

Avoid Being Blindsided By Correspondent Banking Enforcement

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April 22, 2020, 11:21 AM EDT

History teaches that the market disruption caused by a crisis like the COVID-19 outbreak is very likely to result in an uptick in financial crime and related misconduct. Indeed, U.S. regulators and law enforcement are warning institutions to remain vigilant and have assured their constituents that financial crimes enforcement will continue unabated.

Here we will explore the financial crime risks posed by correspondent banking, an activity that remains a priority for regulators and law enforcement. We also offer some practical guidance for financial institutions on mitigating those risks.

Enforcement and Prosecutorial Actions Hit U.S. and Non-U.S. Banks Alike

Regulators, including the U.S. Department of the Treasury's Financial Crimes Enforcement Network, have brought enforcement actions against U.S. banks, as well as domestic branches of foreign financial institutions, or FFIs, for anti-money laundering violations related to foreign correspondent banking services.

Over the past several years, FinCEN has penalized several U.S. banks for failing to conduct ongoing due diligence on foreign correspondent accounts. That lack of diligence is alleged to have allowed hundreds of millions of dollars of suspicious funds flowing into the US financial system.[1]

Non-U.S. banks also have potential exposure. In fact, a number of FFIs have recently disclosed to U.S. regulators that a significant amount of suspicious funds flowed through their foreign branches in recent years as part of various global money laundering schemes.

In these cases, FFIs processed high-value, complex transactions lacking economic substance. Ultimate beneficial ownership and source of funds were often obscured through layers of shell companies. In addition to the AML concerns raised by these suspicious transactions, through investigation FFIs have also uncovered transactions connected to politically exposed persons, raising potential anti-corruption and bribery concerns, as well as transactions potentially violative of U.S. economic sanctions.



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In response to these disclosures, FinCEN, the U.S. Department of Justice, the U.S. Securities and Exchange Commission, and the New York State Department of Financial Services have probed allegations related to hundreds of millions of dollars of high-risk funds flowing through European correspondent banking networks over the past decade.

Treasury Says Correspondent Banking Risk Continues to Threaten the U.S. Financial System

The Treasury recently issued its 2020 national strategy for combating terrorist and other illicit financing,[2] identifying correspondent banking as a significant threat to the U.S. financial system.[3] It illustrates that correspondent banking will continue to be a regulatory priority of FinCEN and other U.S. regulators.

The 2020 national strategy highlights the AML risk posed by correspondent banking relationships. U.S. banks typically receive funds or transfer instructions from foreign correspondent banks without having account relationships with the originators of the payments, who may be a direct or indirect client of the FFI.

As a result, U.S. banks frequently have limited details on the transactions processed through foreign correspondent accounts, leaving them vulnerable to exploitation. As the 2020 national strategy notes, not all FFIs have kept up with U.S. banks in terms of mitigating correspondent banking risks, due in part to weak AML supervision, uneven enforcement, and lack of prioritization of AML in certain jurisdictions.

Legal Obligations for U.S. Banks

U.S. banks are required to establish due diligence programs that include appropriate risk-based policies, procedures, and controls reasonably designed to enable them to detect and report any suspected money laundering activity conducted through or involving any foreign correspondent accounts.[4]

Additionally, U.S. banks must assess and periodically review the AML risk posed by their foreign correspondent banking customers and apply enhanced measures to relationships with certain, higher-risk FFIs.[5] However, U.S. banks are not required to conduct due diligence on their FFIs' customers and therefore must depend in part on the level of AML supervision in the home countries of their foreign correspondent banks.

Recommended Actions for U.S. Banks

U.S. banks should review and, as necessary, update their correspondent banking due diligence programs and periodically train employees on the policies, procedures and controls in place to mitigate the risks associated with maintaining foreign correspondent bank accounts.

Additionally, U.S. banks should evaluate the FFIs for whom they provide correspondent banking services, including by requesting an update on their due diligence programs and internal controls and inquiring into whether they are aware of, and monitoring for, any exposure to the types of money laundering schemes, and any related sanctions or corruption issues, currently under investigation by U.S. and European authorities.

To the extent that a U.S. bank learns that a correspondent account it maintains on behalf of an FFI is implicated in potential money laundering or related financial crimes, it should consider whether it has

disclosure obligations toward US authorities, evaluate the continued provision of correspondent services to that FFI, and request assurances that the FFI is taking appropriate remedial steps.

