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Joint Fact Sheet on Foreign Correspondent Banking Supervision and Enforcement

U.S. Department of Treasury and Federal Banking Agencies Issue Joint Fact Sheet Aimed at Dispelling “Myths” About U.S. BSA/AML and Sanctions Supervisory Expectations and Enforcement Approach for Correspondent Banking

SUMMARY

On August 30, 2016, the U.S. Department of the Treasury (the “Treasury”) and the federal banking agencies (the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, and Office of the Comptroller of the Currency) (collectively the “Federal Banking Agencies” and, together with the Treasury, the “Agencies”) issued a Joint Fact Sheet on Foreign Correspondent Banking (the “Fact Sheet”).[1] The Fact Sheet, accompanied by a Treasury blog post issued the same day, is aimed at dispelling two “myths”[2] about U.S. supervisory expectations that some believe are contributing to the so-called “de-risking” phenomenon. Those myths are: (1) U.S. banks are expected to conduct due diligence on the individual customers of the foreign banks for which they provide correspondent services, *i.e.*, that they must “know” their “customers’ customers”; and (2) the Bank Secrecy Act/anti-money laundering (“BSA/AML”) and Office of Foreign Assets Control (“OFAC”) sanctions enforcement regime is one of “zero tolerance,” *i.e.*, one in which any misstep will result in a public enforcement action. The de-risking in question involves U.S. banks terminating correspondent banking services for all (or most) banks from certain countries because of money laundering and sanctions risks in those countries. The Fact Sheet appears to be responsive to sharp criticism of the de-risking approach by the IMF, legislators, and others.

Various aspects of the Fact Sheet, however, may fail to persuade U.S. banks to discontinue, or reverse, their de-risking efforts. One such factor is the absence of three important constituencies from

involvement in the issuance: the U.S. Department of Justice, state and local criminal authorities, and state bank regulatory authorities. Each has been aggressively pursuing violations related to BSA/AML and OFAC sanctions program compliance. A second factor is the often highly qualified language of the Fact Sheet as described below.

In summary, although the Fact Sheet undoubtedly represents an attempt to provide some helpful assurance, it may be unlikely, without more, to arrest the de-risking phenomenon to any significant extent.

BACKGROUND

Through correspondent banking relationships, banks around the globe are able to meet the cross-border banking needs of their customers, particularly for transactions denominated in U.S. dollars (which remains the global currency of choice).[3] For this and other reasons, foreign correspondent banking plays a vital role in international trade, finance, and development. At the same time, however, foreign correspondent banking relationships present a variety of risks. A foreign bank may not be subject to the same strict legal and regulatory standards and oversight as the U.S. bank providing correspondent services, and the U.S. bank typically has no relationship with the foreign bank's customers. As a result, both institutions may be vulnerable to money laundering, terrorist financing, sanctions violations, and other illicit transactions. For this reason, U.S. banks that offer correspondent banking services to foreign banks are expected to have BSA/AML and OFAC compliance programs appropriate to address the risks presented by those relationships.

Over the past decade, government authorities, the banking industry, and multinational bodies have issued multiple guidance addressing measures financial institutions should properly take to identify, monitor, and control the money laundering, terrorist financing, and sanctions risks associated with foreign correspondent banking.[4] At the same time, U.S. banks and foreign depository institutions operating in the U.S. have become subject to increasingly severe public enforcement measures for BSA/AML and OFAC program-related lapses in conducting their correspondent banking business. In some instances, these enforcement measures have led U.S. banks to conclude that they are expected to conduct at least some level of due diligence regarding the individual customers of the foreign banks for which they provide correspondent services.

Today, a civil money penalty in the hundreds of millions of dollars, or even billions of dollars, and a related criminal action—both of which would have been almost unimaginable a decade ago—are very real prospects in the face of BSA/AML or sanctions program deficiencies that U.S. government authorities deem sufficiently serious. Those highly publicized enforcement measures remain the principal—if not only—metric available to U.S. banks in assessing the consequences of BSA/AML or sanctions missteps. It is against this backdrop that an institution must weigh the risks, costs and benefits of providing correspondent banking services to foreign banks perceived to be higher risk. With those considerations in mind, some U.S. banks have determined that the substantial enforcement risks and significant compliance costs associated with providing such services must be weighted heavily when deciding whether to continue to do business with higher-risk foreign banks.

