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SPECIAL MEASURES UNDER SECTION 311 OF THE USA PATRIOT ACT

A Likely Broader Use of Treasury's Special Measures Authority Will Require Greater Vigilance for U.S. Financial Institutions to Avoid Sanctioned Entities and Perhaps New Record Keeping and Reporting. The Authors Review the Record of Sanctions, Suggest a More Nuanced Approach, and Urge Caution to Avoid Errors and International Backlash.

By Douglas N. Greenburg, John Roth, and Katherine A. Sawyer *

The USA PATRIOT Act, quickly passed in October 2001, contained several hundred distinct provisions, amended at least 15 different statutes, and spanned over 300 pages.[1] One provision, Section 311,[2] empowers the Secretary of the Treasury to take "special measures" against foreign banks, other countries, or specific types of accounts or transactions the Secretary determines to be "of primary money laundering concern." Unlike some of the more prominent financial provisions in Title III of the Act, Section 311 initially received little attention in the media or the banking industry, although it provides the Secretary with unprecedented power to regulate an institution's operations involving foreign parties or transactions. This provision moved from obscurity to the forefront in high stakes diplomatic negotiations involving the United States, North Korea, and China, and there is every indication that it will be used more frequently, with potentially profound effects on the financial services industry. This article describes the Section 311 regime – how it has been used to date, how it may be used in the future, and its potential impact on the industry and U.S. efforts to combat money laundering.

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

[2] 31 U.S.C. §5318A (2006).

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THE STATUTORY SCHEME

Section 311 empowers the Secretary of the Treasury, after consultation with the Secretary of State and the Attorney General, and upon a finding of "reasonable grounds," to designate a foreign jurisdiction, foreign financial institution, class of international transaction, or type of account as of "primary money laundering concern." Such a designation is important because it then permits the Secretary, after consultation with the appropriate federal agencies, [3] to require U.S. financial institutions and financial agencies to take "special measures" against the designated entity, transaction, or account. Section 311 also sets forth the factors that the Secretary must consider before making such a designation and provides procedures for selecting the specific special measures to be imposed.

In determining whether a financial institution within or involving a particular jurisdiction is of primary money laundering concern, Section 311 requires the Secretary to consider "such information as the Secretary determines to be relevant, including the following potentially relevant factors:"[4]

- the extent to which such financial institution is used to facilitate or promote money laundering in or through the jurisdiction;
- the extent to which such financial institution is used for legitimate business purposes in the jurisdiction; and
- the extent to which such action is sufficient to ensure, with respect to transactions involving the institution operating in the jurisdiction, that the purposes of the Bank Secrecy Act continue to be fulfilled, and to guard against international money laundering and other financial crimes.[5]

Once the Secretary finds that reasonable grounds exist for concluding that a foreign jurisdiction, financial institution, class of international transactions, or type of account is of primary money laundering concern, he must then determine which of the specific measures best addresses the particular money laundering concerns at

[3] 31 U.S.C. § 5318A(a)(4)(A) requires the Secretary to consult with the Chairman of the Board of Governors of the Federal Reserve System, any other appropriate Federal Banking Agency, the Secretary of State, the U.S. Securities and Exchange Commission, the Commodity Futures Trading Commission, the National Credit Union Administration, and "such other agencies and interested parties as the Secretary may find to be appropriate."

[4] Section 311 specifies other factors to be considered in the case of a particular jurisdiction, as opposed to an institution within the jurisdiction. They include the following:

> (i) evidence that organized criminal groups, international terrorists, or entities involved in the proliferation of weapons of mass destruction or missiles have transacted business in that jurisdiction;
>
> (ii) the extent to which that jurisdiction or financial institutions operating in that jurisdiction offer bank secrecy or special regulatory

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> advantages to non-residents or non-domiciliaries of that jurisdiction;
>
> (iii) the substance and quality of administration of the bank supervisory and counter-money laundering laws of that jurisdiction;
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> (iv) the relationship between the volume of financial transactions occurring in that jurisdiction and the size of the economy of the jurisdiction;
>
> (v) the extent to which that jurisdiction is characterized as an offshore banking or secrecy haven by credible international organizations or multilateral expert groups;
>
> (vi) whether the United States has a mutual legal assistance treaty with that jurisdiction…and;
>
> (vii) the extent to which that jurisdiction is characterized by high levels of official or international corruption.

31 U.S.C. § 5318A(c)(2)(A).

[5] 31 U.S.C. § 5318A(c)(2)(B).

issue. Section 311 sets forth a variety of special measures that U.S. financial institutions may be required to employ, individually or in concert and in any order. These include:

- record keeping and reporting of certain financial transactions;
- collection of information relating to beneficial ownership;
- collection of information relating to certain payable-through accounts;
- collection of information relating to certain correspondent accounts;
- prohibition or conditions on the opening or maintaining of correspondent or payable-through accounts for a foreign financial institution.[6]

The first four measures may be imposed "by regulation, order or otherwise as permitted by law," whereas the fifth special measure requires issuance of a regulation.[7]

To determine which of these special measures is most appropriate, the Secretary must consult with other federal agencies and consider the following factors:

- whether similar action has been or is being taken by other nations or multilateral groups;
- whether the imposition of any particular special measure would create a significant competitive disadvantage, including any undue cost or burden associated with compliance, for financial institutions organized or licensed in the United States;
- the extent to which the action or the timing of the action would have a significant adverse systemic impact on the international payment, clearance, and settlement system, or on legitimate business activities involving the particular institution; and
- the effect of the action on U.S. national security and foreign policy.[8]

Any order imposing one of the first four special measures must be issued together with a notice of proposed rulemaking. Additionally, those special measures may not remain in effect for more than 120-days absent a rule promulgated on or before the expiration of the 120-day period.[9]

THE USE OF SECTION 311 TO DATE

The Secretary rarely employed Section 311 in the years immediately following the passage of the PATRIOT Act. Indeed, some commentators criticized the Department of the Treasury for failing to use this powerful new weapon. For example, in 2002, the Council on Foreign Relations task force on terrorist financing opined that one obstacle to effective action against terrorist financing was the unwillingness of the government to use Section 311, which it had not once employed before October 2002.[10]

Gradually, however, the government began to make use of Section 311. Treasury's use of its Section 311 authority has occurred in three types of situations. First, it has been used in assisting the United States in fulfilling its multilateral obligations, such as those required by its membership in the Financial Action Task Force ("FATF"), the multilateral body responsible for setting international anti-money laundering standards. As a member of FATF, the United States has an obligation to impose appropriate countermeasures on those countries FATF has decided are not cooperating in the international effort to combat money laundering. FATF takes great pains to ensure that its deliberations have a measure of transparency. For example, it publishes mutual assessments of member countries' anti-money laundering efforts and its resolutions give targeted countries fair warning and a reasonable explanation of the reasons for its decisions. Moreover, such designations give the potentially designated country time to correct its deficiencies before the countermeasures are put in place. Given the deliberative, multilateral, and open nature of that process, the Secretary's use of Section 311 in this manner has raised few concerns.

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[6] 31 U.S.C. § 5318A(b)(1)-(5).

[7] 31 U.S.C. § 5318A(a)(2)(B), (C).

[8] 31 U.S.C. § 5318A(a)(4)(B)(i)-(iv).

[9] 31 U.S.C. § 5318A(a)(3)(A)-(B).

[10] Maurice R. Greenberg, William F. Wechsler, Lee S. Wolosky, *et al.*, TERRORIST FINANCING: REPORT OF AN INDEPENDENT TASK FORCE 17, 26 (Oct. 2002), *available at* www.cfr.org.; *see also The Financial War on Terrorism and the Administration's Implementation of the Anti-Money Laundering Provisions of the USA Patriot Act: Hearing Before the Comm. on Banking, Housing, And Urban Affairs*, 107th Cong. (2002) (statement of Rep. LaFalce, Member, House Comm. on Fin. Servs.).

The Secretary deployed Section 311 for the first time on December 20, 2002 against Ukraine and Nauru, designating them as jurisdictions of primary money laundering concern.[11] The Secretary's decision to impose special measures against Ukraine was based upon his conclusion that the nation suffered from systemic corruption, its government had failed to enforce existing anti-money laundering laws, and the fact that Ukraine was designated by FATF on its list of Non-Cooperative Countries and Territories ("NCCT").[12] In the same notice, the Secretary designated the small island nation of Nauru as of primary money laundering concern. The Secretary found that the sale of offshore banking licenses was subject to cursory and woefully inadequate review and that the banks themselves had no legitimate connection to the economy or business activity of Nauru. Nauru also had been designated on the NCCT list by FATF. As a result, the Secretary issued a proposed rulemaking that would impose special measures on Nauru, prohibiting U.S. financial institutions from maintaining correspondent accounts for, or on behalf of, a Nauru financial institution.[13]

On November 18, 2003, the Secretary designated Burma, another FATF NCCT, as a jurisdiction of primary money laundering concern and proposed a special measure which was imposed as a result of a final rule issued by the Secretary on April 12, 2004. The Secretary found that Burma lacked a "basic set of anti-money laundering laws and regulations," and had not proscribed money laundering outside the context of drug trafficking. The Secretary also imposed special measures against Myanmar Mayflower Bank and Asia Wealth Bank, both of which are located in Burma.[14]

Treasury has also used Section 311 as a classic money laundering control measure. Such use fulfills the original and most fundamental purpose underlying Section 311, in that it has let Treasury close loopholes that allowed "bad" foreign banks access to the U.S. financial system through correspondent accounts in U.S. banks. In enacting Section 311, Congress determined that the inadequate due diligence of the U.S. banks created a significant vulnerability to money laundering and terrorist financing.[15] To close this loophole, Section 311 was intended to function as the international analogue to the powers that a federal banking regulator has over its domestic banks to remedy lax anti-money laundering controls.[16]

As a money laundering control measure, for example, on August 24, 2004, the Secretary issued a proposed rulemaking for special measures against First Merchant Bank OSH, Ltd. ("FMB") and its subsidiaries, which operate out of the Turkish Republic of North Cyprus ("TRNC"). The special measures were imposed based upon a finding that FMB operated as a conduit for the laundering of money generated by the narcotics trade in Turkey and Britain and that TRNC had enacted inadequate anti-money laundering controls, particularly in its offshore sector.[17]

On April 26, 2005, the Secretary issued notice of a proposed rulemaking for special measures against Multibanka, a small commercial bank headquartered in Riga, Latvia.[18] The special measures were imposed based upon the suspicion that the bank had been used by Russian and other shell companies to facilitate financial crime. Specifically, the Secretary noted that "in a one-month period during 2004, one U.S. bank received over 2,000 payment instructions involving $68 million associated with eight suspected shell companies with

[11] 67 Fed. Reg. 78,859 (Dec. 26, 2002). That designation has since been lifted as to Ukraine. 68 Fed. Reg. 19,071 (Apr. 17, 2003).

