Developments in Tri-Border Area Post New Risk to Correspondent Banking

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It is no secret that U.S. correspondent banking relationships are indispensable to global commerce. Indeed, access to the U.S. financial system through correspondent banking is integral to foreign banks and to their customers, who often depend on the U.S. dollar as the anchor currency for their deals. At the same time, U.S. banks are under intense pressure (more than ever before) by regulators and law enforcement to quickly detect and report suspicious activity, and ensure that they are not conduits for illicit funds originating in foreign jurisdictions, and passing through correspondent accounts held for foreign banks.

To that end, in what is certainly not a new phenomenon, U.S. banks are keeping a close watch over their correspondent banking relationships, and quickly moving to exit relationships at the hint of impropriety. Moreover, it is well documented that some U.S. banks are "de-risking" not because of a specific event but because of the overall financial crime risk a foreign-located bank might pose. U.S. banks in some instances may not be interested in managing that risk, and would rather avoid the risk altogether by exiting the relationship. This process led some U.S. banks to terminate correspondent relationships with Latin and South American banks. While there has been significant discussion around the negative impacts of de-risking by U.S. government officials, it is still prevalent.

Recent developments in the Tri-Border Area may accelerate the trend for banks in Latin America and South America. Also known as the Triple Frontier, the Tri-Border Area is a free-trade zone linking Argentina, Brazil, and Paraguay, and it has long been regarded as a haven for smuggling and narcotics. More recently, instability in Venezuela and stepped-up money-laundering enforcement in Panama and the Caribbean have made the region an attractive alternative for transnational criminal organizations looking to launder illicit funds.[1] To that end, news reports indicate that the Department of Justice has targeted the Tri-Border Area as part of a global effort to weaken Hezbollah.[2] Hezbollah is reported to have long-standing ties to the region.[3] In 2018, the Department of Justice designated Hezbollah as a transnational criminal organization. And in June of this year, Paraguay extradited Nader Mohamed Farhat from the Tri-Border Area to the U.S. to face charges of laundering money for drug cartels and other transnational organizations.[4] Although the indictment remains sealed, media reports link Farhat to Hezbollah.[5] This was the second such extradition since 2017, and suggests increasing cooperation between the Department of Justice and authorities in Paraguay and Argentina.[6]

The reported link between Hezbollah and the Tri-Border Area, along with its reputation for harboring willful participants in illicit finance, will place additional pressure on correspondent bank relationships in the region and throughout South America and Latin America. As U.S. banking regulators examine U.S. bank AML programs (both domestic banks and foreign banks with U.S. branches), including examinations of their correspondent relationships, and law enforcement focus on SARs relating to the Tri-Border Area, now is the time to shore up AML controls around these relationships. Section 312 of the USA PATRIOT ACT, 31 U.S.C. §5318(i), and its implementing regulation, 31 CFR §1010.60, require banks operating in the United States to establish effective risk-based due diligence programs for correspondent accounts. The due diligence required is not limited strictly to the correspondent account. Banks are also expected to scrutinize the relationship between a correspondent bank and its customers.[7] The Financial Crimes Enforcement Network ("FinCEN") has recently penalized banks in the United States for failing to conduct adequate due diligence in this context. For example, on November 1, 2017, FinCEN imposed a $2 million penalty on Lone Star National Bank for having inadequate Know Your Customer ("KYC") procedures for correspondent accounts, failing to risk-rate correspondent transactions, and failing to adopt rigorous anti-money laundering ("AML") compliance measures.[8]

If the U.S. focus on the Tri-Border Area continues to expand, the consequences are likely to ripple across the landscape of Latin and South American banking. U.S. banks that offer correspondent services in Latin and South America may feel even greater pressure to de-risk and avoid scrutiny from FinCEN, banking regulators, and the Department of Justice. It may be just a matter of time before U.S. banks push even harder on their South American and Latin American correspondent partners to demonstrate robust AML compliance, and proactive measures to prevent Tri-Border Area funds from making their way to the U.S. National and regional banks in Latin America who hold the correspondent relationships may pass these requirements on to their smaller downstream customers.

These potential consequences combined with the heightened scrutiny of the Tri-Border Area highlight the need for banks in South America and Latin America to take steps to assess their exposure to Tri-Border Area funds (money to and from the Tri-Border area), focusing on transactions connected to the Middle East and Asia, and identifying potential shell corporations and customers potentially involved in the movement of illicit funds. Additionally, Latin and South American banks should consider taking proactive measures to avoid having their correspondent relationship "de-risked", by strengthening their AML and sanctions compliance programs, and ensuring that their AML and sanctions policies and procedures are robust, effective, and comport with U.S. expectations. Moreover, national and regional banks who provide correspondent services to smaller regional banks would do well to work with those smaller banks to enhance their AML programs. Access to correspondent services is a vital component of modern banking. Without these services, banks in South America and Latin America will be unable to participate in the dollar-based global economy, including, for example, accessing a steady supply of US dollars for customers or processing remittances from emigres. Implementation of an effective, risk-based AML compliance program may mitigate potential exposure to the Tri-Border Area, and also allow banks in South and Latin America to more effectively collaborate with U.S. banks to establish or maintain these vital relationships.

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[1] *See* Dr. R. Evan Ellis, The Paraguayan Military and the Struggle against Organized Crime and insecurity, Military Review Online, January 2019, *available at*https://www.armyupress.army.mil/Journals/Military-Review/Online-Exclusive/2019-OLE/Jan/Paraguayan-Military/.

[2] *See* Ian Talley, Hezbollah Said to Be Laundering Money in South American Tri-Border Region," The Wall Street Journal, May 15, 2018.

[3] *Id*.

[4] *See* Jay Weaver, Paraguayan extradited to Miami for key role in huge money laundering schemes, feds say, The Miami Herald, June 21, 2019, *available at* https://www.miamiherald.com/news/local/crime/article231810213.html.

[5] *See* Emanuele Ottolenghi, To Fight Terrorists, Follow the Money, Foreign Policy, July 19, 2019, available at https://foreignpolicy.com/2019/07/19/to-fight-terrorists-follow-the-money/.

[6] *See* Emanuele Ottolenghi, Suspected Hezbollah Financier Extradited to the U.S., Policy Brief, Foundation for Defense of Democracies, June 11, 2019; *available at*https://www.fdd.org/analysis/2019/06/21/suspected-hezbollah-financier-extradited-to-the-u-s/.

[7] *See*, *e.g.*, 31 C.F.R. §1010.610(a)-(c) (requiring U.S. banks to implement due diligence programs that detect and prevent money laundering in correspondent accounts, and to develop enhanced due diligence procedures for correspondent banking in jurisdictions that do not cooperate with international AML standards (*e.g.*, the recommendations of the Financial Action Task Force).)

[8] *See* Assessment of Civil Monetary Penalty, IN THE MATTER OF: Lone Star National Bank, Department of the Treasury, Number 2017-04.

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