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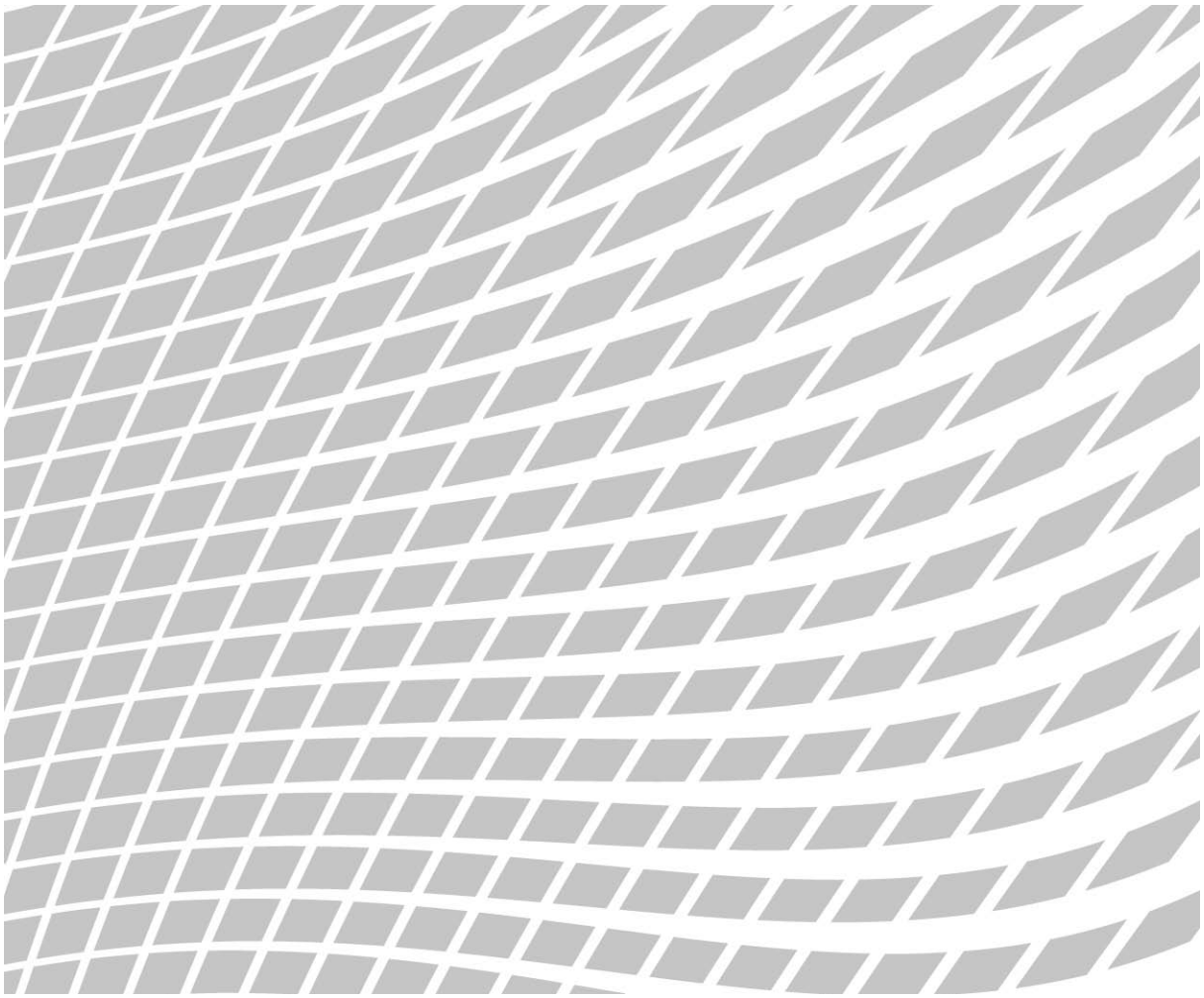
Processing of USD payments for countries and persons sanctioned under the OFAC-Rules