[12] Ukraine was subsequently removed from the NCCT list on February 14, 2003. The proposed designation against Ukraine was withdrawn after FATF received sufficient concrete assurances that the previously noted deficiencies were corrected.

[13] 67 Fed. Reg. 78,861.

[14] 69 Fed. Reg. 19,098-19, 103 (Apr. 12, 2004).

[15] *Hearing Before the Comm. on Banking, Housing, And Urban Affairs*, 107th Cong. (2001) (statement of Sen. Levin, Mem., Sen. Arms Servs. Comm.).

[16] The Federal Reserve, FinCEN, and the Office of the Comptroller of the Currency have, in recent years, imposed significant penalties on U.S. banks, and foreign banks doing business in the United States, as a result of their failure to control money laundering through their institutions. *See, e.g.*, Douglas N. Greenburg and Jonathan C. Su, *Financial Institutions in the Cross-Hairs: Lessons from Recent Anti-Money Laundering Cases*, THE REVIEW OF BANKING AND FINANCIAL SERVICES, Vol. 22, No. 3, March 2006. Federal regulators have stepped up enforcement as a result of the significant congressional criticism they endured when it appeared that that their regulated entities were being used for money laundering. *See, e.g.*, United States Senate, Permanent Subcommittee on Investigations, Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act, A Case Study Involving Riggs Bank, *available at* www.senate.gov/~govt-aff/_files/ACF5F8.pdf .

[17] 69 Fed. Reg. 51,979-81 (Aug. 24, 2004). Turkey is the only nation that recognizes the TRNC.

[18] 70 Fed. Reg. 21,362 (Apr. 26, 2005).

accounts at Multibanka."[19] Similarly, on July 13, 2006, the Secretary also imposed special measures on VEF Banka, also headquartered in Riga. The Secretary found that VEF was used by criminals to facilitate money laundering. Specifically, VEF existed as a significant resource for illegal shell companies and financial fraud rings that allowed criminals to engage in illicit financial activities. VEF also permitted significant ATM withdrawals, which constituted "an essential component in executing large financial fraud schemes" most typical of carding networks.[20]

A third category of countermeasures involves the imposition of Section 311 sanctions to further U.S. foreign policy goals. The use of unilateral economic sanctions in furtherance of U.S. foreign policy is nothing new. It has been part of the U.S. foreign policy arsenal at least since the First World War, when Congress passed the Trading with the Enemy Act, providing the president with power to restrict trade with hostile nations.[21] For the past several decades, the U.S. government has primarily imposed sanctions pursuant to the International Emergency Economic Powers Act ("IEEPA"), which gives the president broad powers to deal with any unusual and extraordinary foreign threat to the national security, foreign policy, or economy of the United States if the president declares a national emergency with respect to such threat.[22] For example, IEEPA provides the basis for the U.S. economic sanctions programs against countries like Iran and Sudan, as well as a whole range of individuals and entities deemed to be terrorists, terrorist supporters, WMD proliferators, drug kingpins, or other enemies of the United States.[23] The Department of Treasury's Office of Foreign Asset Control ("OFAC") administers and enforces the IEEPA sanctions program.[24]

In furtherance of these foreign policy goals, the Secretary used Section 311 again on August 24, 2004 to issue a proposed rulemaking for special measures against Infobank, a national commercial bank located in Belarus. The bank was linked to the procurement and financing of weapons and other military equipment for several nations determined by the United States to be State Sponsors of Terrorism and embargoed by the United Nations. The Secretary also determined that Infobank actively laundered funds for the former Iraqi regime of Saddam Hussein.[25]

More than a year later, the Secretary designated Banco Delta Asia ("BDA"), a then-obscure bank on the island of Macao, as of primary money laundering concern upon finding that the bank had served as a willing conduit for the criminal activities of North Korea's rogue government. On September 20, 2005, the Secretary issued a preliminary rule, finding that BDA consistently tailored its services to Democratic People's Republic of Korea's ("DPRK") demands and that DPRK paid fees to BDA in exchange for financial access to the country's banking system.[26] Finally, on March 15, 2006, the Secretary issued a final rule imposing special measures on the Commercial Bank of Syria and its subsidiary, Syrian Lebanese Commercial Bank, based upon findings that the Commercial Bank of Syria had been used as a conduit for the laundering of proceeds generated from the illicit sale of Iraqi oil and had been

[19] The Secretary ultimately withdrew the proposed rulemaking on July 13, 2006 based upon the finding that Multibanka had since instituted significant remedial measures to address the deficiencies in its anti-money laundering program and internal controls. *See* 71 Fed. Reg. 39,606-09 (Jul. 13, 2006).

