

**DEPARTMENT OF THE TREASURY****31 CFR Part 103**

RIN 1506-AA82

**Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations—Imposition of Special Measure Against VEF Bank, as a Financial Institution of Primary Money Laundering Concern****AGENCY:** Financial Crimes Enforcement Network, Department of the Treasury.**ACTION:** Final rule.

**SUMMARY:** The Financial Crimes Enforcement Network is issuing a final rule imposing a special measure against joint stock company VEF Banka (“VEF”, “VEF Bank”, or the “bank”) as a financial institution of primary money laundering concern, pursuant to the authority contained in 31 U.S.C. 5318A of the Bank Secrecy Act.

**DATES:** This final rule is effective on August 14, 2006.

**FOR FURTHER INFORMATION CONTACT:** Regulatory Policy and Programs Division, Financial Crimes Enforcement Network, (800) 949-2732.

**SUPPLEMENTARY INFORMATION:****I. Background***A. Statutory Provisions*

On October 26, 2001, the President signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Public Law 107-56 (“USA PATRIOT Act”). Title III of the USA PATRIOT Act amends the anti-money laundering provisions of the Bank Secrecy Act, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5314 and 5316-5332, to promote the prevention, detection, and prosecution of money laundering and the financing of terrorism. Regulations implementing the Bank Secrecy Act appear at 31 CFR part 103. The authority of the Secretary of the Treasury (the “Secretary”) to administer the Bank Secrecy Act and its implementing regulations has been delegated to the Director of the Financial Crimes Enforcement Network (the “Director”).<sup>1</sup> The Bank Secrecy Act authorizes the Director to issue regulations requiring all financial institutions defined as such in the Bank Secrecy Act to maintain or file certain reports or records that have been determined to have a high degree of

usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counter-intelligence activities, including analysis, to protect against international terrorism, and to implement anti-money laundering programs and compliance procedures.<sup>2</sup>

Section 311 of the USA PATRIOT Act added section 5318A to the Bank Secrecy Act, granting the Secretary the authority, after finding that reasonable grounds exist for concluding that a foreign jurisdiction, foreign financial institution, international class of transactions, or type of account is of “primary money laundering concern,” to require domestic financial institutions and domestic financial agencies to take certain “special measures” against the primary money laundering concern. Section 311 identifies factors for the Secretary to consider and Federal agencies to consult before he may find that reasonable grounds exist for concluding that a jurisdiction, financial institution, class of transactions, or type of account is of primary money laundering concern. The statute also provides similar procedures, including factors and consultation requirements, for selecting the specific special measures to be imposed against the primary money laundering concern.

Taken as a whole, section 311 provides the Secretary with a range of options that can be adapted to target specific money laundering and terrorist financing concerns most effectively. These options provide the authority to bring additional and useful pressure on those jurisdictions and institutions that pose money laundering threats and the ability to take steps to protect the U.S. financial system. Through the imposition of various special measures, we can: Gain more information about the concerned jurisdictions, financial institutions, transactions, and accounts; monitor more effectively the respective jurisdictions, financial institutions, transactions, and accounts; and ultimately protect U.S. financial institutions from involvement with jurisdictions, financial institutions, transactions, or accounts that pose a money laundering concern.

Before making a finding that reasonable grounds exist for concluding that a foreign financial institution is of primary money laundering concern, the Secretary is required by the Bank Secrecy Act to consult with both the

Secretary of State and the Attorney General.

In addition to these consultations, when finding that a foreign financial institution is of primary money laundering concern, the Secretary is required by section 311 to consider “such information as the Secretary determines to be relevant, including the following potentially relevant factors:”

- The extent to which such financial institution is used to facilitate or promote money laundering in or through the jurisdiction;
- The extent to which such financial institution is used for legitimate business purposes in the jurisdiction; and

- The extent to which such action is sufficient to ensure, with respect to transactions involving the institution operating in the jurisdiction, that the purposes of the Bank Secrecy Act continue to be fulfilled, and to guard against international money laundering and other financial crimes.

If we determine that reasonable grounds exist for concluding that a foreign financial institution is of primary money laundering concern, we must determine the appropriate special measure(s) to address the specific money laundering risks. Section 311 provides a range of special measures that can be imposed, individually or jointly, in any combination, and in any sequence.<sup>3</sup> In the imposition of special measures, we follow procedures similar to those for finding a foreign financial institution to be of primary money laundering concern, but we also engage in additional consultations and consider additional factors. Section 311 requires us to consult with other appropriate Federal agencies and parties<sup>4</sup> and to consider the following specific factors:

<sup>3</sup> Available special measures include requiring: (1) Recordkeeping and reporting of certain financial transactions; (2) collection of information relating to beneficial ownership; (3) collection of information relating to certain payable-through accounts; (4) collection of information relating to certain correspondent accounts; and (5) prohibition or conditions on the opening or maintaining of correspondent or payable-through accounts. 31 U.S.C. 5318A(b)(1)-(5). For a complete discussion of the range of possible countermeasures, see 68 FR 18917 (April 17, 2003) (proposing to impose special measures against Nauru).

<sup>4</sup> Section 5318A(a)(4)(A) requires the Secretary to consult with the Chairman of the Board of Governors of the Federal Reserve System, any other appropriate Federal banking agency, the Secretary of State, the U.S. Securities and Exchange Commission, the Commodity Futures Trading Commission, the National Credit Union Administration, and, in our sole discretion, “such other agencies and interested parties as the Secretary may find to be appropriate.” The consultation process must also include the Attorney General, if the Secretary is considering prohibiting or imposing conditions upon the opening or maintaining of a correspondent account by any

<sup>1</sup> Therefore, references to the authority of the Secretary of the Treasury under section 311 of the USA PATRIOT Act apply equally to the Director of the Financial Crimes Enforcement Network.

