CLIENT MEMORANDUM

U.S. Department of the Treasury and Federal Banking Agencies Release Joint Guidance for Foreign Correspondent Banking

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The U.S. Department of the Treasury and the federal banking agencies[1] have released a joint guidance Fact Sheet on numerous regulatory compliance issues for U.S. financial institutions providing correspondent banking for foreign entities. The Fact Sheet[2] clarifies the agencies' supervisory and enforcement approach for assessing the sufficiency of anti-money laundering ("AML") and countering the financing of terrorism ("CFT") procedures enumerated in the Bank Secrecy Act ("BSA") for U.S. depository institutions required to maintain a special due diligence program for correspondent accounts.

Such programs must include elements set forth in the AML regulations.[3] The Fact Sheet enumerates the expected elements of these due diligence policies, procedures, and processes, which include:

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1 The Federal Reserve, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and the National Credit Union Administration

2 Available here.

3 Such programs must incorporate the elements set forth in the AML regulations at 31 C.F.R. § 1010.610. These regulations are equally applicable to securities broker-dealers, mutual funds, futures commission merchants, and introducing brokers in commodities. However, the new Fact Sheet is designed for depository institutions.

1. generating an appropriate, specific, and risk-based due diligence program that is designed to reasonably assess and manage the risks inherent in correspondent account relationships;

2. monitoring transactions related to correspondent accounts to detect and report suspicious activities; and

3. adjusting the program based on the level of risk posed by the correspondent foreign financial institution by taking into account the size, geographic locations, products and services it offers, and the markets and customer bases it serves.

Treasury Department officials indicated in a corresponding blog post that they intend the Fact Sheet to "dispel certain myths" about U.S. supervisory expectations.[4] The Fact Sheet emphasizes that the agencies' enforcement of the correspondent AML banking regulations is not based on "zero tolerance," but rather uses a risk-based system to evaluate the facts and circumstances of a particular action by an institution. In particular, the agencies noted in the same blog post that the federal banking agencies have no general expectation that banks will conduct due diligence on individual customers of foreign financial institutions.[5]

Although Treasury's Office of Foreign Assets Control ("OFAC") and sanctions are discussed in the Fact Sheet, that guidance is brief and focuses primarily on the importance of cooperating with the federal banking agencies when evaluating compliance programs and addressing infractions. This includes consulting on the quality and effectiveness of an institution's compliance program, how well the institution addressed prior federal banking agency corrective actions, and the significance of the violations.

The Fact Sheet states that past enforcement under BSA/AML and sanctions typically involved "a sustained pattern of reckless or willful violations over a period of multiple years and a failure by the institutions' senior management to respond to warning signs that their actions were illegal." The Fact Sheet elaborates that about 95% of compliance deficiencies identified by the agencies are corrected by the institutions' management without any enforcement action or penalty.

The Fact Sheet comes at a time of growing international concern regarding increasing regulatory oversight over correspondent banking. Christine Lagarde, the managing director of the International Monetary Fund ("IMF"), spoke recently at the New York Federal Reserve Bank, addressing the risk that nations could be cut off from the global financial network due to fears of regulatory enforcement resulting from operations in or transactions with high-risk jurisdictions.

Treasury and the federal banking agencies state in the Fact Sheet that they want to avoid the acceleration of "de-risking" by depository institutions, i.e., the elimination of business lines and customers that present the largest risk of regulatory challenges by such institutions. Noting that correspondent banking is a risky area of business with a slim rate of return,

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[4] Available here.

[5] *Id.*

the agencies also recognize that correspondent accounts play a vital role in allowing foreign banks to process U.S. dollar transactions, a factor the U.S. government sees as vital to an open global business environment. More significantly, access to an open and accessible global financial system ensures the effectiveness of sanctions as a foreign policy tool for the U.S. government, since the liberalization of sanctions by foreign countries is ideally rewarded by reintegration into the financial system.

The agencies refrain from using the Fact Sheet to present any new or significant interpretations of the relevant regulations or provide bright lines for U.S. financial institutions trying to comply with the regulations. Financial institutions should continue to adopt a "risk-based" approach to compliance with AML, CFT, and OFAC regulations. Ultimately, depository institutions (and most other financial institutions) should think critically about where the largest risks are likely to arise and build their compliance programs to address these risks directly while developing more general policies to promote a general culture of compliance.

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