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Compliance Lessons from OFAC Case Studies—Part I

By Paul L. Lee*

This first part of a two-part article analyzes the initial regulatory and law enforcement actions against ABN AMRO Bank N.V., Lloyds TSB Bank plc, Credit Suisse AG, and Barclays Bank PLC for OFAC violations. Part II will analyze the subsequent wave of actions against ING Bank, N.V., Standard Chartered Bank, HSBC Holdings plc, and BNP Paribas S.A. for OFAC violations. At bottom, these case studies provide a cautionary tale of the challenges for global compliance with a national regime when political, cultural, and legal norms among jurisdictions are not adequately aligned.

Introduction

The recent law enforcement actions against Credit Suisse AG and BNP Paribas S.A. represent a new high-water mark in criminal sanctions against the banking sector, though a mark that may yet be exceeded in the near future. These actions have produced a heated and healthy debate on a range of issues underlying the use of criminal sanctions. The range of issues is impressive. How effective have these law enforcement actions been in addressing the perceived "too big to jail" or "too big to indict" phenomenon? How effective can any law enforcement action be in deterring behavior by an incorporeal and insensate entity? What relative priority should be assigned to law enforcement actions against individuals as distinguished from law enforcement actions against corporations? What are the financial and reputational consequences of requiring financial institutions to plead to a criminal offense?

There are other prominent issues as well. How can the law enforcement and regulatory authorities balance the cross-cutting considerations of imposing ever increasing monetary penalties on financial institutions to deter improper behavior against the consequences to the employees and shareholders of the institutions and perhaps even to the stability of the financial system itself? How can law enforcement authorities address the market perception that certain of their recent actions have been motivated in indeterminate part by political considerations, such as responding to public resentment over the financial crisis? How can law enforcement authorities address the further perception that they may be willing to take more draconian action against foreign financial institutions than against domestic financial institutions—other than perhaps by taking more draconian action against domestic financial institutions?

These and other policy questions are implicated by the recent law enforcement actions against foreign banks and financial institutions. Analysis of the consequences of these actions will continue to emerge from various contending quarters in the

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aftermath of these actions. This article does not essay an analysis of the consequences of these actions. Instead, it seeks to analyze the causes of these actions, principally from the perspective of the financial institutions involved.

Collective Patterns of Behavior

The law enforcement action against BNP Paribas S.A. for violations of U.S. sanctions laws and regulations issued by the Office of Foreign Assets Control ("OFAC") follows seven previous law enforcement actions against foreign banks for OFAC violations in the last five years. The law enforcement action against Credit Suisse AG for aiding and abetting tax evasion by its U.S. customers follows law enforcement actions against UBS AG in 2009 and Wegelin & Co. in 2013 and a publicly announced amnesty program for other Swiss banks that may have assisted U.S. customers in evading U.S. taxes (for which 106 Swiss banks have applied). In both cases, the questionable practices persisted over an extended period before they came to light or before they were challenged by the U.S. authorities. In both cases, there have also been suggestions that the U.S. authorities were on notice for years that the practices existed and that it was only the enforcement position of the U.S. authorities that in recent years had changed.

Both situations involve practices that appear to have been widespread—among European banks in the OFAC cases and among Swiss banks in the tax cases. The prevalence of the questionable practices in each area and the competitive effects of the practices may have induced other financial institutions to adopt the practices. It is clear in hindsight, however, that crossing these streets in a crowd provided little or no protection to the members of the crowds. It is also clear that, in both cases, individual institutions missed opportunities to recalibrate their exposure on these practices in response to market or regulatory developments. Rather than recalibrate their exposure, some institutions actually increased their exposure. For example, in some instances, as individual institutions withdrew from a segment of a market or from a segment of customers, other institutions consciously took the opportunity to take over the market segment or the customers.

This article analyzes the approach that the institutions took in adopting their practices in the sanctions area. Part I analyzes the initial regulatory and law enforcement actions against ABN AMRO Bank N.V., Lloyds TSB Bank plc, Credit Suisse AG and Barclays Bank PLC. Part II will analyze the subsequent wave of actions against ING Bank, N.V., Standard Chartered Bank, HSBC Holdings plc and BNP Paribas S.A. This article seeks to provide some insight into the factors that have led to what are now regarded as broad-ranging failures in risk management and compliance.

Each Unhappy in Its Own Way

There are a number of common themes in the stories of how these institutions came to adopt their practices in the sanctions area. Notwithstanding these common themes, the story of each of these banking families is unhappy in its own way. Some of these institutions sought legal advice on OFAC issues in the early stages of their practices; some did not. Of those that sought legal advice at an early stage, some

followed it; some did not or at least did not effectively communicate the advice or implement it in their extended family, or perhaps did not fully comprehend the advice. Some of the institutions identified the issues with their practices at a later stage; some did not. Of those that identified their issues with the OFAC rules at a later stage, some remediated their issues relatively promptly; some did not. Of those that self-identified the issues, some self-reported the issues to OFAC; some did not. If there is one common theme among these stories, however, it is as noted above that almost all the institutions missed one or more opportunities to recalibrate their exposure on OFAC issues or to recalibrate their exposure earlier than they ultimately did.

There are pointed lessons here for the compliance and legal functions in these institutions. In some cases the compliance or legal function objected to a practice as presenting legal or reputational risk, but was unable to change the practice. In some cases the compliance or legal function identified the risk, but acquiesced in the practice because it was thought to be important to the business function. In some cases it appears that the compliance or legal function may actually have become complicit in the practice by expressly approving it.

There are also lessons here for the U.S. authorities. From the mid-1990s the U.S. sanctions framework grew in significance in response to concerns for terrorism and nuclear proliferation. These case studies tell a story of an understudied legal regime and of potential ambiguities in the regime and in the enforcement posture of the U.S. authorities with respect to the extraterritorial application of the regime. At the same time, they tell a story of behavior—by business managers, compliance personnel and legal personnel—in response to that regime that exposed their institutions wittingly or unwittingly to significant legal and reputational harm. At bottom, these case studies provide a cautionary tale of the challenges for global compliance with a national regime when political, cultural and legal norms among jurisdictions are not adequately aligned.

ABN AMRO Bank N.V.

The first public indication that systemic compliance issues might lurk in the U.S. dollar clearing practices of foreign banks came with the high-profile regulatory enforcement actions taken against ABN AMRO Bank N.V. ("ABN") in December 2005.[1] The Board of Governors of the Federal Reserve System, the New York State

[1] Prior to the ABN regulatory enforcement orders, there were indications of weaknesses in the correspondent banking and wire transfer activities of certain foreign banks. *See, e.g., In the Matter of Federal Branch of Arab Bank PLC*, Consent Order No. 2005-14 (Feb. 24, 2005), *available at* http://www.occ.gov/news-issuances/news-releases/2005/pub-consent-order-2005-14.pdf (requiring the closure of all correspondent accounts and wire transfer activity at the New York branch of Arab Bank); *In the Matter of Banco de Chile, New York Branch*, Consent Order No. 2005-2 (Feb. 1, 2005), *available at* http://www.occ.gov/static/enforcement-actons/ea2005-11a.pdf (prohibiting the New York branch of Banco de Chile from accepting cover transactions or wire transfers that merely said "from one of our customers"). These enforcement orders reflected serious problems in wire transfer activities, but may have been thought to represent idiosyncratic problems of the particular banks involved.

Banking Department, Illinois Department of Financial and Professional Regulation, and De Nederlandsche Bank N.V. (the Central Bank of the Netherlands) entered into a Consent Cease and Desist Order with ABN and its New York and Chicago branches (the "ABN Consent Order"), arising from "systemic defects" in ABN's anti-money laundering processes and its processes for ensuring compliance with OFAC sanctions regulations.[2] The ABN Consent Order was accompanied by a Civil Money Penalty Assessment Order (the "ABN Penalty Order") in the aggregate amount of $80 million issued by the U.S. banking regulators and OFAC.[3]

In the nature of bank supervisory orders, the ABN Consent Order and the ABN Penalty Order contained only an abbreviated statement of the practices that prompted the Orders. A recital in the ABN Consent Order stated that in response to a supervisory written agreement entered into by ABN and the banking authorities in July 2004, ABN had discovered a pattern of previously undisclosed unsafe and unsound practices that warranted further enforcement action.[4] Another recital in the ABN Consent Order referenced the fact that one of ABN's overseas branches had implemented "special procedures" for certain funds transfers, check clearing operations, and letter of credit transactions that were designed and used to circumvent the compliance systems established by ABN's New York and Chicago branches to ensure compliance with U.S. laws, including in particular U.S. laws and regulations administered by OFAC.[5]

The recitals in the ABN Penalty Order issued by the banking supervisory agencies and OFAC provided more details on the ABN practices. While the recitals in the ABN Consent Order referred only to unsafe and unsound practices, the recitals in the ABN Penalty Order referred not only to unsafe and unsound practices, but also to violations of the Iranian and Libyan sanction rules issued by OFAC.[6] The recitals in

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[2] *In the Matter of ABN AMRO Bank N.V.,* FRB Dkt. No. 05-035-B-FB, 9-18 (Dec. 19, 2005) (Order to Issue a Direction; Order to Cease and Desist Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/121905attachment1.pdf.

[3] *In the Matter of ABN AMRO Bank N.V. et al.,* FRB Dkt. No. 05-035-CMP-FB (Dec. 19, 2005) (Order of Assessment of a Civil Money Penalty, Monetary Payment and Order to File Reports Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/.

[4] *In the Matter of ABN AMRO Bank N.V.,* FRB Dkt. No. 05-035-B-FB, 3 (Dec. 19, 2005) (Order to Issue a Direction; Order to Cease and Desist Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/121905attachment1.pdf. As is standard in bank enforcement orders, the ABN Penalty Order and the ABN Consent Order contained language stating that the ABN Penalty Order and the ABN Consent Order did not constitute an admission or a denial by ABN of "any allegation made or implied" by the supervisors who issued the order.

[5] *In the Matter of ABN AMRO Bank N.V.,* FRB Dkt. No. 05-035-B-FB, 3 (Dec. 19, 2005) (Order to Issue a Direction; Order to Cease and Desist Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/121905attachment1.pdf.