<sup>2</sup> Language expanding the scope of the Bank Secrecy Act to intelligence or counter-intelligence activities to protect against international terrorism was added by section 358 of the USA PATRIOT Act.

- Whether similar action has been or is being taken by other nations or multilateral groups;

- Whether the imposition of any particular special measure would create a significant competitive disadvantage, including any undue cost or burden associated with compliance, for financial institutions organized or licensed in the United States;

- The extent to which the action or the timing of the action would have a significant adverse systemic impact on the international payment, clearance, and settlement system, or on legitimate business activities involving the particular institution; and

- The effect of the action on U.S. national security and foreign policy.<sup>5</sup>

In this final rule, we are imposing the fifth special measure (31 U.S.C. 5318A(b)(5)) against VEF, a commercial bank in the Republic of Latvia ("Latvia"). The fifth special measure allows for the imposition of conditions upon, or the prohibition of, the opening or maintaining of correspondent or payable-through accounts in the United States for or on behalf of a foreign financial institution of primary money laundering concern. Unlike the other special measures, this special measure may be imposed only through the issuance of a regulation.

#### B. VEF

VEF is headquartered in Riga, the capital of Latvia. VEF is one of the smallest of Latvia's 23 banks, and in 2004 was reported to have approximately \$80 million in assets and 87 employees. Total assets for the bank as of June 30, 2005 were 27.3 million LATS, equivalent to approximately \$47.4 million. For the first six months of 2005, the bank made a profit of 288,410 LATS, equivalent to over \$501,000. The bank has one subsidiary, Veiksmes lizings, which offers financial leasing and factoring services. In addition to its headquarters in Riga, VEF has one branch in Riga and one representative office in the Czech Republic. VEF offers corporate and private banking services, issues a variety of credit cards for non-Latvians, and provides currency exchange through Internet banking services, i.e., virtual currencies. In addition, according to

domestic financial institution or domestic financial agency for the foreign financial institution of primary money laundering concern.

<sup>5</sup> Classified information used in support of a section 311 finding of primary money laundering concern and imposition of special measure(s) may be submitted by the Department of the Treasury to a reviewing court ex parte and in camera. See section 376 of the Intelligence Authorization Act for Fiscal Year 2004, Pub. L. 108-177 (amending 31 U.S.C. 5318A by adding new paragraph (f)).

VEF's financial statements, VEF maintains correspondent accounts in countries worldwide, but currently reports none in the United States.<sup>6</sup> However, many of the foreign financial institutions from which VEF obtains financial services in turn maintain correspondent accounts with financial institutions in the United States. Accordingly, it appears that VEF may still have indirect access to the U.S. financial system.

## II. The 2005 Finding and Subsequent Developments

### A. The 2005 Finding

Based upon review and analysis of pertinent information, consultations with relevant Federal agencies and parties, and after consideration of the factors enumerated in section 311, in April 2005 the Secretary, through his delegate, the Director of the Financial Crimes Enforcement Network, found that reasonable grounds exist for concluding that VEF is a financial institution of primary money laundering concern. This finding was published in a notice of proposed rulemaking, which proposed prohibiting covered financial institutions from, directly or indirectly, opening or maintaining correspondent accounts in the United States for VEF or any of its branches, offices, or subsidiaries, pursuant to the authority under 31 U.S.C. 5318A.<sup>7</sup>

The notice of proposed rulemaking outlined the various factors supporting the finding and proposed prohibition. In finding VEF to be of primary money laundering concern, we determined that:

- VEF was used by criminals to facilitate or promote money laundering. In particular, we determined that VEF was an important banking resource for illicit shell companies and financial fraud rings, allowing criminals to pursue illegal financial activities. VEF permitted ATM withdrawals in significant amounts, an essential component to the execution of large financial fraud schemes typically associated with carding networks.

- Any legitimate business use of VEF appeared to be significantly outweighed by its use to promote or facilitate money laundering and other financial crimes.

- A finding that VEF is of primary money laundering concern and prohibiting the maintenance of correspondent accounts for that

institution would prevent suspect accountholders at VEF from accessing the U.S. financial system to facilitate money laundering and would bring criminal conduct occurring at or through VEF to the attention of the international financial community and thus serve the purposes of the Bank Secrecy Act as well as guard against international money laundering and other financial crime.

We determined, based on a variety of sources, that VEF Bank has been used to facilitate or promote money laundering based in part on its lax identification and verification of accountholders and on its weak internal controls. In addition, the proceeds of alleged illicit activity have been transferred to or through accounts held by VEF Bank at covered financial institutions.

### B. Jurisdictional Developments

Latvia's geographical position, situated by the Baltic Sea and bordering Russia, Estonia, Belarus, and Lithuania, makes it an attractive transit country for both legitimate and illegitimate trade. Sources of illegitimate trade include counterfeiting, arms trafficking, contraband smuggling, and other crimes. It is believed that most of Latvia's narcotics trafficking is conducted by organized crime groups that began with cigarette and alcohol smuggling and then progressed to narcotics. Latvian authorities recently have sought tighter legislative controls designed to fight money laundering and other financial crime. However, Latvia's role as a regional financial center, the number of commercial banks (23), and those banks' sizeable non-resident deposit base continue to make it vulnerable to money laundering.

