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

RIN 1506-AA65

**Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations—Imposition of Special Measure Against First Merchant Bank OSH Ltd, Including Its Subsidiaries, FMB Finance Ltd, First Merchant International Inc, First Merchant Finance Ltd, and First Merchant Trust Ltd, as a Financial Institution of Primary Money Laundering Concern****AGENCY:** Financial Crimes Enforcement Network (FinCEN), Treasury.**ACTION:** Notice of proposed rulemaking.**SUMMARY:** FinCEN is issuing this notice of proposed rulemaking to impose a special measure against First Merchant Bank OSH Ltd 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:** Written comments on the notice of proposed rulemaking must be submitted on or before September 23, 2004.**ADDRESSES:** You may submit comments, identified by RIN 1506-AA65, by any of the following methods:

- Federal e-rulemaking portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.

- E-mail: [regcomments@fincen.treas.gov](mailto:regcomments@fincen.treas.gov). Include RIN 1506-AA65 in the subject line of the message.

- Mail: FinCEN, P.O. Box 39, Vienna, VA 22183. Include RIN 1506-AA65 in the body of the text.

*Instructions:* It is preferable for comments to be submitted by electronic mail because paper mail in the Washington, DC, area may be delayed. Please submit comments by one method only. All submissions received must

include the agency name and the Regulatory Information Number (RIN) for this proposed rulemaking. All comments received will be posted without change to <http://www.fincen.gov>, including any personal information provided. Comments may be inspected at FinCEN between 10 a.m. and 4 p.m., in the FinCEN reading room in Washington, DC. Persons wishing to inspect the comments submitted must request an appointment by telephoning (202) 354-6400 (not a toll-free number).

**FOR FURTHER INFORMATION CONTACT:** Office of Regulatory Programs, FinCEN, at (202) 354-6400 or Office of Chief Counsel, FinCEN, at (703) 905-3590 (not toll-free numbers).

**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 (USA PATRIOT Act) Act of 2001 (the USA Patriot Act), Pub. L. 107-56. Title III of the USA Patriot Act amends the anti-money laundering provisions of the Bank Secrecy Act (BSA), codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5314, 5316-5332, to promote the prevention, detection, and prosecution of international money laundering and the financing of terrorism. Regulations implementing the BSA appear at 31 CFR Part 103. The authority of the Secretary of the Treasury (Secretary) to administer the BSA and its implementing regulations has been delegated to the Director of FinCEN.

Section 311 of the USA Patriot Act (section 311) added section 5318A to the BSA, granting the Secretary the authority, upon finding that reasonable grounds exist for concluding that a foreign jurisdiction, institution, class of transactions, or type of account is of "primary money laundering concern," to require domestic financial institutions and 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 the Secretary may find that reasonable grounds exist for concluding that a jurisdiction, institution, or transaction is of primary money laundering concern. The statute also provides similar procedures, *i.e.*, factors and consultation requirements, for selecting the imposition of specific special measures 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 give the Secretary the authority to bring additional and useful pressure on those jurisdictions and institutions that pose money laundering threats. Through the imposition of various special measures, the Secretary can gain more information about the concerned jurisdictions, institutions, transactions, and accounts; monitor more effectively the respective jurisdictions, institutions, transactions, and accounts; and/or protect U.S. financial institutions from involvement with jurisdictions, 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 to consult with both the Secretary of State and the Attorney General.

In addition to these consultations, the Secretary, when finding that a foreign financial institution is of primary money laundering concern, 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 BSA continue to be fulfilled, and to guard against international money laundering and other financial crimes.

If the Secretary determines that reasonable grounds exist for concluding that a foreign financial institution is of primary money laundering concern, the Secretary 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, jointly, in any combination, and in any sequence.<sup>1</sup> In

<sup>1</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

the imposition of special measures, the Secretary follows procedures similar to those for finding a foreign financial institution to be of primary money laundering concern, but performs additional consultations and considers additional factors. Section 311 requires the Secretary to consult with other appropriate Federal agencies and parties<sup>2</sup> and to consider the following specific factors:

- 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 United States national security and foreign policy.<sup>3</sup>

#### A. "Turkish Republic of Northern Cyprus"

In this proposed rulemaking, FinCEN proposes to impose the fifth special measure (31 U.S.C. 5318A(b)(5)) against First Merchant Bank OSH Ltd (First Merchant Bank or the Bank). The fifth special measure prohibits or imposes conditions upon the opening or maintaining of correspondent or payable-through accounts for the foreign

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>2</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 Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), the National Credit Union Administration (NCUA), and, in the sole discretion of the Secretary, "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 domestic financial institution or domestic financial agency for the foreign financial institution of primary money laundering concern.