[6] *In the Matter of ABN AMRO Bank N.V.,* FRB Dkt. No. 05-035-B-FB, 3 (Dec. 19, 2005) (Order to Issue a Direction; Order to Cease and Desist Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/121905attachment1.pdf. A recital in

the ABN Penalty Order stated that prior to August 1, 2004, ABN's New York branch had processed wire transfers originated by Bank Melli Iran, an institution owned or controlled by the government of Iran, and that the payment instructions had been modified by one of ABN's overseas branches to remove any reference to Bank Melli Iran.[7] The recitals further stated that prior to August 1, 2004, ABN's New York and Chicago branches had also advised a number of letters of credit issued by Bank Melli Iran that had been reissued by one of ABN's overseas branches to remove any reference to Bank Melli Iran.[8] Similarly, prior to August 1, 2004, ABN's New York and Chicago branches had advised letters of credit for a U.A.E. chartered bank that was owned by the government of Libya, which letters of credit had been reissued by one of ABN's overseas branches to conceal the origin of the letters of credit.[9] The period during which these practices occurred was not specified in the ABN Penalty Order.[10] The recitals nonetheless appeared to suggest systemic and deliberate attempts by one of ABN's overseas branches to use the New York and Chicago branches of ABN to process transactions for Iranian and Libyan government entities in violation of OFAC regulations.

The remedial steps required by the ABN Consent Order were indicative of the reach of the jurisdiction of the U.S. regulators and the expanse of their expectations. The ABN Consent Order required ABN to develop an enhanced *global* regulatory

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the ABN Penalty Order stated that ABN was also subject to a penalty for failing to maintain appropriate books and records of all transactions effected at its New York branch as required by Section 200-c of the New York Banking Law. *In the Matter of ABN AMRO Bank N.V. et al.,* FRB Dkt. No. 05-035-CMP-FB, 6 (Dec. 19, 2005) (Order of Assessment of a Civil Money Penalty, Monetary Payment and Order to File Reports Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/. As discussed *infra*, the invocation of a books and records violation under New York Penal Law would play an even more prominent role in subsequent actions against other foreign banks.

[7] *In the Matter of ABN AMRO Bank N.V. et al.,* FRB Dkt. No. 05-035-CMP-FB, 5 (Dec. 19, 2005) (Order of Assessment of a Civil Money Penalty, Monetary Payment and Order to File Reports Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/.

[8] *In the Matter of ABN AMRO Bank N.V. et al.,* FRB Dkt. No. 05-035-CMP-FB, 5 (Dec. 19, 2005) (Order of Assessment of a Civil Money Penalty, Monetary Payment and Order to File Reports Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/.

[9] *In the Matter of ABN AMRO Bank N.V. et al.,* FRB Dkt. No. 05-035-CMP-FB, 5-6 (Dec. 19, 2005) (Order of Assessment of a Civil Money Penalty, Monetary Payment and Order to File Reports Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/.

[10] The ABN Penalty Order did contain a requirement that ABN retain an independent third party to review transactions in its Dubai branch and its Chennai, India operations center for the period from August 2002 through August 2004 to determine whether any transactions subject to OFAC regulations had been processed through or on behalf of any U.S. individual or entity. *In the Matter of ABN AMRO Bank N.V. et al.,* FRB Dkt. No. 05-035-CMP-FB, 11 (Dec. 19, 2005) (Order of Assessment of a Civil Money Penalty, Monetary Payment and Order to File Reports Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/.

compliance program for all matters related to compliance with applicable state and federal laws in the United States.[11] Among the various elements to be covered by the global compliance program were strategies for training both U.S. and non-U.S. employees on OFAC issues appropriate to the employees' job responsibilities, especially with regard to cross-border U.S. dollar payment processing procedures, policies to ensure that non-U.S. offices and affiliates do not engage in practices aimed at evading or circumventing compliance programs in the United States, and procedures throughout ABN for reporting known or suspected violations of U.S. laws and for resolving or escalating suspected violations.[12] The ABN Consent Order also required that a committee of ABN's supervisory board be responsible for overseeing the global compliance program for U.S. law, including conducting a review of all significant compliance incidents.[13] It also contained detailed requirements for enhanced internal audit procedures to identify compliance deficiencies relating to U.S. laws.[14] Finally, the ABN Consent Order also required strengthened head office oversight of the New York and Chicago branches, particularly with respect to compliance matters. The breadth of the horizontal and vertical elements in the required remedial program signaled the extent of the supervisory concerns with ABN's operations.

The ABN enforcement orders attracted significant press attention at the time. Shortly after the issuance of the orders, *The Wall Street Journal* carried a lengthy article providing further details of the ABN compliance problems. The title, *How Top Dutch Bank Plunged Into World of Shadowy Money*, foretold the thrust of the article.[15] The article told the story of how ABN ignored red flags and wound up processing more than $70 billion in suspicious or illegal transfers through its New York office.[16] The article also told the story of how the chief executive officer of ABN issued an order (later rescinded) to destroy an internal report on ABN's dealings with Iranian

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[11] *In the Matter of ABN AMRO Bank N.V.,* FRB Dkt. No. 05-035-B-FB, 8 (Dec. 19, 2005) (Order to Issue a Direction; Order to Cease and Desist Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/121905attachment1.pdf.

[12] *In the Matter of ABN AMRO Bank N.V.,* FRB Dkt. No. 05-035-B-FB, 10-18 (Dec. 19, 2005) (Order to Issue a Direction; Order to Cease and Desist Issued Upon Consent) *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/121905attachment1.pdf.

[13] *In the Matter of ABN AMRO Bank N.V.,* FRB Dkt. No. 05-035-B-FB, 8 (Dec. 19, 2005) (Order to Issue a Direction; Order to Cease and Desist Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/121905attachment1.pdf.

[14] *In the Matter of ABN AMRO Bank N.V.,* FRB Dkt. No. 05-035-B-FB, 11-13 (Dec. 19, 2005) (Order to Issue a Direction; Order to Cease and Desist Issued Upon Consent), *available at* http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/121905attachment1.pdf.

[15] Glenn R. Simpson, *How Top Dutch Bank Plunged Into World of Shadowy Money*, WALL ST. J., Dec. 30, 2005, at A1.

[16] Glenn R. Simpson, *How Top Dutch Bank Plunged Into World of Shadowy Money*, WALL ST. J., Dec. 30, 2005, at A1(quoting from an e-mail of an ABN executive in London who warned his U.S. colleagues that ABN had "been drinking in the Last Chance Saloon" and that the bartenders were "about to call time and present us with the tab!").

and Libyan entities.[17] The article described in particular how internal auditors at ABN in 2004 discovered that the Dubai branch of ABN had been falsifying information in wire transfers going to the New York branch "to skirt" U.S. sanctions against Iran and Libya and that the practice had gone on for approximately seven years. The article then offered a prescient observation on one of the arcane legal provisions in the Iranian sanctions rules:

> In many cases, the falsification [of the Iranian wire transfers] was unnecessary. Because the U.S. wants the dollar to remain the international currency of choice, it allows overseas companies to sell products to Iran and route the dollar-denominated payments through U.S. banks. If the Dubai branch had truthfully reported such transactions, it wouldn't have been violating any U.S. law.[18]

This was a reference to the so-called "U-turn" exemption in the OFAC Iranian Transactions Regulations (the "ITR"), which was to receive much attention in subsequent enforcement actions. Finally, the article confirmed that ABN was also subject to an ongoing investigation by the United States Department of Justice (the "DOJ") with respect to the practices identified in the regulatory enforcement orders.

A Detour for a Discussion of the U-Turn Exemption

The allusion in *The Wall Street Journal* story to the U-turn exemption requires a short detour in the narrative of OFAC enforcement actions to set the stage for subsequent developments. The U-turn general license or exemption, which was added to the ITR in June 1995 and remained in force until its repeal in November 2008, was unique to the Iranian country sanctions and distinguished the ITR from other country-based sanction programs.[19] The U-turn exemption in the ITR allowed a broad set of U.S. dollar transactions involving Iran to be processed by U.S. banking institutions. Simply stated, it allowed U.S. banks to process indirectly U.S. dollar payments involving Iran if the payment started and ended with a non-Iranian foreign bank outside the United States. More precisely stated, the exemption allowed a U.S. bank to process a transfer of funds to or from Iran or for the direct or indirect benefit of persons in Iran or the government of Iran when the transfer was by order of a non-Iranian foreign bank from its own account in a U.S. bank to an account held by a U.S. bank for a non-Iranian foreign bank. As OFAC has explained a U-turn transaction, it is one initiated offshore as a dollar-denominated transaction by order of a foreign bank's customer (the originating party); it then becomes a transfer from a correspondent account held by a U.S. bank for the foreign bank to a correspondent

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[17] Glenn R. Simpson, *How Top Dutch Bank Plunged Into World of Shadowy Money*, WALL ST. J., Dec. 30, 2005, at A1.

[18] Glenn R. Simpson, *How Top Dutch Bank Plunged Into World of Shadowy Money*, WALL ST. J., Dec. 30, 2005, at A1.

[19] Iranian Transactions Regulations: Implementation of Executive Orders 12957 & 12959, 60 Fed. Reg. 47061 (Sept. 11, 1995); Implementation of Executive Order 12959 With Respect to Iran, 60 Fed. Reg. 40881 (Aug. 10, 1995).

account held by a U.S. bank for another foreign bank.[20] The transfer ends up offshore as a transfer to a dollar-denominated account of the second foreign bank's customer (the beneficiary).

The U-turn exemption was created shortly after the issuance by President Clinton of Executive Order 12959 of May 6, 1995, which imposed broad restrictions on financial dealings by U.S. persons with Iran. The U-turn exemption was originally issued as an interim general license on June 1, 1995 and thereafter incorporated into the ITR as a general license or exemption when the ITR was revised in September 1995. The September 1995 Federal Register notice promulgating the revised ITR includes no discussion of the U-turn exemption nor does the August 1995 Federal Register notice publishing the original interim general license. Indeed, the only substantive discussion of the U-turn exemption appears in the November 2008 Federal Register notice, which repealed the exemption, and in a U.S. Treasury Department Fact Sheet that accompanied the repeal of the exemption.[21] The Fact Sheet describes how Iran's access to the international financial system through the U-turn exemption had enabled Iran to support terrorism and nuclear proliferation.[22] The Fact Sheet also describes how the Iranian regime disguised its involvement in its illicit activities through the use of a wide array of deceptive techniques designed to evade detection. One of these techniques was requesting non-Iranian banks to remove (or strip) any references to Iran from their transactions.[23] The Treasury Department had concluded that the U-turn exemption was being exploited by Iran. Indeed, starting in 2006, the Treasury Department had taken a series of steps to restrict the availability of the U-turn exemption to various Iranian government-owned banks because of their activities supporting terrorism and nuclear proliferation.[24] Based on the views expressed by the Treasury Department in 2006 and again

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[20] *See* Iranian Transactions Regulations, 73 Fed. Reg. 66541 (Nov. 10, 2008) (repealing the U-turn exemption).