[20] 71 Fed. Reg. 39,554-55 (Jul. 13, 2006).

[21] 50 App. U.S.C. §§ 1-6, 7-39, 41-44 (2007).

[22] 50 U.S.C. §§ 1701, *et seq.* (2007).

[23] The U.S. Government has been highly active in attempting to use IEEPA to cut off money supply in furtherance of its foreign policy goals. In September 2006, for example, OFAC amended the Iranian Transactions Regulations to cut off Iran's Bank Saderat from the U.S. financial system. One of Iran's largest government banks, Bank Saderat allegedly acted as a conduit for the transfer of $50 million to terrorist organizations such as Hezbollah, Hamas, and Palestinian Islamic Jihad. 71 Fed. Reg. 53,569-71 (Sept. 12, 2006) (as codified at 31 C.F.R. pt. 560). Additionally, pursuant to Executive Order 13382,

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Treasury imposed a similar ban on Iran's Bank Sepah in January 2007. Press Release, Prepared Remarks of Stuart Levey Under Secretary for Terrorism and Financial Intelligence On the Designation of Bank Sepah for Facilitating Iran's Weapons Program (January 9, 2007), *available at* http://www.ustreas.gov/ press/releases/hp220.htm.

[24] *See* IEEPA, 50 U.S.C. §§ 1701-07 (2007). The longstanding sanction regime against Cuba and Cuban interests exists pursuant to the Trading with the Enemy Act, which OFAC also administers and enforces. Persons who engage in transactions with prohibited parties in violation of these statutes and OFAC's implementing regulations are subject to civil penalties or, in cases of intentional violations, to criminal prosecution.

[25] 69 Fed. Reg. 51,973-74 (Aug. 24, 2004).

[26] 70 Fed. Reg. 55,213-22 (Sept. 20, 2005). The Secretary issued a final rule against BDA on March 19, 2007. 72 Fed. Reg. 12,730 (Mar. 19, 2007) (to be codified at 31 CFR pt. 103).

used by terrorists or individuals associated with terrorist organizations.[27]

SECTION 311 SANCTIONS COULD BE APPLIED IN A MUCH BROADER CONTEXT

MORE RECORD KEEPING AND REPORTING REQUIREMENTS?

Section 311 has had a powerful impact, especially the special measures imposed on BDA, which have been widely credited as highly effective in putting pressure on North Korea.[28] The apparent success of Section 311 is likely to lead its greater use. Indeed, the government's 2007 National Money Laundering Strategy, released May 3, 2007, states explicitly that Treasury "will use Section 311" to safeguard the country from foreign money laundering threats.[29] Increased use of Section 311 will necessitate greater vigilance on the part of U.S. financial institutions to avoid sanctioned entities and potentially more requirements to gather and provide information to the government. In particular, banks may find themselves facing significantly more record keeping and reporting obligations if Treasury decides to avail itself of some of the "special measures" that it has not yet used.

Each application of Section 311 sanctions to date has involved the most extreme of the five possible sanctions – the prohibition of the use of correspondent accounts for the foreign financial institutions based in a jurisdiction deemed to be of primary money laundering concern. However, Section 311 was passed, in part, to give Treasury a series of graduated and proportional tools to address specific known money laundering vulnerabilities. The regulatory scheme in place prior to the passage of the PATRIOT Act was hampered by its "all or nothing" approach. Previously, the government could issue advisories, notifying financial institutions of a particular vulnerability or weakness, but was left to hope that the banks would address the issue, or, alternatively, it could use the "blunt and forceful" measures in IEEPA to issue economic sanctions and blocking orders. There was little middle ground.[30] Section 311 was enacted to give government policy-makers a greater ability to give a calibrated response to specific, even narrow criminal threats.

Moreover, the lesser, intermediate sanctions were also designed to give policymakers data and insight on potential money laundering threats to the U.S. financial system. A lack of solid information on how, and how much, money gets laundered through the system has bedeviled policymakers. Inherently, money laundering is a secret enterprise. Its purpose is to disguise the source, ownership, and control of ill-gotten gains. Within the law enforcement and regulatory community, little consensus exists on the most prevalent forms of money laundering and any judgments on it are based on very little empirical data. To date, the best assessments of money laundering vulnerabilities have been largely anecdotal. For example, in 2000, the staff of the U.S. Senate's Permanent Subcommittee on Investigations conducted a groundbreaking investigation on abuses within the U.S. financial system by the most egregious of money launderers, offshore shell banks.[31] That investigation revealed significant abuses in this area of banking. Previously, the same subcommittee explored risks involved in private banking, particularly private banking services given to foreign public officials.[32] Likewise, FATF has engaged in a systematic attempt to understand and define the problem of money laundering by engaging in "typology" exercises, in which law enforcement and regulatory experts discuss and report on types of money laundering they have seen in the

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[27] 71 Fed. Reg. 13,261 (Mar. 15, 2006).

[28] *See infra*, at notes 48-50 and corresponding text.

[29] 2007 National Money Laundering Strategy at 11, *available at* http://www.treas.gov/press/releases/docs/nmls.pdf. The National Money Laundering Strategy is a collaborative effort of the U.S. Departments of Justice, Treasury, and Homeland Security.

