WorldECR

The journal of export controls and compliance

General enquiries, advertising enquiries, press releases, subscriptions: info@worldecr.com

Contact the editor, Tom Blass: tnb@worldecr.com tel +44 (0)7930405003

Contact the publisher, Mark Cusick: mark.cusick@worldecr.com tel: +44 (0)7702289830

WorldECR is published by D.C. Houghton Ltd.

ISSN 2046-4797. Refer to this issue as: WorldECR [0205]

Correspondence address: D.C. Houghton Ltd, Suite 17271, Lower Ground Floor, 145-157 St John Street, London EC1V 4PW England

D.C. Houghton Ltd is registered in England and Wales (registered number 7490482)
with its registered office at 145 - 157 St John St, EC1V 4PY, London, UK

ISSUE 15. SEPTEMBER 2012
www.WorldECR.com

The story behind Standard Chartered Bank's $340m settlement


The SCB case is just the latest in a series of high-profile and increasingly aggressive enforcement actions against non-U.S. banks. F. Amanda DeBusk and Lynn G. Kamarck examine the facts and ask what the action and settlement mean for the international banking community.

On 14 August, Standard Chartered Bank ('SCB'), a wholly owned subsidiary of Standard Chartered plc, a UK-based bank, reached a $340 million settlement with New York State's Department of Financial Services ('DFS') over charges that it violated money-laundering provisions in connection with its handling of Iranian transactions. This case is the latest in a string of $100 million-plus bank settlements involving Iran and other sanctioned countries. The case reaches new heights of aggressiveness because many of the allegations relate to activity that was lawful under federal law at the time of the activity. In addition, SCB is facing investigations by federal agencies on related charges.

One of the most striking aspects of this case was that a newly created New York State agency, the DFS, jumped out ahead of other federal and state agencies in reaching this settlement. The trend in recent cases has been for the relevant federal/state agencies to cooperate in the investigation and to reach a joint settlement agreement with the target company. The DFS forced a separate settlement by scheduling a hearing on the question of whether the alleged violations justified SCB's loss of its New York banking licence. By reaching a settlement, SCB avoided such a hearing.

Some have faulted DFS, alleging that this was a publicity grab by DFS head, Benjamin Lawksy, a long-time aide to New York governor Andrew Cuomo, or that it was an effort to set Lawsky up as a kind of alternative New York attorney general, continuing a turf war with the actual attorney general, Eric Schneiderman, that began when Cuomo left the office. Others have argued that this is a political coup for New York governor Cuomo, whose aspirations for higher political office are well known. Regardless, the implications for SCB and for future prosecutions against foreign banks are significant. This case has sent shock waves through the foreign banking community as many foreign banking institutions are now re-evaluating whether they want to continue to operate in New York.

Allegations against SCB

The DFS Order Pursuant to Banking Law §39 (hereinafter 'complaint') was strongly worded. It characterized SCB as a 'rogue institution' and quoted one of its executives as saying: 'You (expletive) Americans. Who are you to tell us, the rest of the world, that we're not going to deal with Iranians.' [1]

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According to the DFS complaint, for nearly a decade, SCB engaged in deceptive and fraudulent misconduct in order to move at least $250 billion through its New York branch on behalf of client Iranian financial institutions that were subject to U.S. economic sanctions. In particular, according to the complaint:

- From January 2001 through 2007, SCB conspired with its Iranian clients to route nearly 60,000 U.S. dollar payments through SCB's New York branch after first stripping information from wire transfer messages used to identify sanctioned countries. SCB replaced the stripped information with false entries. (DFS complaint at ¶¶ 3 & 4).
- SCB intentionally withheld material information from New York and federal regulators in its effort to service Iranian clients (allegedly aided by its independent accounting firm). (DFS complaint at ¶ 6).
- SCB made misrepresentations to state and federal regulators. SCB was already subject to a formal enforcement action between 2004 and 2007 for other regulatory compliance issues relating to Bank Secrecy Act and anti-money laundering policies and procedures. The complaint alleges that, with the assistance of its independent accounting firm, SCB presented a 'watered-down' report to regulators and lied to regulators regarding its practice of wire stripping. (DFS complaint at ¶¶6, 45 & 46).
- SCB engaged in a cover-up in that SCB provided only very abbreviated U-Turn data in response to a request from New York regulators. (DFS complaint at ¶ 48).

One of the striking aspects of the DFS complaint is that it extensively quotes from emails providing damning legal advice.[2] SCB appears to have been harmed by a decision to waive attorney-client privilege. While firms often hand over privileged documents to investigators in an effort to appease U.S. authorities, that practice generally comes with an understanding that the information will not be made public. Apparently DFS did not follow such an approach.