[21] *See* Iranian Transactions Regulations, 73 Fed. Reg. 66541 (Nov. 10, 2008) (repealing the U-turn exemption).

[22] Press Release, U.S. Dep't of the Treasury, *Fact Sheet: Treasury Strengthens Preventive Measures Against Iran* (11/6/2008), *available at* http://www.treasury.gov/press-center/press-releases/Pages/hp1258.aspx.

[23] Press Release, U.S. Dep't of the Treasury, *Fact Sheet: Treasury Strengthens Preventive Measures Against Iran* (11/6/2008), *available at* http://www.treasury.gov/press-center/press-releases/Pages/hp1258.aspx.

[24] In 2006 the Treasury Department amended the U–turn exemption to exclude from it any transactions involving Bank Saderat. *See* Iranian Transactions Regulations, 71 Fed. Reg. 53569 (Sept. 12, 2006). Beginning in 2007 the Treasury Department designated a succession of other Iranian government-owned banks as Specially Designated Nationals, requiring the blocking of any transaction in which they had an interest and thereby also denying them the benefit of the U-turn exemption. For a discussion of these actions, see Danforth Newcomb, *Non-U.S. Banks Are Target of Recent Economic Actions by U.S. Government,* 125 BANKING L. J. 468 (2008). For an insider's view of the Treasury Department's program to isolate the Iranian banking sector, see JUAN C. ZARATE, TREASURY'S WAR: THE UNLEASHING OF A NEW ERA OF FINANCIAL WARFARE, 287–318 (2013). Zarate notes that when the Treasury Department first considered the possibility of taking targeted action against Bank Saderat in 2004, the

in 2008 at the time of the repeal of the U-turn exemption, one would scarcely be inclined to say of the U-turn exemption that nothing in its life became it like the leaving it.

There was, of course, a rationale for the exemption at the time of its inception. The common understanding of the rationale for the exemption was that it took account of the fact that Iranian oil sales were denominated in U.S. dollars as were most oil sales around the world.[25] To permit a relatively smooth functioning of the world oil markets, it was necessary to permit non-U.S. persons, particularly European and Asian allies of the United States, to continue to purchase Iranian oil. A small irony is that the exemption was also available to clear transactions involving foreign subsidiaries of U.S. oil companies, which were treated as non-U.S. persons under the ITR, and thus could continue to trade in Iranian oil in U.S. dollars. The exemption was also clearly intended to preserve the position of the U.S. dollar as the dominant currency in global trade and as the dominant global reserve currency. The exemption was also in keeping with a general concern in various quarters of the U.S. government about avoiding the unnecessary extraterritorial application of U.S. law.

There was in fact a precedent for the U-turn exemption in the ITR. A similar exemption was contained in the Iranian Assets Control Regulations (the "IACR") issued in November 1979 when the U.S. government first blocked Iranian assets.[26] At the time, there was much discussion in the leafy pages of legal journals and in the wood-paneled offices of foreign ministries about the extraterritorial effects of the initial U.S. blocking order. The exemption in the IACR was characterized by one U.S. commentator as an "innovative and creative" effort to limit the extraterritorial application of the Iranian blocking order and to minimize the risk of legal challenge to the IACR in foreign courts.[27] Even the somewhat limited extraterritoriality of U.S.

Deputies Committee of the National Security Council raised concerns about "inadvertently affecting global oil prices without gaining much in return." *Id.* at 291.

[25] *See* JUAN C. ZARATE, TREASURY'S WAR: THE UNLEASHING OF A NEW ERA OF FINANCIAL WARFARE, 308 (2013) (indicating that the U-turn exemption existed "as a realistic function of the oil markets" and that the decision to repeal the U-turn exemption was made in 2008 "despite concerns that oil prices would spike or the oil markets would be disrupted"). Those concerns did not materialize.

[26] Iranian Assets Control Regulations; Amendments, 44 Fed. Reg. 66832, 66833 (Nov. 21, 1979) (authorizing transfers by order of a non-Iranian foreign bank from its account in a U.S. bank to an account held by a U.S. bank for a second non-Iranian foreign bank that in turn credits an account held by it abroad for Iran). For a detailed discussion of the issues relating to the extraterritorial application of the IACR, particularly the exemption for transfers between U.S. dollar accounts held by foreign banks, see Robert Carswell & Richard J. Davis, *The Economic and Financial Pressures: Freeze and Sanctions, in* AMERICAN HOSTAGES IN IRAN: THE CONDUCT OF A CRISIS (1985). Messrs. Carswell and Davis were the senior Treasury Department officials responsible for implementing the IACR in 1979 and 1980. They specifically note that concern with allied reaction and with the position of the U.S. dollar were factors in the decision to exempt the clearing of transfers between foreign bank U.S. dollar accounts from the IACR. *Id.* at 179 n.8.

[27] *See* Michael P. Malloy, *The Iran Crisis: Law Under Pressure*, 1984 WIS. INT'L L.J. 15, 41-44 (discussing the issue of the extraterritorial effects of the IACR and the addition of a U-turn exemption to the IACR as one of the means used to limit the extraterritorial effects). *See also* Richard W. Edwards,

sanctions under the Trading with the Enemy Act (the "TWEA") and the International Emergency Economic Powers Act ("IEEPA") has been an abiding concern for foreign jurisdictions. That concern has been magnified by the expanded extraterritoriality of more recent U.S. sanctions laws, such as the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, the Iran Threat Reduction and Syria Human Rights Act of 2012, and the Iran Freedom and Counter–Proliferation Act of 2012.[28] Foreign jurisdictions have shown a strong antipathy to the successive extensions of extraterritoriality in U.S. sanctions measures. That antipathy is palpable in the reaction of many foreign commentators to the recent U.S. law enforcement actions against foreign banks. The same long-standing antipathy appears to have affected the thinking of many foreign banks themselves as they implemented their clearing practices.

Even as an historical matter, the U-turn exemption in the ITR presented issues. Its inclusion in the ITR created a negative implication for all other country-based sanctions, namely, that a non-U.S. person trading with persons in the other sanctioned countries in U.S. dollar-denominated transactions had no exemption to clear those transactions in the United States. Did the U.S. government assume that there was no U.S. dollar-denominated trade being conducted between non-U.S. persons and the countries subject to country-based sanctions, such as Cuba, Libya, and later the Sudan? Assuming that there were such transactions, how were they being cleared in the United States? It appears that the U.S. government must have assumed that such foreign trade existed, but concluded that the difficulty of trying to detect and enforce a complete boycott of these countries on foreign trade denominated in U.S. dollars, including by close allies of the United States, outweighed the advantages of achieving a complete boycott. Ultimately, the policy calculus would be different for Iran, where the United States would openly adopt as broad a boycott as possible by revoking the U-turn exemption and by encouraging allied countries to stop dealing with Iran in any currency. The addition of the U-turn exemption to the ITR in June 1995 nonetheless implicitly put foreign banks on notice that clearing U.S. dollar transactions for non-U.S. persons dealing with Cuba or Libya was a violation of the Cuban and Libyan sanctions regulations.

As noted above, the U-turn exemption was intended to allow the continuation of global trade with Iran in U.S. dollars by non-U.S. persons. In practice, however, the U-turn exemption may have become a trap, particularly for those foreign banks that focused on the presumed policy of facilitating global trade in U.S. dollars and not on the risk that they would be seen to be evading the legal requirements for the exemption through the use of certain mechanisms to clear the U.S. dollars.[29] As

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Jr., *Extraterritorial Application of the U.S. Iranian Assets Control Regulations*, 75 AM. J. INT'L L. 870 (1981).

[28] For a detailed discussion of the extraterritorial application of these recent sanctions laws, see Paul L. Lee, Satish M. Kini & Carl Micarelli, *Anti-Money Laundering and Economic Sanctions Laws, in* REGULATION OF FOREIGN BANKS AND AFFILIATES IN THE UNITED STATES § 13.12 (7th ed. 2013).

[29] Commentators have previously noted the risk of other traps in the OFAC regimes. *See, e.g.,*

subsequent law enforcement actions would confirm, certain foreign banks had been clearing U.S. dollar transactions involving Cuba and Libya well before the U-turn exemption was created for the ITR. To clear these transactions, these banks had already adopted techniques to modify the wire transfer instructions they sent into the United States or had come to rely on another payment technique, so-called cover payments, to clear the U.S. dollar transactions. As discussed further below, a cover payment refers to the use of a SWIFT MT 202 payment message to make a payment. A SWIFT MT 202 message is the standard message used to effect bank-to-bank credit transfers. A SWIFT MT 103 message is the standard message used to effect cross-border customer credit transfers. A MT 103 message calls for information on the originator and the beneficiary of the payment. The MT 202 message, during the time relevant to this discussion, did not require disclosure of the originator or the beneficiary of the payment and thus allowed payments to be processed that might otherwise have been rejected or blocked by the OFAC filter at U.S. banks. Foreign banks extended these same payment techniques to U-turn exempt transactions and in doing so created greater exposure for themselves.

The Gathering Storm

The regulatory enforcement orders issued against ABN in December 2005 were the first public indication of systematic practices by a foreign bank in evading OFAC sanction programs. It would take another three years, however, for the first criminal enforcement actions against a foreign bank on OFAC violations to occur. Although not publicly visible at the time of the issuance of the regulatory orders against ABN, a number of other large foreign institutions were already enmeshed in issues with their own U.S. dollar clearing practices. Some institutions had commenced reviews of their U.S. dollar clearing practices on their own well before the public announcement of the ABN regulatory orders. Other institutions had heard—in the months before the December 2005 announcement of the regulatory actions—that the U.S. authorities were investigating ABN's use of cover payments to process U.S. dollar transactions for sanctioned countries.

Indeed, it appears that at least as early as September 2005 OFAC had privately communicated to several foreign banks that suppressing information on payment messages might result in civil or criminal enforcement actions. A story appearing in *The Wall Street Journal* in January 2006 reported that in addition to ABN, Standard Chartered Bank, UBS, HSBC Holdings, and BNP Paribas were also being investigated by the DOJ for OFAC violations.[30] During the course of 2005 and 2006, the bank regulators began questioning other foreign banks about their use of cover payments and their practices in clearing U-turn transactions. In March 2006, a senior official from the Financial Crimes Enforcement Network in the Treasury Department remarked that "[c]over payment is a huge issue" because a cover payment

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Michael P. Malloy, *U.S. International Banking and Treasury's Foreign Assets Controls: Springing Traps for the Unwary*, 8 ANN. REV. BANKING L. 181 (1989).