<sup>3</sup> Classified information used in support of a section 311 designation and measure(s) may be submitted by 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)).

financial institution of primary money laundering concern. This special measure may be imposed only through the issuance of a regulation.

Cyprus was divided in 1974 when a coup d'état directed from Greece induced the Turkish military to intervene. Since then, the southern part of the country has been under the control of the Government of the Republic of Cyprus. The northern part is controlled by a Turkish Cypriot administration that in 1983 proclaimed itself the "Turkish Republic of Northern Cyprus" ("TRNC").<sup>4</sup> Turkey is the only country that recognizes the "TRNC."

The "TRNC" has a sizeable offshore sector that is not subject to effective anti-money laundering regulation. The offshore sector consists of 33 banks and approximately 54 international business companies. Under Turkish Cypriot law, the offshore banks may not conduct business with "TRNC" residents and may not deal in cash. The offshore entities are audited by the Turkish Cypriot "Central Bank" and are required to submit a yearly report on their activities. However, the "Central Bank" has no regulatory authority over the offshore banks and can neither grant nor revoke licenses. Instead, the Turkish Cypriot "Ministry of the Interior" performs this function, which leaves the process open to politicization and possible corruption. Although a recently proposed law would have restricted the granting of new bank licenses to only those banks already having licenses in an OECD country, the law never passed.

The Turkish Cypriot anti-money laundering law became effective in 1999. Although the law, on paper, is a significant improvement over the money laundering controls previously in place, the Government of the "TRNC" has received few suspicious activity reports from financial institutions and has been lax in enforcing the law.<sup>5</sup> The fact that the "TRNC" is recognized only by Turkey prevents "TRNC" officials from receiving training or funding from international organizations with experience in combating money laundering.

There continues to be evidence that narcotics trade with Turkey and Britain and money laundering are conducted in or through the "TRNC."<sup>6</sup> Criminals reportedly use casinos operating in the

<sup>4</sup> Because the United States does not recognize the "Turkish Republic of Northern Cyprus," all references to the country or government in this proposed rulemaking are placed within quotation marks.

<sup>5</sup> See U.S. Department of State, 2003 International Narcotics Control Strategy Report, issued March 1, 2004 (INCSR).

<sup>6</sup> INCSR, *supra* note 11.

“TRNC” and Turkish Cypriot banks licensed to operate offshore to launder money from their illegal activities. The jurisdiction’s 21 primarily Turkish-mainland owned casinos are essentially unregulated. “TRNC” officials believe that much of the currency generated by these casinos is transported directly to Turkey without entering the “TRNC” banking system.<sup>7</sup> And, as noted above, the licensing process and supervision of offshore banks by the Government of the “TRNC” is not rigorous. Although Turkish Cypriot law prohibits individuals entering or leaving the “TRNC” from transporting more than the equivalent of \$10,000 in currency, Central Bank officials note that this law is difficult to enforce, given the large volume of travelers between Turkey and the “TRNC” and the growing number of individuals crossing the U.N.-patrolled buffer zone since travel restrictions were relaxed between north and south Cyprus in 2003.<sup>8</sup>

#### B. First Merchant Bank OSH Ltd

First Merchant Bank operates out of offices in Lefkosa/Nicosia, “TRNC,” and has 21 employees. First Merchant Bank was licensed in the “TRNC” in 1993 as an offshore bank. It is a privately owned commercial bank specializing in the provision of commercial and investment banking services to individual and corporate offshore customers. On its Web site, the Bank repeatedly advertises the “private” and “discreet” nature of its services, stressing that customers receive the “highest confidentiality” from and “a close relationship” with the Bank.<sup>9</sup> First Merchant Bank maintains correspondent accounts with banks in countries all over the world, including several U.S. and foreign banks located in New York City.<sup>10</sup> According to published reports, Dr. Hakki Yaman Namli is President, Chairman, and General Manager of First Merchant Bank.<sup>11</sup> First Merchant Bank is owned by Standard Finance Ltd. (Ireland) and private shareholders (98% and 2%, respectively).<sup>12</sup> Standard Finance Ltd., in turn, is owned by Provincial & Allied Funding Corp. (Bahamas) and Millvale Holdings Inc. (British Virgin Islands). As stated on its Web site, First Merchant Bank has four wholly owned subsidiaries: FMB Finance Ltd (British Virgin Islands), First Merchant International Inc (Bahamas), First

Merchant Finance Ltd (Ireland), and First Merchant Trust Ltd (Ireland). For the purposes of this document, unless the context dictates otherwise, references to First Merchant Bank include FMB Finance Ltd, First Merchant International Inc, First Merchant Finance Ltd, and First Merchant Trust Ltd, and any other branch, office, or subsidiary of First Merchant Bank operating in the “TRNC” or in any other jurisdiction.