Latvia has taken a number of significant steps to address the reported money laundering risks and corruption highlighted in the notice of proposed rulemaking. The Parliament of Latvia recently passed a new law, *On the Declaration of Cash on the State Border*, which will go into effect on July 1, 2006.<sup>8</sup> The law is aimed at preventing money laundering consistent with the United Nations Convention Against Transnational Organized Crime and the European Union draft regulation on the control of cash leaving and entering the European Community. In 2005, Latvian law was amended to broaden

<sup>8</sup> The law requires that individuals crossing the Latvian border with the equivalent of 10,000 Euros (€10,000) in coins, cash, and/or certain monetary instruments to complete a form stating the origin of the currency or monetary instruments, the purpose or use of the currency or monetary instruments, and the receiver of the currency or monetary instruments.

<sup>6</sup> Some covered financial institutions closed their correspondent accounts with VEF before, and another closed its account with VEF after, the issuance of the notice of proposed rulemaking in April 2005.

<sup>7</sup> See 70 FR 21369 (April 26, 2005).

supervisory authority to revoke banking licenses and to allow enforcement agencies greater access to bank account information. The amendments also provide for fines of between 5,000 and 100,000 LATS (equivalent to over \$8,687.50 and over \$173,750.00, respectively) against banks in violation of the anti-money laundering laws; include a definition of and procedures for determining who qualifies as a "true beneficiary"; and introduce criminal liability for providing false information to banks. Additionally, Latvia has: Banned the establishment of shell banks; clarified the authority of Latvian financial institutions to demand customer disclosure regarding the source of funds; and allowed for the sharing of information between financial institutions on suspicious activities.

In terms of implementation, the Latvian authorities have made strides in strengthening their anti-money laundering regulation and supervision and in developing more robust anti-money laundering examination procedures. To ensure proper protection of Latvia's financial sector, authorities will need to continue their efforts to effectively implement and enforce their strengthened anti-money laundering regime.

### C. VEF's Subsequent Developments

We acknowledge that VEF has taken steps to address many of the money laundering concerns that we previously identified. For example, the bank revised its policies and procedures, including training procedures; created an Anti-Money Laundering Manual; closed approximately 600 questionable accounts; changed some of its management personnel;<sup>9</sup> and retained the services of an independent international accounting firm to identify weaknesses in its anti-money laundering program and to assist the bank in its goal of reaching a best practices standard for its anti-money laundering program and controls.

Despite the steps VEF has taken, based on a variety of sources including classified information, we continue to have serious concerns about the commitment of the bank to implement its revised policies and procedures. Specifically, we have continued concern with reported links between the bank's ownership and organized crime groups that reportedly facilitate money laundering. Accordingly, we find that

<sup>9</sup>In September 2005, VEF removed its Head of Department for the Supervision of Clients and its Chief Manager for Remote Attraction of Clients, as well as dismissed some of the members of its Board and appointed new members.

VEF continues to be a financial institution of primary money laundering concern.

### III. Imposition of the Fifth Special Measure

Consistent with the finding that VEF is a financial institution of primary money laundering concern, and based upon additional consultations with required Federal agencies and parties as well as consideration of additional relevant factors, including the comments received on the proposed rule, we are imposing the special measure authorized by 31 U.S.C. 5318A(b)(5) with regard to VEF.<sup>10</sup> That special measure authorizes the prohibition of, or the imposition of conditions upon, the opening or maintaining of correspondent or payable-through accounts<sup>11</sup> by any domestic financial institution or domestic financial agency for, or on behalf of, a foreign financial institution found to be of primary money laundering concern. A discussion of the additional section 311 factors relevant to the imposition of this particular special measure follows.

#### A. Similar Actions Have Not Been or May Not Be Taken by Other Nations or Multilateral Groups Against VEF Bank

At this time, other countries and multilateral groups have not taken any action similar to the imposition of the fifth special measure pursuant to section 311, which allows the prohibition of U.S. financial institutions and financial agencies from opening or maintaining a correspondent account in the United States for or on behalf of VEF and requires those institutions and agencies to guard against indirect use by VEF. We are encouraging other countries to take similar action based on our finding that VEF is a financial institution of primary money laundering concern.

#### B. The Imposition of the Fifth Special Measure Would Not Create a Significant Competitive Disadvantage, Including Any Undue Cost or Burden Associated With Compliance, for Financial Institutions Organized or Licensed in the United States

The fifth special measure imposed by this rule prohibits covered financial institutions from opening or maintaining correspondent accounts in

<sup>10</sup> *Supra* footnote 3.

<sup>11</sup> For purposes of the rule, a correspondent account is defined as an account established to receive deposits from, or make payments or other disbursements on behalf of, a foreign bank, or handle other financial transactions related to the foreign bank (see 31 U.S.C. 5318A(e)(1)(B) as implemented in 31 CFR 103.175(d)(1)(ii)).

the United States for, or on behalf of, VEF. As a corollary to this measure, covered financial institutions also are required to take reasonable steps to apply due diligence to all of their correspondent accounts to ensure that no such account is being used indirectly to provide services to VEF. The burden associated with these requirements is not expected to be significant, given that we are not aware of any covered financial institution that maintains a correspondent account directly for VEF. Moreover, there is a minimal burden involved in transmitting a one-time notice to all correspondent accountholders concerning the prohibition on indirectly providing services to VEF. In addition, covered financial institutions generally apply some degree of due diligence in screening their transactions and accounts, often through the use of commercially available software, such as that used for compliance with the economic sanctions programs administered by the Department of the Treasury's Office of Foreign Assets Control. As explained in more detail in the section-by-section analysis below, financial institutions should be able to adapt their existing screening procedures to comply with this special measure. Thus, the due diligence that is required by this rule is not expected to impose a significant additional burden upon covered financial institutions.