[30] Glenn R. Simpson & John R. Wilke, *Sanction Threat Prompts Big Firms to Cut Iran Ties*, WALL ST. J., Jan. 31, 2006, at A3.

did not reveal information about who the originator of the funds transfer was.[31] The non-transparent nature of a cover payment presented problems for compliance not only with OFAC sanctions, but also more broadly with general anti-money laundering requirements.

At the same time, the U.S. Treasury Department commenced a diplomatic effort to encourage foreign banks in major European and Asian jurisdictions to cease doing business with Iran. It is not clear whether the Treasury Department understood at the outset of this initiative the full extent to which many large foreign banks were conducting business with Iran—not only in foreign currencies, but also in U.S. dollars, using cover payments to effect the dollar transfers. It is possible that even before the discovery of ABN's activities, the Treasury Department had access to some information about Iranian bank transfer activities through a confidential arrangement that gave the Treasury Department direct access to certain wire transfer records maintained by SWIFT.[32] In testimony delivered in June 2006, an official from the U.S. Treasury Department noted that in response to U.S. diplomatic efforts to forge an international approach to curtailing financial ties with Iran, UBS had ceased activities with Iran, Credit Suisse had announced that it would no longer establish new business relations with Iran, and ABN and HSBC had also curbed their dealings with Iran.[33] In March 2007, another senior U.S. Treasury Department official in discussing Iran's deceptive practices in sponsoring terrorism specifically noted that Iranian banks had requested other financial institutions to take their names off U.S. dollar transactions to evade controls put in place by responsible financial institutions.[34]

The December 2005 regulatory orders against ABN should have served as a warning to other foreign banks that practices like those engaged in by ABN would subject them not simply to diplomatic pressures, but also to regulatory and possibly criminal penalties. On the same day that a *Financial Times* story appeared in August 2007, reporting that the ABN regulatory orders had sent "seismic waves through the international banking system," another *Financial Times* story appeared reporting that the U.S. regulatory and criminal authorities had broadened the scope of the OFAC

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[31] *FinCEN Flags Wire Transfer Form as Concern for B/Ds*, COMPLIANCE REPORTER, March 31, 2006, *available at* http://www.complianceintel.com/pdf/cr040306.pdf.

[32] *See* JUAN C. ZARATE, TREASURY'S WAR: THE UNLEASHING OF A NEW ERA OF FINANCIAL WARFARE, 49–65 (2013) (discussing the access that the Treasury Department had to certain SWIFT records under a program called the Terrorist Financing Tracking Program). *See also* Glen R. Simpson, *U.S. Treasury Tracks Financial Data in Secret Program*, WALL ST. J., June 23, 2006, at A1.

[33] *Reauthorization of the Iran-Libya Sanctions Act: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 109th Cong. 26 (2006) (statement of Pat O'Brien, Assistant Sec'y, Office of Terrorist Financing & Financial Crimes, U.S. Treasury Dep't), *available at* http://www.treasury.gov/press-center/press-releases/Pages/js4331.aspx.

[34] *Minimizing Potential Threats from Iran: Assessing the Effectiveness of Current U.S. Sanctions on Iran: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 110th Cong. 64 (2007) (statement of Stuart Levy, Under Sec'y for Terrorism & Financial Intelligence, U.S. Treasury Dep't), *available at* http://www.treasury.gov/press-center/press-releases/Pages/hp325.aspx.

investigation that began with ABN to encompass other European banks.[35] Additional press stories appearing in March 2008 reported that Lloyds TSB Bank, Barclays Bank and Credit Suisse were also under investigation by the DOJ and the New York County District Attorney's Office (the "DANY") with respect to potential violations of OFAC regulations.[36] By this time, it was clear that the ABN regulatory enforcement orders were merely the opening shots in what would be a much broader enforcement campaign.

Lloyds TSB Bank plc

There was some fortuity, if not irony, in the fact that Lloyds TSB Bank plc ("Lloyds"), which was the first of the large foreign banks to exit the U.S. dollar clearing business for Iranian banks on its own initiative, was also the subject of the first criminal enforcement action against a foreign bank for conducting Iranian transactions. In January 2009, the DOJ and the DANY announced that they had entered into deferred prosecution agreements with Lloyds relating to "stripping" practices for U.S. dollar wire transfers similar to those identified in the ABN regulatory enforcement orders.[37] Lloyds subsequently entered into a settlement agreement with OFAC in December 2009 covering essentially the same matters.[38] Under the deferred prosecution agreements, Lloyds agreed to forfeit $350 million to the DOJ and the DANY. The Lloyds deferred prosecution agreements provided official confirmation that the type of practices cited in the ABN regulatory enforcement orders were not limited to ABN.

The initial investigation of Lloyds grew out of an investigation begun in 2006 by the DANY of suspicious money transfers to two Iranian-government front companies that owned an office building in New York. In the course of that investigation, the DANY uncovered evidence that Lloyds was involved in transferring funds into the United States on behalf of Iranian banks. Through its investigation of the Iranian front companies, the DANY confirmed, as it had previously in its investigation of Bank of Credit and Commerce International, that it served not only as a county sheriff, but also as an estimable member of an international constabulary.[39] Based on

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[35] Stephanie Kirchgaessner, *Banks Braced for Fines*, FIN. TIMES (Aug. 29, 2007), http://www.ft.com/intl/cms/s/0/0527e010-5672-11dc-ab9c-0000779fd2ac.html#axzz37fWbpnQO; Stephanie Kirchgaessner, US Steps Up Probe of EU Banks, FIN. TIMES (Aug. 29, 2007), http://www.ft.com/intl/cms/s/0/b0ae8198-5666-11dc-ab9c-0000779fd2ac.html#axzz37fWbpnQO.

[36] Stephanie Kirchgaessner & Peter Thal Larsen, *Three European Banks Face Joint US Probe*, FIN. TIMES (March 31, 2008), http://www.ft.com/intl/cms/s/0/2e7df67c-feae-11dc-9e04-000077b07658.html#axzz37fWbpnQO.

[37] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement); *Lloyds TSB Bank PLC and District Attorney of the County of New York Deferred Prosecution Agreement*, Jan. 9, 2009.

[38] Settlement Agreement, U.S. Dep't of the Treasury and Lloyds (Dec. 22, 2009), *available at* http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/lloyds_agreement.pdf.

[39] For a detailed description of how the DANY came to pursue its investigations of OFAC violations

its vigorous pursuit of the two Iranian front companies, the DANY assumed a leading role in the investigation of OFAC violations by foreign banks in New York.

The DOJ and the DANY contacted Lloyds in April 2007 and informed Lloyds of their joint investigation. Lloyds immediately started an internal investigation of its U.S. dollar clearing business. As the DOJ and the DANY acknowledged, Lloyds thereafter provided prompt and substantial assistance to the DOJ and the DANY by sharing the results of its internal investigation. The deferred prosecution agreement with the DOJ charged Lloyds with knowingly violating Sections 560.203 and 560.204 of the ITR, issued under IEEPA, which prohibit (a) the exportation from the United States of a service, including a financial service, to Iran and (b) any transaction *within the United States* that evaded or had the purpose of evading the ITR.[40]

The Factual Statement accompanying the deferred prosecution agreement with Lloyds was of its nature significantly more detailed than the 2005 ABN enforcement orders and provided a wider window on the practices in the U.S. dollar clearing market. The Factual Statement recited that beginning in June 1995, in response to the promulgation of the Iranian sanctions, Lloyds' U.K.-based international payments processing unit implemented a process to review manually all incoming wire transfer messages received from Iranian banks to ensure that references to Iran were removed from outgoing U.S. dollar wire transfer messages. This was to ensure that the wire transfers would pass undetected through the OFAC filters at the U.S. correspondent banks processing the payments.[41] This allowed certain transactions to be processed by U.S. correspondent banks that they would otherwise have been required to reject or block and thus caused these institutions unwittingly to provide services to sanctioned countries in violation of the U.S. sanctions laws.

Lloyds' staff referred to this process as "stripping" and memorialized the process in an internal document, anodynely entitled the *Payment Services Aide Memoire*.[42] The payments processing unit in Lloyds dedicated specific processors to focus exclusively on reviewing and amending, as necessary, payment messages for Iranian banks. The Factual Statement further noted that although certain of the Iranian transactions may have qualified for the U-turn exemption in the ITR, Lloyds' processing team made no inquiry into the existence of such an exemption for the wire transfer messages that

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by foreign banks, see Jessica Silver-Greenberg & Ben Protess, *Grieving Father Pulls a Thread That Unravels Illegal Bank Deals*, N.Y. TIMES, July 1, 2014, at A1.

[40] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007, 1 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement).

[41] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement), Exhibit A at 6-7. Unlike ABN, Lloyds did not clear U.S. dollar payments through its own U.S. branches in New York or Miami. Instead Lloyds cleared through other U.S. banking institutions.

[42] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement), Exhibit A at 7.

were being stripped.[43]

As the subsequent OFAC settlement agreement with Lloyds indicated, the stated rationale for Lloyds' policy with respect to Iranian transactions was to expedite these transactions because the OFAC filters used by U.S. correspondent banks were perceived to subject "legitimate payments," e.g., permissible U-turn transactions, to delays or blocking.[44] It is also possible that the Iranian banks wanted to shield information about their transactions from scrutiny by U.S. government authorities, including U.S. intelligence agencies. One of the issues for Lloyds is that it also applied similar procedures to its U.K.-based U.S. dollar correspondent accounts for Sudanese banks and other sanctioned entities, which were not entitled to a U-turn exemption. The Dubai and Tokyo branches of Lloyds also maintained U.S. dollar correspondent accounts for Iranian banks and processed payments for these banks that did not qualify for the U-turn exemption. The Dubai and Tokyo branches of Lloyds also engaged in U.S. dollar trade financing transactions, such as import and export letters of credit, that concealed the involvement of Iranian and Sudanese banks.

In early 2002, senior members of Lloyds' payments processing unit and the director of the Lloyds Group Financial Crime Unit raised concerns about the intentional removal of Iranian-related information from the payment messages, expressing the view that the process might violate U.S. law.[45] This questioning by the Lloyds staff may have been occasioned at least in part by the adoption in October 2001 by the Financial Action Task Force ("FATF") of a set of Special Recommendations on Terrorist Financing.[46] One of these recommendations, Special Recommendation VII, recommended that countries should take measures to require financial institutions to include accurate and meaningful originator information on wire transfers and that the information should remain with the transfer through the payment chain.[47]

FATF developed its Special Recommendations on Terrorist Financing at the same

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[43] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement), Exhibit A at 8.

