 (Iran).

⁶⁶⁵*See, e.g.*, 31 C.F.R. § 538.206 (Sudan), 560.208 (Iran).

[10] Sanctions Against Foreign Companies and Financial Institutions Doing Business with Iran

In 2010, Congress enacted the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA),⁶⁶⁶ which was intended to isolate Iran further by imposing sanctions on foreign companies that do certain types of business with Iran. In particular, CISADA requires the President to impose sanctions against any foreign company or financial institution that is found to have knowingly engaged in certain types of business with Iran.

Two sections of CISADA are particularly relevant from the standpoint of a foreign financial institution. Section 102 of CISADA amends the Iran Sanctions Act of 1996 (ISA)⁶⁶⁷ to trigger sanctions against any foreign company—potentially including foreign financial institutions—that assist Iran in developing petroleum resources, developing petroleum refining capability, or importing refined petroleum. Section 104 of CISADA adds some additional prohibitions specifically targeted at foreign financial institutions.

Subsequent legislation expanded the scope of possible Iran-related sanctions against foreign banks and other non-U.S. companies. In particular, Section 1245 of the National Defense Authorization Act for Fiscal Year 2012 (NDAA),⁶⁶⁸ adopted in 2011, added additional sanctions targeted at foreign financial institutions doing business with Iranian banks or related to Iranian petroleum exports. The Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRSHRA)⁶⁶⁹ The Iran Freedom and Counter-Proliferation Act of 2012 (IFCPA), which became law on January 3, 2013, adds sanctions for additional types of transactions related to Iran, including sanctions specifically targeted at foreign financial institutions.⁶⁷⁰ The most significant provisions of CISADA, NDAA, ITRSHRA and IFCPA are discussed below.

⁶⁶⁶Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, Pub. L. No. 111-195, 124 Stat. 1312 (2010) (CISADA).

⁶⁶⁷Iran Sanctions Act of 1996, Pub. L. No. 104-172, 110 Stat. 1541 (1996) (ISA) (reprinted as amended at 50 U.S.C.A. § 1701 note).

⁶⁶⁸National Defense Authorization Act for Fiscal Year 2012, Pub. L. No. 112-81, § 1245, 125 Stat. 1298, 1647–1650 (2011) (NDAA) (codified at 22 U.S.C.A. § 8513a).

⁶⁶⁹Iran Threat Reduction and Syria Human Rights Act of 2012, Pub. L. No. 112-158, 126 Stat. 1214 (2012) (ITRSHRA) (codified in scattered sections of U.S.C.A.).

⁶⁷⁰Iran Freedom and Counter-Proliferation Act of 2012, Subtitle XII(D) of the National Defense Authorization Act for Fiscal Year 2013, H.R. 4310, 112th Cong. (signed Jan. 3, 2013) (IFCPA).

[a] Sanctions Not Specific to Financial Institutions

Section 5 of the ISA, as amended by Section 102 of CISADA, applies to any company that knowingly makes an investment of \$20 million or more that “significantly contributes to the enhancement of Iran’s ability to develop petroleum resources.”⁶⁷¹ CISADA also applies to knowingly entering into any of the following transactions having a fair market value of \$1 million or more or multiple such transactions aggregating to \$5 million or more in a 12-month period:

- Selling, leasing or providing to Iran goods, services, support, information or technology that “could directly and significantly facilitate the maintenance or expansion of Iran’s domestic production of refined petroleum products, including any direct and significant assistance with respect to the construction, modernization, or repair of petroleum refineries.”⁶⁷² Presumably, this would include financing and other banking activities in support of such production.
- Selling refined petroleum products to Iran.⁶⁷³
- Selling, leasing or providing to Iran goods, services, technology, information, or support valued at \$1 million or more that “could directly and significantly contribute to the enhancement of Iran’s ability to import refined petroleum products.”⁶⁷⁴ This specifically includes financing, brokering, insuring or providing shipping for such a sale, lease or provision of goods, services, technology, information or support.⁶⁷⁵

Finally, CISADA imposes sanctions on foreign companies that provide any “goods, services, technology, or other items” to Iran knowing that they can be used to facilitate the development of

⁶⁷¹ISA § 5(a)(1) *as amended by* CISADA § 102(a)(1). The threshold can also be reached by multiple transactions of \$5 million or more aggregating to \$20 million or more in a 12-month period.

