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Expert Analysis

Foreign Banks Challenge FinCEN Anti-Money Laundering Efforts

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Anti-money laundering (AML) is one of the most dominant international legal issues of the day. Countries have dramatically increased AML efforts, requiring financial firms to spend tremendous amounts of time and money on compliance. Although banks may lament the expense—and the fact that such efforts do not guarantee success or at least protect banks from prosecution—two recent actions reveal just how serious the risks can be in failing to comply with AML measures. In each action, foreign banks resorted to suing the U.S. Treasury's Financial Crime Enforcement Network (FinCEN) to try to stop it from barring them from the U.S. financial system. These cases illustrate the powerful tools available to FinCEN and other regulators and re-emphasize the need for serious AML compliance. But they also may signal increased judicial scrutiny of FinCEN's powers.

The 'Fifth Special Measure'

Pursuant to Section 311 of the PATRIOT Act of 2001 (31 U.S.C. §5318A), the Treasury can designate certain foreign financial institutions, accounts, or even jurisdictions as being "of primary money laundering concern," and take action against them. The Treasury Secretary has delegated authority under this statute to FinCEN. FinCEN need only find that "reasonable grounds exist for concluding" that the jurisdiction or institution is of primary money laundering concern. It can then require domestic financial institutions such as banks and other financial institutions to take "special measures" regarding such entities.

Upon such a finding, FinCEN can propose five possible special measures. The first four generally require institutions to provide additional information about transactions. But the dreaded "fifth special measure" permits FinCEN—in consultation with the other federal authorities—to require domestic financial institutions to prohibit "the opening or maintaining in the United States of a correspondent account…by any domestic financial institution or domestic financial agency" on behalf of the foreign bank."[1] Such a finding essentially freezes a foreign institution out of the American banking system. If a significant percentage of the institution's transactions are dollar-denominated, this measure can put the institution out of business.

The fifth special measure is a peculiar—and powerful—tool because it is not achieved by success in court, but rather is imposed through administrative rulemaking. As with other agency rulemaking, FinCEN must provide notice of its findings and proposed rule. The rule, however, becomes the sanction freezing the firm out of the U.S. In short, FinCEN can shut down a foreign bank without even going to court.

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Moreover, FinCEN can make a finding as to an entire country. In 2002, it found that Ukraine was of primary money laundering concern, although it did not announce a proposed rule enacting a special measure. FinCEN rescinded the finding four months later after Ukraine improved its AML enforcement, but FinCEN had apparently succeeded in unilaterally forcing policy changes within a foreign country.

FinCEN, to its credit, has used its power sparingly, with only about 20 such proceedings commenced since the law was passed.[2] Moreover, many of the jurisdictions involved in these actions, such as Syria, Burma and Iran, read like a Who's Who of international troublespots. Further, in a handful of instances, FinCEN has rescinded proposed rules that would have imposed special measures after the bank or jurisdiction took remedial measures.

Yet, two recent actions challenging FinCEN's exercise of authority reveal the disadvantages foreign banks can face on the way to being shut out of the U.S. financial system. They also underscore that a mere finding concerning a foreign firm can put domestic firms in a difficult position. These actions, however, may also signal increased judicial skepticism of FinCEN's rulemaking.

FBME Bank Ltd.

In July 2014, FinCEN announced its finding that FBME Bank Ltd. was of primary money laundering concern.[3] FBME has a checkered past. Founded in Cyprus in 1982 as the Federal Bank of the Middle East, it changed its incorporation to the Caymans in 1986, but then left for Tanzania after failing to meet Cayman capital requirements. In 2005, it changed its name to FBME and became the largest bank in Tanzania by asset amount. Despite its incorporation in Tanzania, 90 percent of its business was conducted in Cyprus, where it got into trouble under Cypriot banking laws.

According to FinCEN, FBME accesses the U.S. financial system via correspondent accounts with U.S. institutions and uses such access to engage in hundreds of millions of dollars in suspect wire transfers. FinCEN alleges that FBME's deficient AML controls allow customers to engage in "money laundering, terrorist financing, transnational organized crime, fraud, sanctions evasion, and other illicit activity." FinCEN's notice describes specific transactions that involve, among other things, stock fraud, financing Hezbollah and cybercrime. FinCEN also alleges that FBME allowed customers, including a Syrian distributor of weapons of mass destruction, to circumvent U.S. economic sanctions.