[44] Settlement Agreement, U.S. Dep't of the Treasury and Lloyds, at 3 (Dec. 22, 2009), *available at* http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/lloyds_agreement.pdf.

[45] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement), Exhibit A at 11.

[46] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement), Exhibit A at 2. FATF is an intergovernmental body established in 1989 to develop and promote national and international policies to combat money laundering. In response to the terrorist attacks on September 11, 2001, FATF expanded its work to encompass combatting terrorist financing as well. *See* FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING: ANNUAL REPORT 2001-2002 (June 21, 2002), *available at* http://www.fatf-gafi.org/media/fatf/documents/reports/2001%202002%20ENG.pdf; FATF IX SPECIAL RECOMMENDATIONS (Oct. 2001) (incorporating all subsequent amendments until Feb. 2008), *available at* http://www.fatf-gafi.org/topics/fatfrecommendations/documents/ixspecialrecommendations.html.

[47] FATF IX SPECIAL RECOMMENDATIONS at VII (Oct. 2001) (incorporating all subsequent amend-

time that the United States was enacting the USA PATRIOT Act, its comprehensive legislative response to the September 11, 2001 terrorist attacks.[48] Among its many provisions, the USA PATRIOT Act required U.S. financial institutions, including the U.S. branches of foreign banks, to develop specific due diligence procedures for foreign correspondent accounts.[49] The enactment of the USA PATRIOT Act itself provided an opportunity for foreign banks with correspondent accounts in the United States to re-assess their practices with respect to such accounts.[50]

Other foreign banking institutions apparently did not use the adoption of the FATF Special Recommendations or the enactment of the USA PATRIOT Act as an occasion to re-assess the risks of providing undisclosed wire transfer services to Iranian banks and other sanctioned entities. Instead, as subsequent enforcement actions would show, several other foreign institutions responded to the adoption of the FATF Special Recommendations by switching to a cover payment approach to processing U.S. dollar payments for sanctioned entities as a way "to skirt" the recommendation. Thus, rather than re-assessing the appropriateness of their underlying practices (which were clearly called into question by the principles underlying the Special Recommendations), these institutions simply extended their risk by adopting another payment method to avoid the objectives of the Special Recommendations.

In apparent response to FATF Special Recommendation VII, the payments processing unit at Lloyds stopped their own manual stripping of information in payment messages. Instead, in July 2002, Lloyds' financial institutions unit began instructing Iranian banks on how they could "clean" the payment messages that they were sending to Lloyds. But staff in Lloyds' payments processing unit continued to raise concerns about the processing of U.S. dollar payments for Iranian banks. The staff in Lloyds' financial institutions unit, however, reasoned that Lloyds should continue to provide processing services to Iranian banks—in the words of the Factual Statement—"on the mistaken belief that because Lloyds is a U.K. institution it was

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ments until Feb. 2008), *available at* http://www.fatf-gafi.org/topics/fatfrecommendations/documents/ixspecialrecommendations.html.

[48] Pub. L. No. 107-56, 115 Stat. 272-502 (2001) (codified at various titles of the U.S. Code).

[49] Pub. L. No. 107-56, § 312(a), 115 Stat. at 304 (codified at 31 U.S.C. § 5318(i)). For a detailed discussion of the USA PATRIOT Act provisions applicable to foreign bank correspondent accounts, see Paul L. Lee, *The USA PATRIOT Act and Due Diligence Requirements for Foreign Correspondent and Private Banking Accounts: Parts I and II*, 2 J. OF PAYMENT SYSTEMS L. 87 (2006).

[50] Various commentators urged upon the domestic and foreign banking community the need for heightened caution with respect to their correspondent accounts. *See*, *e.g.*, Paul L. Lee, *USA PATRIOT Act Requirements for Foreign Banks*, *in* REGULATION OF FOREIGN BANKS § 1.01 (4th ed. 2007) (warning that the enactment of the USA PATRIOT Act had "reshaped the contours of political discourse and the bounds of regulatory action in the United States to an extent perhaps not fully understood by many foreign institutions or even some domestic institutions"). Writing more recently about the post 9/11 world, a former Treasury Department official has said that "[t]his was a new period, where the old rules no longer applied." JUAN C. ZARATE, TREASURY'S WAR: THE UNLEASHING OF A NEW ERA OF FINANCIAL WARFARE, 85 (2013).

not subject to OFAC regulations for such processing activity."[51] This was a freighted reference, because, as subsequent enforcement actions would indicate, personnel in other foreign banks also appeared to believe that their activities in their home country were not subject to the jurisdiction of U.S. laws. As subsequent enforcement orders also indicated, their sense of comfort may have been further fortified by the belief that their activities were not in violation of their home country laws.

In the Lloyds' case, the payments processing unit—the people who were closest to the stripping process—appeared to have voiced the strongest reservations about the practice, while other Lloyds' personnel, such as those in the financial institutions unit, endorsed the practice, based on a technical (and ultimately unavailing) interpretation of U.S. sanctions law. The instincts of the personnel in the payments processing unit proved correct, confirming perhaps the wisdom of Rousseau's observation that reason often deceives, but conscience never does. The instincts and scruples of the payments processing unit ultimately prevailed. In March 2003, the executive director of Lloyds' Group Risk Management unit advised the executive director of Lloyds' wholesale and international division that "regardless of whether the OFAC regulations applied to the [U.S. dollar] payment services, they should either operate on a fully transparent basis or be terminated."[52]

The Factual Statement indicates that the risk department of Lloyds then brought the issue of the U.S. dollar processing services for Iranian banks to the attention of the Lloyds Group Executive Committee (the "GEC") in April 2003.[53] The GEC asked for further information on the issue as a matter of urgency. In little more than a week, the risk group provided the GEC with further information and a written recommendation that the Iranian payments business be terminated on reputational grounds. On the same day that it received the recommendation, the GEC decided to terminate the business.[54] There was some delay in fully implementing the exit from Iranian business and business related to Libya and Sudan. But overall, Lloyds appears to have been one of the few foreign banks that self-initiated an exit from the business of providing U.S. dollar wire transfer services to a sanctioned country. As subsequent law enforcement actions indicate, other foreign banks were prepared to take over the Iranian business terminated by Lloyds with little or no compunction.

The Lloyds deferred prosecution agreements were sufficient to dispel any notion that the activities in question were not subject to U.S. laws, at least in the view of U.S. law enforcement authorities. The deferred prosecution agreement with the DOJ charged Lloyds with knowingly and willfully violating IEEPA and the ITR by

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[51] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement), Exhibit A at 12.

[52] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement), Exhibit A at 13.

[53] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement), Exhibit A at 13.

[54] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement), Exhibit A at 13.

falsifying payment messages being sent into the United States.[55] This charge was made against Lloyds even though Lloyds did not process any of these transactions through either of its U.S. branches in New York or Miami. Thus, it was clear that activities such as stripping would subject a foreign bank to criminal sanctions in the United States even if the foreign bank did not process any of the U.S. dollar transactions through its own operations in the United States and instead processed the U.S. dollar payments through unaffiliated U.S. banking institutions.

The separate deferred prosecution agreement with the DANY charged Lloyds with a violation of Section 175.10 of the New York Penal Law, which makes it a felony to cause a false entry or the omission of a true entry in the business record of an institution in New York, in this case, any institution in New York receiving the falsified wire transfer instructions sent by Lloyds.[56] This interpretation of the New York State Penal Law and its application to Lloyds' practices was significant in its own right. It provided the basis for asserting that wire transfer transactions that might otherwise meet the requirements for a U-turn exemption under the ITR would nonetheless constitute violations of the New York Penal Law if they were effected through the use of false or incomplete wire instructions sent into New York. This legal position would prove important in subsequent enforcement actions against other foreign banks.

It nonetheless appears that the forfeiture in the Lloyds deferred prosecution agreement was calculated based only on transactions that did not qualify for the U-turn exemption. The deferred prosecution agreement with the DOJ refers to approximately $350,000,000 in transactions that are described functionally in the relevant sections of the Factual Statement as transactions that would not qualify for the U-turn exemption.[57] The implications for forfeitures in future enforcement actions resulting from transactions that were stripped or processed as cover payments but otherwise were exempt under the U-turn provision of the Iranian regulations were left unclear by the Lloyds deferred prosecution agreements. The Lloyds criminal enforcement actions nonetheless assured that there would be future developments. The press release issued by the DANY indicated that the joint investigation of the DANY and the DOJ into stripping by other banks besides Lloyds was continuing.

Credit Suisse AG

The stripping practices cited in the Lloyds enforcement actions were subsequently shown to be more widespread in the U.S. dollar clearing market when the DOJ and the DANY brought deferred prosecution actions against Credit Suisse AG ("Credit

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[55] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007, 1 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement).

[56] *Lloyds TSB Bank PLC and District Attorney of the County of New York Deferred Prosecution Agreement*, Jan. 9, 2009 at 1; *United States v. Lloyds TSB Bank PLC*, No. CR-09-007 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement), Exhibit A at 5.

[57] *United States v. Lloyds TSB Bank PLC*, No. CR-09-007, 2 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement); *United States v. Lloyds TSB Bank PLC*, No. CR-09-007 (D.D.C. Jan. 9, 2009) (deferred prosecution agreement), Exhibit A at 13.

Suisse") in December 2009.[58] Under the deferred prosecution agreements, Credit Suisse agreed to a $536 million forfeiture, at the time the largest penalty in OFAC history. The criminal enforcement actions against Credit Suisse, like the earlier criminal enforcement actions against Lloyds, grew out of an investigation commenced in 2006 by the DANY of two Iranian-government front companies operating in New York. The DANY investigation had found evidence that Lloyds, Credit Suisse and other banks had processed wire transfer payments from Bank Melli Iran to the front companies.[59]

The Factual Statement accompanying the deferred prosecution agreements states that Credit Suisse engaged in criminal conduct by (i) removing or falsifying references from outgoing wire transfer messages sent to U.S. correspondent banks; (ii) advising sanctioned entities on how to evade automated filters at U.S. financial institutions; and (iii) causing U.S. financial institutions to process sanctioned transactions unknowingly.[60] These activities also prevented U.S. financial institutions from filing Bank Secrecy Act ("BSA") and OFAC-required reports, caused false information to be recorded in the records of U.S. financial institutions, and caused U.S. financial institutions not to make records otherwise required by U.S. law.[61] Although the legal charges in the deferred prosecution agreement with the DOJ related to violations of the Iranian sanctions, the Factual Statement also detailed Credit Suisse's stripping practices with respect to Libyan, Burmese, Sudanese and Cuban entities as well as individual Specially Designated Nationals. In respect of Iranian customers, the Factual Statement states that Credit Suisse altered U.S. dollar payment messages by removing Iranian customer names and putting in Credit Suisse's name, by substituting abbreviations for Iranian customer names, or by inserting the phrase "one of our customers" for the actual names of the Iranian customers.[62]

The Factual Statement described the background of Credit Suisse's practices as beginning as early as 1986 when Libyan sanctions were implemented by the United States. Shortly thereafter, Credit Suisse instituted an internal policy that stated that "[p]ayment orders of Libyan banks or government organizations to third party accounts in the United States or with U.S. banks abroad are to be executed without stating the name of the ordering parties."[63] Credit Suisse issued an internal instruction stating that the phrase "by order of a customer" could be used in payment messages if the ordering customer did not want to be identified.[64] These actions, which were intended to facilitate the continuation of Libyan transactions and to

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[58] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009); *Credit Suisse AG and District Attorney of the County of New York Deferred Prosecution Agreement*, Dec. 16, 2009.