⁶⁷²ISA § 5(a)(2) *as amended by* CISADA § 102(a)(1). The threshold can also be reached by multiple transactions aggregating to \$5 million or more in a 12-month period.

⁶⁷³ISA § 5(a)(3)(A)(i) *as amended by* CISADA § 102(a)(1). The threshold can also be reached by multiple transactions aggregating to \$5 million or more in a 12-month period.

⁶⁷⁴ISA § 5(a)(3)(A)(ii) *as amended by* CISADA § 102(a)(1). The threshold can also be reached by multiple transactions aggregating to \$5 million or more in a 12-month period.

⁶⁷⁵ISA § 5(a)(3)(B) *as amended by* CISADA § 102(a)(1).

weapons of mass destruction or advanced conventional weapons.⁶⁷⁶

Sections 201 and 202 of ITRSHRA, enacted in 2012, expand the list of sanctionable activities to include the following:

- Joint ventures with Iran to develop petroleum resources outside Iran.⁶⁷⁷
- Providing goods, services, technology or support having a fair market of \$1 million or more in a single transaction, or \$5 million over a 12 month period, that contribute to the maintenance or enhancement of Iran's ability to develop petroleum resources or export refined petroleum.⁶⁷⁸ Presumably, this could include financing and other financial services.
- Providing goods, services, technology or support having a fair market value of \$250,000 or more in a single transaction, or \$1 million over a 12-month period, that could directly and significantly contribute to the maintenance or expansion of Iran's domestic production of petroleum or petrochemical products.⁶⁷⁹ Again, presumably, this could include financing and other financial services.
- Owning, operating, controlling or insuring a vessel used to transport crude oil from Iran to another country (with exceptions for certain countries),⁶⁸⁰ or concealing the origin of Iranian oil.⁶⁸¹
- Providing insurance, reinsurance or underwriting services for the National Iranian Oil Company or the National Iranian Tanker Company.⁶⁸²
- Purchasing, subscribing to or facilitating the issuance of Iranian sovereign debt.⁶⁸³

ITRSHRA also expands the sanctions for development of weapons of mass destruction, including activities related to the mining, production or transportation of uranium in Iran.⁶⁸⁴ Separately, CISADA and ITRSHRA direct the President to block the property of, or otherwise impose IEEPA sanctions with re-

⁶⁷⁶ISA § 5(b) as amended by CISADA § 102(a)(2).

⁶⁷⁷ISA § 5(a)(4), as added by ITRSHRA § 201(5).

⁶⁷⁸ISA § 5(a)(5), as added by ITRSHRA § 201(5).

⁶⁷⁹ISA § 5(a)(6), as added by ITRSHRA § 201(5).

⁶⁸⁰ISA § 5(a)(7), as added by ITRSHRA § 202(a).

⁶⁸¹ISA § 5(a)(8), as added by ITRSHRA § 202(a).

⁶⁸²ITRSHRA § 212.

⁶⁸³ITRSHRA § 213.

⁶⁸⁴ISA § 5(b)(1) and (2), as amended by ITRSHRA § 203(a).

spect to, any person or entity that engages in certain activities involving Iran. These activities include providing shipping services with respect to transactions contributing to the Government of Iran's activities involving terrorism or weapons of mass destruction, which would appear to include financing services;⁶⁸⁵ engaging in transfers of goods, services or technologies to Iran that are likely to be used to commit human rights abuses;⁶⁸⁶ evading or causing a violation of U.S. sanctions laws with respect to Iran or Syria, including by facilitating violations of those laws by U.S. persons;⁶⁸⁷ or providing financial messaging services to the Central Bank of Iran or other designated Iranian financial institutions.⁶⁸⁸

IFCPA, signed into law in January 2013, continues the trend of expanding sanctions on Iran by adding additional items to the list of sanctionable activities, including:

- Selling, supplying or exporting to Iran significant goods used in the Iranian energy, shipping or shipbuilding industry (with limited exceptions and possible waivers relating to crude oil and natural gas).⁶⁸⁹
- Selling, supplying or exporting to Iran certain industrial materials, specifically graphite, raw or semi-finished metals (such as aluminum and steel), coal, and software for integrating industrial processes.⁶⁹⁰
- Certain underwriting, insurance or reinsurance transactions with respect to Iran.⁶⁹¹

As discussed in Section 13:12[9][b], CISADA, NDAA, ITRSHRA and IFCPA also impose other restrictions and sanctions that are specific to foreign financial institutions. Of the provisions of these laws that apply to foreign companies generally, however, the inclusion in Section 102 of CISADA and Section 201 of ITRSHRA of financing of certain transactions related to Iran's petroleum industry may be of particular concern to a foreign bank. The sanctions that can be imposed on a foreign bank or other company that engages in one of the transactions that these provisions

⁶⁸⁵ITSHRA § 211 (codified at 22 U.S.C.A. § 8721).

⁶⁸⁶CISADA § 105A, *as added by* ITRSHRA § 402 (codified at 22 U.S.C.A. § 8514a).

⁶⁸⁷ITRSHRA § 217(b) (codified at 22 U.S.C.A. § 8724(b)); *see* Exec. Order No. 13608, 77 Fed. Reg. 26,409 (May 1, 2012).

⁶⁸⁸ITSHRA § 220 (codified at 22 U.S.C.A. § 8726).

⁶⁸⁹IFCPA § 1244(d)(1), (3).

⁶⁹⁰IFCPA § 1245(a), (d).

⁶⁹¹IFCPA § 1246.

were meant to deter are particularly severe. Specifically, the laws state that the President must impose at least five of the following sanctions against the foreign person or company that engaged in the transaction with Iran:⁶⁹²

- A prohibition on receiving ExImBank assistance.⁶⁹³
- A prohibition on receiving exports from the United States or of U.S.-origin goods.⁶⁹⁴
- A prohibition on loans from U.S. financial institutions of \$10 million or more in any one year.⁶⁹⁵
- A prohibition on designation as a primary dealer in U.S. government securities or a repository of U.S. government funds.⁶⁹⁶
- A prohibition on entering into any contract to supply goods or services to the U.S. government.⁶⁹⁷
- A prohibition on foreign exchange transactions that are subject to U.S. jurisdiction.⁶⁹⁸
- A prohibition on banking transactions that are subject to U.S. jurisdiction.⁶⁹⁹
- A prohibition on any transaction in property subject to U.S. jurisdiction—in other words, complete blocking under OFAC regulations (*see* Section 13:12[5]).⁷⁰⁰
- A prohibition on any U.S. person investing in the equity or debt of the sanctioned company.⁷⁰¹
- Exclusion of the sanctioned company's officers, principals and controlling shareholders from entry into the United States.⁷⁰²
- Imposition on the principal executive officers of the

⁶⁹²ISA § 5(a)(1)(A), (a)(2)(A), (a)(3)(A), (a)(4)(A), (a)(5)(A), (a)(6)(A), (a)(7)(A), (a)(8)(A), (b)(1), (b)(2)(A), *as amended by* ITRSHRA §§ 201 to 203; IFCPA §§ 1244(d)(1)(A), 1245(a)(1), 1246(a)(1).

⁶⁹³ISA § 6(a)(1), *as renumbered by* CISADA § 102(b).

⁶⁹⁴ISA § 6(a)(2), *as renumbered by* CISADA § 102(b).

⁶⁹⁵ISA § 6(a)(3), *as renumbered by* CISADA § 102(b).

⁶⁹⁶ISA § 6(a)(4), *as renumbered by* CISADA § 102(b).

⁶⁹⁷ISA § 6(a)(5), *as renumbered by* CISADA § 102(b).

⁶⁹⁸ISA § 6(a)(6), *as added by* CISADA § 102(b).

⁶⁹⁹ISA § 6(a)(7), *as added by* CISADA § 102(b).