#### C. The Action or Timing of the Action Will Not Have a Significant Adverse Systemic Impact on the International Payment, Clearance, and Settlement System, or on Legitimate Business Activities Involving VEF Bank

VEF is not a major participant in the international payment system and is not relied upon by the international banking community for clearance or settlement services. Thus, the imposition of the fifth special measure against VEF will not have a significant adverse systemic impact on the international payment, clearance, and settlement system. In addition, we believe that any legitimate use of VEF is significantly outweighed by its reported use to promote or facilitate money laundering. Moreover, in light of the existence of approximately 15 larger banks in Latvia, we believe that imposition of the fifth special measure against VEF will not impose an undue burden on legitimate business activities in Latvia.

#### D. The Action Enhances U.S. National Security and Complements U.S. Foreign Policy

The exclusion from the U.S. financial system of banks such as VEF that serve

as conduits for significant money laundering activity and that participate in other financial crime enhances U.S. national security by making it more difficult for criminals to access the substantial resources and services of the U.S. financial system. In addition, the imposition of the fifth special measure against VEF complements the U.S. Government's overall foreign policy strategy of making entry into the U.S. financial system more difficult for high-risk financial institutions.

#### IV. Notice of Proposed Rulemaking and Comments

We received 13 comment letters on the notice of proposed rulemaking: Three on behalf of VEF;<sup>12</sup> one comment letter from a securities industry trade association; one from a U.S. firm providing search software to U.S. financial institutions; one from Latvia's banking regulator, the Financial and Capital Markets Commission; five comment letters from VEF accountholders; and two comment letters from foreign companies that do business with VEF accountholders. Additionally, we met with representatives of VEF on several occasions.

Most of the comments raised by VEF were unrelated to our request for comment on the proposed imposition of the fifth special measure. VEF claims: That it was unaware of accountholders funneling illicit proceeds through its accounts; that the references in the notice of proposed rulemaking were too vague to rebut; and that we did not provide the bank notice before issuing the proposed rule.

The bank also claims that we did not respond fully to certain statutory criteria. VEF asserts that we did not address whether the imposition of the fifth special measure would have a significant adverse systemic impact on the international payment, clearance, and settlement system. However, we addressed this issue when we stated in the notice of proposed rulemaking that VEF is not a major participant in the international payment system and is not relied upon by the international banking community for clearance or settlement services and, therefore, imposing the fifth special measure would not have a significant adverse impact on the international payment, settlement, and clearance system.<sup>13</sup> Furthermore, although we recognize that certain current accountholders at VEF will be

affected by this final rule, Latvia has 22 other banks that can meet their legitimate business needs. The statutory criteria for finding VEF to be a financial institution of primary money laundering concern and for imposing the fifth special measure have been fully addressed.<sup>14</sup>

The Latvian regulator commented on representations that we made about Latvian financial institutions. In response to our concern that Latvian financial institutions did not appear to serve the Latvian community, it stated that foreign deposits have always been a central feature in Latvia, which is a regional financial center due to its geographic location. The regulator also took issue with our representation that Latvia had material weaknesses in the implementation and enforcement of its anti-money laundering laws. As previously stated in section II.B., *supra*, Latvia has significantly enhanced its anti-money laundering laws.

The remaining commenters were companies that were accountholders at VEF (five commenters), companies that conducted business with accountholders at VEF (two commenters), a trade association, and a U.S. search software solutions company. The VEF accountholders and the companies that conducted business with VEF accountholders maintained that VEF operated lawfully and professionally and that the issuance of the proposed rule adversely impacted them. Some of the accountholders expressed concern that the closure of correspondent accounts held by VEF at covered financial institutions might require accountholders to: (1) Open new accounts with other banks that are unfamiliar with their businesses and products; and (2) revise many contracts that include banking details for the parties involved. We specifically solicited comment on the impact of the fifth special measure on legitimate business involving VEF, and we understand that the measure may require legitimate businesses to make alternative banking arrangements with any one of the other 22 available Latvian banking institutions. Despite the difficulty this may pose for some businesses, we continue to believe that legitimate business use involving VEF is outweighed by its use to promote or facilitate money laundering and other financial crimes.

#### V. Section-by-Section Analysis

The final rule prohibits covered financial institutions from opening or maintaining any correspondent account

for, or on behalf of, VEF. Covered financial institutions are required to apply due diligence to their correspondent accounts to guard against their indirect use by VEF. At a minimum, that due diligence must include two elements. First, a covered financial institution must notify its correspondent accountholders that the account may not be used to provide VEF with access to the covered financial institution. Second, a covered financial institution must take reasonable steps to identify any indirect use of its correspondent accounts by VEF, to the extent that such indirect use can be determined from transactional records maintained by the covered financial institution in the normal course of business. A covered financial institution must take a risk-based approach when deciding what, if any, additional due diligence measures it should adopt to guard against the indirect use of correspondent accounts by VEF, based on risk factors such as the type of services offered by, and geographic locations of, its correspondents.

##### A. Section 103.192(a)—Definitions

###### 1. VEF

Section 103.192(a)(4) of the rule defines VEF to include all branches, offices, and subsidiaries of VEF operating in the Republic of Latvia or in any other jurisdiction. The one known VEF subsidiary, Veiksmes lizings, and any of its branches or offices, is included in the definition. We will provide information regarding the existence or establishment of any other subsidiaries as it becomes available; however, covered financial institutions should take commercially reasonable measures to determine whether a customer is a branch, office, or subsidiary of VEF.

###### 2. Correspondent Account

Section 103.192(a)(1) defines the term "correspondent account" by reference to the definition contained in 31 CFR 103.175(d)(1)(ii). Section 103.175(d)(1)(ii) defines a correspondent account to mean an account established for a foreign bank to receive deposits from, or make payments or other disbursements on behalf of the foreign bank, or to handle other financial transactions related to the foreign bank.

