September 1, 2016

Treasury and Federal Banking Agencies Clarify BSA/AML and Sanctions Enforcement Standards for Foreign Correspondent Banking Relationships

On August 30, 2016, the U.S. Department of the Treasury, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency, issued a *Joint Fact Sheet on Foreign Correspondent Banking: Approach to BSA/AML and OFAC Sanctions Supervision and Enforcement*.[1] The Fact Sheet seeks to clarify certain aspects of federal supervision and enforcement with respect to foreign correspondent banking relationships. While the New York State Department of Financial Services ("DFS") recently issued a final rule governing the Bank Secrecy Act ("BSA"), anti-money laundering laws ("AML") and sanctions screening,[2] the Fact Sheet pertains only to Treasury and federal banking agencies.

Although not addressing the phenomenon of "de-risking" per se, the Fact Sheet was issued against a backdrop of concern over U.S. financial institutions broadly terminating correspondent relationships with jurisdictions thought to pose heightened risks. The Fact Sheet also comes at a time when financial institutions are contemplating implementation of new rules promulgated by the Financial Crimes Enforcement Network ("FinCEN") regarding customer due diligence, and banks subject to DFS oversight are considering the implications of the new DFS final rule governing AML/sanctions noted above.[3]

A blog post published on the Treasury Department website the same day the Fact Sheet was issued characterized correspondent banking relationships as "important arteries within the global financial system" and noted that the Fact Sheet is intended to "dispel certain myths" about OFAC's and federal banking agencies' expectations regarding correspondent banking.[4] The blog post was co-authored by Adam Szubin, Treasury's Acting Under Secretary for Terrorism and Financial Intelligence, who oversees both OFAC and FinCEN.

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1 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* http://www.ots.treas.gov/topics/compliance-bsa/foreign-correspondent-banking-fact-sheet.pdf

2 New York State Department of Financial Services Regulations Part 504 – Banking Division Transaction Monitoring and Filtering Program Requirements and Certifications, *available at* http://www.dfs.ny.gov/legal/regulations/adoptions/dfsp504t.pdf. For Paul, Weiss's Client Memorandum discussing the DFS rule, please see *New York DFS Finalizes Stringent Anti-Money Laundering and Sanctions Regulation* (July 1, 2016), https://www.paulweiss.com/media/3611359/1jul2016dfssanctions.pdf.

3 Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 91, 29,398–29,458 (May 11, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-05-11/pdf/2016-10567.pdf

4 Nathan Sheets, Adam Szubin & Amias Gerety, *Complementary Goals – Protecting the Financial System from Abuse and Expanding Access to the Financial System*, TREASURY NOTES (Aug. 30, 2016), https://www.treasury.gov/connect/blog/Pages/Complementary-Goals---Protecting-the-Financial-System-from-Abuse-and-Expanding-Access-to-the-Financial-System.aspx

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Governing Standards for Assessing and Managing Risks Posed by Foreign Correspondent Accounts

The Fact Sheet explains that U.S. banks (including foreign bank branches operating in the U.S.) that maintain foreign correspondent accounts are required to establish "appropriate, specific, and risk-based due diligence policies, procedures, and processes that are reasonably designed to assess and manage the risks inherent with these relationships." U.S. banks are expected to undertake appropriate customer due diligence to form a "clear understanding" of a foreign bank's risk profile and expected account activity, including by obtaining sufficient information about the types of customers served by a foreign bank, the markets in which it operates, and the supervisory regime of the jurisdiction in which the foreign bank is licensed. This information will allow a U.S. bank to assess the risks presented and determine the level and nature of suspicious activity monitoring needed to manage those risks effectively.

The Fact Sheet notes that "there is no general requirement for U.S. depository institutions to conduct due diligence on a [foreign bank's] customers." However, the risk factors associated with particular correspondent accounts may require U.S. banks to request additional information concerning the activity underlying the foreign bank's transactions "in accordance with the suspicious activity reporting rules and sanctions compliance obligations."

Federal Enforcement Approach to BSA/AML and Sanctions Violations

The overarching message of the Fact Sheet is that Treasury and the federal banking agencies do not employ a "zero tolerance" approach to enforcing BSA/AML laws or U.S. sanctions programs that would require them to bring enforcement actions regardless of the facts and circumstances of a particular situation.

The Fact Sheet also seeks to put into context the circumstances under which financial institutions might face civil money penalties or criminal prosecution for violating BSA/AML laws or sanctions programs. The Fact Sheet states that approximately 95 percent of the deficiencies identified at U.S. depository institutions by federal banking agencies are resolved through their supervisory processes, without any penalty or enforcement action. Enforcement actions, which can take a variety of forms, are used to address "more serious deficiencies" or situations in which "deficiencies have not been corrected in the course of the supervisory process." Similarly, over 95 percent of sanctions investigations by OFAC are closed with administrative measures, such as a cautionary or no action letter, rather than a civil money penalty or other public enforcement response.

The Fact Sheet recognizes that, "[o]ver the past several years, certain major enforcement cases involved large enforcement penalties related to BSA/AML and OFAC sanctions." The "largest and most prominent" of these cases, the Fact Sheet notes, generally involved a "sustained pattern of serious violations on the part of depository institutions." And with regard to sanctions violations, these cases did

not "involve unintentional mistakes, but 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." Similarly, the U.S. Department of Justice typically brings criminal actions for BSA/AML and sanctions violations only where there is "sufficient evidence of willful wrongdoing."

Conclusion

The Fact Sheet provides a useful summary of the federal compliance expectations faced by U.S. banks that engage in foreign correspondent banking. The Fact Sheet also provides a helpful overview of how federal agencies approach enforcement decisions in the BSA/AML and sanctions space. Notably, the Fact Sheet does not address state-level enforcement related to BSA/AML and OFAC sanctions or the level of coordination between federal and state agencies. The DFS's recent $180 million penalty against Taiwan-based Mega Bank and its New York branch for BSA/AML and sanctions compliance program deficiencies is an important reminder that federal agencies are only part of the regulatory and enforcement environment in which many U.S. banks operate.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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