Legal Risks to FFIs

Although typically not subject to U.S. jurisdiction, FFIs without a U.S. presence also face the potential for severe consequences from FinCEN action. Under Section 311 of the Patriot Act, FinCEN has the authority to prohibit U.S. banks from engaging in activity related to foreign jurisdictions or financial institutions that it considers of “primary money laundering concern.”[6]

This sweeping authority can prohibit U.S. banks from opening or maintaining a U.S. correspondent account for non-U.S. banks so designated.[7] U.S. authorities have also aggressively targeted FFIs for U.S. sanctions violations[8] and increasingly for involvement in international corruption through prosecution of the Foreign Corrupt Practices Act.

Recommend Actions for FFIs

To avoid potential investigative or enforcement action in connection with the provision of correspondent banking services, FFIs should take proactive steps to safeguard their institutions from bad actors intent on laundering money through the U.S. financial system.

In addition to reassessing their correspondent banking due diligence programs and related training efforts, FFIs should review their customer bases and account activity for potential high risk clients and suspicious transactions. Where FFIs identify clients that present a higher risk of money laundering, or sanctions and corruption violations, they should pay specific attention to U.S. dollar account activity and their obligations toward their U.S. correspondent banks.

Legal and compliance functions can leverage a cache of information and documentation published by investigative journalists and websites, such as the Organized Crime and Corruption Reporting Project and the International Consortium of Investigative Journalists. The information made available by these sources includes detailed information on the schemes employed and the parties involved.

Banks that take these steps, and keep their eye on correspondent banking risk even in the face of myriad exigent issues and distractions, should be well positioned to avoid enforcement and prosecutorial risk.

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[1] See, e.g., In the Matter of Merchants Bank of California, N.A., FinCEN No. 2017-02 (Feb. 16, 2017), available at [https://www.fincen.gov/sites/default/files/enforcement_action/2017-02-27/Merchants Bank of California Assessment of CMP 02.24.2017.v2.pdf](https://www.fincen.gov/sites/default/files/enforcement_action/2017-02-27/Merchants_Bank_of_California_Assessment_of_CMP_02.24.2017.v2.pdf); In the Matter of Lone Star National Bank,

FinCEN No. 2017-04 (Oct. 27, 2017), available at [https://www.fincen.gov/sites/default/files/enforcement_action/2017-11-01/Lone Star.ASSESSMENT OF CIVIL MONEY PENALTY - Final 11.01.pdf](https://www.fincen.gov/sites/default/files/enforcement_action/2017-11-01/Lone%20Star.ASSESSMENT%20OF%20CIVIL%20MONEY%20PENALTY%20-%20Final%2011.01.pdf).

[2] National Strategy for Combating Terrorist and Other Illicit Financing 2020, U.S. Department of the Treasury, available at <https://home.treasury.gov/system/files/136/National-Strategy-to-Counter-Illicit-Financev2.pdf>.

[3] A correspondent banking relationship is formed when one bank (the “correspondent bank”) establishes an account to receive deposits from, make payments on behalf of, or conduct other business transactions related to another bank (the “respondent bank”). 31 C.F.R. § 1010.605(c)(1)(i).

[4] 31 C.F.R. § 1010.610(a).

[5] 31 C.F.R. § 1010.610(b).

[6] 31 U.S.C. § 5318A. See also FinCEN Names ABLV Bank of Latvia an Institution of Primary Money Laundering Concern and Proposes Section 311 Special Measure, FinCEN (February 13, 2018), available at <https://www.fincen.gov/news/news-releases/fincen-names-ablv-bank-latvia-institution-primary-money-laundering-concern-and>.

[7] Section 311 of the USA PATRIOT Act empowers FinCEN to “prohibit, or impose conditions upon, the opening or maintaining in the United States of a correspondent account ... by any domestic financial institution ... for or on behalf of a foreign banking institution” the U.S. government deems to be of primary money laundering concern. 31 U.S.C. § 5318A(b)(5).

[8] For a discussion of a recent enforcement action highlighting the breadth of the Office of Foreign Assets Control’s assertion of jurisdiction, see OFAC Settlement with Swiss ICT Service Provider Reinforces Message to Foreign Companies: Beware Any U.S. Nexus, available at <https://www.mayerbrown.com/en/perspectives-events/publications/2020/03/ofac>.