[30] As a former Treasury official in favor of the legislation testified:

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> There are, however, many other situations in which we will not want to block all transactions, or in which our concern centers around under-regulated foreign financial institutions or holes in foreign counter-money laundering efforts. In those cases a more flexible tool is necessary, but we do not have one available, because under present law there is nothing between the two ends of the spectrum - a Treasury Advisory on the one hand, and full-blown IEEPA sanctions on the other.

Hearing Before the Comm. on Banking, Housing, And Urban Affairs, 107th Cong. (2001) (statement of Stuart Eizenstat, Former Assistant Sec'y of Treasury).

[31] *See*, Minority Staff of the Permanent Subcommittee On Investigations Report On Correspondent Banking: A Gateway For Money Laundering, February 5, 2001, *available at* http://www.senate.gov/~govt-aff/psi_finalreport.pdf.

[32] *See Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities: Hearings before U.S. Committee on Government Affairs, Permanent Subcommittee on Investigations*, 106th Cong. (1999).

course of their work.[33] However, their approach is largely anecdotal, and no attempt has been made to quantify the problem or attempt to understand on an analytical basis the most significant money laundering risks.

Even attempts to quantify the most basic of facts – the size of the money laundering problem itself, measured by the amount of money laundered – have ended in failure. Estimates on the amount of money laundered through U.S. financial institutions have been extremely rough, and not based on any empirical data. Treasury itself has been unable to determine the size of the problem,[34] FATF has been similarly stymied,[35] and economists have failed to arrive at reliable estimates.[36]

The intermediate sanctions contained in Section 311 are designed to give policymakers, regulators, and law enforcement the ability to obtain information required to make sound policy judgments on the effectiveness of the current anti-money laundering regime. Senator Sarbanes, one of the proponents of the legislation that ultimately became Section 311, noted that "[t]he special measures all involve special record keeping and reporting measures – to eliminate the curtains behind which launderers hide."[37] To date, Treasury has not attempted to use Section 311 to better understand the nature of the problem.

Additionally, Treasury has limited itself to addressing only those problems posed by individual countries and rogue banks. However, Treasury's powers under Section 311 are far broader. Section 311 also allows it to sanction "classes of transactions" within or involving a jurisdiction outside the United States as well as "types of accounts." "Transaction" is defined very broadly under federal regulations,[38] and could include virtually any type of financial product or action undertaken by or with a foreign bank or foreign jurisdiction. The breadth of Treasury's authority is functionally unlimited. Treasury, if it so chose, could target specific areas, either to attempt to suppress a known money laundering problem or to gain data by which it could make informed judgments.

For example, the Secretary could determine that wire transfers or money remittances to a specific country are a "primary money laundering concern." U.S. law enforcement and regulators have recognized that international wire remittances through money service businesses ("MSBs") are used for significant money laundering, and the current regulatory scheme and law enforcement efforts have thus far been insufficient to deal with the problem.[39] Heightened record keeping requirements, targeted against a specific high-risk

[33] *See e.g.* FATF Typologies Report, *The Misuse of Corporate Vehicles, Including Trust and Company Service Providers* (Oct. 13, 2006), *available at* http://www.fatf-gafi.org/dataoecd/30/46/37627377.pdf.

[34] 2002 National Money Laundering Strategy, at 5, *available at* http://www.treas.gov/offices/enforcement/publications/ml2002.pdf.

[35] As FATF noted:

> By its very nature, money laundering is an illegal activity carried out by criminals which occurs outside of the normal range of economic and financial statistics…. [I]t must be said that overall it is absolutely impossible to produce a reliable estimate of the amount of money laundered and therefore the FATF does not publish any figures in this regard.

FATF Money Laundering FAQ, *available at* http://www.fatf-gafi.org/document/29/0,2340,en_32250379_32235720_33659613_1_1_1_1,00.html.

[36] As one economist noted:

> Estimating how much money is actually laundered in the United States, any other country, or globally, is extremely difficult…In fact, no direct estimates exist of how much money passes through the financial system, whether broadly or narrowly defined, for the purposes of converting illegal gains into a non-traceable form. Financial firms lack both incentive and tools to estimate the extent of laundering in their accounts, so it is unlikely that any such figure will ever be produced, though changes in technology might help financial institutions in this respect.

PETER REUTER & EDWIN M. TRUMAN, CHASING DIRTY MONEY: THE FIGHT AGAINST MONEY LAUNDERING 9 (2004).

[37] 147 CONG. REC. S10562, 51 (2001) (statement of Sen. Sarbanes).

[38] 31 C.F.R. pt. 103.11(ii).

[39] According to the most definitive government report on the matter:

> [MSB's] pose a considerable threat. MSBs in the United States are expanding at a rapid rate, often operate without supervision, and transact business with overseas counterparts that are largely unregulated. Moreover, their services are available without the necessity of opening an account. As other financial institutions come under greater scrutiny in their implementation of and compliance with BSA requirements, MSBs have become increasingly attractive to financial criminals.

U.S. Money Laundering Threat Assessment (Dec. 2005), *available at* http://www.treas.gov/offices/enforcement/pdf/mlta.pdf.

country, for example, would afford the United States both a better understanding of the nature and extent of the problem and a method to suppress specific money laundering activity.