In the case of a depository institution in the United States, this broad definition of account includes most types of banking relationships between the depository institution and a foreign bank that are established to provide regular services, dealings, and other

<sup>12</sup> One comment letter is from VEF, through its U.S. legal counsel, and two comment letters are from the chairman of the Supervisory Council, who owns between 33 and 50 percent of VEF.

<sup>13</sup> See 70 FR at 21373.

<sup>14</sup> See note 7, *supra*.

financial transactions including a demand deposit, savings deposit, or other transaction or asset account, and a credit account or other extension of credit.

In the case of securities broker-dealers, futures commission merchants, introducing brokers in commodities, and investment companies that are open-end companies (“mutual funds”), we are using the same definition of “account” for purposes of this rule that was established in the final rule implementing section 312 of the USA PATRIOT Act.<sup>15</sup>

### 3. Covered Financial Institution

Section 103.192(a)(2) of the rule defines covered financial institution to include the following:

- An insured bank (as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h));
- A commercial bank;
- An agency or branch of a foreign bank in the United States;
- A federally insured credit union;
- A savings association;
- A corporation acting under section 25A of the Federal Reserve Act (12 U.S.C. 611 *et seq.*);
- A trust bank or trust company that is federally regulated and is subject to an anti-money laundering program requirement;
- A broker or dealer in securities registered, or required to be registered, with the U.S. Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*), except persons who register pursuant to section 15(b)(11) of the Securities Exchange Act of 1934;
- A futures commission merchant or an introducing broker registered, or required to be registered, with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*), except persons who register pursuant to section 4(f)(a)(2) of the Commodity Exchange Act; and
- A mutual fund, which means an investment company (as defined in section 3(a)(1) of the Investment Company Act of 1940 (“Investment Company Act”) (15 U.S.C. 80a–3(a)(1)) that is an open-end company (as defined in section 5(a)(1) of the Investment Company Act (15 U.S.C. 80a–5(a)(1)) and that is registered, or is required to register, with the U.S. Securities and Exchange Commission pursuant to the Investment Company Act.

In the notice of proposed rulemaking, we defined “covered financial institution” by reference to 31 CFR

103.175(f)(2), the operative definition of that term for purposes of the rules implementing sections 313 and 319 of the USA PATRIOT Act, and we also included in the definition futures commission merchants, introducing brokers, and mutual funds. The definition of “covered financial institution” we are adopting for purposes of this final rule is substantially the same as in 31 CFR 103.175(f)(2).

#### *B. Section 103.192(b)—Requirements for Covered Financial Institutions*

For purposes of complying with the final rule’s prohibition on the opening or maintaining in the United States of correspondent accounts for, or on behalf of, VEF Bank, we expect a covered financial institution to take such steps that a reasonable and prudent financial institution would take to protect itself from loan or other fraud or loss based on misidentification of a person’s status.

##### 1. Prohibition of Direct Use of Correspondent Accounts

Section 103.192(b)(1) of the rule prohibits all covered financial institutions from opening or maintaining a correspondent account in the United States for, or on behalf of, VEF Bank. The prohibition requires all covered financial institutions to review their account records to ensure that they maintain no accounts directly for, or on behalf of, VEF Bank.

##### 2. Due Diligence Upon Correspondent Accounts To Prohibit Indirect Use

As a corollary to the prohibition on the opening or maintaining of correspondent accounts directly for VEF Bank, § 103.192(b)(2) requires a covered financial institution to apply due diligence to its correspondent accounts<sup>16</sup> that is reasonably designed to guard against their indirect use by VEF Bank. At a minimum, that due diligence must include notifying correspondent accountholders that correspondent accounts may not be used to provide VEF Bank with access to the covered financial institution. For example, a covered financial institution may satisfy this requirement by

transmitting the following notice to all of its correspondent accountholders:

*Notice:* Pursuant to U.S. regulations issued under section 311 of the USA PATRIOT Act, 31 CFR 103.192, we are prohibited from opening or maintaining a correspondent account for, or on behalf of, VEF Bank (Republic of Latvia) or any of its subsidiaries (including Veiksmes lizings). The regulations also require us to notify you that your correspondent account with our financial institution may not be used to provide VEF Bank or any of its subsidiaries with access to our financial institution. If we become aware that VEF Bank or any of its subsidiaries is indirectly using the correspondent account you hold at our financial institution, we will be required to take appropriate steps to prevent such access, including terminating your account.

The purpose of the notice requirement is to help ensure that VEF is denied access to the U.S. financial system, as well as to increase awareness within the international financial community of the risks and deficiencies of VEF. However, we do not require or expect a covered financial institution to obtain a certification from its correspondent accountholders that indirect access will not be provided in order to comply with this notice requirement. Instead, methods of compliance with the notice requirement could include, for example, transmitting a one-time notice by mail, fax, or e-mail to a covered financial institution’s correspondent accountholders, informing those accountholders that their correspondent accounts may not be used to provide VEF Bank with indirect access to the covered financial institution, or including such information in the next regularly occurring transmittal from the covered financial institution to its correspondent accountholders.

In its comment letter, the trade association requested that we consider permitting other methods of providing notice to correspondent accountholders or allowing sufficient flexibility so that covered financial institutions can use systems already established under other provisions of the USA PATRIOT Act to provide notice. As we indicated in the notice of proposed rulemaking, a covered financial institution is not obligated to use any specific form or method in notifying its correspondent accountholders of the special measure. We suggested the provision of written notice containing certain language as only one example of how a covered financial institution could comply with its obligation to notify its correspondents. The trade association further suggested that we specifically consider means such as including the notice within the certificates used by financial institutions to comply with the

<sup>16</sup> Again, for purposes of the final rule, a correspondent account is defined as an account established by a covered financial institution for a foreign bank to receive deposits from, or to make payments or other disbursements on behalf of, a foreign bank, or to handle other financial transactions related to the foreign bank. For purposes of this definition, the term account means any formal banking or business relationship established to provide regular services, dealings, and other financial transactions. See 31 CFR 103.175(d)(2).