At least in part due to this imbalance, some U.S. banks have chosen to exit the correspondent banking line of business—or de-risk—rather than face the potential repercussions of non-compliance with regulatory and supervisory expectations that often seem increasingly difficult to achieve. As noted above, U.S. regulators, legislators and international organizations have expressed concerns over, and urged financial institutions to avoid, de-risking. In late May, a bipartisan coalition of U.S. Senators sent a letter to the Office of the Comptroller of the Currency (the "OCC") urging it to address de-risking, and in early July a group of Republican U.S. Representatives asked the Treasury's Inspector General to examine the OCC's execution of BSA/AML and OFAC and other sanctions compliance in light of the de-risking trend. Later that same month, Christine Lagarde, Managing Director of the International Monetary Fund, in a speech at the Federal Reserve Bank of New York, highlighted the significant adverse global implications of the decline in correspondent banking relationships, although recognizing that the possibility of large penalties and the reputational risk associated with enforcement actions addressing BSA/AML and sanctions concerns, coupled with the considerable uncertainty among banks concerning their regulatory obligations, may mean that the decline "simply reflect[s] rational business decisions."[5] Ms. Lagarde, like others before her, recognized the need for regulators to "clarify—and consistently communicate—regulatory expectations." This need was similarly recognized in the August 25 progress report to the G20 on the Financial Stability Board's action plan to assess and address the decline in correspondent banking.[6]

KNOWING YOUR CUSTOMERS' CUSTOMERS

The Fact Sheet specifically states, apparently for the first time in explicit guidance developed by the Agencies, that, "[u]nder existing U.S. regulations, there is no general requirement for U.S. banks to conduct due diligence on a [foreign bank customer's] customers."[7] Rather, a U.S. bank must conduct due diligence sufficient to assess the risks posed by the relationship and to "satisfy the institution's obligations to detect and report suspicious activity, and comply with U.S. economic sanctions."

At first blush, this statement appears to address directly the concern that U.S. banks offering foreign correspondent banking services must know their foreign bank customers' customers. On closer inspection, however, we believe it fails to address key aspects of the issue.

- The concern is not that U.S. regulations (or law) require U.S. banks to conduct due diligence on a foreign bank customer's customer as existing regulations specifically impose no such requirement. The concern is with the *absence* of guidance or regulations explaining how a U.S. bank is expected to monitor foreign correspondent banking transactions at the entity level (*i.e.*, including the foreign bank customer's customers) and obtain sufficient information to comply with suspicious activity reporting rules and sanctions compliance obligations.
- The Fact Sheet arguably perpetuates this uncertainty in stating that, in order to comply with suspicious activity reporting rules and sanctions compliance obligations, an institution may need

to secure information related not only to the foreign bank customer's markets and types of customers, but also "additional information concerning the activity *underlying the [foreign bank's] transactions*" (emphasis added). In the absence of greater specificity as to regulatory expectations relating to the transactions of the foreign bank customer's customers, the de-risking phenomenon is likely to continue.

- The Fact Sheet also does not address the significant challenges banks face in obtaining access to information about the foreign bank customer's customers under local data privacy and bank secrecy laws, particularly in countries with strict adherence to bank secrecy.

ZERO TOLERANCE REGIME

Although U.S. authorities have repeatedly stated that the U.S. BSA/AML and OFAC enforcement regime is not one of zero tolerance,[8] the Fact Sheet appears to represent the Agencies' first collective effort to dispel this "myth." In the Fact Sheet, they endeavor to do so by briefly describing (a) the Federal Banking Agencies' risk-based approach to supervision and the resolution of BSA/AML and OFAC deficiencies during that process, (b) the situations in which the Federal Banking Agencies take enforcement action, (c) the role the Financial Crimes Enforcement Network ("FinCEN") and OFAC play, and (d) recent large enforcement actions by the Federal Banking Agencies, FinCEN and OFAC. In the context of these discussions, the Agencies cite several statistics as evidence that the U.S. regime is in fact *not* one of zero tolerance. Nonetheless, language in the Fact Sheet may not dispel the concern of U.S. financial institutions about the risk of severe sanctions for BSA/AML and OFAC lapses in the context of correspondent banking.

First, according to the Fact Sheet, "[t]he vast majority of BSA/AML compliance deficiencies identified by the [Federal Banking Agencies]—approximately 95%—are resolved through the supervisory process without the need for an enforcement action."

- This statistic, although intended to demonstrate the absence of a zero tolerance regime, does not present a realistic picture of enforcement risk. The Federal Banking Agencies examine thousands of financial institutions annually, only a very small percentage of which—generally, large U.S. banks with a global presence—engage in foreign correspondent banking. A realistic picture of enforcement risk is presented only by identifying the percentage of *those* institutions that are subject to enforcement actions for BSA/AML compliance deficiencies and the percentage of BSA/AML enforcement actions that relate to foreign correspondent banking. Almost certainly the numbers would be much higher.

Second, the Fact Sheet explains that enforcement actions by the Federal Banking Agencies are an "extension of the supervisory process and are used to address more serious deficiencies or situations where deficiencies have not been corrected in the course of the supervisory process. … In very limited instances, when corrective action has not been achieved within a reasonable amount of time or serious violations or unsafe or unsound practices or breaches of fiduciary duty have been identified, the [Federal Banking Agencies] also have the authority to assess civil money penalties[.]"

- Although the use of terms such as "more serious deficiencies," "very limited instances," "reasonable amount of time," and "serious violations" were almost certainly intended to dispel notions of zero tolerance, the Fact Sheet does not explain what those terms mean or the circumstances in which they are triggered.