Similarly, law enforcement and regulators have been attempting to understand trade-based money laundering, in which such techniques as under- or over-invoicing are used to disguise moving the proceeds of unlawful activity.[40] Money laundering enforcement officials have concluded that trade-based money laundering is especially prevalent in Free Trade Zones, such as the Colon, Panama Free Trade Zone, and the lack of information and transparency is a significant barrier to U.S. law enforcement efforts.[41] Indeed, FATF recently concluded, as one of its "key findings," that enforcement authorities worldwide have a limited understanding of the technique and that few measures are in place to counter an increasingly important avenue of money laundering.[42] Domestic financial institutions can play a significant role in facilitating such trade through wire transfers between parties as well as in the issuance of letters of credit. Information about such activities, appropriately collected and analyzed, could give powerful insights into trade-based money laundering. Section 311 allows Treasury to impose reporting requirements on U.S. financial institutions in a highly targeted manner; it could, for example, require record keeping in transactions above a certain threshold, involving a specific commodity, or from or to a specific Free Trade Zone. Doing so could allow for an intelligent study of the specific problem and could force launderers to use less efficient means of laundering their proceeds.

Treasury achieved considerable success in the past using analogous tools. Under the Geographical Targeting Orders ("GTOs") power,[43] the Secretary can impose financial reporting requirements on currency transactions in a specific U.S. geographical location. Treasury first tried this approach in New York as part of a concerted law enforcement effort to stem drug remittances from Jackson Heights, New York to the country of Colombia. Wire remittances fell off significantly and law enforcement was able to focus efforts on interdicting bulk cash exportations, a more expensive and risky means of moving money; the strategy was deemed to be a significant success in a problem area.[44]

Financial institutions believe themselves already significantly burdened by anti-money laundering regulations, and any additional record keeping and reporting requirements should be imposed only after a compelling showing of the necessity and efficacy of such measures. Still, institutions should recognize that, properly wielded, the record keeping and reporting requirements of Section 311 special measures could be highly effective in combating money laundering and other criminal activity. The key, of course, will be the method of implementation. Treasury bears the responsibility to use Section 311 in a way that weighs the legitimate needs of the government for information against the burdens that providing such information will impose on financial institutions. The good news is that, unlike the "all or nothing" regime that previously existed, Section 311 was designed to be used in a more focused way that makes this balancing possible, and the tool, properly deployed, could be extremely useful to law enforcement without over-burdening the industry.

DANGERS IN PROHIBITING CORRESPONDENT ACCOUNTS

Section 311 must be used carefully. The most powerful of the special measures, the prohibition on correspondent accounts, could easily backfire on the U.S. government if the Secretary does not wield this

[40] FATF, *Trade Based Money Laundering* 4 (Jun. 23, 2006), *available at* http://www.fatfgafi.org/dataoecd/60/25/37038272.pdf; 2003 National Money Laundering Strategy at 19-20, *available at* http://www.treas.gov/offices/enforcement/publications/ml2003.pdf.

[41] U.S. Money Laundering Threat Assessment at 43 (Dec. 2005).

[42] FATF, *Trade Based Money Laundering* at 25.

[43] 31 U.S.C. § 5326 (2007), 31 C.F.R. pt. 103.26.

[44] The government reported notable success in an area in which success is fairly uncommon:

> The Colombia GTO caused an immediate and dramatic reduction in the flow of narcotics proceeds to Colombia through New York City money transmitters. The targeted money transmitters' business volume to Colombia dropped approximately 30 percent. Transmitter business to Colombia declined even from money transmitters not subject to the GTO, suggesting that much of the money remitted to Colombia was controlled centrally by high-level cartel money brokers.
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> Also during the first six months of the GTO, U.S. law enforcement agencies observed a marked increase in interdiction and seizure activity of cash at east coast US borders - over $50 million in the six-month period, approximately four times more than in prior years.

U.S. Department of State, 1997 International Narcotics Control Strategy Report, March 1998.

powerful weapon carefully. It is functionally a death sentence for a foreign bank dependent on its ability to clear dollars through U.S. financial institutions. Section 311 gives Treasury the power to drive, unilaterally and secretly,[45] a foreign bank out of business. Because special measures are imposed through an administrative rather than a judicial proceeding, only Treasury itself knows the quantum and reliability of evidence supporting the government's decision. Neither the affected institution nor the general public has any method by which to determine the reasonableness of the designation. The statute allows for the use of intelligence information to make the determination to exclude a foreign bank from U.S. markets. Intelligence sources can vary dramatically in their reliability, and over-reliance on intelligence information to make administrative decisions could lead to erroneous decision-making. Moreover, the use of classified intelligence information, even if accurate, can deprive U.S. authorities of the ability to publicly document the reasons for their actions, which can potentially alienate foreign allies and undermine the legitimacy of the government's action.