Dispute as to the treatment of 'U-Turn' transactions

SCB has disputed the magnitude of the violations and claims that only $14 million of its transactions were unlawful. The dispute as to the

magnitude of violations arises from the treatment of so-called 'U-Turn transactions'. Prior to November 2008, the Iranian Transactions Regulations ('ITR'), administered by Treasury Department's Office of Foreign Assets Control ('OFAC'), authorized U.S. depository institutions to process funds transfers to or from Iran, or for the direct or indirect benefit of persons in Iran, if the transfers were initiated outside the United States by non-Iranian foreign financial institutions and ended up with other non-Iranian foreign financial institutions and met other conditions.[3] U-Turn transactions were legal under the ITR in effect during the time that SCB's alleged activity occurred (2001 through 2007), but the U-Turn exemption was revoked on 6 November 2008.

In count 7 of the DFS complaint, DFS alleges that SCB failed to comply with 560.516 of the ITR (31 CFR 560.516) in that SCB 'prevented its New York branch from determining whether the underlying transactions were permissible under 31 CFR 560.516 before effecting them'[4]. However, it is not clear that this stripping was illegal under the OFAC regulations if the underlying transaction was still permissible under the U-Turn rules.

Indeed, OFAC has weighed in on this issue, disagreeing with DFS' interpretation of the OFAC regulation. In an 8 August 2012 letter to Tom Scholar, second permanent secretary, HM Treasury, Adam Szubin, director, OFAC, took the position that, before the ITR was amended in 2008 to revoke the U-Turn transaction exemption, subsection 560.516(c) of the ITR required U.S. financial institutions, including foreign financial institutions operating in the U.S., to confirm the applicability of a licence 'only if the institution holds an account for a customer that is initiating or receiving a payment – generally, the first and last banks in a transaction. Because U.S. financial institutions could not serve as either the originating or recipient bank on offshore-to-offshore U-Turn transactions, this subsection did not apply to U.S. financial institutions serving as intermediaries on licensed U-Turn transactions.' The bottom line is that in a U-Turn transaction, the U.S. bank, by definition, would not be transferring money to or from one of its customers, so 31 CFR 560.516(c) would not be applicable.

DFS' interpretation of section 560.516 is at odds with the federal agency (OFAC) in charge of administering this provision.

Thus, DFS' interpretation of section 560.516 is at odds with the federal agency (OFAC) in charge of administering this provision. While Mr. Szubin's letter to Mr. Scholar further notes that this analysis of pre-2008 and post-2008 OFAC regulations 'is not a comment on the August 6, 2012 Order issued by the [DFS against SCB],' it is hard not to read it as such. Mr. Szubin did not, however, rule out the possibility that SCB may have violated other provisions of the OFAC regulations, and indeed noted in his letter that OFAC 'is investigating [SCB] for potential Iran-related violations as well as a broader set of potential sanctions violations'.

Falsified books and records

Despite OFAC's position that the stripping/alteration of information with respect to U-Turn transactions did not constitute a violation of section 560.516(c) while the U-Turn exemption was still in effect, that does not mean that financial institutions may strip/alter information without running afoul of other provisions of U.S. law, including sanctions provisions.

First, most of the DFS complaint is premised on violations of New York State regulations. In particular, the DFS order claims that SCB:

- Count 1 – failed to maintain accurate books and records (NYBL §200-c);
- Count 2 – obstructed governmental administration (P.L. §195.05);
- Count 3 – failed to report crimes

Can banks expect more prosecutions?

DFS is a relatively new agency, having been established in October 2011. Its posture in this case indicates an aggressive stance against banks operating in New York. DFS may be encouraged to continue to act unilaterally in the future, since by doing so, it was able to keep all of the settlement amounts instead of sharing them with other regulatory agencies, as is typically done. However, the relevant federal agencies are reportedly angered by DFS's decision to go it alone and they may exert pressure on DFS to cooperate with them on the next case.

There has been a recent trend toward aggressive enforcement of U.S. economic sanctions and money-laundering provisions against foreign financial institutions. In addition to the ING Bank settlement discussed above, other recent enforcement cases against foreign financial institutions include:

- $500 million Department of Justice ('DOJ') settlement against ABN AMRO Bank, N.V., now known as the Royal Bank of Scotland ('RBS') in 2010 for violations of U.S. sanctions law. (OFAC had previously settled with RBS for $40 million in 2006);
- $298 million DOJ settlement with Barclays Bank in 2010 (OFAC's penalties deemed satisfied by DOJ settlement);
- $536 million DOJ settlement with Credit Suisse in 2009 (OFAC's penalties deemed satisfied by DOJ settlement); and
- $567 million settlement with Lloyds TSB Bank in 2009 (including $350 million payment to DOJ and $217 million payment to OFAC).

All of these settlements included accusations that the banks stripped out identifying information from transfer and routing documentation before processing transactions through U.S. financial institutions and that the banks were actively involved in evading U.S. sanctions.

There are already reports of at least four other European banks being investigated by U.S. authorities for alleged sanctions and money-laundering violations. While the focus is on the European banks right now, there is a good chance the U.S. regulators will continue around the globe to Latin American banks and elsewhere.

and misconduct (2 N.Y.C.R.R. §300.1);
- Count 4 – falsified books and reports (N.Y.B.L. §672.1);
- Count 5 – offered false instrument for filing (P.L. §175.35); and
- Count 6 – falsified business records (P.L. §175.10).