<sup>15</sup> See 31 CFR 103.175(d)(2)(ii)–(iv).

rules issued under sections 313 and 319 of the USA PATRIOT Act. Although there may be circumstances where this would be appropriate, we note that those certificates are renewable only every three years and that relying solely on the certification process for notice purposes would not be reasonable where a re-certification would not be made within a reasonable time following the issuance of this final rule. Furthermore, as noted above, we are not requiring that covered financial institutions obtain a certification regarding compliance with the final rule from each correspondent accountholder.

This final rule also requires a covered financial institution to take reasonable steps to identify any indirect use of its correspondent accounts by VEF, to the extent that such indirect use can be determined from transactional records maintained by the covered financial institution in the normal course of business. For example, a covered financial institution is expected to apply an appropriate screening mechanism to be able to identify a funds transfer order that, on its face, lists VEF as the originator's or beneficiary's financial institution, or otherwise references VEF in a manner detectable under the financial institution's normal business screening procedures. We acknowledge that not all institutions are capable of screening every field in a funds transfer message and that the risk-based controls of some institutions may not necessitate such comprehensive screening. Alternatively, other institutions may perform more thorough screening as part of their risk-based determination to perform "additional due diligence," as described below. An appropriate screening mechanism could be the mechanism currently used by a covered financial institution to comply with various legal requirements, such as the commercially available software used to comply with the sanctions programs administered by the Office of Foreign Assets Control.

In its letter, the software company commenter sought clarification on how covered financial institutions were expected to prevent indirect use of correspondent services to VEF. In particular, the software company asked if a one-time search was sufficient to determine if the financial institution was being used indirectly by a subject to a section 311 special measure and whether the proposed rule also extends to wire transfer activity, payable-through accounts, debit and credit card transactions, and any other financial activities through which a U.S. financial institution may eventually directly transact or act as an intermediary.

After we issue a final section 311 rulemaking and impose the fifth special measure with regard to a financial institution ("section 311 institution"), a covered financial institution is required to apply due diligence to its correspondent accounts that is reasonably designed to guard against their indirect use by the section 311 institution. Specifically, a covered financial institution must: (1) Notify its correspondent accountholders that the correspondent account may not be used to provide the section 311 institution with access to the covered financial institution; and (2) take reasonable steps to identify any indirect use of its correspondent accounts by the section 311 institution. We gave an example above of how a one-time transmittal notice to correspondent accountholders would satisfy the notification requirement. With respect to the second requirement, a covered financial institution has an ongoing—as opposed to a one-time—obligation to take reasonable steps to identify all correspondent account services it may directly or indirectly provide to the section 311 institution.

This commenter also suggested that section 311 institutions, like VEF, be included in the Office of Foreign Assets Control Specially Designated Nationals List to avoid compelling covered financial institutions to comply with two separate lists and, therefore, alleviate regulatory burden.<sup>17</sup> However, the suggestion is problematic given that the Financial Crimes Enforcement Network and the Office of Foreign Assets Control are distinct governmental entities with different policy objectives. The Office of Foreign Assets Control administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals, while the intent of imposing the fifth special measure under a section 311 rulemaking is to prevent entities of primary money laundering concern from accessing the U.S. financial system. The two lists referenced are not comparable and have separate statutory criteria and legal

<sup>17</sup> The software company commenter also requested that we provide a list of section 311 institutions in an electronic format available for download on its Web site in the same formats as our section 314(a) (mandatory law enforcement information sharing request) lists and lists provided by the Office of Foreign Assets Control. This request presupposes that the section 311 list is as massive or frequent as the other lists and merits our providing it in a downloadable format. However, the number of section 311 rulemakings issued in one year does not merit such treatment. We maintain a list of section 311 rulemakings and withdrawals at <http://www.fincen.gov> under *Regulatory/Section 311*.

bases and are, therefore, not equivalent or interchangeable.

Nonetheless, as stated above, covered financial institutions may seek to monitor for section 311 institutions by using software that they are currently using, such as the commercially available software used to comply with the sanctions programs administered by the Office of Foreign Assets Control to flag certain entities. Using existing screening software should alleviate regulatory burden for covered financial institutions in complying with this rulemaking. However, each covered financial institution has the flexibility to establish and apply a screening mechanism appropriate for its business.

Notifying correspondent accountholders and taking reasonable steps to identify any indirect use of correspondent accounts by VEF in the manner discussed above are the minimum due diligence requirements under this final rule. Beyond these minimum steps, a covered financial institution should adopt a risk-based approach for determining what, if any, additional due diligence measures it should implement to guard against the indirect use of its correspondent accounts by VEF, based on risk factors such as the type of services it offers and the geographic locations of its correspondent accountholders.

A covered financial institution that obtains knowledge that a correspondent account is being used by a foreign bank to provide indirect access to VEF must take all appropriate steps to prevent such indirect access, including, when necessary, terminating the correspondent account. A covered financial institution may afford such foreign bank a reasonable opportunity to take corrective action prior to terminating the correspondent account. We have added language in the final rule clarifying that, should the foreign bank refuse to comply, or if the covered financial institution cannot obtain adequate assurances that the account will not be available to VEF, the covered financial institution must terminate the account within a commercially reasonable time. This means that the covered financial institution should not permit the foreign bank to establish any new positions or execute any transactions through the account, other than those necessary to close the account. A covered financial institution may reestablish an account closed under this rule if it determines that the account will not be used to provide banking services indirectly to VEF.

