



November 16, 2000

By Hand

Larry D. Thompson
Chairman
Judicial Review Commission on
Foreign Asset Control
1331 F Street, NW
Washington, DC 20530

Re: **Foreign Narcotics Kingpin Designation Act**

Dear Mr. Thompson:

This is in response to your letter dated August 16, 2000 inviting the Securities Industry Association ("SIA") to participate in proceedings before the Judicial Review Commission on Foreign Asset Control. SIA welcomes the opportunity to express its views on the Foreign Narcotics Kingpin Designation Act ("the Kingpin Act" or the "Act"). We are supportive of the goals of the Kingpin Act and believe that the criminal activities of international narcotics traffickers threaten the United States and the integrity of its economy. We believe the application of the sanctions authorized by the legislation will aid government efforts to continue the fight against the international distribution of drugs and other related criminal activity. As requested, we address below some of the issues concerning the Kingpin Act that the Commission has raised for comment.

SIA's membership includes more than 740 securities firms, including investment banks, broker-dealers, and mutual fund companies, throughout North America. SIA member firms are active in U.S. and foreign markets and in all phases of corporate and public finance.¹ SIA believes that its membership and its extensive involvement in financial transactions here and abroad make it particularly well-positioned to comment on the Kingpin Act from the perspective of the securities industry.

¹ The U.S. securities industry manages the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans. The industry generates more than \$300 billion of revenues yearly in the U.S. economy and employs more than 600,000 individuals.

SIA's Support of Anti-Money Laundering and OFAC Efforts

SIA has long supported anti-money laundering goals and has worked for years with regulators and law enforcement officials to improve efforts to thwart money laundering. Over the past several years, SIA has worked closely with the Securities and Exchange Commission and the U.S. Treasury Department to develop regulations extending the requirement to file "Suspicious Activity Reports" to broker-dealers. In addition, SIA has a long history of participation in government and industry programs to help educate firms about money laundering laws, regulations, and policies.

SIA has also worked with the Treasury Department's Office of Foreign Assets Control ("OFAC") to aid their understanding of the securities industry. Furthermore, SIA has implemented certain initiatives to help its member firms be aware of the trading restrictions and asset freezes imposed by OFAC.

The Impact of the Kingpin Act on Securities Firms

The Kingpin Act, which was signed by the President on December 3, 1999 and became effective on June 1, 2000, imposes a number of compliance responsibilities on financial institutions, as well as other defined "U.S. persons," including foreign branches of entities organized under U.S. law. The securities industry is familiar with the sanctions program under the Kingpin Act due to its experience in complying with Executive Order No. 12978 (Blocking Assets and Prohibiting Transactions With Significant Narcotics Traffickers)(hereinafter the "Executive Order"), dated October 21, 1995, which like the Kingpin Act was promulgated under the International Emergency Powers Act ("IEEPA").

The Act prohibits U.S. persons, including U.S. financial institutions, from conducting financial or business transactions with those individuals or entities designated as "Significant Foreign Narcotics Traffickers" ("SFNTs"). SFNTs are defined as "any foreign person that plays a significant role in international narcotics trafficking that the President has determined to be appropriate for sanctions . . . and that the President has publicly identified." 21 U.S.C.A. § 1907(7). In addition, the Secretary of the Treasury may add any foreign person or entity to the list which (1) "materially assists" or provides support to a person on the list; (2) that is owned, controlled, directed by, or acting for someone on the list; or (3) who is "playing a significant role in international narcotics trafficking." See 21 U.S.C.A. § 1904(b). We note that the amount of international business conducted by U.S. financial institutions and the globalization of financial services makes the compliance obligations imposed by the Act on securities firms significant. For example, the Treasury Secretary's ability to add "second tier" individuals to the SFNT list dramatically increases the number of individuals or entities that must be screened by U.S. firms.

The Kingpin Act also requires the blocking of assets, including all property and interests in property within the U.S. or within the possession or control of any U.S.

person, which are owned or controlled by: (i) any SFNT; (ii) any foreign person that has been designated as "materially assisting in, or providing financial or technological support for or to, or providing goods or services in support of " the international narcotics trafficking activities of an SFNT identified in the report; (iii) any foreign person designated as "owned, controlled, or directed by, or acting for or on behalf of" a SFNT identified in the report; or (iv) any foreign person designated "as playing a significant role in international narcotics trafficking." 21 U.S.C.A. § 1094(b).

In addition, the Kingpin Act subjects securities firms and other U.S. persons to severe penalties. Criminal penalties of imprisonment of up to 10 years and \$10,000,000 in fines may be imposed on anyone who "willfully violates" the Act, or any rule or regulation issued under it, or "willfully neglects or refuses to comply with any order of the President" issued under the statute. Moreover, "[a]ny officer, director, or agent of any entity who knowingly participates" in a violation faces imprisonment of up to thirty (30) years and a fine of not more than \$5,000,000, or both. Civil penalties of up to \$1,000,000 are also authorized. 21 U.S.C.A. § 1906(a)-(b).

SIA's Comments on the Kingpin Act

The Commission has requested comment on a number of issues that relate to whether the Act provides reasonable protections for innocent U.S. businesses and reasonable opportunities to correct erroneous determinations. The Commission also seeks comment on whether legislative amendments should be enacted to improve the current asset blocking scheme under IEEPA or the Kingpin Act. We have provided feedback on several of those issues, along with some additional observations.