## II. Imposition of Special Measure Against First Merchant Bank, Including Its Subsidiaries, FMB Finance Ltd, First Merchant International Inc, First Merchant Finance Ltd, and First Merchant Trust Ltd, as a Financial Institution of Primary Money Laundering Concern

### A. Finding

Based upon a review and analysis of relevant information, consultations with relevant Federal agencies and departments, and after consideration of the factors enumerated in section 311, the Secretary, through his delegate, the Director of FinCEN, has found that reasonable grounds exist for concluding that First Merchant Bank is a financial institution of primary money laundering concern. FinCEN has found First Merchant Bank to be of primary money laundering concern based on a number of factors, including: (1) It is licensed as an offshore bank in the “TRNC,” a jurisdiction with inadequate anti-money laundering controls, particularly those applicable to its offshore sector; (2) it is involved in the marketing and sale of fraudulent financial products and services; (3) it has been used as a conduit for the laundering of fraudulently obtained funds; and (4) the individuals who own, control, and operate First Merchant Bank have links with organized crime and apparently have used First Merchant Bank to launder criminal proceeds. A discussion of the section 311 factors relevant to this finding follows.

#### 1. The Extent to Which First Merchant Bank Has Been Used To Facilitate or Promote Money Laundering in or Through the Jurisdiction

FinCEN has determined, based on a variety of sources, that First Merchant Bank is used to facilitate or promote money laundering in or through the “TRNC.” Indeed, some of the money laundering occurring at First Merchant Bank appears to involve the proceeds of First Merchant Bank’s own fraudulent activity, as further described below. In addition, the proceeds of alleged illicit activity have been transferred to or

through accounts held by First Merchant Bank at U.S. financial institutions.

In January 2003, a Federal grand jury sitting in the Southern District of New York indicted First Merchant Bank’s President, Chairman, and General Manager, Dr. Hakki Yaman Namli, as a co-conspirator with an associate, Ralph Jarson,<sup>13</sup> in a scheme to market “credit enhancement” products, which consisted of deceptive bank documents showing that a customer had assets that did not exist, and to sell worthless “credit facilities” to investors.<sup>14</sup> Allegedly, the conspirators worked with First Merchant Bank to produce and market the deceptive bank documents and worthless credit facilities. Because Dr. Hakki Yaman Namli became a fugitive from justice he was not tried on the indictment; however, his associate, Ralph Jarson, was convicted on six felony counts, including one count of conspiring with Dr. Hakki Yaman Namli to engage in wire fraud, and five counts of committing wire fraud, on October 30, 2003.

The indictment on which Ralph Jarson was tried describes two different schemes perpetrated by Ralph Jarson, Dr. Hakki Yaman Namli, and First Merchant Bank. First, Ralph Jarson and Dr. Hakki Yaman Namli negotiated the sale of a fraudulent “special account statement” issued by First Merchant Bank to an FBI undercover agent posing as a representative of a brokerage firm for a fee of \$2 million. The “special account statement” showed that the brokerage firm had \$20 million in immediately available assets when, in fact, no assets existed. Second, in exchange for \$1 million, First Merchant Bank issued a worthless letter of credit with a face value of \$100 million to an investor for the purchase of discounted medium term bank notes that the investor later discovered were non-existent.

A review of records obtained from a number of financial institutions in the U.S. shows a pattern of fraudulent conduct similar to that described in the indictment by Dr. Hakki Yaman Namli and First Merchant Bank that began as early as 1997 and continued through at least the end of 2002. Several different U.S. banks were approached by First Merchant Bank customers attempting to use fraudulent letters of credit or fraudulent loan guarantees issued or provided by First Merchant Bank as

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> See <http://www.firstmerchantbank.com>.

<sup>10</sup> The Bankers’ Almanac, Reed Business Information Ltd (2003).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> Jarson operated through his company Concorde Wyvern Atlantic, a/k/a Wyvern Anstalt, located in London and registered in Liechtenstein.