Settlement between Credit Suisse and the U.S. authorities



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Summary

Today, 16 December 2009, Credit Suisse AG, Zurich, and various U.S. authorities signed an agreement to settle investigations underway since 2007. As one of the consequences of this settlement impending criminal charges against the bank in the USA could be avoided. The subject of the investigations was the processing of USD payments by Credit Suisse employees from 1995 to the beginning of 2007 for countries and individuals subject to unilateral economic sanctions of the USA. The U.S. authorities accused the bank of deliberately circumventing U.S. sanctions by its actions in Switzerland and of preventing its U.S. correspondent banks from complying with the regulations by which they are bound. Such actions are deemed impermissible by the U.S. authorities under various sections of U.S. law, and institutions domiciled outside the USA can also be punished. The bank is required to pay a fine totalling USD 536 million for the infringements of which it stands accused and, to the extent this has not yet already taken place, must implement a global compliance programme to ensure compliance with the USA's embargo regulations. This makes Credit Suisse the fourth non-U.S. bank, following on from ABN AMRO, Lloyds TSB Bank and Australia and New Zealand Banking Group, to reach a settlement with the U.S. authorities on this matter. Investigations are apparently pending against other non-U.S. banks. FINMA will assist with the implementation and monitoring of the compliance programme agreed between the bank and the applicable U.S. supervisory authorities.

FINMA (up until the end of 2008, the Swiss Federal Banking Commission) has kept a very close watch on this case from the outset. It has cooperated with the U.S. authorities and provided administrative assistance to the Federal Reserve Bank of New York ("NY Fed"). It also assessed the accusations made against Credit Suisse in the light of Swiss supervisory law and, in September 2009, harshly reprimanded the bank for its actions.

Foreign rules with an extra-territorial scope, such as the U.S. embargo law administered by the U.S. Office of Foreign Assets Control ("OFAC"), can possibly be applied to financial institutions and employees which qualify as "U.S. persons", even if the actions in question take place outside U.S. territory. The U.S. authorities have also recently started applying their embargo regulations to non-U.S. persons who export services from the USA to sanctioned countries. Although FINMA has no remit to directly enforce foreign regulations (such as the OFAC-rules) against the entities it supervises, Swiss supervisory law does however require supervised entities to pay due consideration to the legal risks associated with standards of this type which have a territorial and an extra-territorial scope. In particular, they must take all possible organisational measures to prevent such risks from materialising.

1 U.S. sanctions law

The U.S. government, acting for reasons of foreign policy and security, has passed numerous unilateral regulations which wholly or partially restrict trade with certain countries and persons. The legal basis is provided by the *International Emergency Economic Powers Act* and the *Trading with the Enemy Act*. Iran, Cuba, Burma (Myanmar), Libya (until 2004) and Sudan are subject to fairly comprehensive sanction programmes. The *Office of Foreign Assets Control* ("OFAC"), as part of the *U.S. Treasury*, is tasked with the administration and enforcement of sanctions rules ("OFAC-rules").

The scope of application of the OFAC-rules has continually been extended over time and thus lead to considerable legal uncertainty. In principle, the OFAC-rules govern the actions of U.S. persons (such as U.S. citizens and residents and other individuals and companies that are domiciled in the USA), subjecting them to specific restrictions when trading with OFAC-sanctioned countries or persons. In accordance with the recent approach adopted and pulled through with Lloyds TSB Bank[1] in 2009 it is no longer imperative for a U.S. person to be involved; rather, a sufficient (extra-territorial) connecting factor exists where a financial institution (wherever its domicile in the world) exports services from the USA to a sanctioned country or by its actions prevents U.S. correspondent banks involved in a business transaction from complying or being able to comply with the OFAC-rules. This is the case, for example, if a foreign bank, in processing a USD payment for an Iranian ordering institution, systematically seeks to avoid any reference to Iran in the SWIFT-Message to be sent to the U.S. correspondent bank for clearing purposes (known as *stripping*). These actions prevent the payment from being caught by the OFAC-filters installed at the U.S. correspondent bank and, as a consequence thereof, the payment may be processed contrary to applicable OFAC-rules. In the eyes of the U.S. authorities, the foreign bank is culpable for preventing the U.S. correspondent bank from complying with or being able to comply with the OFAC-rules. An involvement of a U.S. group company of the foreign bank in such activities is thereby not a requirement.

