

Memorandum

U.S. Treasury Department Takes Steps Aimed at Isolating North Korean Financial Institutions from the Rest of the World

June 6, 2016

On June 1, 2016, the U.S. Department of the Treasury announced that it had designated the Democratic People's Republic of Korea ("North Korea") as a jurisdiction of "primary money laundering concern" under Section 311 of the USA PATRIOT Act.¹ Treasury further issued a notice of proposed rulemaking setting forth certain special measures to further sever banking relationships with North Korea (the "proposed rule") pursuant to rules administered and enforced by the Financial Crimes Enforcement Network ("FinCEN").² The proposed rule, when finalized, would aim to isolate North Korea's financial institutions from the global financial community by forcing non-U.S. financial institutions to choose between doing business with North Korea or the United States.

Proposed Rule Would Prohibit Use of Correspondent Accounts on Behalf of North Korean Financial Institutions

U.S. regulations already prohibit U.S. financial institutions from processing transactions involving the North Korean government or persons in North Korea unless authorized by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC"). The proposed rule would also prohibit covered financial institutions—including U.S. branches and offices of foreign banks—from opening, maintaining, administering, or managing in the United States a correspondent account for or on behalf of a North Korean financial institution.³ Covered financial institutions would also be prohibited from processing a transaction involving

¹ See 81 Fed. Reg. 35441 (June 2, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-06-02/pdf/2016-13038.pdf>.

² See 81 Fed. Reg. 35665 (June 3, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-06-03/pdf/2016-13037.pdf>.

³ The term "North Korean financial institution" is defined as any branch, office, or subsidiary of any foreign financial institution chartered or licensed by North Korea, including any branches, offices, or subsidiaries of such financial institutions operating in any jurisdiction, and any branch or office within North Korea of any foreign financial

a North Korean financial institution through the United States correspondent account of a foreign banking institution.

In practical terms, all foreign financial institutions would be prevented under the proposed rule from accessing the U.S. financial system to process transactions for North Korea. The proposed rule also would impose new due diligence obligations on covered financial institutions to guard against the inadvertent processing of transactions involving North Korean financial institutions. If a covered financial institution knows or has reason to believe that a foreign financial institution's U.S. correspondent account is being used to provide services to a North Korean financial institution, the covered financial institution would be required to notify the foreign correspondent that it may not give any such access to the North Korean financial institution. The covered financial institution would also be required to document compliance with the notice obligation. This notification provision is intended to facilitate cooperation from foreign correspondent account holders in preventing transactions involving North Korean financial institutions from being processed by the U.S. financial system.

Potential Penalties Could Be Severe

The proposed rule does not identify the nature and scope of civil or criminal penalties that could be imposed for violations. Generally, civil penalties for violations of regulations pursuant to Section 311 of the USA PATRIOT Act may be the greater of the amount (not to exceed \$100,000) involved in the transaction or \$25,000. Criminal penalties for violation of special measures imposed pursuant to Section 311 of the USA PATRIOT Act may be an amount equal to not less than two times the amount of the transaction, but not more than \$1,000,000.

Written comments on the proposed rule are due by August 2, 2016.

Simpson Thacher will monitor the proposed rule as well as any developments in North Korea-related economic sanctions.

institution. "Covered financial institution" is generally defined to include insured banks (as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. § 1813(h))), commercial banks, agencies or branches of a foreign bank in the United States, federally insured credit unions, savings associations, corporations acting under the Federal Reserve Act (12 U.S.C. § 611), trust banks and trust companies, securities brokers and securities dealers, futures commission merchants and brokers, and mutual funds.

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