<sup>14</sup> Indictment S1 02 Cr. 679 (MGC); Southern District of New York, United States of America, versus Ralph Jarson and Hakki Yaman Namli.

collateral to obtain funds from the U.S. banks.

In addition, it appears that First Merchant Bank has used its correspondent accounts with banks in the U.S. as conduits for the transfer of fraudulently obtained funds. In one case, \$4 million in proceeds of a "prime bank" fraud<sup>15</sup> were transferred through one of First Merchant Bank's correspondent accounts in the U.S. to the perpetrator's account in the "TRNC." In another case, a former officer of a third bank wired \$700,000 to the same correspondent account for the benefit of First Merchant Bank. The third bank suspected that the funds derived from the former officer's misuse of position or self-dealing while employed at the bank.

Domestic and foreign newspapers and magazines report that First Merchant Bank has been used for illicit transactions since its founding in 1993. Apparently, First Merchant Bank was established, at least in part, to facilitate the movement of funds between organized crime rings and corrupt politicians. The earliest indicators of illicit activity on the part of First Merchant Bank or its principals involved the original shareholders or partners of the Bank. One of the original partners of First Merchant Bank is reported to be a former KGB employee identified as Vladimir Kobarel, who allegedly involved First Merchant Bank in transferring underground money to Russian banks. Another original partner, Tarik Umit, was a former Turkish National Intelligence Organization (MIT) member who was believed killed in connection with a well-known Turkish investigation into links between the Turkish mafia, the MIT, and right wing politicians (the Susurluk scandal).<sup>16</sup> First Merchant Bank, Tarik

<sup>15</sup>The persons promoting these fraudulent schemes often claim that an innocent investor's funds will be used to purchase and trade financial instruments issued by well-regarded and financially sound institutions ("prime banks") on clandestine overseas markets to generate huge returns in which the investor will share. However, neither the instruments, nor the markets on which they allegedly trade, exist.

<sup>16</sup>The Susurluk scandal began with an automobile accident in Susurluk, Turkey, on November 3, 1996. Four people occupied the automobile: The deputy police chief of Istanbul; an alleged "extreme nationalist hit man" previously convicted of heroin trafficking and wanted for terrorism; the hit man's girlfriend, who couriered drugs and had been the mistress of several prominent members of the Turkish mafia; and a member of the Turkish Parliament, whose private militia had helped the army fight Kurdish militants. The member of Parliament was the only survivor of the crash and claimed to have lost his memory. The trunk of the car was full of weapons. The incident received national notoriety and served as the basis for Parliamentary investigations into links among politicians, the arms trade, and organized crime.

Umit, and Dr. Hakki Yaman Namli are alleged to have been involved with the laundering of \$450 million in narcotics proceeds for the "Susurluk gang."

## 2. The Extent to Which First Merchant Bank Is Used for Legitimate Business Purposes in the Jurisdiction

Because First Merchant Bank is located in the "TRNC," which is not recognized by the United States and has weak anti-money laundering laws, and is an offshore bank subject to limited government oversight, the extent of First Merchant Bank's legitimate activities is ultimately difficult to quantify. FinCEN has identified several instances in which First Merchant Bank and its Chairman have engaged in fraudulent activity and money laundering and in which illicit funds have passed through First Merchant Bank or one of its subsidiaries. Considering this evidence and the lack of evidence showing that the Bank is used for legitimate business purposes, FinCEN believes that First Merchant Bank is rarely, if ever, used for legitimate business transactions and any legitimate use of First Merchant Bank and its subsidiaries is significantly outweighed by their use to promote or facilitate money laundering. Nevertheless, FinCEN specifically solicits comment on the impact of the proposed special measure upon the any legitimate transactions conducted with First Merchant Bank involving, for example, United States businesses, United Nations agencies, and non-governmental and private voluntary organizations doing business in or operating in the "TRNC."

