CLIENT ALERT

District Court Upholds FinCEN Rule Imposing Special Measures on Tanzanian Bank FBME

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On April 14, 2017, the U.S. District Court for the District of Columbia upheld the Treasury Department's use of Section 311 of the USA PATRIOT Act to impose "special measures" with respect to Tanzanian Bank FBME, Ltd.

The court's ruling allows the Treasury Department's Financial Crimes Enforcement Network (FinCEN) to proceed with implementing a final rule that prohibits U.S. banks from maintaining correspondent accounts for FBME, and thereby effectively bars it from the U.S. financial system. The court's decision follows two successful challenges by FBME in August 2015 and September 2016 that had blocked implementation of a final rule.

Under Section 311, if FinCEN's Director finds that a foreign financial institution qualifies as a "primary money laundering concern," she may propose a rule that would impose one or more of five different "special measures" against it. The most serious special measure, and the one typically imposed, is the fifth, which prohibits U.S. banks from maintaining correspondent relationships with the named foreign financial institution. Proposed rules to impose special measures are made available for public comment and become effective once the rule is finalized.

FinCEN issued a Notice of Finding on July 22, 2014, that identified FBME as a "primary money laundering concern," along with a proposed rule to impose the fifth special measure. In the NOF, FinCEN described FBME as the largest bank in Tanzania, but one that conducted 90 percent of its global activity and held more than 90 percent of its assets at a single branch in Cyprus.

FinCEN found, among other things, that FBME had maintained accounts or facilitated transactions for an international narcotics trafficker, an organized crime figure, a financier for the terrorist group Hezbollah, parties engaged in cyber-fraud against victims in the U.S., and a front company related to Syria's efforts to proliferate weapons of mass destruction. FinCEN also relied on an analysis of suspicious activity reports (SARs) filed by U.S. financial institutions about FBME to conclude that FBME processed large volumes of transactions through U.S. correspondent accounts on behalf of shell companies whose owners could not be readily identified, and conducted other transactions indicative of potential money laundering, such as short-term "surge" wire activity, structuring, and catering to high-risk business customers. After a public comment period, FinCEN then issued a final rule imposing the fifth special measure against FBME in July 2015.

FBME challenged the final rule in the D.C. District Court and sought a preliminary injunction to prevent it from being implemented. The court rejected FBME's substantive arguments that the agency had failed to adequately demonstrate that the bank was appropriately classified as a primary money laundering concern. It also rejected FBME's argument that FinCEN could not rely on classified intelligence and SARs summarized in the NOF to support its action without sharing these underlying documents with the target of the Section 311. However, the court ruled in plaintiff's favor on two procedural issues respecting FinCEN's adherence to the requirements of the Administrative Procedure Act: first, that FinCEN was required to share with the plaintiff all unclassified, non-privileged information that supported its action and to provide an opportunity for comment on this material, and had not done so; and, second, that FinCEN was required by Section 311 to consider whether some measure short

of a complete prohibition on correspondent banking might address the risk posed by FBME. The court therefore enjoined the rule from going into effect.

In response, FinCEN re-opened the rule to solicit comments, this time disclosing unclassified, non-privileged exhibits supporting the final rule to the plaintiff and to the public at large, and, with the permission of the court, conducted a second rulemaking process. The disclosures included 74 exhibits, including press reports, blog posts, public money laundering jurisdictional risk reports from governmental and intergovernmental agencies, and a redacted internal memorandum to the Director of FinCEN providing a staff recommendation for a finding that FBME was a primary money laundering concern. FinCEN also specifically considered whether options short of a prohibition on correspondent banking would adequately address the risks from FBME, and concluded that they would not. FinCEN ultimately issued a new final rule again imposing the fifth special measure on FBME on March 31, 2016.

In a second holding on the new final rule, the court determined that FinCEN had failed to respond to certain non-frivolous arguments the plaintiff had made about FinCEN's explanation for how the aggregate SAR information available to the agency supported a conclusion that FBME was a money laundering concern, requiring FinCEN to go back and supplement the new rule to address these issues.

In its most recent decision on April 14, 2017, the D.C. District court accepted FinCEN's responses to the plaintiff's arguments as reasonable and upheld FinCEN's final rule, concluding that "[s]ometimes, the third time really is the charm." The court granted summary judgment to the government and lifted the stay on implementation of the final rule. FBME has appealed the decision to the United States Court of Appeals for the District of Columbia, although that court has declined to stay implementation of the rule during the appeal.

