

New Enforcement Action Highlights Potential OFAC Risks for Non-U.S. Financial Institutions

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On January 9, 2009, Lloyds TSB Bank plc (“Lloyds”) entered into a deferred prosecution agreement (“DPA”) with the U.S. Department of Justice (“DOJ”) regarding certain violations of U.S. sanctions administered by the Office of Foreign Assets Control (“OFAC”) against Iran and Sudan.¹ Under the DPA, Lloyds has agreed to pay a total of \$350 million to the United States and the State of New York. This prosecution appears to be the first time an enforcement action has been brought against a non-U.S. financial institution for causing OFAC violations in the United States by a non-affiliated U.S. person.

I. Background

OFAC implements and administers various U.S. sanctions under the International Emergency Economic Powers Act (“IEEPA”), including sanctions against countries such as Iran and Sudan. Among other provisions, OFAC sanctions prohibit the exportation of financial services from the United States to Iran and Sudan. IEEPA provides that any willful violation (or attempted violation) of OFAC sanctions is punishable as a federal felony offense.

According to the Factual Statement filed with the DPA, from the mid-1990s through September 2007, Lloyds – both in the U.K. and at other non-U.S. branches – systematically removed identifying information, such as client names and addresses, from U.S. dollar payment instructions that it received from Iranian and Sudanese clients. Lloyds then forwarded those instructions to non-affiliated U.S. banks for processing. This practice, commonly referred to as “stripping” by Lloyds employees, enabled Lloyds to process transactions through U.S. banks on behalf of sanctioned clients that OFAC would otherwise have required the U.S. banks to block or reject. Lloyds eventually exited its Iranian business

¹ See http://www.usdoj.gov/criminal/pr/press_releases/2009/01/01-09-09lloyds-attachment.pdf. Concurrently, Lloyds entered into a second deferred prosecution agreement with the District Attorney for the County of New York for related violations of New York state law. Both agreements also address certain violations of U.S. sanctions against Libya that, while in effect at the time of the violation, have since been lifted.

by April 2004, but continued to strip transactions for its Sudanese clients through September 2007. Lloyds was ultimately responsible for stripping approximately \$350 million in transactions that were then processed unknowingly by non-affiliated U.S. banks.

In addition to accepting responsibility for its conduct and agreeing to forfeit \$350 million to the United States and the State of New York, Lloyds also agreed under the DPA to conduct an internal “look-back” investigation of its U.S. dollar payment practices from April 2002 through December 2007 and to provide those results and related information to the DOJ. The DPA expressly notes that the DOJ gave Lloyds credit for voluntarily terminating its criminal misconduct, cooperating with the DOJ, and committing to comply in the future with international anti-money laundering best practices.

II. Implications

As a general matter, OFAC sanctions are drafted to impose restrictions on the activities of “U.S. persons” – such as U.S. citizens, lawful permanent residents, and other individuals or entities located within the United States.² The Lloyds prosecution appears to mark the first time the DOJ has asserted jurisdiction over a non-U.S. person whose conduct occurred entirely outside the United States, but which caused OFAC violations by a non-affiliated U.S. person. In addition, unlike the 2005 joint civil enforcement action against ABN AMRO by OFAC and various banking regulators, the stripping of transactions by Lloyds appears to have occurred without any participation by its U.S. affiliates or employees. Accordingly, the only link between Lloyds and the United States appears to have been the transmittal of payment instructions to U.S. financial institutions, which in turn violated OFAC sanctions, albeit unknowingly, by processing those requests.

Recent changes to IEEPA suggest that this “causation” basis for liability will be increasingly used by the DOJ and other U.S. government agencies. At the time of the violations by Lloyds, IEEPA did not include clear language imposing liability on a person for causing violations of OFAC sanctions. However, in late 2007, IEEPA was amended to explicitly state that any person who “causes” a violation of OFAC sanctions may be held liable for both civil and criminal penalties.

Also notable is the amount of the monetary penalty imposed on Lloyds. While OFAC has not yet announced any action related to Lloyds’ conduct,³ the magnitude of the

² See, e.g., 31 C.F.R. §§ 538.205, 560.204 (prohibitions on the export of services to Sudan and Iran by U.S. persons); 31 C.F.R. §§ 538.315, 560.314 (definitions of “United States person”).

³ At the same time it entered into the DPA, Lloyds filed a Form 6-K with the U.S. Securities and Exchange Commission, which stated that discussions with OFAC are ongoing and that the \$350 million forfeiture will be credited towards satisfying any civil monetary penalty imposed by OFAC.

criminal forfeiture, which was based on the total size of the stripped transactions, and the attention to mitigating circumstances (e.g., substantial cooperation by Lloyds) suggest that the DOJ considered factors similar to those set forth in OFAC's recently adopted enforcement guidelines.⁴ It also appears that cooperation with the U.S. Government will not significantly reduce a fine for intentional misconduct, although nothing in the DPA or related documents indicates that Lloyds voluntarily disclosed its conduct, which presumably would have reduced its fine substantially (by half under the OFAC guidelines).

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If you should have any questions regarding the Agreement or related issues, please contact any of your regular contacts at the Firm or Kenneth Bachman, Shawn Chen, Katherine Carroll or Nathaniel Stankard in our Washington Office at +1 202 974 1500, or Robert Tortoriello or Paul Glotzer in our New York Office at +1 212 225 2000.

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⁴ For more information about the guidelines, see Cleary Gottlieb's alert memorandum, "OFAC Publishes New Economic Sanctions Enforcement Guidelines," Sept. 10, 2008.

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