[59] Press Release, District Attorney for the County of New York (Dec. 16, 2009) (on file with author).

[60] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 1.

[61] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 1.

[62] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 2.

[63] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 6.

[64] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 5.

evade their detection in the United States, laid the groundwork for a broader program to process Iranian transactions when the Iranian sanctions were promulgated in 1995.

After the promulgation of the Iranian sanctions in 1995, Credit Suisse implemented a system under which all MT 103 message payments involving Iran were manually reviewed before they were sent to U.S. financial institutions. This system allowed Credit Suisse employees to substitute such phrases as "by order of a customer" for a reference to an Iranian bank in the MT 103 message.[65] In 1998, when Credit Suisse outsourced its U.S. dollar clearing activities in the United States to the Bank of New York, Credit Suisse provided its Iranian clients with a pamphlet, entitled *How to transfer USD payments*, which included detailed instructions on how to avoid triggering OFAC filters at U.S. financial institutions.[66]

The Factual Statement revealed another practice that had grown up around Iranian transactions. The Factual Statement recited that in 1995 an Iranian bank requested that Credit Suisse process all its payments using a cover payment method.[67] As discussed above, a cover payment refers to a SWIFT payment message (MT 202) used to effect a bank-to-bank transfer. The historical MT 202 payment message did not require the disclosure of the originating party or the beneficiary.[68] The use of an MT 202 payment message shielded the identity of the originating party and the beneficiary for payments sent through U.S. financial institutions. Apparently, the use of cover payment messages dominated the Credit Suisse processing of Iranian payments. The Factual Statement states that Credit Suisse used cover payment messages approximately 95% of the time for outgoing customer payments involving Iran.[69] Credit Suisse also used cover payments to process U.S. dollar payments for Burmese, Sudanese, and Cuban entities, as well as various Specially Designated Nationals.

The adoption by FATF in October 2001 of Special Recommendation VII, which states that countries should require their financial institutions to include accurate and meaningful originator information in cross-border wire transfers, provided an opportunity for Credit Suisse to re-assess its practices with respect to the alteration of MT 103 payment messages.[70] The Swiss Banking Commission implemented Special Recommendation VII in 2004. As the Swiss rule was about to come into effect,

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[65] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 7.

[66] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 9–10.

[67] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 8.

[68] For a discussion of the historical use of cover payments and changes in the form of cover payment messages in November 2009 designed to provide originator and beneficiary information, see *New Standards for Cover Payments,* SWIFT.COM, http://www.swift.com/about_swift/shownews?param_dcr=news.data/en/swift_com/archived_news/home_page_stories_archive_2009_Newstandardsforcoverpayments.xml. *See also* The Wolfsberg Group & The Clearing House Association L.L.C., *Cover Payments: Some Practical Questions Regarding the Implementation of the New Payments Messages*, Aug. 18, 2009, *available at* https://www.chips.org/docs/070069.pdf.

[69] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 8.

[70] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 15.

Credit Suisse revised its internal procedures and prohibited the use of the phrase "by order of a customer" in payment messages. According to the Factual Statement, Credit Suisse thereafter used cover payment messages to process Iranian payments where it might previously have used MT 103 serial messages.[71]

It appears that Credit Suisse and other foreign banks missed another opportunity to re-assess their approach to doing business with sanctioned countries in 2002. Credit Suisse and a number of other leading international banking institutions had formed the Wolfsberg Group in 1999 to develop best practices for combatting money laundering. Following the terrorist attacks on the United States on September 11, 2001, the Wolfsberg Group in 2002 released the Wolfsberg Statement on the Suppression of the Financing of Terrorism.[72] Among the recommendations contained in that Statement was that governments and clearing agencies should develop uniform global formats for funds transfers that require information to assist in preventing and detecting the financing of terrorism. Apparently unknown to the units within Credit Suisse that were endorsing the disclosure of more complete information on wire transfers, other units were stripping information from wire transfers or otherwise avoiding the use of such information. Similarly, in 2002 the Wolfsberg Group adopted the Wolfsberg Anti-Money Laundering Principles for Correspondent Banking.[73] These Wolfsberg Principles, like the FATF Recommendations discussed above, were prompted *inter alia* by the USA PATRIOT Act provisions imposing due diligence requirements on foreign correspondent accounts and on activities for correspondent banking clients and were intended to establish best practices among leading international banking institutions.[74]

Credit Suisse had another opportunity during this period to re-assess specifically its Iranian payment practices. This opportunity arose in 2003 when, as previously noted, Lloyds decided to terminate its U.S. dollar clearing activities for all of its Iranian bank clients. In August 2003, Lloyds' Iranian bank customers agreed to move their U.S. dollar clearing business to Credit Suisse. The Factual Statement says that despite reports that Lloyds' Iranian customers did not want to diversify their correspondent accounts, "Credit Suisse did no due diligence to determine why nearly every Iranian bank customer left it for Credit Suisse."[75] As a result of this shift of business, Credit Suisse became one of the main dollar clearing banks for the Iranian banking system.

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[71] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 16.

[72] Press Release, The Wolfsberg Group, *Wolfsberg Statement on the Suppression of the Financing of Terrorism* (2002), *available at* www.wolfsberg-principles.com/pdf/standards/Wolfsberg_Statement_on_the_Suppression_of_the_Financing_of_Terrorism_(2002).pdf.

[73] *Wolfsberg Anti-Money Laundering Principles for Correspondent Banking*, THE WOLFSBERG GROUP (Feb. 2014), *available at* http://www.wolfsberg-principles.com/pdf/home/Wolfsberg-Correspondent-Banking-Principles-2014.pdf.

[74] Credit Suisse was not the only member of the Wolfsberg Group that missed an opportunity to re-assess its practices in light of the Wolfsberg Group recommendations. ABN, Barclays and HSBC were also founding members of the Wolfsberg Group. Each ultimately faced criminal enforcement actions relating to OFAC violations.

[75] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 10.

The number of Iranian bank dollar transactions at Credit Suisse went from approximately 49,000 in 2002 to almost 200,000 in 2005.[76]

A proposed internal reorganization involving Credit Suisse and Credit Suisse First Boston in 2004 prompted Credit Suisse to consider its approach to doing business with sanctioned countries because with the proposed reorganization Credit Suisse could no longer ensure that U.S. employees would be segregated from business relationships with U.S. sanctioned countries and entities.[77] As a result of the reorganization Credit Suisse made the decision in December 2005 to wind down all its business relationships with U.S. sanctioned countries or entities, whether denominated in U.S. dollars or not.[78]

In March 2006, Credit Suisse separately commenced an internal review of accounts at Credit Suisse Asset Management ("CSAM"), a U.K. subsidiary, and Credit Suisse Securities (USA) LLC ("CSSUS"), a U.S. subsidiary. This review revealed that in 2000, CSAM had begun executing trades in U.S. securities for a Sudanese bank and a Libyan bank. At that time, CSAM put in place procedures designed to: use code names for the two bank clients; restrict the knowledge of the clients' identities internally and externally; and restrict communication from the clients to the client teams and the legal and compliance departments.[79] The execution of the securities trades for these clients was done through an omnibus account at CSSUS and at other U.S. brokerage firms. In April 2006, CSSUS informed OFAC about its internal investigation.[80] OFAC later stated that it regarded the report by CSSUS as a voluntary self-disclosure under its enforcement guidelines.[81] In March 2007, Credit Suisse commenced an extensive internal investigation of its U.S. dollar clearing business involving U.S. sanctioned countries and persons. Shortly thereafter, Credit Suisse was contacted by the DOJ and the DANY as part of their joint investigation. The Factual Statement indicates that Credit Suisse provided prompt and substantial assistance to the DOJ and the DANY by sharing the results of its internal investigation. OFAC, however, did not regard the results of the Credit Suisse internal investigation as a voluntary self-disclosure for purposes of its

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[76] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 10.

[77] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 22.

[78] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 3. Although not discussed in the Credit Suisse Factual Statement, Credit Suisse's decision to exit its Iranian business was also likely influenced by the Treasury Department's campaign to discourage foreign banks from maintaining commercial relationships with the Iranian banking sector. JUAN C. ZARATE, TREASURY'S WAR: THE UNLEASHING OF A NEW ERA OF FINANCIAL WARFARE, 303 (2013).

[79] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 20-21.

[80] *See* Settlement Agreement, U.S. Dep't of the Treasury and Credit Suisse AG (Dec. 16, 2009), *available at* http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/12162009.pdf.

[81] OFAC Web Posting, Credit Suisse AG Settles Allegations of Violations of Multiple Sanctions Programs (Dec. 16, 2009), *available at* http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/12162009_a.pdf.

enforcement guidelines.[82]

The deferred prosecution agreement with the DOJ is not a model of clarity on the aggregate amount of illegal transactions that were the subject of the agreement. It refers to at least $536,000,000 in transactions described in the Factual Statement.[83] The Factual Statement itself simply refers to the transactions exceeding $1.6 billion in value.[84] The DANY press release is actually more detailed on this point. It states that between 2002 and 2006 Credit Suisse processed over $700 million in payments that violated U.S. sanctions law and that in addition Credit Suisse processed over $1.1 billion in payments that were formatted or manipulated to hide their Iranian origin "but may not have violated U.S. sanctions."[85] This appears to be a reference to transactions exempt under the U-turn exemption. The forfeiture in the Credit Suisse deferred prosecution agreement appears to have followed an approach similar to that in the Lloyds deferred prosecution agreement. Unlike the Lloyds Factual Statement, however, the Credit Suisse Factual Statement does not explicitly mention the U-turn exemption.