2 Various proceedings against banks not domiciled in the USA

Various U.S. authorities are conducting investigations into a hand-full of non-U.S. banks in connection with the processing of USD payments for OFAC-sanctioned countries and persons. To date, three (four including Credit Suisse) cases have been concluded by means of a settlement (ABN AMRO, Lloyds TSB Bank, Australia and New Zealand Banking Group). Other cases are apparently still pending. As a consequence of the extended scope of application of the OFAC-rules, as outlined in Point 1 above, this subject matter has become an industry issue, which still affects a number of financial institutions not domiciled in the USA. FINMA is not aware of any other investigations into Swiss banks over this issue.

[1] http://www.justice.gov/criminal/pr/press_releases/2009/01/01-09-09lloyds-attachment.pdf

Breaches of U.S. sanctions law are only one issue being investigated. The actions of the institutions involved are also being investigated from a criminal law perspective. In time, violations of the OFAC-rules are punishable under both administrative law and criminal law. Furthermore, there may be cases of falsification under U.S. federal and/or state law, based on the premise that information relevant to the origin of USD payments for OFAC-sanctioned countries or persons was falsified or suppressed when processed. At the same time, the U.S. banking supervisory authorities are also investigating whether these cases violate the *fit and proper* requirement. Apart from other non-U.S. banks, Credit Suisse came to the attention of the U.S. authorities at the start of 2007, since when it has been subjected to intensive investigations.

3 Credit Suisse case

3.1 Background

From 1995 to 2006, Credit Suisse processed USD payments for institutions in OFAC-sanctioned countries which held USD clearing accounts with it. In 2003, there was a significant rise in the number of Iranian USD clearing accounts at Credit Suisse, after Lloyds TSB Bank exited from this business.

As there was a risk that USD payments relating to an OFAC-sanctioned country might be caught by the OFAC-filters of the U.S. correspondent banks, various methods were developed over time to enable the payments to be processed via the USA. One particular method was to complete or change the SWIFT messages used for processing payments with this purpose in mind.

One of the solutions used by Credit Suisse employees to circumvent the rules was to replace the name of the (OFAC-sanctioned) Iranian ordering institution in field 52 of SWIFT 202 messages ("MT 202") with other details – in particular with the comment "Order of a Customer" – before forwarding the payment instructions to U.S. banks. In other cases, the bank sent U.S. banks SWIFT MT 202's containing incorrect information that the (OFAC-sanctioned) ordering institution had itself inserted. For example, one ordering institution gave "CS" as the ordering customer of the payment; Credit Suisse condoned this incorrect information and sent the message to the U.S. correspondent bank involved in the payment chain.

In December 2005, Credit Suisse decided to exit the business with U.S. sanctioned countries such as Iran and Cuba, etc. This decision was then gradually implemented in 2006 and 2007.

3.2 Accusations made by the U.S. authorities

In the opinion of the OFAC and the U.S. Department of Justice ("DoJ"), the latter being tasked with prosecuting breaches of U.S. federal criminal law, Credit Suisse breached the provisions of the *International Emergency Economic Powers Act* and the *Trading with the Enemy Act*[2] by forwarding USD payments not permitted under U.S. regulations to U.S. correspondent banks. The U.S. authorities view such actions as a prohibited export of services by U.S. correspondent banks to OFAC-sanctioned countries, which is prohibited also for non-U.S. banks.

Credit Suisse was further accused of having followed criminal practices since the mid-1990s which served to help entities subject to U.S. sanctions regulations circumvent the applicable restrictions. It allegedly pumped hundreds of millions of USD in illegal payments through the U.S. system. Under one accusation, the bank was alleged to have used "stripping" to falsify 521 SWIFT messages and to have informed sanctioned entities how to avoid the OFAC-filters used by U.S. banks, thereby causing its U.S. correspondent banks to process such payments in ignorance of their origin. The U.S. authorities view such practices as a criminal offence against U.S. banks and the U.S. government. The bank was also blamed for preventing the U.S. banks from correctly recording or correctly reporting such transactions, or from being able to correctly report such transactions.

