CLIENT ALERT

U.S. and UN Take Strong Action Against North Korea

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The months of November and December saw major steps by both the U.S. and the United Nations targeting the Democratic People's Republic of Korea's (DPRK) nuclear and ballistic missile programs. First, on November 9, the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) published a final rule imposing correspondent banking restrictions on U.S. financial institutions in an effort to wall off North Korean banks from the U.S. financial system. Citing ongoing concerns over the DPRK's ability "to access the international financial system to support its WMD and conventional weapons programs," the rule exercises FinCEN's authority under Section 311 of the USA PATRIOT Act to impose so-called "special measures," requiring covered financial institutions to both prevent North Korean banks from opening correspondent accounts and to take steps to ensure that North Korean banks do not indirectly make use of their correspondent relationships with other foreign financial institutions.

Second, on November 30, the United Nations Security Council passed United Nations Security Council Resolution (UNSCR) 2321, which imposed additional sanctions targeting North Korea's government as well as the country's trade in commodities. The new sanctions aim to cut the DPRK's coal exports by an estimated 60 percent and ban the export of copper, nickel, silver, and zinc. The resolution requires member states to prohibit persons subject to their jurisdictions from providing public or private support for trade with the DPRK such as export credits, guarantees, and insurance; to close foreign bank offices, accounts, and subsidiaries within the DPRK within 90 days, except as approved by a committee of the council; and to expel from their territory persons working on behalf of DPRK banks or financial institutions. It also calls on U.N. member states to limit the number of bank accounts held by DPRK diplomatic missions and consular posts, as well as the number of DPRK diplomats within their respective territories. The resolution imposes asset freezes on 11 individuals and 10 entities, including North Korean banks like Korea United Development Bank and North Korean trading companies like Singwang Economics and Trading General Corporation. The U.S. Ambassador to the United Nations, Samantha Power, estimated that, altogether, the new sanctions would slash the DPRK's export revenue by at least $800 million dollars per year, or 25 percent of its total export revenues. UNSCR 2321 builds on a previous UNSCR (2270) from March, which imposed several similarly strong measures with respect to the DPRK, most notably requiring member states to inspect cargo transiting their territories originating from or directed to the DPRK.

Third, on December 2, the U.S. Treasury Department's Office of Foreign Assets Control (OFAC) designated seven individuals and sixteen entities for sanctions, some of which are names from resolution 2321, some of which are unilateral actions by OFAC. Among the latter is OFAC's designation of Air Koryo, North Korea's only commercial airline, and the identification as blocked property of 16 of its planes. The Council of the European Union has since issued its own statement on December 12 welcoming UNSCR 2321 and promising that it soon will take steps to implement it.

The new FinCEN rule is particularly significant to U.S. banks. Although U.S. financial institutions have been prohibited from maintaining direct relationships with North Korea's financial institutions since at least March 2016, when Executive Order 13722 prohibited U.S. persons from exporting any goods, services, or technology to North Korea, according to the final rule the DPRK nonetheless has accessed the U.S. financial system "through its use of aliases, agents, foreign individuals in multiple jurisdictions, and a long-standing network of front companies." The rule targets such indirect access, requiring covered financial institutions to "take reasonable steps to not process a transaction for the correspondent account of a foreign bank in the United States if such a transaction involves a North Korean financial institution." FinCEN specified that these "reasonable steps" include sending a formal notice to foreign correspondent account holders informing them that they may not allow any North Korean financial institution to use their accounts and implementing risk-based procedures to identify any foreign correspondent accounts that violate this prohibition. To that end, banks must follow up with account holders whenever there is reason to believe that North Korean financial institutions are involved in transactions through the use of aliases or front companies. Foreign correspondent account holders involved in such transactions risk having their accounts terminated.

The rule follows FinCEN's June 2016 Notice of Finding designating the DPRK as a "primary money laundering concern" for its covert use of the financial system to support its nuclear and ballistic missile programs. The Notice of Finding provides insight into the types of activities that U.S. banks should monitor. For instance, it describes how, in 2013, "senior North Korean leadership utilized a . . . front company to open accounts at a major Chinese bank under the names of Chinese citizens, and deposited millions of U.S. dollars into the accounts" before processing transactions through U.S. correspondent accounts. In another example, it recounts how a front company named Leader (Hong Kong) International Trading Limited "cleared at least $13.5 million through correspondent accounts at U.S. banks." In its final rule, FinCEN urges U.S. banks to use current screening and reporting procedures, such as those used for compliance with economic sanctions programs administered by the Office of Foreign Assets Control (OFAC), to detect such covert transactions.

Practical Considerations

The final rule and the recent UNSCR increase the pressure on banks to accurately identify and prevent transactions with DPRK financial institutions and their agents. At the same time, the DPRK's fluid network of foreign companies presents a substantial hurdle to compliance with the rule. As discussed in a recent report by C4ADS, a nonprofit organization dedicated to transnational security issues, the DPRK evades, or quickly responds to, detection of its illicit network by frequently changing the names and ownership structures of its front businesses. To U.S. financial institutions dealing with foreign banks, the DPRK network is therefore often obscured by layers of apparently legitimate operations. In some cases, specialized commercial compliance databases already used in sanctions screening may be able to assist with identifying foreign financial institutions and other parties likely to be dealing with or affiliated with DPRK financial institutions. However, banks providing correspondent access to foreign financial institutions that operate in areas at high risk for DPRK involvement may in special cases wish to seek expert assistance in considering available information, posing questions as needed to correspondent account holders, and determining their obligations under this rule. Given the likely continued increase of U.S. designations and enforcement in this area, it is not unreasonable for banks to expect greater cooperation and partnership with U.S. regulators to recognize and take action against such risks.

FinCEN's final rule is effective on December 9.

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