### 3. Reporting Not Required

Section 103.192(b)(3) of the rule clarifies that the rule does not impose any reporting requirement upon any covered financial institution that is not otherwise required by applicable law or regulation. However, a covered financial institution must document its compliance with the requirement that it notify its correspondent account holders that the accounts may not be used to provide VEF with access to the covered financial institution.

### VI. Regulatory Flexibility Act

It is hereby certified that this rule will not have a significant economic impact on a substantial number of small entities. It appears that VEF no longer holds correspondent accounts in the United States. The correspondent accounts that the bank previously held in the United States were closed, and any correspondent accounts that may still be held in the United States for foreign banks that still maintain a correspondent relationship with VEF are held with large banks. Thus, the prohibition on establishing or maintaining such correspondent accounts will not have a significant impact on a substantial number of small entities. In addition, all covered financial institutions currently must exercise some degree of due diligence in order to comply with various legal requirements. The tools used for such purposes, including commercially available software used to comply with the economic sanctions programs administered by the Office of Foreign Assets Control, can be modified to monitor for the use of correspondent accounts by VEF. Thus, the due diligence that is required by this rule—i.e., the one-time transmittal of notice to correspondent account holders and screening of transactions to identify any indirect use of a correspondent account—is not expected to impose a significant additional economic burden on small covered financial institutions.

### VII. Paperwork Reduction Act of 1995

The collection of information contained in the final rule has been approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), and has been assigned OMB Control Number 1506-0041. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by OMB.

The only requirements in the final rule that are subject to the Paperwork

Reduction Act are the requirements that a covered financial institution notify its correspondent account holders that the correspondent accounts maintained on their behalf may not be used to provide VEF with access to the covered financial institution and the requirement that a covered financial institution document its compliance with this obligation to notify its correspondents. The estimated annual average burden associated with this collection of information is one hour per affected financial institution. We received no comments on this information collection burden estimate.

Comments concerning the accuracy of this information collection estimate and suggestions for reducing this burden should be sent (preferably by fax (202-395-6974)) to Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503 (or by the Internet to [Alexander\\_T.\\_Hunt@omb.eop.gov](mailto:Alexander_T._Hunt@omb.eop.gov)), with a copy to the Financial Crimes Enforcement Network by paper mail to FinCEN, P.O. Box 39, Vienna, VA 22183, "ATTN: Section 311—Imposition of Special Measure Against VEF" or by electronic mail to [regcomments@fincen.treas.gov](mailto:regcomments@fincen.treas.gov) with the caption "ATTN: Section 311—Imposition of Special Measure Against VEF" in the body of the text.

### VIII. Executive Order 12866

This rule is not a significant regulatory action for purposes of Executive Order 12866, "Regulatory Planning and Review."

#### List of Subjects in 31 CFR Part 103

Administrative practice and procedure, Banks and banking, Brokers, Counter-money laundering, Counter-terrorism, and Foreign banking.

#### Authority and Issuance

■ For the reasons set forth in the preamble, part 103 of title 31 of the Code of Federal Regulations is amended as follows:

#### PART 103—FINANCIAL RECORDKEEPING AND REPORTING OF CURRENCY AND FINANCIAL TRANSACTIONS

■ 1. The authority citation for part 103 continues to read as follows:

**Authority:** 12 U.S.C. 1829b and 1951-1959; 31 U.S.C. 5311-5314 and 5316-5332; title III, sec. 314 Pub. L. 107-56, 115 Stat. 307.

#### Subpart I—[Amended]

■ 2. Subpart I of part 103 is amended by adding new § 103.192 as follows:

#### § 103.192 Special measures against VEF Bank.

(a) *Definitions.* For purposes of this section:

(1) *Correspondent account* has the same meaning as provided in § 103.175(d)(1)(ii).

(2) *Covered financial institution* includes:

(i) An insured bank (as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)));

(ii) A commercial bank;

(iii) An agency or branch of a foreign bank in the United States;

(iv) A federally insured credit union;

(v) A savings association;

(vi) A corporation acting under section 25A of the Federal Reserve Act (12 U.S.C. 611 *et seq.*);

(vii) A trust bank or trust company that is federally regulated and is subject to an anti-money laundering program requirement;

(viii) A broker or dealer in securities registered, or required to be registered, with the U.S. Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*), except persons who register pursuant to section 15(b)(11) of the Securities Exchange Act of 1934;

(ix) A futures commission merchant or an introducing broker registered, or required to be registered, with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*), except persons who register pursuant to section 4(f)(a)(2) of the Commodity Exchange Act; and

(x) A mutual fund, which means an investment company (as defined in section 3(a)(1) of the Investment Company Act of 1940 ("Investment Company Act") (15 U.S.C. 80a-3(a)(1))) that is an open-end company (as defined in section 5(a)(1) of the Investment Company Act (15 U.S.C. 80a-5(a)(1))) and that is registered, or is required to register, with the U.S. Securities and Exchange Commission pursuant to the Investment Company Act.

(3) *Subsidiary* means a company of which more than 50 percent of the voting stock or analogous equity interest is owned by another company.

(4) *VEF Bank* means any branch, office, or subsidiary of joint stock company VEF Banka operating in the Republic of Latvia or in any other jurisdiction. The one known VEF Bank subsidiary, Veiksmes lizings, and any branches or offices, are included in the definition.

(b) *Requirements for covered financial institutions*—(1) *Prohibition on direct use of correspondent accounts.* A covered financial institution shall

terminate any correspondent account that is opened or maintained in the United States for, or on behalf of, VEF Bank.