## 3. The Extent to Which Such Action Is Sufficient To Ensure, With Respect to Transactions Involving First Merchant Bank, That the Purposes of the BSA Continue To Be Fulfilled, and To Guard Against International Money Laundering and Other Financial Crimes

As detailed above, FinCEN has reasonable grounds to conclude that First Merchant Bank is being used to promote or facilitate money laundering, including the transmission of fraudulent bank instruments through the U.S. financial system and the international laundering of the proceeds of fraudulent activity. Currently, there are no protective measures that specifically target First Merchant Bank or otherwise serve to notify U.S. and foreign financial institutions of the money laundering risks associated with First Merchant Bank. Thus, finding First Merchant Bank to be a financial institution of primary money laundering concern and prohibiting the opening or maintaining of correspondent accounts for that

institution, is a necessary step to ensure that First Merchant Bank is not able to access the U.S. financial system to facilitate money laundering or any other criminal activity. The finding of primary money laundering concern and the imposition of the special measure also bring the Bank's criminal conduct to the attention of the international financial community and hopefully further limit the Bank's ability to conduct transactions.

## B. Imposition of Special Measure

As a result of the finding that First Merchant Bank is a financial institution of primary money laundering concern, and based upon additional consultations with certain Federal agencies and departments and consideration of additional relevant factors, the Secretary, through his delegate, the Director of FinCEN, proposes imposition of the special measure authorized by 31 U.S.C. 5318A(b)(5).<sup>17</sup> That special measure authorizes the prohibition of the opening or maintaining of correspondent or payable-through accounts<sup>18</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.

### 1. Whether Similar Actions Have Been or Will Be Taken by Other Nations or Multilateral Groups Against First Merchant Bank

Other countries have not taken any action similar to the one proposed in this proposed rulemaking that would prohibit domestic financial institutions and domestic financial agencies from opening or maintaining a correspondent account for or on behalf of First Merchant Bank. The United States hopes that other countries will take similar action based on the findings contained in this proposed rulemaking. In the meantime, lack of similar action by other countries makes it even more imperative that the fifth special measure be imposed to prevent access by First Merchant Bank to the U.S. financial system.

<sup>17</sup>In connection with this action, FinCEN consulted with the Federal functional regulators, the Department of Justice, and the Department of State.

<sup>18</sup>For purposes of the proposed 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.

## 2. Whether the Imposition of the Fifth 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 fifth special measure sought to be imposed by this proposed rulemaking would prohibit covered financial institutions from opening or maintaining correspondent accounts for, or on behalf of, First Merchant Bank. As a corollary to this measure, covered financial institutions also would be required to apply special due diligence to all of their correspondent accounts to ensure that no such account is being used indirectly to provide services to First Merchant Bank. The burden associated with these requirements is not expected to be significant, given that only a few domestic banks currently maintain correspondent accounts for First Merchant Bank. In addition, all U.S. financial institutions currently apply some degree of due diligence to the transactions or accounts subject to sanctions administered by the Office of Foreign Assets Control (OFAC) of the Department of the Treasury. As explained in more detail in the section-by-section analysis below, financial institutions should be able to adapt their current screening procedures for OFAC sanctions to comply with this special measure. Thus, the special due diligence that would be required by this proposed rulemaking is not expected to impose a significant additional burden upon U.S. financial institutions.

## 3. The Extent to Which the Proposed Action or Timing of the Action Will Have a Significant Adverse Systemic Impact on the International Payment, Clearance, and Settlement System, or on Legitimate Business Activities of the Bank

This proposed rulemaking targets First Merchant Bank specifically; it does not target a class of financial transactions (such as wire transfers) or a particular jurisdiction. First Merchant Bank 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. Moreover, as an offshore bank, it is prohibited from offering banking services to the residents of its home jurisdiction. Thus, the imposition of the fifth special measure against First Merchant Bank will not have a significant adverse systemic impact on the international payment, clearance, and settlement system. In addition, as discussed above, FinCEN believes that

First Merchant Bank is rarely, if ever, used for legitimate business transactions and any legitimate use of First Merchant Bank and its subsidiaries is significantly outweighed by their use to promote or facilitate money laundering.

## 4. The Effect of the Proposed Action on the United States' National Security and Foreign Policy

The exclusion from the U.S. financial system of banks that serve as conduits for significant money laundering activity and participate in other financial crime enhances national security, by making it more difficult for criminals to access the substantial resources of the U.S. financial system. In addition, the imposition of the fifth special measure against First Merchant Bank would complement the U.S. Government's overall foreign policy strategy of making the entry into the U.S. financial system more difficult for high-risk financial institutions located in jurisdictions with lax anti-money laundering controls.

Therefore, after conducting the required consultations and weighing the relevant factors, FinCEN has determined that reasonable grounds exist for concluding that First Merchant Bank is a financial institution of primary money laundering concern and for imposing the special measure authorized by 31 U.S.C. 5318A(b)(5).

