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Legal Sidebar

Treasury Proposes Rule That Could Deliver a "Death Sentence" to Chinese Bank

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In June, the Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued a Notice of Proposed Rulemaking (NPRM) to invoke the "Fifth Special Measure"—a legal tool sometimes characterized as constituting a "death sentence" for targeted financial institutions—against the China-based Bank of Dandong (Bank). FinCEN claims that the Bank "acts as a conduit for North Korea to access the U.S. and international financial systems, including by facilitating millions of dollars of transactions for companies involved in North Korea's [weapons of mass destruction] and ballistic missile programs." If FinCEN were to issue a final rule invoking the Fifth Special Measure against the Bank, certain domestic "covered financial institutions" would be required to take steps to ensure that they do not provide financial services directly or indirectly to the Bank or its subsidiaries, which would essentially cut off the Bank's access to the U.S. financial system.

Although FinCEN has only issued a NPRM and has not yet invoked the Fifth Special Measure, most U.S. financial institutions and many entities around the globe have voluntarily stopped providing financial services to the Bank, because of the legal and reputational risks associated with having financial ties with the institution. Thus, FinCEN's use of the Fifth Special Measure against the Bank or other financial entities may be of congressional interest not just because of the Measure's dramatic consequences, but also because those consequences typically are felt *as soon as the Fifth Special Measure is proposed*—before FinCEN obtains public feedback on the substance of the proposal and before the targeted foreign financial institution generally is able to seek judicial review of FinCEN's action.

Evading Sanctions on North Korea through the Bank of Dandong. For more than a decade, North Korea has been subject to a number of U.S. and United Nations (U.N.)-based sanctions stemming from North Korea's weapons development programs, severely restricting North Korea's access to the international financial system. However, according to FinCEN, North Korean entities have circumvented the sanctions regime through surreptitious means, including using "aliases, agents, foreign individuals in multiple jurisdictions, and a longstanding network of front companies and embassy personnel that support illicit activities through banking, bulk cash, and trade." FinCEN has determined that the Bank, located near the Chinese border with North Korea, has assisted North Korea in these activities in violation of U.S. and international sanctions. FinCEN also believes the Bank has violated federal anti-money laundering laws. In the NPRM, FinCEN states that the imposition of the Fifth Special Measure "is the only special

measure that can adequately protect the U.S. financial system from the illicit finance risks posed by Bank of Dandong."

Background on Money Laundering Statutes. Congress has crafted a legal system that enlists financial institutions to aid law enforcement agencies in the investigation and prosecution of those involved in laundering money. Failing to comply with these requirements potentially opens financial institutions and their directors, officers, employees, and owners to severe criminal, civil, and administrative liabilities, including monetary penalties and asset forfeiture.

Title III of the USA PATRIOT Act buttressed this regime with a particular focus on "prevent[ing], detect[ing], and prosecut[ing] international money laundering and the financing of terrorism." Under Section 311 of the act, FinCEN, as delegated by the Secretary of the Treasury, may require certain domestic covered financial institutions to take "special measures" against a foreign financial institution if FinCEN concludes that the foreign institution is of "primary money laundering concern." FinCEN's conclusion can be substantively supported by classified and certain other nonpublic information that can remain confidential even to the targeted institution. Before invoking a "special measure," FinCEN must consider a number of factors, among them whether the foreign institution is used to further "money laundering activity by organized criminal groups, international terrorists, or entities involved in the proliferation of weapons of mass destruction or missiles." Four of the five available "special measures" are reporting and recordkeeping standards, which FinCEN may impose by order or via regulations promulgated in accordance with the Administrative Procedure Act (APA). However, FinCEN may only impose the more severe Fifth Special Measure via the APA's notice-and-comment rulemaking procedures and only after "consult[ation] with the Secretary of State, the Attorney General, and the Chairman of the Board of Governors of the Federal Reserve System."

Judicial Review. Few financial institutions have judicially challenged FinCEN's use of the Fifth Special Measure, in part because its proposed invocation "can put a bank in a financial position where it cannot afford to take legal action" to oppose the action. Consequently, courts have had limited opportunities to assess FinCEN's application of these authorities. In fact, while FinCEN has issued NPRMs that would impose the Fifth Special Measure against approximately 20 foreign financial institutions, it rescinded the vast majority of those proposals before a final rule was ever issued. Observers have argued that FinCEN's decision not to issue final rules in some of these instances may have been influenced, in part, upon the mere issuance of the NPRM having been sufficient to accomplish the intended effect of severing the institutions from the U.S. financial system.

As discussed in previous Legal Sidebar posts, the few judicial decisions on Section 311 have focused on matters of procedure. To date, FinCEN has successfully addressed the legal issues in these cases by either: (1) rescinding the relevant NPRM, thus leading to the dismissal of the foreign bank's legal claims on mootness or standing grounds; or (2) re-opening the notice-and-comment period for the relevant rule to address court-noted procedural deficiencies by building a stronger evidentiary record to justify the use of the Fifth Special Measure, such as by generally releasing all unclassified, non-privileged supporting documents to the accused and the general public. While these judicial opinions may have affected the way FinCEN issues and supports the justification for invoking the Fifth Special Measure, they do not appear, at least thus far, to have altered the way in which financial institutions respond to the initial proposal to exact the Fifth Special Measure against a foreign financial institution.

Issues for Congress. FinCEN's use of the Fifth Special Measure against the Bank highlights questions that continue to be raised about FinCEN's authority under Section 311. Does the law provide FinCEN sufficient authority to weed out money laundering from the U.S. financial system? Are there sufficient controls built into the Section 311 program to ensure that FinCEN is properly exercising this significant power? Are the legislative objectives of requiring FinCEN to exercise a Fifth Special Measure in accordance with the APA being met if the measure's effects are typically born as soon as a rule is proposed? Are foreign financial institutions provided adequate legal tools and opportunity to defend

themselves against the invocation of a "death sentence"? Are the international relations implications of invoking the Fifth Special Measure against a foreign financial institution being appropriately considered in the existing process? These and other questions are all issues Congress may wish to explore as FinCEN continues to wield this significant power.

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