ABN Redux

The ABN tale of woe took another turn for the worse in May 2010 when ABN (now a part of The Royal Bank of Scotland) entered into a deferred prosecution agreement with the DOJ. Under the deferred prosecution agreement, ABN paid an additional $500 million in forfeitures in connection with violations of U.S. sanctions laws and anti-money laundering laws.[86] ABN was charged with one count of a conspiracy to violate IEEPA in connection with financial transactions involving Iran, Libya and Sudan and the TWEA in connection with financial transactions with Cuba.[87] ABN was charged in a second count with a failure to maintain an adequate anti-money laundering program as required under the BSA.[88]

As would be expected, the Factual Statement accompanying the ABN deferred prosecution agreement provided significantly more detail on ABN's practices than the 2005 regulatory enforcement orders. The general pattern in ABN's case followed the patterns in the Lloyds and Credit Suisse cases. The Factual Statement recited that

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[82] OFAC Web Posting, Credit Suisse AG Settles Allegations of Violations of Multiple Sanctions Programs (Dec. 16, 2009), *available at* http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/12162009_a.pdf.

[83] *United States v. Credit Suisse AG*, No. CR-09-352, 2 (D.D.C. Dec. 16, 2009).

[84] *United States v. Credit Suisse AG*, No. CR-09-352 (D.D.C. Dec. 16, 2009), Exhibit A at 21.

[85] Press Release, District Attorney for the County of New York (Dec. 16, 2009) (on file with author).

[86] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement).

[87] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement) ¶ 1(a).

[88] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement) ¶ 1(b).

ABN engaged in criminal conduct by: (i) methodically removing or falsifying references in outgoing U.S. dollar payment messages involving sanctioned parties or countries; and (ii) advising sanctioned parties and countries on how to evade automatic filters at financial institutions in the United States.[89]

The Factual Statement confirmed that shortly after U.S. sanctions were imposed on Iran in May 1995, at the request of various Iranian banks ABN began processing U.S. dollar payments by omitting the names and other identifying information relating to the Iranian banks from wire transfer instructions sent into the United States.[90] The ABN Factual Statement introduces another element not discussed in either the Lloyds or Credit Suisse Factual Statements. The ABN Factual Statement states that officials at ABN's Amsterdam headquarters and New York offices received advice from external U.S. counsel in June or July 1995 about the proposal for ABN to serve as a conduit for Iranian bank transfers. The Factual Statement quotes from the U.S. counsel's advice as follows:

> The fund transfer mechanics proposed by [the Iranian bank] are an attempt to circumvent the Iranian trade embargo. Given that violations of an Executive Order and OFAC regulations carry substantial penalties, not to mention the negative publicity, the [Iranian bank] proposal must be strictly scrutinized and ABN AMRO must weigh the risks before proceeding with any such transfers.[91]

The Factual Statement concludes that certain ABN employees approved of ABN undertaking these activities "contrary to the advice of outside counsel that ABN's involvement in such transactions would potentially violate U.S. law."[92] Disregard of advice from external U.S. counsel would re-appear as a significant issue in subsequent deferred prosecution agreements for other foreign banks.

ABN implemented a special manual queue to flag payments involving sanctioned countries so that ABN could amend any problematic text in incoming wire transfer messages. It also added instructions to its payment manuals on how to process transactions with sanctioned countries to circumvent the laws of the United States.[93] These practices permitted U.S. dollar transactions to be effected in violation of Iranian, Libyan, Sudanese and Cuban sanctions regulations. The Factual Statement noted that "ABN also used cover payments, on their face legitimate payment

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[89] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement), Exhibit A at 1.

[90] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement), Exhibit A at 12.

[91] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement), Exhibit A at 15.

[92] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement), Exhibit A at 12.

[93] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement), Exhibit A at 19.

methods, to shield the identities of [s]anctioned [e]ntities."[94] That is, instead of using serial MT 103 payment messages, ABN used MT 202 payment messages to avoid revealing the identity of the ordering customer and beneficiary party for payments sent through financial institutions in the United States.[95]

The Dubai branch of ABN played a particularly active role in the stripping process and appeared to have become part of a burgeoning cottage industry in Dubai that assisted Iranian banks in processing U.S. dollar payments.[96] The Dubai branch established a special payment system for sanctioned entities, which involved pulling payment messages out of its normal automated system, routing them into a special queue, and then manually altering them to eliminate language that would be detected by OFAC filters in U.S. financial institutions. The Dubai branch also established special procedures to remove the name of Iranian entities from letters of credit and foreign exchange transactions and replace it with ABN's name to conceal the involvement of the Iranian banks. The Factual Statement notes that this was done even though the overwhelming majority of these transactions were at the time permissible under the U.S. regulations pursuant to the U-turn exemption.[97]

The deferred prosecution agreement and the Factual Statement recognized that the ABN had self-identified the special procedures used by its Dubai branch and reported the results of its general internal investigation into violations of U.S. sanction laws to the U.S. bank regulatory agencies.[98] The Factual Statement also recognized that ABN had taken disciplinary actions against employees involved in the practices, including the termination of senior management, audit, legal and compliance officers in the United States as well as other senior bank officials.[99] Personnel actions would come to feature even more prominently in subsequent enforcement agreements for OFAC violations.

Barclays Bank PLC

In August 2010, Barclays Bank PLC ("Barclays") entered into deferred prosecution agreements with the DOJ and the DANY.[100] Under the deferred prosecution

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[94] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement), Exhibit A at 13.

[95] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement), Exhibit A at 13.

[96] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement), Exhibit A at 19.

[97] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement), Exhibit A at 20-21.

[98] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement), Exhibit A at 26.

[99] *United States v. ABN AMRO Bank N.V.*, No. 10-124 (CKK) (D.D.C. May 10, 2010) (deferred prosecution agreement), Exhibit A at 28.

[100] *United States v. Barclays Bank PLC*, No. 10-CR-00218-EGS (D.D.C. Aug. 16, 2010) (deferred prosecution agreement); *Barclays Bank PLC and District Attorney of the County of New York Deferred Prosecution Agreement*, Aug. 16, 2010.

agreements, Barclays agreed to forfeit $298 million to the DOJ and the DANY. As in the ABN deferred prosecution agreements, Barclays was charged with violations of the TWEA, and the Cuban sanctions regulations issued thereunder, and IEEPA, and the Iranian, Libyan and Sudanese regulations issued thereunder.[101] The total value of the prohibited transactions for the period covered by the deferred prosecution agreements was approximately $500 million.[102]

The Factual Statement states that Barclays engaged in criminal conduct by:

(i) following instructions from banks in various sanctioned countries not to mention their names in U.S. dollar payment messages sent to Barclays' New York branch;

(ii) wiring U.S. dollar payments through an internal Barclays sundry account to hide the payments' connection to sanctioned countries or entities;

(iii) amending and reformatting payment messages to remove information identifying sanctioned entities; and

(iv) deliberately using a less transparent method of payment messages, i.e., cover payments.[103]

According to the Factual Statement, this conduct occurring outside the United States caused effects in the United States, namely, it caused Barclays' New York branch and other financial institutions in the United States to process payments that would have been rejected or blocked under the OFAC rules.[104] The conduct also prevented Barclays' New York branch and other U.S. financial institutions from filing required BSA and OFAC-related reports and caused false information to be recorded in the records of U.S. financial institutions.

The Factual Statement recounts that as early as November 1987, Barclays began to receive instructions from sanctioned banks not to mention their names in payment messages sent into the United States.[105] The Barclays payment operations manual directed the Barclays operators not to mention the name of any sanctioned entity. Compounding the issues for Barclays was the fact that Barclays' principal U.S. dollar payments processing center in the U.K. had its own OFAC filter. The OFAC filter in the U.K. was used to screen outgoing U.S. dollar payment messages against the OFAC list. The purpose of the filter in the U.K. was to catch payment messages before they were sent into the United States to avoid their seizure in the United

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[101] *United States v. Barclays Bank PLC*, No. 10-CR-00218-EGS, 1 (D.D.C. Aug. 16, 2010) (deferred prosecution agreement).

[102] *United States v. Barclays Bank PLC*, No. 10-CR-00218-EGS (D.D.C. Aug. 16, 2010), Exhibit A at 8.

[103] *United States v. Barclays Bank PLC*, No. 10-CR-00218-EGS (D.D.C. Aug. 16, 2010) (deferred prosecution agreement), Exhibit A at 1.

[104] *United States v. Barclays Bank PLC*, No. 10-CR-00218-EGS (D.D.C. Aug. 16, 2010) (deferred prosecution agreement), Exhibit A at 1-2.

[105] *United States v. Barclays Bank PLC*, No. 10-CR-00218-EGS (D.D.C. Aug. 16, 2010) (deferred prosecution agreement), Exhibit A at 10.

States. If the U.K. filter identified a reference to a sanctioned entity in a payment message, the Barclays staff would:

(i) return the message to the remitting area;

(ii) alter or delete fields in the payment message; or

(iii) change the routing of the payment from a serial payment to a cover payment to hide the connection with a sanctioned entity.[106]

The Barclays Factual Statement introduces an element that would become even more prominent in subsequent deferred prosecution agreements: the failure to respond to internal compliance warnings. The Factual Statement notes that after the passage of the USA PATRIOT Act in 2001, Barclays reviewed its correspondent banking practices and identified certain of its practices as problematic, but it did not begin to take effective action until 2006.[107] The failure to respond to internal compliance warnings was also a prominent point in the OFAC settlement agreement with Barclays. The OFAC settlement agreement states that Barclays failed to heed concerns raised by senior employees relating to its payment practices. It quotes from a 2001 memorandum from the Compliance Director, Business Banking of Barclays to the Head of Group Compliance of Barclays, stating that the Barclays internal procedures "include directions to make transfers in U.S. dollars which circumvent constraints and breach OFAC sanctions . . . . Substantial reputational damage could be focused on the Group should these procedures reach the public domain."[108] The Factual Statement further notes that in October 2001, a staff member in Barclays' New York branch warned the London operation that using a cover payment to process payments relating to sanctioned entities was a "clear example of how foreign banks circumvent the OFAC [r]egulations."[109] The Factual Statement notes that despite this warning from its New York branch, Barclays continued routing sanctioned payments through the New York branch until early to mid-2006.[110]

Senior management of Barclays apparently learned of the use of cover payments to process U.S. dollar transactions for sanctioned entities in the spring of 2006 and immediately made a voluntary disclosure to OFAC and its bank regulators.[111]

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[106] *United States v. Barclays Bank PLC*, No. 10-CR-00218-EGS (D.D.C. Aug. 16, 2010) (deferred prosecution agreement), Exhibit A at 13.