⁷⁰⁰ISA § 6(a)(8), *as added by* CISADA § 102(b).

⁷⁰¹ISA § 6(a)(9), *as added by* ITRSHRA § 204(a)(2).

⁷⁰²ISA § 6(a)(10), *as added by* ITRSHRA § 204(a)(2).

sanctioned company of any of the sanctions that could be imposed on the company itself.⁷⁰³

- Any other sanctions that can be imposed on a foreign national under the IEEPA by the President of the United States.⁷⁰⁴

[b] Sanctions Specific to Financial Institutions

Separately from the provisions that apply to foreign companies generally, Section 104(c) of CISADA⁷⁰⁵ specifically targets foreign financial institutions that engage in certain dealings with Iran. Section 104(c) applies to the following transactions, if knowingly entered into:

- Facilitating the Iranian government to acquire weapons of mass destruction or delivery systems for weapons of mass destruction.⁷⁰⁶
- Facilitating the Iranian government in assisting a designated foreign terrorist organization.⁷⁰⁷
- Facilitating the activity of a person sanctioned under UN Security Council resolutions dealing with Iran.⁷⁰⁸
- Money-laundering in support of the above-listed activities.⁷⁰⁹
- Facilitating efforts by the Central Bank of Iran to carry out the above-listed activities.⁷¹⁰
- Providing significant services for Iran's Islamic Revolutionary Guard or its agents or affiliates who are blocked by the United States.⁷¹¹
- Providing significant services for Iranian banks that are blocked by the United States.⁷¹²

The NDAA, enacted in 2011, expanded the list of sanctionable transactions by foreign financial institutions to include the following activities:

- Knowingly conducting or facilitating any significant financial transaction with the Central Bank of Iran or an-

⁷⁰³ISA § 6(a)(11), as added by ITRSHRA § 204(a)(2).

⁷⁰⁴ISA § 6(a)(12), as renumbered by ITRSHRA § 204(a)(1).

⁷⁰⁵CISADA § 104 (codified at 22 U.S.C.A. § 8513).

⁷⁰⁶22 U.S.C.A. § 8513(c)(2)(A)(i).

⁷⁰⁷22 U.S.C.A. § 8513(c)(2)(A)(ii).

⁷⁰⁸22 U.S.C.A. § 8513(c)(2)(B).

⁷⁰⁹22 U.S.C.A. § 8513(c)(2)(C).

⁷¹⁰22 U.S.C.A. § 8513(c)(2)(D).

⁷¹¹22 U.S.C.A. § 8513(c)(2)(E)(i).

⁷¹²22 U.S.C.A. § 8513(c)(2)(E)(ii).

other Iranian financial institution designated for sanctions.⁷¹³

- Conducting or facilitating a financial transaction for purchase of petroleum products from Iran, subject to exceptions for certain countries.⁷¹⁴

ITRSHRA, enacted in 2012, did not directly add to the list of sanctionable activities under Section 104 of CISADA, but expanded the scope of the financial institutions subject to those sanctions for those activities. Specifically, ITRSHRA requires the imposition of sanctions not only on a foreign financial institution that directly engages in the activities listed in CISADA Section 104, but also on any foreign financial institution that facilitates, participates in or assists in such activities, or is owned or controlled by a foreign financial institution that does so.⁷¹⁵

Finally, effective July 2, 2013 (180 days after its enactment), IFCPA imposes sanctions on non-U.S. financial institutions that knowingly facilitate or assist three additional types of transactions:

- Any significant transaction for selling, supplying or exporting to Iran significant goods used in the Iranian energy, shipping or shipbuilding industry (with limited exceptions and possible waivers relating to crude oil and natural gas).⁷¹⁶
- Any significant transaction for selling, supplying or exporting to Iran certain industrial materials, specifically graphite, raw or semi-finished metals (such as aluminum and steel), coal, and software for integrating industrial processes.⁷¹⁷
- Any significant transaction with an Iranian person or entity that is on the Specially Designated Nationals List (with limited exceptions and possible waivers relating to humanitarian activities, crude oil and natural gas).⁷¹⁸

If a foreign financial institution is found to have knowingly engaged in a transaction contrary to these provisions, the Secretary of the Treasury is required to prohibit or impose restrictions on the foreign institution's ability to maintain a correspondent or

⁷¹³22 U.S.C.A. § 8513a(d)(1)(A).