The impacts of the Section 311 action on FBME have been severe. After FinCEN's initial finding that FBME was a primary money laundering concern, FBME's U.S. correspondent banks severed their relationships with the bank without waiting for any rule to be finalized. Moreover, the Central Bank of Cyprus placed FBME's Cyprus branch "under resolution," and Tanzania's central bank, the Bank of Tanzania, took over management of FBME's headquarters in Tanzania.

Following the district court's most recent ruling, the Bank of Tanzania announced that it had discontinued all banking operations by FBME, revoked its banking business license, and placed it under liquidation effective May 8, 2017. It is unclear whether the bank will survive to complete its appeal.

The court's ruling that FinCEN must make available the unclassified, non-privileged exhibits as part of the rulemaking process is a significant procedural win that is likely to bring increased transparency to future Section 311 actions. However, this will not pose a significant obstacle to FinCEN's ability to impose special measure under this section, make future 311 designations, and the case overall remains an important win for the government and a strong initial "stress test" of the Section 311 tool in contentious litigation with a well-represented party. The court upheld FinCEN's ability to rely on classified intelligence and, moreover, unclassified SARs to support a Section 311 action without disclosing these underlying documents to the target of the action or to the public. It applied a highly deferential standard of review of the agency's substantive determination that FBME was a primary money laundering concern, and its application of facts to the statutory factors the agency was required to consider in deciding which special measure to impose, requiring only that the agency show that it had considered each factor. It held that FBME was likely not entitled to due process under the U.S. Constitution solely by virtue of holding a U.S. correspondent account and that, even if it was, it would not have been entitled to more process than it received through FinCEN's amended public rulemaking

process. And it rejected FBME's arguments to re-open the administrative record FinCEN relied on and to conduct civil discovery. Even the court's procedural holding on access to the unclassified, non-privileged exhibits serves mostly to align Section 311 actions with previous case law in the similar context of sanctions imposed by the Treasury Department's Office of Foreign Assets Control, where such exhibits are made available to parties challenging sanctions designations.

In addition to FBME, there has been only one other fully litigated challenge to FinCEN's use of Section 311. In *Cierco v. Lew*, the D.C. District Court dismissed a challenge to FinCEN's NOF for Andorran bank Banco Privada d'Andorra as moot because the Andorran regulator responded to the NOF by seizing the bank with intent to liquidate it, prompting FinCEN to withdraw its NOF, concluding that the seizure rendered the bank no longer a money laundering "concern". Both actions are from one court only – the D.C. District Court, a trial-level court. However, as the only decisions to address this issue, they are likely to carry outsized weight in any future challenge to FinCEN's use of a Section 311, and to encourage more aggressive use by FinCEN of this tool, much as early OFAC victories on sanctions led to a substantial growth in sanctions designations.

One final issue is whether Section 311, which generally must be done through rulemaking, is affected by the recent Executive Order, 13771, which requires that two rules be identified for repeal for each new one proposed. Because this order excludes "regulations issued with respect to a military, national security, or foreign affairs function of the United States," an exemption that almost certainly applies here, the order seems unlikely to serve as a brake on increased use of this tool.

PRACTICAL CONSIDERATIONS

The unclassified, non-privileged exhibits FinCEN published in the latter FBME rulemaking, and any future publication of such materials in future Section 311 actions, are likely to provide an important new source of information to regulated banks on red flags of potential money laundering activity and concerns that FinCEN and other anti-money laundering (AML) regulators may be focused on.

Banks should monitor any such information disclosed as part of future Section 311 designations, as well as information appearing directly in related proposed rules and findings, as an ongoing part of their compliance operations. U.S. banks that provide correspondent banking services for foreign financial institutions in particular should closely follow such information. Further, U.S. banks across the board should expect that regulators will hold them accountable for awareness of any money laundering red flags that appear in these documents.

Separately, the court's decision provides important reassurance that SARs filed by regulated financial institutions are seeing use by FinCEN to address money laundering threats, but also that these reports will remain confidential and not be subject to public disclosure in future challenges to Section 311 designations.

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