Treasury has encountered similar problems in the past with regard to the reliability of the evidence used to impose sanctions. In November 2001, in its efforts to discover and choke off potential terrorist funds emanating from the United States, OFAC designated, under IEEPA and the implementing executive order, a Somalia-based money transmitter, al-Barakaat, as a supporter of terrorism. Relying primarily on intelligence sources, it issued an administrative order and froze the assets of all branches and offices of al-Barakaat in the United States. Other nations, relying on the U.S. designation, instituted similar freezes worldwide. The United Arab Emirates, where al-Barakaat had its primary clearing accounts, froze al-Barakaat's bank accounts and seized its deposits. Al-Barakaat was driven out of business worldwide as a result of the designation.

Shortly thereafter, however, the designation and companion blocking of transactions and freezing of assets began to unravel. Other countries, which had relied on the U.S. designation to engage in enforcement actions of their own, began receiving complaints from their own citizens. Those countries, in turn, demanded information from Treasury regarding the basis of the freeze. Because of the largely non-public and classified nature of the material that was used in the designation, the United States government could not respond to the satisfaction of the complaining countries. U.S. citizens and entities who had been designated as affiliates of al-Barakaat filed suit against Treasury. Faced with its inability to justify the freezes in court, Treasury ultimately withdrew its designations against some of the listed entities.

As members of the Staff of the National Commission on Terrorist Attacks Upon the United States (familiarly known as the 9/11 Commission), two of the authors specifically analyzed the government's conduct in the al-Barakaat actions. In our Monograph on Terrorist Financing,[46] we noted that after OFAC's designation, an extensive investigation by the FBI, which included complete and unfettered access to al-Barakaat's financial records in the United Arab Emirates and interviews of the principal players in al-Barakaat, could not substantiate any links between al-Barakaat and terrorism. As a result, the FBI, which was conducting a parallel criminal investigation, closed its case for lack of evidence that the individuals were involved in any terrorist financing. Moreover, the intelligence agencies responsible for much of the reporting regarding al-Barakaat's purported connections to al Qaeda terminated their sources after finding that they may have fabricated information.

The al-Barakaat case illustrated the problem with relying too heavily on intelligence assessments in a rulemaking or administrative procedure. The counterterrorism program was dealt a setback as a result of misguided administrative action. For example, in al-Barakaat, Treasury's inability to publicly justify its actions resulted in significant protests from other countries, including close allies of the United States in the war on terror. Those protests in turn led to the revamping of the United Nations protocol for designating sanctioned individuals and entities to build in appropriate safeguards to help prevent mistakes.

As discussed in the 9/11 Commission's Monograph on Terrorist Financing, the government must balance its

[45] Section 311 provides that if the government relied on classified information in making the decision to impose special measures, the government may submit such evidence ex parte and in camera to the court in any judicial review of the Secretary's decision. The statute takes pains to indicate, however, that the provision itself does not create a right to judicial review of decisions made by Treasury. 31 U.S.C. § 5318A(f). In press statements, Treasury has taken the position that affected institutions would be able to challenge Treasury's actions in court.

[46] *See* John Roth, Douglas Greenburg, Serena Wille, National Commission on Terrorist Attacks Upon the United States, Monograph on Terrorist Financing, released August 2004, *available at* www.911commission.gov.

need to ensure prompt action against problem institutions against the risk of making an inaccurate or unsupported action. At times, the government may be faced with a legitimate need to move quickly based on incomplete information, but it must recognize that doing so increases the risk of mistakes. Moreover, where the administrative record used to make those decisions is classified or otherwise unavailable, those decisions will almost certainly be called into question.

Like the IEEPA regime under which al-Barakaat was designated, the basis for Treasury's Section 311 designations is not public and often rests on classified information. Moreover, while the final rule is not instituted until after a period of public comment, the mere institution of the preliminary rule may have catastrophic consequences on the financial institution involved.

In Treasury's preliminary designation of BDA in September of 2005, it noted that the bank had allowed the government of North Korea access to the banking system "with little oversight or control," that it handled multi-million dollar cash deposits and withdrawals, and that it had maintained relations with a business customer long after it knew that the head of that business was involved in an attempted deposit of counterfeit currency. Perhaps more significantly, the preliminary rule noted, "sources show that senior officials in Banco Delta Asia are working with DPRK officials to accept large deposits of cash, including counterfeit U.S. currency, and agreeing to place that currency in circulation."[47]

The Section 311 designation had a powerful impact.[48] The preliminary rule alone, which prohibited U.S. banks from directly or indirectly maintaining accounts for BDA, caused a run on the bank's deposits, forcing the bank to accept an offer of receivership of the operation of the bank from the Macau government. The receivers, fearful of action by the United States against other banks in Macau, in turn, froze about $25 million in North Korean accounts. The message resonated throughout other nations, with banks in China and Vietnam similarly refusing to operate accounts with ties to North Korea.[49] The mere designation of BDA as of primary money laundering concern served as the catalyst for responsive action throughout the financial world with banks around the globe refusing to transact business with BDA, thus effectively excluding it from the international banking system.[50]

Not surprisingly, the bank itself has denied any involvement in illegitimate dealings with the North Korean government and has argued that it was merely caught in a foreign policy dispute between the United States and North Korea.[51] Lawyers from the bank have publicly cited as evidence of Treasury's error an independent audit from a major public accounting firm, commissioned by the Macau government within days of the 2005 designation. That report, according to the lawyers representing the bank, found that, while the bank had lax anti-money laundering controls and record keeping, there was no evidence of Treasury's most compelling charge, that the bank laundered North Korean-produced U.S. counterfeit bills into the international markets. News reports quote the report as stating: "[f]rom our investigations is it apparent that … the Bank did not introduce counterfeit U.S. currency notes into circulation."[52] In an attempt to forestall a final rule, BDA terminated its relationships with entities in North Korea, and noted that it had implemented new policies and procedures to guard against money laundering.