⁷¹⁴22 U.S.C.A. § 8513a(d)(4)(C).

⁷¹⁵22 U.S.C.A. § 8513b.

⁷¹⁶IFCPA § 1244(d)(2).

⁷¹⁷IFCPA § 1245(c).

⁷¹⁸IFCPA § 1247(a).

payable-through account in the United States.⁷¹⁹ In 2010, OFAC promulgated the Iranian Financial Sanctions Regulations to implement the restrictions imposed by CISADA.⁷²⁰ The regulations provide that the Secretary of the Treasury can impose an outright ban on the foreign financial institution's opening or maintaining a correspondent account or payable-through account in the United States⁷²¹ or may impose one or more of several restrictions on such account.⁷²² These restrictions can include a ban on providing trade finance through the account, limiting the account to only a certain type of transaction such as personal remittances, placing monetary limits on transactions through the account, or requiring the U.S. financial institution where the account is maintained to preapprove all transactions through the account.⁷²³

A U.S. financial institution (including a branch or subsidiary of a foreign institution) that fails to enforce these restrictions against a foreign financial institution that maintains a correspondent or payable-through account is subject to civil or criminal penalties under IEEPA (*see* Section 13:12[7]).⁷²⁴

Section 104(e) of CISADA requires U.S. financial institutions to make reports or take other specific steps, to be specified in regulations to be issued by the Treasury Department, to ensure compliance by foreign banks for which it maintains correspondent accounts.⁷²⁵ The Treasury, through its Financial Crimes Enforcement Network (FinCEN), has issued regulations implementing CISADA's reporting requirements.⁷²⁶

The regulations authorize FinCEN to request, in writing, that a U.S. bank make inquiries of any specified foreign bank

⁷¹⁹CISADA § 104(c)(1) (codified at 22 U.S.C.A. § 8513(c)(1)); CISADA § 104A, *as added by* ITRSHRA § 216(a) (codified at 22 U.S.C.A. § 8513b); IFCPA §§ 1244(d)(2), 1245(c), 1247(a).

⁷²⁰Iranian Financial Sanctions Regulations, 31 C.F.R. Pt. 561. The regulations were subsequently amended to implement ITRSHRA.

⁷²¹31 C.F.R. § 561.201(c).

⁷²²31 C.F.R. § 561.201(b).

⁷²³31 C.F.R. § 561.201(b).

⁷²⁴22 U.S.C.A. § 8513(c)(3) (2006); 31 C.F.R. § 561.701(a)(1).

⁷²⁵22 U.S.C.A. § 8513(e).

⁷²⁶Financial Crimes Enforcement Network, Comprehensive Iran Sanctions, Accountability, and Divestment Reporting Requirements, 31 C.F.R. Pt. 1060, *adopted by* 76 Fed. Reg. 62,607 (Oct. 11, 2011).

maintaining a correspondent account with a U.S. bank.⁷²⁷ Upon receiving such a request from FinCEN, the U.S. bank is required to obtain a certification from the foreign bank indicating whether, in the 90 days prior to the FinCEN request, the foreign bank maintained a correspondent account for an “Iranian-linked financial institution designated under IEEPA” or otherwise processed fund transfers related to such an institution or related to Iran’s Islamic Revolutionary Guard Corps or any of its designated agents or affiliates.⁷²⁸ The U.S. bank must also request the foreign bank to notify the U.S. bank if at any time within 365 days after its initial response, the foreign bank opens a correspondent account for an Iranian-linked financial institution designated under IEEPA.