## III. Section-by-Section Analysis

The proposed rule would prohibit covered financial institutions from establishing, maintaining, administering, or managing in the United States any correspondent account for, or on behalf of, First Merchant Bank. As a corollary to this prohibition, covered financial institutions would be required to apply special due diligence to their correspondent accounts to guard against their indirect use by First Merchant Bank. At a minimum, that special due diligence must include two elements. First, a covered financial institution must notify its correspondent account holders that they may not provide First Merchant Bank with access to the correspondent account maintained at the covered financial institution. Second, a covered financial institution must take reasonable steps to identify any indirect use of its correspondent accounts by First Merchant Bank, 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, other due

diligence measures it should adopt to guard against the indirect use of its correspondent accounts by First Merchant Bank, based on risk factors such as the type of services it offers and geographic locations of its correspondents.

### A. 103.189(a)—Definitions

#### 1. Correspondent Account

Section 103.189(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 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.

In the case of a U.S. depository institution, this broad definition would include most types of banking relationships between a U.S. depository institution and a foreign bank, including payable-through accounts.

In the case of securities broker-dealers, futures commission merchants, introducing brokers, and investment companies that are open-end companies (mutual funds), a correspondent account would include any account that permits the foreign bank to engage in (1) trading in securities and commodity futures or options, (2) funds transfers, or (3) other types of financial transactions.

FinCEN is using the same definition for purposes of the proposed rule as that established in the final rule implementing sections 313 and 319(b) of the USA Patriot Act,<sup>19</sup> except that the term is being expanded to cover such accounts maintained by mutual funds, futures commission merchants, and introducing brokers.

#### 2. Covered Financial Institution

Section 103.189(a)(2) of the proposed rule defines covered financial institution to mean all of the following: Any insured bank (as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)); a commercial bank or trust company; a private banker; an agency or branch of a foreign bank in the United States; a credit union; a thrift institution; a corporation acting under section 25A of the Federal Reserve Act (12 U.S.C. 611 *et seq.*); a broker or dealer registered or required to register with the SEC under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*); a futures commission merchant or an introducing broker registered, or required to register, with

<sup>19</sup> See 67 FR 60562 (September 26, 2002), codified at 31 CFR 103.175(d)(1).

the CFTC under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*); and an investment company (as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3)) that is an open-end company (as defined in section 5 of the Investment Company Act of 1940 (15 U.S.C. 80a-5)) that is registered, or required to register, with the SEC under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8).

### 3. First Merchant Bank

Section 103.189(a)(3) of the proposed rule defines First Merchant Bank to include all subsidiaries, branches, and offices of First Merchant Bank operating in the "TRNC" or in any other jurisdiction. FMB Finance Ltd. (British Virgin Islands), First Merchant International Inc. (Bahamas), First Merchant Finance Ltd. (Ireland), and First Merchant Trust Ltd. (Ireland), and their branches, are included in the definition, although FinCEN understands that First Merchant Bank currently has only the four subsidiaries mentioned here. FinCEN 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 subsidiary of First Merchant Bank.

#### B. 103.189(b)—Requirements for Covered Financial Institutions

For purposes of complying with the proposed rule's prohibition on the opening or maintaining of correspondent accounts for, or on behalf of, First Merchant Bank, FinCEN expects that a covered financial institution will 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 on Direct Use of Correspondent Accounts

Section 103.189(b)(1) of the proposed rule prohibits all covered financial institutions from establishing, maintaining, administering, or managing a correspondent account in the United States for, or on behalf of, First Merchant Bank. The prohibition would require all covered financial institutions to review their account records to ensure that they maintain no accounts directly for, or on behalf of, First Merchant Bank.

#### 2. Special Due Diligence of Correspondent Accounts To Prohibit Indirect Use

As a corollary to the prohibition on the opening or maintaining of correspondent accounts directly for First Merchant Bank, section 103.189(b)(2) requires a covered financial institution to apply special due diligence to its correspondent accounts<sup>20</sup> that is reasonably designed to guard against their indirect use by First Merchant Bank. At a minimum, that special due diligence must include notifying correspondent account holders that they may not provide First Merchant Bank with access to the correspondent account maintained at the covered financial institution. For example, a covered financial institution may satisfy this requirement by transmitting the following notice to all of its correspondent account holders:

*Notice:* Pursuant to U.S. regulations issued under section 311 of the USA PATRIOT Act, 31 CFR 103.189, we are prohibited from establishing, maintaining, administering, or managing a correspondent account for, or on behalf of, First Merchant Bank or any of its subsidiaries (including FMB Finance Ltd. First Merchant International Inc. First Merchant Finance Ltd. and First Merchant Trust Ltd.). The regulations also require us to notify you that you may not provide First Merchant Bank or any of its subsidiaries with access to the correspondent account you hold at our financial institution. If we become aware that First Merchant 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 block such access, including by terminating your account.