Pursuant to Section 311, FinCEN also published a proposed rule imposing a fifth special measure on FBME, which would exclude it from the U.S. financial system.[4] The proposed rule walks through the Section 311 factors, and notes that the rule will not propose "an undue regulatory burden" because FBME currently has an account at only one domestic firm. Like a typical rule, the notice invites comments during a 60-day period. FinCEN's press release, however, notes that the findings are

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effective immediately, and that "U.S. financial institutions should take this information into account as part of their overall risk management programs."[5]

FinCEN considered the comments made by FBME, as well as other information, and on July 23, 2015, promulgated the final rule imposing the fifth special measure. The rule would have become effective on Aug. 28, 2015, but FBME sued FinCEN in the U.S. District Court for the District of Columbia and sought a preliminary injunction against enforcement.[6]

FBME asserted three claims.[7] The first was that FinCEN violated the Administrative Procedure Act (APA) by failing to give FBME sufficient notice of the factual and legal basis for the rule. FBME asserted that FinCEN withheld three categories of documents: (1) classified information, (2) non-public Suspicious Activity Reports (SARs) and (3) information that was neither classified nor secret. The court held that FinCEN could withhold the first two categories because the Patriot Act specifically contemplates FinCEN's reliance on undisclosed classified information, and because FinCEN provided detailed descriptions of the SARs. The third category consisted of news articles describing Cyprus and an FBME transaction, as well as a blog post describing an investigation of cybercrimes. The court held that FBME had no notice of these allegations and thus no opportunity to challenge them.

FBME's second claim asserted that FinCEN acted in an arbitrary and capricious manner by not properly considering its comments or applying the statutory factors. FBME also asserted that the sanction was excessive and FinCEN did not consider less severe but permissible alternatives, such as imposition of a monitor. While the court agreed that imposition of the fifth special measure was not arbitrary or capricious, it held that FinCEN should have considered such alternatives.

The court explained that FinCEN could, for example, impose conditions on maintaining correspondent accounts that would achieve FinCEN's goals without shutting FBME out of the U.S. financial system. The court added, "And given how rarely the fifth special measure is imposed, as well as the unusual procedural character of agency action Section 311 calls for, it was incumbent upon the agency, in the Court's view, to consider alternative forms the fifth special measure might take."

The court rejected the bank's other arguments and did not reach its third claim, asserting that its due process rights had been violated. But the court granted FBME's request for a preliminary injunction based on a likelihood of success on the merits of the first and second claims. In short, the court held that the bank did not get a fair chance to oppose FinCEN's decision to shut it out of the financial system. Underlying the court's reasoning was an apparent concern over Section 311's unusual procedures and arguably due process under this powerful statute. FinCEN has now moved to remand and stay the action pending additional notice and comment proceedings to address the court's concerns. FBME opposes the motion, arguing that the court should proceed to judgment, rather than allow FinCEN to perform a "do over." The bank accuses FinCEN of "pushing the eject button only when staring at an adverse final judgment."[8]

Banca Privada d'Andorra

FBME is not the only bank resisting FinCEN's special measures. In March 2015, FinCEN announced its finding that Banca Privada d'Andorra (BPA) is of primary money laundering concern and proposed the fifth special measure.[9] The fourth largest of five banks in Andorra, BPA had correspondent banking business in North America, Europe and Asia, and four correspondent accounts with U.S. institutions. FinCEN's finding accuses unnamed but designated BPA managers of facilitating billions of dollars in money laundering for Venezuelan money laundering networks, Russian organized crime figures, the Sinaloa Cartel, and a Chinese businessman accused of human trafficking.

FinCEN's actions come after years of investigations and arrests by Spanish and other authorities combating Russian organized crime. And just last week reports emerged that U.S. authorities are now investigating Venezuela's state-owned oil giant, Petróleos de Venezuela, for schemes involving BPA.[10]

Interestingly, FinCEN's finding concedes that BPA offers legitimate banking services, but adds that "[i]t is difficult to assess on the information available the extent to which BPA is used for legitimate business purposes." The proposed rule states, "any impact on the legitimate business activities of BPA is outweighed by the need to protect the US financial system."[11]

On Oct. 7, 2015, BPA commenced an action against FinCEN in the District of Columbia.[12] The complaint accuses FinCEN of cherry-picking a handful of incidents that BPA discovered and self-reported, and using them as the basis for the finding. Further, it accuses FinCEN of using BPA as a pawn, with the finding and proposed rule only announced to force Andorran authorities to enact banking reforms that the United States had been pushing. In addition, BPA, likely noting the preliminary injunction in the FBME action, also accuses FinCEN of failing to explain why it proceeded straight to the fifth special measure. Finally, BPA strikes a populist note, pointing out that many major international banks have settled massive money laundering investigations without FinCEN essentially killing them with the fifth special measure.[13]

BPA's complaint—like other good pleadings—paints the bank as the victim of an injustice. FinCEN has not yet had its say, and the case may well look different after it does. It is thus unclear whether BPA's arguments will resonate as did FBME's.