For these purposes, “Iranian-linked financial institution designated under IEEPA” means a financial institution specifically designated by OFAC in connection with Iran’s support for international terrorism or proliferation of weapons of mass destruction or delivery systems for weapons of mass destruction.⁷²⁹ These institutions can be identified by the designation “IFSR” in their listing in OFAC’s master list of Specially Designated Nationals and Blocked Persons (SDN list).⁷³⁰ Designated agents and affiliates of the Islamic Revolutionary Guard Corps can be identified by the designation “IRGC” in their listing on the SDN List.⁷³¹ It seems likely that FinCEN will expand these requirements to cover additional Iranian financial institutions once the financial institution provisions of IFCPA go into effect in July 2013.⁷³²

After receiving an inquiry from FinCEN, the U.S. bank has to report back to FinCEN on the results of its inquiries of the foreign

⁷²⁷31 C.F.R. § 1060.300(a)(1).

⁷²⁸31 C.F.R. § 1060.300(b).

⁷²⁹31 C.F.R. § 1060.300(a)(2).

⁷³⁰Financial Crimes Enforcement Network, Comprehensive Iran Sanctions, Accountability, and Divestment Reporting Requirements, Supplementary Information, 76 Fed. Reg. 62,607, 62,613 (Oct. 11, 2011).

⁷³¹Financial Crimes Enforcement Network, Comprehensive Iran Sanctions, Accountability, and Divestment Reporting Requirements, Supplementary Information, 76 Fed. Reg. 62,607, 62,618 (Oct. 11, 2011).

⁷³²See IFCPA § 1247(a) and (b) (imposing sanctions on foreign financial institutions who have engaged in transactions with Iranian persons on the Specially Designated Nationals List, other than Iranian financial institutions designated for the imposition of sanctions in connection with Iran’s support for international terrorism, proliferation of weapons of mass destruction or delivery systems for weapons of mass destruction, or abuses of human rights).

bank, to the best of U.S. bank's knowledge, within 30 days of FinCEN's request.⁷³³ If the U.S. bank subsequently receives new information from the foreign bank, it will have 10 days to submit a supplemental report to FinCEN.⁷³⁴ U.S. banks that fail to comply with the regulations may be subject to civil or criminal penalties.⁷³⁵

Finally, Section 104(d) of CISADA prohibits any foreign financial institution that is owned or controlled by a U.S. financial institution from doing business with Iran's Islamic Revolutionary Guard Corps or any of its agents or affiliates who are listed on OFAC's Specially Designated Nationals List.⁷³⁶ In the event of a violation, the U.S. parent financial institution is subject to civil but not criminal penalties under IEEPA if it knew or should have known of the violation by its foreign subsidiary (*see* Section 13:12[7]).⁷³⁷ The statute and regulations, however, do not explicitly provide for IEEPA penalties to be imposed against the foreign subsidiary itself for violation of CISADA Section 104(d) or its implementing regulation,⁷³⁸ and as a result it appears that the penalties could only be imposed against the U.S. parent company. The foreign subsidiary nonetheless could be subject to restrictions on maintaining correspondent or payable-through accounts.⁷³⁹

§ 13:13 Conclusion

The enactment of the USA PATRIOT Act marked a significant point in the ongoing development of the anti-money laundering regime in the United States. Although banking institutions in the United States were already subject to regulatory requirements to maintain an anti-money laundering program and a suspicious activity reporting program, the USA PATRIOT Act served to intensify the regulatory and law-enforcement focus on these requirements. In addition, the USA PATRIOT Act imposed new statutory requirements on banking institutions such as record-keeping requirements and specific due diligence and enhanced due diligence requirements with respect to foreign cor-

⁷³³31 C.F.R. § 1060.300(c)(2)(i).

⁷³⁴31 C.F.R. § 1060.300(c)(2)(ii).

⁷³⁵22 U.S.C.A. § 8513(e)(2) (2006) (making noncompliance subject to penalties in 31 U.S.C.A. §§ 5321(a), 5322).

⁷³⁶22 U.S.C.A. § 8513(d)(1) (2006); 31 C.F.R. § 561.202.

⁷³⁷22 U.S.C.A. § 8513(d)(2) (2006); 31 C.F.R. § 561.701(a)(2).

⁷³⁸22 U.S.C.A. § 8513(d); 31 C.F.R. § 561.202.