[107] *United States v. Barclays Bank PLC*, No. 10-CR-00218-EGS (D.D.C. Aug. 16, 2010) (deferred prosecution agreement), Exhibit A at 10.

[108] Settlement Agreement, U.S. Dep't of the Treasury and Barclays Bank PLC, 3 (Aug. 18, 2010), *available at* http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/08182010.pdf.

[109] *United States v. Barclays Bank PLC*, No. 10-CR-00218-EGS (D.D.C. Aug. 16, 2010) (deferred prosecution agreement), Exhibit A at 16.

[110] *United States v. Barclays Bank PLC*, No. 10-CR-00218-EGS (D.D.C. Aug. 16, 2010) (deferred prosecution agreement), Exhibit A at 16.

[111] *United States v. Barclays Bank PLC*, No. 10-CR-00218-EGS (D.D.C. Aug. 16, 2010) (deferred prosecution agreement), Exhibit A at 17.

Thereafter, in 2007, Barclays was contacted by the DOJ and the DANY as part of their joint investigative effort. In its press release announcing the Barclays' forfeiture, the DOJ said that the settlement with Barclays was the first of its magnitude where OFAC had determined that all of the apparent violations had been voluntarily self-disclosed by the bank.[112] This was a significant mitigating factor in the size of the forfeiture imposed on Barclays.

Initial Lessons

There are lessons from these case studies for foreign banks and the U.S. authorities alike. As the discussion in Part I suggests and the discussion in Part II will confirm, these case studies present elements of a pandemic.[113] Of its nature, a pandemic transcends the strengths and weaknesses of the defense mechanisms of any one entity, in this case the compliance culture and governance structure of an individual banking institution. This statement is not intended in any way to diminish the importance of the compliance culture and governance structure of an individual institution. If anything, the case studies actually highlight the importance of these factors. But in the case of a pandemic, it is also useful to study the larger environment for clues as to other factors that may have permitted or propagated the spread of the disease.

A Failure to Communicate

One such factor in the case of the OFAC regime was a general failure of communication. The U.S. authorities failed to articulate and communicate at an early stage their expectations for extraterritorial compliance with OFAC sanctions. This failure in the 1980s and 1990s may have stemmed from policy differences among departments in the U.S. government as to the appropriate extent of extraterritorial application, particularly as to a foreign bank's clearing of U.S. dollars for transactions between non-U.S. persons and sanctioned countries. In any event, as the U.S. Treasury Department in 2005 began to articulate a view on the appropriateness of U.S. dollar clearing for such transactions, it would have been appropriate for the Treasury Department—at least for retrospective enforcement purposes—to recognize the air of benign neglect that surrounded these issues for many years.

The case studies also point to a failure to communicate by the foreign banks themselves. From the public records surrounding these case studies, it appears that the first high-level discussion of the U-turn exemption between a foreign bank and OFAC occurred in September 2001, coincidentally just days before the September 11 terrorist attacks. This was fully six years after the introduction of the U-turn

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[112] Press Release, U.S. Dep't of Justice, Barclays Bank PLC Agrees to Forfeit $298 Million in Connection with Violations of the International Emergency Economic Powers Act and the Trading with the Enemy Act (Aug. 18, 2010), *available at* http://www.justice.gov/opa/pr/2010/August/10-crm-933.html.

[113] Other industry sectors also appear to suffer from pandemics. *See, e.g.*, Alia Dharssi, *U.S. Oil Firm Prosecutions Show Need for Transparency*, THOMAS REUTERS FOUNDATION, (May 29, 2014), *available at* http://www.trust.org/item/20140529163828-w184v/ (reporting that oil and gas companies with major U.S. operations have been the subject of at least 30 prosecutions under the Foreign Corrupt Practices Act since 2007).

exemption in the ITR. It appears that prior communications between foreign banks and OFAC on the U-turn exemption and other U.S. dollar clearing practices were typically handled by internal compliance personnel on routine matters and by external U.S. counsel on more sensitive issues, sometimes on a no-names basis. This overall approach did not promote effective dialogue. Moreover, there were instances of conflicting answers being given in response to these inquiries by different offices within OFAC. The conflicting answers related to crucial issues, such as the permissibility of conducting due diligence for the U-turn exemption outside the United States. This conflicting advice from OFAC may have been reflected in the conflicting advice that U.S. law firms provided on some of these issues at least until the time of the ABN regulatory orders in December 2005. As will be discussed in Part II, as late as January 2006, one U.S. law firm was still advising that there was "great uncertainty *at the moment*" (emphasis added) as to whether anything less than full transparency was permissible for U-turn transactions—this more than 10 years after the introduction of the U-turn exemption. There was a failure of communication on all sides. One may say with only a hint of hyperbole that never have so many communicated so little to so few.

There was another environmental factor that contributed to the problems in the U.S. dollar clearing process. That factor was the general lack of transparency in the correspondent banking market. As recent revelations in the LIBOR and foreign exchange markets suggest, a market that lacks even minimal transparency is a breeding ground for trouble. Even before the enactment of the USA PATRIOT Act, there was abundant evidence of the risks presented by correspondent banking practices.[114] Here too there was an element of benign neglect, or at least lack of focus, both by the regulators and the banking community on the vulnerabilities in the correspondent banking system. The USA PATRIOT Act for the first time required the regulators and the banking industry to devote substantial resources to addressing these vulnerabilities. This focus did not come soon enough to prevent questionable practices from being implemented with respect to sanctioned entities, but it should at least have provided an opportunity for institutions to push a re-set button on certain practices—as a few institutions like Lloyds did.

The Role of Senior Management

The Lloyds case demonstrates the value of a strong culture and a robust governance structure. Lloyds was the first bank to be associated with the term "stripping," but Lloyds was also the first bank to exit the Iranian business on its own initiative. That exit appears to have been a direct and immediate result of senior management committee involvement in the decision-making process. In little more than a week's time after first being advised of the risks in its Iranian bank business, the senior management committee of Lloyds decided to terminate the business. As other case studies indicate, at other institutions these issues were generally handled at a less

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[114] *See, e.g.*, *Role of U.S. Correspondent Banking in International Money Laundering: Hearings Before the Perm. Subcomm. on Investigations of the S. Comm. on Governmental Affairs,* 107th Cong. (2001).

senior level and were not resolved successfully or took much longer time to resolve.

The Barclays case also suggests that its senior management played an important role when it became aware of certain OFAC violations by promptly self-reporting the violations to OFAC and initiating an internal investigation. The self-disclosure to OFAC was a significant factor in reducing the size of the forfeiture required from Barclays. OFAC was nonetheless critical of certain business managers at Barclays for not heeding warnings about their dollar clearing practices from their own compliance personnel. The ABN case, of course, paints a less attractive picture of the involvement of senior management in addressing compliance issues as do several of the cases that will be discussed in Part II.

The Role of the Compliance and Legal Functions

The case studies, particularly those to be discussed in Part II, raise critical issues about the involvement of compliance and internal legal staff in identifying and resolving OFAC compliance issues. In some cases these personnel identified and warned about practices, but were not able on their own to effect changes in the practices. This scenario presents a dilemma for a banking institution. The dilemma, indeed paradox, is that a strong compliance program can be self-defeating if it effectively monitors behavior and identifies problems, but its findings and warnings are then disregarded by the business units. Such a fact pattern supplies the prosecutors with indelible evidence that the institution in continuing the practices or activities was acting with the requisite knowledge and intent to support criminal prosecution. This dilemma can be addressed (though never wholly solved) by creating a culture and governance structure that empowers the compliance function itself to address the practices or requires the compliance function to escalate the issues to a more senior level for prompt resolution.

A few of the case studies in Part II will provide a more damaging perspective on the compliance and legal function. In the case of several institutions, the U.S. authorities concluded that the business managers engaged in illegal conduct with the knowledge of the compliance and legal staff and, in the case of at least one institution, with their encouragement. These constitute stark judgments about the compliance culture of the institutions involved.[115]

The Role of External Counsel

It is also appropriate to reflect on the role of external counsel in providing advice on these OFAC issues. As suggested above and as will be further explored in Part II, there were instances of U.S. external counsel reaching different judgments on the scope and requirements of the U-turn exemption and more broadly on the question of the application of the OFAC rules to the conduct of non-U.S. persons outside the United States. Part of the problem may have derived from the lack of clarity from OFAC itself on certain of these issues. In other instances, the problem appears to have

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[115] There are other recent examples of regulatory and Congressional scrutiny of the role of senior corporate lawyers in the management of compliance problems. *See, e.g.*, Jeff Bennett et al., *Top GM Lawyer Faces Scrutiny on Defect*, WALL ST. J., Jul. 15, 2014, at B3.

derived from imperfect communication between the external U.S. counsel and the business and operations personnel in the foreign bank clients. The technical and non-transparent nature of much of the payments processing system may also have contributed to a lack of effective communication between external counsel and the client. In all events, it appears that advice from certain external U.S. counsel became more conservative over time, perhaps as external counsel came to understand the actual practices in the payments processing units better, and certainly as external counsel considered the implications of the ABN regulatory orders from 2005. Some institutions failed to respond with appropriate speed to the revised legal advice.

The Role of Judgment

Risk management depends upon sound judgment. If one requires evidence of this seemingly self-evident proposition, these case studies provide it. Accept for a moment the proposition that during the 1980s and 1990s, OFAC and the Treasury Department did not adequately articulate their views on certain aspects of the extraterritorial application of the U.S. sanction regimes. Accept too for a moment the proposition that in the new millennium, OFAC and the Treasury Department changed their posture on the enforcement of extraterritorial features of the U.S. sanction regimes in response to greater perceived national security threats from various sanctioned countries and in response to the discovery of practices specifically designed by sanctioned countries to evade the sanctions. These risks, though outside the control of financial institutions, are nonetheless the kinds of risks that a risk management function is supposed to identify and address. An institution does not need a risk management function to deal with certainty. An institution needs a risk management function to deal with uncertainty and with change—particularly change that is outside the control of the institution.

Some institutions identified the risks of a changing OFAC enforcement posture in the new millennium sooner than others and mitigated their risks, for example, by exiting the Iranian market and other sanctioned country markets sooner than others. In the face of conflicting legal advice, some institutions mitigated their risks by following the most conservative version of the legal advice that they received. In hindsight, alert management and good judgment served to mitigate at least some of the legal and reputational damage to these institutions and might have served, if given the opportunity, to mitigate some of the damage in other institutions.