The New York County District Attorney's Office ("DANY") views the actions of Credit Suisse as "*falsifying business records*" under New York State's penal law. Under this law, a person commits an offence when, with intent to defraud, he makes or causes a false entry in the business records of an enterprise, or prevents the making of a true entry or causes the omission thereof in the business records of an enterprise[3].

In the NY Fed's opinion, Credit Suisse failed to establish the requisite compliance infrastructure to comply with U.S. law and prevent breaches of U.S. law. Furthermore, through these actions it exposed itself to increased reputational risk and jeopardised its ability to ensure the "safety and soundness" of its business.

3.3 Settlement between Credit Suisse and the US authorities

The settlement executed on 16 December 2009 has brought the ongoing investigations to a conclusion. All U.S. authorities that have lodged claims in respect of this matter are covered by these documents.

As is usual in such cases, the actual settlement documents are based on a detailed Statement of Facts. It summarises the facts from the perspective of the criminal prosecution authorities conducting

[2] See Title 50, United States Code, Section 1705; Title 31, Code of Federal Regulations, Sections 560.203 and 560. 204.

[3] See New York Penal Law, Sections 175.05 and 175.10.

the investigations and must be acknowledged by the bank. The Deferred Prosecution Agreement ("DPA") concluded between the bank and the DoJ and between the bank and the DANY is based – in accordance with the DPA's basic mechanism – on the fact that the Statement of Facts provides sufficient grounds for criminal charges, but that for the time being at least, these will not be pressed. After a probationary period, in this case of 24 months, the entire proceedings will be dismissed, providing the institution has complied with the DPA's terms. In practice, it is extremely rare for charges to be pressed at a later date. Under the terms of the settlement, the bank undertakes to pay a fine totalling USD 536 million. The bank also undertakes to cooperate with the U.S. authorities within the limits of the applicable laws for the duration of the DPA's. In terms of supervisory law, the bank undertook vis-à-vis the Board of Governors of the Federal Reserve System („Board") and the NY Fed that it will implement and/or continue implementing a global compliance programme and provide reports on it. A settlement agreement was also concluded between the OFAC and the bank.

4 Assessment of the Credit Suisse case according to Swiss supervisory law/FINMA's expectations of supervised entities

The Swiss Federal Banking Commission (SFBC), and subsequently FINMA, has closely monitored this case since 2007. It has followed the investigations into the case and repeatedly facilitated between the bank and the U.S. authorities. In response to the NY Fed's request and with the consent of the Swiss Federal Office for Justice, FINMA provided the U.S. authorities with administrative and legal assistance (Art. 42 para. 3 FINMASA).

FINMA has assessed the actions of Credit Suisse from the perspective of Swiss supervisory law. Basically, FINMA is not tasked with directly enforcing foreign law against entities that it supervises. Conversely, Swiss supervisory law requires supervised entities to duly capture, limit and control their risks (appropriate risk management) and take the organisational measures required to achieve this (organisational requirement). This also applies to legal risks incurred by financial institutions outside Switzerland or when trading outside Switzerland. Cases where these duties are neglected are relevant from the aspect of whether or not the requirement to ensure the business' safety and soundness has been met.

In the case of Credit Suisse, FINMA has come to the conclusion that it is not acceptable under the aforementioned supervisory legislation for a globally active financial institution such as the one in question to develop methods and practices to circumvent U.S. law and to expose itself in the USA in the described fashion. Furthermore, the bank's actions increased its reputational risk. FINMA therefore harshly reprimanded the bank for its actions in September 2009 and required it to report on disciplinary measures and provide other clarifications within a specified timeframe.

Financial institutions cannot abscond from the application of foreign extra-territorial rules like the OFAC-rules and provisions related therewith, even so, if no actions have taken place directly on the

territory concerned. Swiss supervisory law requires supervised entities to pay due consideration to legal risks inherent to rules with territorial and extra-territorial scope and to take organisational and other measures to prevent such risks from materialising.