Criticisms of Section 311

Domestic and foreign interests have expressed a range of criticisms of Section 311 proceedings. Critics point out that FinCEN's findings are taken into account by domestic firms the moment they are announced, even though a proposed rule is not yet enacted.[14] Indeed, in one final rule concerning a Syrian bank, FinCEN acknowledged that "several U.S. banks terminated their correspondent accounts…after we found the foreign bank to be of primary money laundering concern," which according to FinCEN minimized the impact of the regulatory action on domestic firms.[15]

A 2008 report by the Government Accountability Office noted many additional criticisms of Section 311 actions. Complaints ranged from FinCEN's lack of resources to quickly resolve proposed rules to foreign officials claiming that Section 311 is a "political tool" that allows FinCEN to unilaterally impose sanctions on foreign firms and jurisdictions. Foreign officials have also complained that the effects of a finding can linger even after FinCEN has rescinded a proposed rule. Both U.S. and foreign officials have also apparently complained that FinCEN targets smaller banks and not the largest money laundering concerns.[16]

FinCEN has defended the process as consistent with the APA. Moreover, FinCEN counters that it must be reluctant to impose sanctions against larger banks because doing so poses greater threats to the global banking system.[17] Although this defense echoes the "too big to fail" argument that has been criticized since the 2008 financial crisis, in fairness FinCEN should not be blamed for exercising an awesome power sparingly and selectively.

The question remains whether Section 311 is simply too much power. The FBME and BPA cases may provide some clarity on what the courts think of Section 311. Early indications are that FinCEN will have to expand its notice and comment activities to include consideration of sanctions short of shutting foreign banks out of the U.S. banking system. In the meantime, however, the safest course of action for domestic firms is to continue to treat FinCEN findings as gospel. Both domestic and foreign firms must also continue to fund and emphasize all aspects of AML compliance.

1. 31 U.S.C. §5318A(b)(5).
2. "SECTION 311 - SPECIAL MEASURES," available at http://www.fincen.gov/statutes_regs/patriot/section311.html.
3. Notice of Finding, 79 Fed. Reg. 42639, available at http://www.fincen.gov/statutes_regs/patriot/pdf/FBME_NOF.pdf.
4. Notice of Proposed Rule, 79 Fed. Reg. 42486, available at http://www.fincen.gov/statutes_regs/patriot/pdf/FBME_NPRM.pdf.
5. Press Release, available at http://www.fincen.gov/news_room/nr/html/20140716.html.
6. *FBME Bank v. Lew*, 15 CV 1270 (CRC) (D.D.C. filed Aug. 7, 2015).
7. *FBME Bank v. Lew*, No. 15 CV 1270, 2015 U.S. Dist. Lexis 113687 (D.D.C. Aug. 27, 2015).
8. Memo in Opposition to Motion for Remand, *FBME Bank v. Lew*, 15 CV 1270 (CRC) (D.D.C. 2015), Doc. No. 40 at pp.1, 3.
9. Notice of Finding, March 6, 2015, available at http://www.fincen.gov/news_room/nr/files/BPA_NOF.pdf
10. "U.S. Investigates Venezuelan Oil Giant," WSJ, Oct. 21, 2015.
11. Proposed Rule, 31 CFR Part 1010, RIN 1506-AB30, available at http://www.fincen.gov/news_room/nr/files/BPA_NPRM.pdf.
12. *Cierco v. Lew*, 15 CV 1641 (D.D.C.filed Oct. 7, 2015).
13. Complaint, *Cierco v. Lew*, 15 CV 1641 (D.D.C. Oct. 7, 2015).
14. See, e.g., The Clearing House Association, "Comment on Imposition of Special Measure Against CredexBank," July 30, 2012.
15. Notice of Final Rule, 31 CFR Part 103, RIN 1506-AA64, available at http://www.fincen.gov/statutes_regs/patriot/pdf/noticeoffinalrule03152006.pdf.
16. Government Accountability Office, "Better Interagency Coordination and Implementing Guidance for Section 311 Could Improve U.S. Anti-Money Laundering Efforts," available at http://www.gao.gov/products/GAO-08-1058.
17. See id.