Third, the Fact Sheet states that "the largest and most prominent monetary penalties for BSA/AML and sanctions violations in recent years *generally* involved a sustained pattern of serious violations on the part of depository institutions[,]" while the sanctions cases "*generally* involved intentional evasion of U.S. sanctions over a period of years and/or the failure of the institutions' officers and/or senior management to respond to warning signs that their actions were illegal" (emphases added). According to the Fact Sheet, many of these major cases also involved criminal conduct that was prosecuted separately by the U.S. Department of Justice, and "[c]riminal prosecutions for BSA/AML and sanctions violations are *typically* brought against financial institutions only when there is sufficient evidence of willful wrongdoing" (emphasis added).

- Much like the prior observation, although almost certainly intended to dispel notions of zero tolerance, the repeated use of qualifying terms such as "generally" and "typically" reduce the level of comfort for financial institutions. The use of those terms suggests that there are circumstances in which action is taken even where there is no "sustained pattern," "intentional evasion," or "willful wrongdoing."

IMPLICATIONS

The Fact Sheet represents the latest—and perhaps most significant—effort by the Agencies to counter criticisms that unclear or inconsistent government expectations, particularly as they relate to the extent to which U.S. banks providing correspondent banking services must know their customers' customers and zero tolerance approach, are contributing to the de-risking phenomenon. In view, however, of the frequent use of qualifying language and the absence of participation by the U.S. Department of Justice, state and local criminal authorities, and state bank regulatory authorities, the Fact Sheet may not serve as a sufficient basis for U.S. banks to change their views concerning enforcement risk associated with BSA/AML and OFAC lapses.

Clients interested in further information concerning the Fact Sheet, and BSA/AML and sanctions developments generally, are encouraged to contact Sullivan & Cromwell lawyers identified at the end of this memorandum.

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ENDNOTES

1 *See* U.S. Department of the Treasury and Federal Banking Agencies Joint Fact Sheet on Foreign Correspondent Banking: Approach to BSA/AML and OFAC Sanctions Supervision and Enforcement (Aug. 30, 2016), available at https://www.treasury.gov/press-center/press-releases/Pages/jl0541.aspx.

2 *See* Treasury Notes, Complementary Goals—Protecting the Financial System from Abuse and Expanding Access to the Financial System, by Nathan Sheets, Adam Szubin, and Amias Gerety, August 30, 2016, available at https://www.treasury.gov/connect/blog/Pages/Complementary-Goals---Protecting-the-Financial-System-from-Abuse-and-Expanding-Access-to-the-Financial-System.aspx.

3 In a typical foreign correspondent banking relationship, one bank provides an account to a foreign bank through which third-party payments, cash clearing, or other transactions are executed in a particular currency. The first bank effectively acts as an intermediary for the foreign bank, allowing the foreign bank to execute transactions for the foreign bank's customers. That foreign bank may be unaffiliated with the bank providing the services, or it may be an affiliate, subsidiary or branch of that bank. In either case, the correspondent banking relationship permits the foreign bank to access financial services in jurisdictions in which it does not operate and provide cross-border payment services to its customers.

4 *See*, *e.g.*, Wolfsberg Anti-Money Laundering Principles for Correspondent Banking, The Clearing House's Guiding Principles for Anti-Money Laundering Policies and Procedures in Correspondent Banking, the Financial Action Task Force's standards on correspondent banking (Recommendation 13), the Basel Committee on Banking Supervision's Customer Due Diligence for Banks, and the Federal Financial Institutions Examination Council's Bank Secrecy Act/Anti-Money Laundering Examination Manual.

5 Speech By Christine Lagarde, Managing Director of the International Monetary Fund, Relations in Banking—Making it Work for Everyone (July 18, 2016), available at http://www.imf.org/en/News/Articles/2016/07/15/13/45/SP071816-Relations-in-Banking-Making-It-Work-For-Everyone. *See also* International Monetary Fund Staff Discussion Note, The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action.

6 Financial Stability Board, Progress report to G20 on the FSB Action Plan to Assess and Address the Decline in Correspondent Banking (Aug. 25, 2016), available at http://www.fsb.org/wp-content/uploads/Progress-report-to-G20-on-the-FSB-action-plan-to-assess-and-address-the-decline-in-correspondent-banking.pdf.

7 Government officials have, however, publicly stated that there is no obligation under the BSA to know a customer's customer. *See*, *e.g.*, Remarks of Jennifer Shasky Calvery, Director of the Financial Crimes Enforcement Network, at the ABA/ABA Money Laundering Enforcement Conference (Nov. 16, 2015), available at https://www.fincen.gov/news_room/speech/html/20151116.html.

8 *See*, *e.g.*, Opening Remarks of Under Secretary for Terrorism and Financial Intelligence David S. Cohen at the Treasury Roundtable on Financial Access for Money Services Businesses (Jan. 13, 2015), available at https://www.treasury.gov/press-center/press-releases/Pages/jl9736.aspx; Remarks By Acting Under Secretary Adam Szubin At The ABA/ABA Money Laundering Enforcement Conference (Nov. 16, 2015), available at https://www.treasury.gov/press-center/press-releases/Pages/jl0275.aspx.

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