⁷³⁹31 C.F.R. § 561.201(b) and (c).

respondent accounts and foreign private banking accounts. Although certain of these new statutory requirements reflected prior supervisory practice in the United States, the codification of the requirements in statute raised the prospect that the requirements would become inflexible and prescriptive. In the rule-making processes under the USA PATRIOT Act, the Treasury and FinCEN have generally been responsive to the idea that the implementing regulations should be risk-based to provide financial institutions the flexibility to tailor their programs to their individual risk profile. As a result, the regulations implementing the USA PATRIOT Act incorporate both prescriptive and risk-based elements.

Financial institutions should be wary of taking too much comfort from the substitution of a risk-based approach for a prescriptive approach. The expectations of the regulatory and law-enforcement authorities have steadily increased since the enactment of the USA PATRIOT Act. Best practices in the financial industry have also rapidly evolved. Banking institutions will be at risk if they fail to measure their own programs against the best practices in the industry. Banking institutions must also be alert to any guidance issued by the bank regulatory authorities or FinCEN. In a risk-based regime, guidance from the regulatory authorities must substitute for the specificity (and prescription) that would otherwise be provided by a rules-based regime. Banking institutions must also be alert to the actions of the regulatory and law-enforcement authorities. Recent regulatory enforcement orders reflect a continuing focus on robust anti-money laundering controls, including detailed customer due diligence and systematic monitoring of accounts.

The requirements of the USA PATRIOT Act present special challenges for foreign banks operating in the United States because many of their business lines will involve cross-border customers and transactions. The incidence of formal enforcement actions in the form of written agreements and cease and desist orders against branches of foreign banks suggests that their natural lines of business fall within the areas of high perceived risk such as foreign correspondent banking and foreign private banking. Robust anti-money laundering controls and monitoring must surround each of these high-risk areas, including transactions on behalf of other offices or affiliates of the foreign bank.

Paralleling the heightened focus on U.S. anti-money laundering measures is the heightened prominence accorded the U.S. economic sanctions regime, particularly with respect to sanctions against countries and parties suspected of terrorist or other

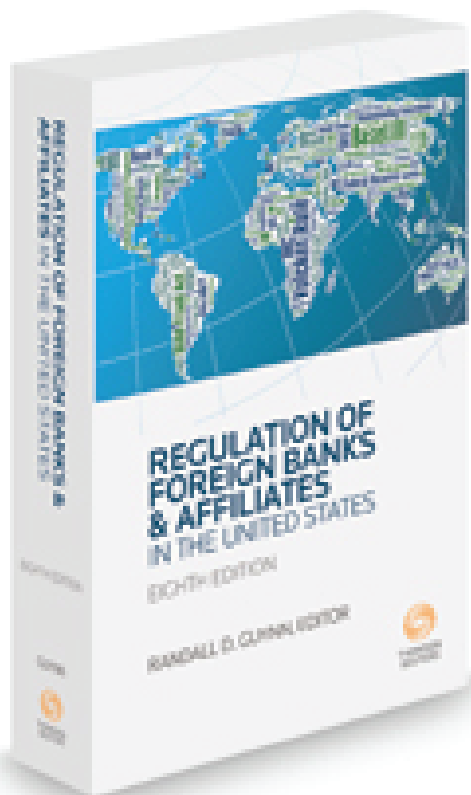
activities related to the proliferation of weapons of mass destruction. U.S. law-enforcement and regulatory authorities have significantly expanded their focus on sanctions compliance and extended their scrutiny to U.S. dollar transactions wherever initiated. Foreign banks involved in processing U.S. dollar transactions must implement comprehensive OFAC screening and compliance programs. The enactment of CISADA in 2010, NDAA in 2011, ITRSHRA in 2012, and IFCPA in 2013 represents a further expansion of the Iranian sanctions regime by expressly imposing sanctions on foreign parties that engage in certain activities related to the development of Iranian petroleum resources or Iranian development of nuclear or other advanced weapons and on foreign financial institutions that provide services to the designated Iranian entities. The breadth of the U.S. economic sanctions regime continues to expand, creating ever greater exposure particularly for foreign financial institutions.

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