The purpose of the notice requirement is to help ensure cooperation from correspondent account holders in denying First Merchant Bank access to the U.S. financial system, as well as to increase awareness within the international financial community of the risks and deficiencies of First Merchant Bank. However, FinCEN does not require or expect a covered financial institution to obtain a certification from its correspondent account holders 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 account customers, informing them that they may not

provide First Merchant Bank with access to the covered financial institution's correspondent account, or including such information in the next regularly occurring transmittal from the covered financial institution to its correspondent account holders. FinCEN specifically solicits comments on the appropriate form, scope, and timing of the notice that would be required under the rule.

A covered financial institution also would be required under this rulemaking to take reasonable steps to identify any indirect use of its correspondent accounts by First Merchant Bank, 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 would be expected to apply an appropriate screening mechanism to be able to identify a funds transfer order that on its face listed First Merchant Bank as the originator's or beneficiary's financial institution, or otherwise referenced First Merchant Bank. An appropriate screening mechanism could be the mechanism used by a covered financial institution to comply with sanctions programs administered by OFAC. FinCEN specifically solicits comments on the requirement under the proposed rule that a covered financial institution take reasonable steps to screen its correspondent accounts to identify any indirect use of such accounts by First Merchant Bank.

Notifying its correspondent account holders and taking reasonable steps to identify any indirect use of its correspondent accounts by First Merchant Bank in the manner discussed above are the minimum due diligence requirements under the proposed 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 First Merchant Bank, based on risk factors such as the type of services it offers and the geographic locations of its correspondent account holders.

A covered financial institution that obtains knowledge that a correspondent account is being used by a foreign bank to provide indirect access to First Merchant Bank must take all appropriate steps to block such indirect access, including, when necessary, terminating the correspondent account. A covered financial institution may afford the foreign bank a reasonable opportunity to take corrective action prior to terminating the correspondent account. Should the foreign

<sup>20</sup> Again, for purposes of the proposed 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.

bank refuse to comply, or if the covered financial institution cannot obtain adequate assurances that the account will no longer be used for impermissible purposes, 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 the proposed rule if it determines that the account will not be used to provide banking services indirectly to First Merchant Bank. FinCEN specifically solicits comment on the requirement under the proposed rule that a covered financial institution block indirect access to First Merchant Bank, once such indirect access is identified.

### 3. Reporting Not Required

Section 103.189(b)(3) of the proposed 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. A covered financial institution must, however, document its compliance with the requirement that it notify its correspondent account holders that they may not provide First Merchant Bank with access to the correspondent account maintained at the covered financial institution.

### IV. Request for Comments

FinCEN invites comments on all aspects of the proposal to prohibit the opening or maintaining of correspondent accounts for or on behalf of First Merchant Bank, and specifically invites comments on the following matters:

1. The appropriate form, scope, and timing of the notice to correspondent account holders that would be required under the rule;
2. The appropriate scope of the proposed requirement for a covered financial institution to take reasonable steps to identify any indirect use of its correspondent accounts by First Merchant Bank;
3. The appropriate steps a covered financial institution should take once it identifies an indirect use of one of its correspondent accounts by First Merchant Bank; and
4. The impact of the proposed special measure upon any legitimate transactions conducted with First Merchant Bank by United States businesses, United Nations agencies, and non-governmental and private voluntary organizations doing business in or operating in the "TRNC."

### V. Regulatory Flexibility Act

It is hereby certified that this proposed rule will not have a significant

economic impact on a substantial number of small entities. FinCEN understands that First Merchant Bank currently maintains only a few correspondent accounts in the United States, and that those accounts are maintained at large banks. Thus, the prohibition on maintaining such accounts will not have a significant impact on a substantial number of small entities. In addition, all U.S. persons, including U.S. financial institutions, currently exercise some degree of due diligence in order to comply with U.S. sanctions programs administered by OFAC, which can be easily modified to monitor for the use of correspondent accounts by First Merchant Bank. Thus, the special due diligence that would be required by this proposed rulemaking—*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 upon small U.S. financial institutions. FinCEN invites comments from members of the public who believe there will be a significant economic impact on small entities.