First, we are concerned that under the present text of the Kingpin Act a foreign subsidiary of a U.S. corporation could be added to the SFNT list without ever knowingly committing a violation of the Act. This concern arises from the Secretary of the Treasury's authority to *add* any foreign person or entity to the list which is "materially assisting in, or providing financial or technological support for or to, or providing goods or services in support of" the international narcotics trafficking activities of a SFNT. Thus, under the Kingpin Act, an American company's foreign affiliate could be determined to be a "foreign person," which is defined as "any citizen or national of a foreign state or any entity not organized under the laws of the United States, but does not include a foreign state." See 21 U.S.C.A. § 1907(2).

The provision allowing a U.S. firm's foreign subsidiary to be added to the SFNT list is particularly troubling for securities firms that maintain global operations and are in the business of providing financial support and financial services to clients in both domestic and international markets. As we interpret the Act, if a U.S. securities firm's foreign subsidiary accepted funds for investment from an entity on the SFNT list, the foreign subsidiary could be determined to be "providing financial support" to the SFNT and could itself be added to the SFNT list. We are concerned that, under this scenario, the parent firm could be held to violate the Act when the "offending" transaction by the foreign subsidiary took place wholly outside the U.S. and was unknown to U.S.

management. This provision is even more troubling in that the foreign subsidiary would be added to the list without notice and an opportunity for a hearing because the Act currently provides that such a determination is not subject to judicial review.

We also note that the Kingpin Act incorporates a definition of "U.S. person" that encompasses all entities organized under the laws of the U.S., including their foreign branches. This definition parallels language contained in the Executive Order. However, given the broader scope of the Kingpin Act, the Commission may wish to consider the potential hardship that such a definition would create for U.S. financial institutions with branches abroad.

Second, we are equally troubled that the Act and the implementing regulations issued by OFAC on July 5, 2000 do not contemplate judicial review pursuant to the Administrative Procedures Act. The lack of judicial review not only raises issues of fundamental fairness and constitutional concerns, such as when a foreign subsidiary is added to the SFNT list or a civil monetary penalty is imposed without any hearing, but is also inconsistent with other parts of the Foreign Assets Control regulations that provide for some form of judicial review. For example, the regulations set forth in Part 500 state that "[a]ny person may seek judicial review as provided under 5 U.S.C. 702 for a penalty and/or forfeiture imposed pursuant to this part." 31 C.F.R. 500.717 (1999). Similarly, OFAC has specific procedures governing the removal of names from the various lists it enforces and for reconsideration of the agency's designation. Under 31 C.F.R. 501.807, a person may submit in writing arguments or evidence that he or she believes will establish that an insufficient basis exists for OFAC's designation. See 31 C.F.R. 501.807(a) (1999). Clearly, incorporating some judicial review mechanism into the Kingpin Act regulatory structure would offer a level of protection to innocent U.S. businesses without detracting from the effectiveness of the sanctions program.

One noteworthy difference between the Act and IEEPA is the insertion of language into the Kingpin Act that allows the Secretary of the Treasury to "*block during the pendency of an investigation*" any property in which any foreign country or a national thereof has any interest. See 21 U.S.C.A. § 1905(a)(2). This power is not one specifically delineated in IEEPA and, accordingly, is not contained in the Executive Order. Compare 50 U.S.C.A. § 1702(a)(1)(B). We have some reservations about the Secretary's ability to exercise this authority, primarily because there is no precedent for this power and the extent of its reach is unclear.

We also point out that the penalties under the Kingpin Act are much more severe than those authorized in the Executive Order. While, as previously noted, the Kingpin Act allows for criminal fines up to \$10,000,000, the Executive Order, pursuant to IEEPA, allows for only a \$50,000 fine. Furthermore, civil penalties under the Kingpin Act can go up to \$1,000,000, while the Executive Order allows only for a civil penalty not to exceed \$10,000. See 50 U.S.C.A. § 1705.

We applaud the inclusion of a "defense section" that provides that "[n]o person shall be held liable in any court for or with respect to anything done or omitted in good

faith in connection with the administration of, or pursuant to” the Act. The Act also provides that full and actual compliance with any regulation, order, license, instruction, or direction issued under the Act shall be a defense in any proceeding alleging a violation of the law. For financial institutions that act in good faith, these kinds of protections are essential to encourage full cooperation. Moreover, these kinds of protections are wholly consistent with other statutory provisions that protect financial institutions from civil exposure in complying with other OFAC sanctions programs and the reporting of suspicious activity.

We remain concerned, however, that the present system does not allow for innocent mistakes by financial institutions in the failure to identify SFNT’s or other named parties. Nor does it provide for a defense from sanctions where an institution has a system in place to detect, identify, and report prohibited transactions, but where a technical violation occurred. We suggest that the statutory scheme be revised to allow an institution to raise as an affirmative defense the fact it has a system in place to detect, identify, and report such transactions.

Lastly, we recommend that the Treasury Department establish a Financial Assets Control Advisory Committee. We envision that this committee would perform a similar function as Treasury’s Bank Secrecy Act Advisory Group. We believe such a committee would be beneficial to both members of the industry and regulators, and could play an important role in ensuring that implementation of the U.S. sanctions program takes into account the complexities of the securities industry and its diverse business sectors.

SIA’s Commitment to Stopping Foreign Narcotics Traffickers

SIA remains committed to working with government authorities to stem the criminal activities of international narcotics traffickers. We understand the challenges facing law enforcement and the importance of vigorous compliance programs on the part of the securities industry. We believe that such efforts are vital to protecting the U.S., its economy, and its consumers.

We commend the Commission for conducting this review and for seeking the views of the securities industry. We hope you find our comments helpful. If we can provide any further information, please contact the undersigned at (202) 296-9410.

Sincerely,

Alan E. Sorcher
Vice President and
Associate General Counsel