(2) *Due diligence of correspondent accounts to prohibit indirect use.* (i) A covered financial institution shall apply due diligence to its correspondent accounts that is reasonably designed to guard against their indirect use by VEF Bank. At a minimum, that due diligence must include:

(A) Notifying correspondent account holders that the correspondent account may not be used to provide VEF Bank with access to the covered financial institution; and

(B) Taking reasonable steps to identify any indirect use of its correspondent accounts by VEF Bank, to the extent that such indirect use can be determined from transactional records maintained in the covered financial institution's normal course of business.

(ii) A covered financial institution shall take a risk-based approach when deciding what, if any, additional due diligence measures it should adopt to guard against the indirect use of its correspondent accounts by VEF Bank.

(iii) A covered financial institution that obtains knowledge that a correspondent account is being used by the foreign bank to provide indirect access to VEF Bank shall take all appropriate steps to prevent such indirect access, including, where necessary, terminating the correspondent account.

(iv) A covered financial institution required to terminate a correspondent account pursuant to paragraph (b)(2)(iii) of this section:

(A) Should do so within a commercially reasonable time, and should not permit the foreign bank to establish any new positions or execute any transaction through such correspondent account, other than those necessary to close the correspondent account; and

(B) May reestablish a correspondent account closed pursuant to this paragraph if it determines that the correspondent account will not be used to provide banking services indirectly to VEF Bank.

(3) *Recordkeeping and reporting.* (i) A covered financial institution is required to document its compliance with the notice requirement set forth in paragraph (b)(2)(i)(A) of this section.

(ii) Nothing in this section shall require a covered financial institution to report any information not otherwise required to be reported by law or regulation.

Dated: July 5, 2006.

**Robert W. Werner,**

*Director, Financial Crimes Enforcement Network.*

[FR Doc. E6-11043 Filed 7-12-06; 8:45 am]

**BILLING CODE 4810-02-P**

## DEPARTMENT OF HOMELAND SECURITY

### Coast Guard

#### 33 CFR Part 100

[CGD05-06-036]

RIN 1625-AA08

#### Special Local Regulations for Marine Events; Chesapeake Bay, Cape Charles, VA

**AGENCY:** Coast Guard, DHS.

**ACTION:** Temporary final rule.

**SUMMARY:** The Coast Guard is establishing special local regulations for the "East Coast Boat Racing Club power boat race", a marine event to be held over the waters of the Chesapeake Bay adjacent to Cape Charles, Virginia. These special local regulations are necessary to provide for the safety of life on navigable waters during the event. This action is intended to restrict vessel traffic on the Chesapeake Bay in the vicinity of Cape Charles Beach, Cape Charles, Virginia during the event.

**DATES:** This rule is effective from 11:30 a.m. on August 5, 2006 to 4:30 p.m. on August 6, 2006.

**ADDRESSES:** Documents indicated in this preamble as being available in the docket, are part of docket [CGD05-06-036] and are available for inspection or copying at Commander (dpi), Fifth Coast Guard District, 431 Crawford Street, Portsmouth, Virginia 23704-5004, between 9 a.m. and 2 p.m., Monday through Friday, except Federal holidays.

**FOR FURTHER INFORMATION CONTACT:** Dennis Sens, Project Manager, Fifth Coast Guard District, Inspections and Investigations Branch, at (757) 398-6204.

#### SUPPLEMENTARY INFORMATION:

##### Regulatory Information

On May 19, 2006, we published a Notice of proposed rulemaking (NPRM) entitled Special Local Regulations for Marine Events; Chesapeake Bay, Cape Charles, VA in the **Federal Register** (71 FR 29115). We received no letters commenting on the proposed rule. No public meeting was requested, and none was held.

### Background and Purpose

On August 5, 2006, the East Coast Boat Racing Club of New Jersey will sponsor a power boat race, on the waters of the Chesapeake Bay, Cape Charles, Virginia. The event will consist of approximately 20 New Jersey Speed Garveys and Jersey Speed Skiffs conducting high-speed competitive races along an oval race course in close proximity to Cape Charles Beach, Cape Charles, Virginia. A fleet of spectator vessels is expected to gather nearby to view the competition. Due to the need for vessel control during the event, vessel traffic will be temporarily restricted to provide for the safety of participants, spectators and transiting vessels.

### Discussion of Comments and Changes

The Coast Guard did not receive comments in response to the Notice of proposed rulemaking (NPRM) published in the **Federal Register**. Accordingly, the Coast Guard is establishing temporary special local regulations on specified waters of the Chesapeake Bay, Cape Charles, Virginia.

### Regulatory Evaluation

This rule is not a "significant regulatory action" under section 3(f) of Executive Order 12866, Regulatory Planning and Review, and does not require an assessment of potential costs and benefits under section 6(a)(3) of that Order. The Office of Management and Budget has not reviewed it under that Order. It is not "significant" under the regulatory policies and procedures of the Department of Homeland Security (DHS).

We expect the economic impact of this rule to be so minimal that a full Regulatory Evaluation under the regulatory policies and procedures of DHS is unnecessary. Although this regulation will prevent traffic from transiting a portion of the Chesapeake Bay during the event, the effect of this regulation will not be significant due to the limited duration that the regulated area will be in effect and the extensive advance notifications that will be made to the maritime community via the Local Notice to Mariners, marine information broadcasts, and area newspapers, so mariners can adjust their plans accordingly. Additionally, the regulated area has been narrowly tailored to impose the least impact on general navigation yet provide the level of safety deemed necessary. Vessel traffic will be able to transit the regulated area between heats, when the Coast Guard Patrol Commander deems it is safe to do so.