Treasury issued its final rule against BDA in March of 2007, indicating that its internal controls were still too weak, that the receivership was temporary, that it had engaged in large suspicious transactions, and that a historical review of the bank "revealed a deliberate effort to attract and maintain high-risk accounts regardless of their nexus to illicit activities."[53] The rule noted that the bank's accounts included customers who had connections to entities involved in trade in counterfeit

[47] 70 Fed. Reg. 55216 (Sept. 20, 2005).

[48] *See e.g.*, David Lague and Donald Greenlees, *Squeeze on Banco Delta Asia Hit North Korea Where It Hurt: Disruption of Funds at Macao Bank Hits the Regime Hardest*, INT'L HERALD TRIBUNE, Jan. 18, 2007 (noting that no sanction against North Korea "seems to have stung as much" as the special measures imposed on BDA); Anna Fifield, *North Korea Passed Tens of Millions Via Macao Bank*, FINANCIAL TIMES, Dec. 18, 2006 (noting that "the actions in Macao have dealt a severe blow to North Korea's already moribund economy, severely limiting Pyong-yang's ability to earn foreign exchange and leading to banks in China and Vietnam to refuse to operate accounts with links to North Korea.").

[49] Fifield, *supra* note 48.

[50] David Ignatius, *U.S. Sanctions With Teeth*, WASHINGTON POST, Feb. 28, 2007, A19 (noting that the targeted financial measures contained in Section 311 have been "more powerful than many thought possible"); Lague, *supra* note 48.

[51] David Lague, *Macao Bank Challenges U.S. Ban as Politically Based*, NEW YORK TIMES, Apr. 17, 2007, A6.

[52] Kevin Hall, *Audit Clears Tiny Bank of U.S. Charges*, FORT WORTH STAR-TELEGRAM (McClatchy News Service), A9.

[53] 72 Fed. Reg. 12734 (March 19, 2007).

currency, cigarettes, and narcotics, and companies suspected of laundering hundreds of millions of dollars through the bank. It also noted that the bank offered bulk currency depositors a discount, notwithstanding the risk of counterfeiting. The finding stopped short of accusing the bank of knowingly engaging in counterfeit transactions.

BDA, in turn, defended itself in public statements to the media, claiming that the large cash transactions were a fact of life in dealing with the cash-based economy of North Korea,[54] and has announced its intention to seek review of the decision.[55] In the meantime, North Korea, in protest, discontinued its nuclear non-proliferation talks with the United States and has refused to continue negotiations until the $25 million frozen as a result of the Section 311 action is returned to North Korea. The money has reportedly been unfrozen with the blessing of the United States, but it appears that it has not been returned to North Korea.[56] In a testament to the reach of Treasury's use of the Section 311 sanction, it appears that the money is not being returned, and the sensitive talks are being held up, because no financial institution is willing to accept the funds for fear of adverse consequences.[57]

We do not intend to suggest that the sanctions on BDA are unjustified. Like the rest of the world, we simply have no evidence upon which to make a judgment about the reasonableness of Treasury's actions. Rather, our point is that the imposition of Section 311's most powerful special measures must be limited to situations in which the threat is great and then only when a strong evidentiary record, based on credible evidence that can be made public, supports the action. Otherwise, the United States may find that it has undermined its own credibility and alienated key allies needed to combat the very real threat posed by international money laundering. If we do so, we will have then moved away from our goal.

CONCLUSION

Section 311 gives the U.S. government a broad range of powers to combat dirty money and those who seek to move and hide it, and the government has begun to use these powers with significant effect. We can expect to see increased use of Section 311 in the future. In wielding this powerful weapon, government officials need to balance the great benefits it provides against the potential negative consequences of a greater regulatory burden on U.S. financial institutions and the potential major setback for U.S. policy goals if a decisive blow against a foreign institution proves to be based on inaccurate intelligence. U.S. financial institutions should anticipate being asked to assist the campaign against money laundering by complying with Section 311 sanctions imposed on foreign entities and, if the government begins using the record keeping and reporting special measures, by adding these requirements to their regulatory obligations. At least, U.S. institutions can take comfort in the knowledge that, if properly applied in a focused manner, Section 311 special measures can be a truly effective tool to combat money laundering. ■

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[54] Greg Torode, *Macau Bank Did Not Deal In Face Notes: Report; Banco Delta Cleared Of Key Allegation*, SOUTH CHINA MORNING POST, Apr. 18, 2007, p. 1.

[55] Lague, *supra* note 51.

[56] Foster Klug, *Bush Advisor Urges North Koreans to Act*, WASHINGTON POST, Apr. 24, 2007.

[57] Robin Kwong, *Banks Shun Korea Fund*, FINANCIAL TIMES (U.S. edition), Apr. 18, 2007, p. 4.