### VI. Paperwork Reduction Act

The collection of information contained in this proposed rule is being submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information 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, Paperwork Reduction Project (1506), Washington, DC 20503 (or by e-mail to [jlackeyj@omb.eop.gov](mailto:jlackeyj@omb.eop.gov)), with a copy to FinCEN by mail or e-mail at the addresses previously specified. Comments on the collection of information should be received by September 23, 2004. In accordance with the requirements of the Paperwork Reduction Act of 1995, 44 U.S.C. 3506(c)(2)(A), and its implementing regulations, 5 CFR 1320, the following information concerning the collection of information as required by 31 CFR 103.189 is presented to assist those persons wishing to comment on the information collection.

The collection of information in this proposed rule is in 31 CFR 103.189(b)(2)(i) and 31 CFR 103.189(b)(3)(i). The disclosure requirement in 31 CFR 103.189(b)(2)(i) is intended to ensure cooperation from correspondent account holders in

denying access to the U.S. financial system, as well as to increase awareness within the international financial community of the risks and deficiencies of First Merchant Bank. The information required to be maintained by 31 CFR 103.189(b)(3)(i) will be used by Federal agencies and certain self-regulatory organizations to verify compliance by covered financial institutions with the provisions of 31 CFR 103.189. The class of financial institutions affected by the disclosure requirement is identical to the class of financial institutions affected by the recordkeeping requirement. The collection of information is mandatory.

*Description of Affected Financial Institutions:* Banks, broker-dealers in securities, futures commission merchants and introducing brokers, and mutual funds maintaining correspondent accounts.

*Estimated Number of Affected Financial Institutions:* 5,000.

*Estimated Average Annual Burden Hours per Affected Financial Institution:* The estimated average burden associated with the collection of information in this proposed rule is 1 hour per affected financial institution.

*Estimated Total Annual Burden:* 5,000 hours.

FinCEN specifically invites comments on: (a) Whether the proposed collection of information is necessary for the proper performance of the mission of FinCEN, including whether the information shall have practical utility; (b) the accuracy of FinCEN's estimate of the burden of the proposed collection of information; (c) ways to enhance the quality, utility, and clarity of the information required to be maintained; (d) ways to minimize the burden of the required collection of information, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to maintain the information.

### VII. Executive Order 12866

This proposed 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 proposed to be amended as follows:

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

1. The authority citation for part 103 is revised to read as follows:

**Authority:** 12 U.S.C. 1829b and 1951–1959; 31 U.S.C. 5311–5314, 5316–5332; title III, secs. 311, 312, 313, 314, 319, 326, 352, Pub. L. 107–56, 115 Stat. 307.

2. The undesignated center heading preceding §103.185 is removed.

3. Subpart I of part 103 is proposed to be amended by adding new § 103.189 as follows:

**§ 103.189 Special measures against First Merchant 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* has the same meaning as provided in § 103.175(f)(2) and also includes:

(i) A futures commission merchant or an introducing broker registered, or required to register, with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*); and

(ii) An investment company (as defined in section 3 of the Investment Company Act (15 U.S.C. 80a–3)) that is an open-end company (as defined in section 5 of the Investment Company Act (15 U.S.C. 80a–5)) and that is registered, or required to register, with the Securities and Exchange Commission under section 8 of the Investment Company Act (15 U.S.C. 80a–8).

(3) *First Merchant Bank* means any headquarters, branch, office, or subsidiary of First Merchant Bank OSH Ltd operating in the “Turkish Republic of Northern Cyprus” (“TRNC”) or in any other jurisdiction, including FMB Finance Ltd (British Virgin Islands), First Merchant International Inc (Bahamas), First Merchant Finance Ltd (Ireland), and First Merchant Trust Ltd (Ireland).

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

(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 established, maintained, administered, or managed in the United

States for, or on behalf of, First Merchant Bank.

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

(A) Notifying correspondent account holders that they may not provide First Merchant Bank with access to the correspondent account maintained at the covered financial institution; and

(B) Taking reasonable steps to identify any indirect use of its correspondent accounts by First Merchant 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 First Merchant 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 First Merchant Bank, shall take all appropriate steps to block such indirect access, including, where necessary, terminating the correspondent account.

(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: August 18, 2004.

**William J. Fox,**

*Director, Financial Crimes Enforcement Network.*

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