Second, as evidenced in the recent ING Bank NV ('ING Bank') joint settlement, the intentional manipulation and deletion of information in clearing transfers of funds through the U.S. banking system can be the basis for a finding of sanctions and other violations. In June of this year, ING Bank, a Netherlands-based financial institution, reached a $619 million joint settlement with OFAC, the U.S. attorney's office for the District of Columbia, the Justice Department's National Security Division and Asset Forfeiture and Money Laundering Section, and the New York County district attorney's office. Not only did the OFAC settlement agreement list repeated instances of intentional manipulation,[5] but the Justice Department's criminal information described the criminal removal of references to sanctioned parties/countries,[6] and the New York district attorney focused on violations of New York's false records provisions.

In addition, Mr. Szubin's 8 August letter to Tom Scholar did not rule out the possibility that OFAC would find that SCB's stripping of transactions violated OFAC provisions. Indeed, as described above, Mr. Szubin expressly stated that OFAC was investigating SCB for sanctions violations.

What next for SCB?

As part of its settlement with DFS, SCB agreed to install a monitor for a term of at least two years who will report directly to DFS. DFS examiners will be placed on site at the bank and, in addition, SCB agreed to permanently install personnel within its New York branch to oversee and audit any offshore money-laundering due diligence and monitoring undertaken by the bank.[7]

DFS has indicated that it has ongoing investigations into similar SCB schemes to conduct business with other U.S.-sanctioned countries, such as Libya, Myanmar and Sudan.[8]

SCB is not off the hook yet, and it appears that it still has legal challenges ahead.

OFAC and Justice have both announced that they will also be bringing actions against SCB. A settlement will also likely include the Justice Department and the Manhattan district attorney. These agencies may feel pressured to reach significant settlements with SCB to demonstrate that they are just as aggressive in enforcement as DFS.

Thus, SCB is not off the hook yet, and it appears that it still has legal challenges ahead.

Conclusion

The SCB case is another in a series of U.S. enforcement actions against foreign banks. U.S. federal and state regulators have become increasingly aggressive in their enforcement of sanctions, money-laundering and records provisions. Banks are clearly under pressure to settle these cases even when the grounds for the allegations may be questioned if they want to continue to do business in the United States.

Links and notes

1 DFS Complaint at ¶ 8.

2 For example the complaint quotes an email from SCB's general counsel as stating that 'if SCB London were to ignore OFACs regulations AND SCB NY were not involved in an way & (2) had no knowledge of SCB Londons [sic] activities & (3) could not be said to be in a position to control SCB London, then IF OFAC discovered SCB Londons [sic] breach, there is nothing they could do against SCB London, or more importantly against SCBNY.' He also instructed that a memorandum containing this plan was 'highly confidential & MUST NOT be sent to the US.' Complaint ¶ 20 (emphasis in original).

3 Specifically, prior to November 2008, Section 31 CFR 560.516(a) of OFAC's ITR authorized U.S. depository institutions to process funds transfers to or from Iran, or for the direct or indirect benefit of persons in Iran, if the transfers: (a) did not involve the debiting or crediting of an Iranian account maintained on the books of a U.S. depository institution (the accounts of both the ultimate originator and beneficiary were held on the books of a non-U.S. financial institution); and (b) did not involve a person or entity whose property and interests in property are blocked, such as a bank designated by OFAC pursuant to U.S. sanctions on proliferators of weapons of mass destruction.

4 The specific provision relied upon is section 560.516(c), which provides: 'Before a United States depository institution or a United States registered broker or dealer in securities initiates a payment on behalf of any customer, or credits a transfer to the account on its books of the ultimate beneficiary, the United States depository institution or United States registered broker or dealer in securities must determine that the underlying transaction is not prohibited by this part.'

5 Settlement agreement between U.S. Department of the Treasury's Office of Foreign Assets Control and ING Bank N.V. MUL-565595 (11 June 2012).

6 For example, the Justice Department's criminal information in the ING Bank case states, 'Although payments may have complied with exceptions in the [OFAC regulations] then in effect, ING Bank employees removed all references of Iran in payment messages sent to the United States to ensure that unaffiliated correspondent U.S. financial institutions could not identify the Iranian origin of the transactions, without making any determination as to whether the underlying transactions were legal or illegal.' United States v. ING Bank, N.V., No. 12-CR-00136-PLF, criminal information (D.D.C. 12 June 2012).

7 Statement from Benjamin M. Lawsky, Superintendent of Financial Services, regarding SCB. (14 August 2012).

8 DFS complaint at footnote 1.

F. Amanda DeBusk is a partner at Hughes Hubbard & Reed in Washington, D.C., and chair of the firm's international trade department. She serves as a private-sector adviser to the State Department on sanctions policy. She previously served as U.S. Commerce Department Assistant Secretary for Export Administration.

Lynn Kamarck is counsel at Hughes Hubbard & Reed, where she concentrates on export controls, sanctions and trade remedies matters. She previously served as senior counsel for antidumping and countervailing duty proceedings at the Commerce Department.

DeBusk@HughesHubbard.com

Kamarck@Hugheshubbard.com.