

ALERTS

Sanctions and AML Update: North Korea and Venezuela

September 27, 2017

On Sept. 20, 2017, in response to North Korea's recent military actions and public statements made by North Korean leader Kim Jong-un, President Trump issued Executive Order 13810 ("E.O. 13810"), which authorizes the U.S. Secretary of the Treasury to impose sanctions against persons, including foreign financial institutions, that knowingly engage in transactions and activity involving North Korea.[1] As Secretary Mnuchin stated in his remarks announcing the action, E.O. 13810 puts foreign financial institutions "on notice that, going forward, they can choose to do business with the United States or with North Korea, but not both." [2] Subsequently, on Sept. 26, 2017, the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") imposed sanctions against a number of North Korean banks and individuals linked to North Korean financial networks.[3]

Separately, on Sept. 1, 2017, OFAC released two new Frequently Asked Questions ("FAQs") concerning the scope of the sanctions announced last month relating to Venezuelan-issued bonds.[4] In another development relating to Venezuela, on Sept. 20, 2017, the U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN") published an Advisory warning financial institutions of "widespread public corruption in Venezuela." [5]

North Korea Sanctions Program*Executive Order 13810*

E.O. 13810 lays the groundwork for expanded sanctions that the U.S. Secretary of the Treasury may impose to discourage foreign persons,

including foreign financial institutions, from engaging in activity that serves to enable the continued existence of the current North Korean regime. The provisions, as discussed below, do not, on their own, alter the existing North Korea sanctions program; such changes will be the result of action by the Department of Treasury to implement E.O. 13810.

Section 1(a) blocks all property and interests in property of persons that the U.S. Secretary of the Treasury determines, among other things, operate in the construction, energy, financial services, fishing, information technology, manufacturing, medical, mining, textiles, or transportation industries in North Korea, or have engaged in at least one significant importation from or exportation to North Korea of any goods, services, or technology.[6] (While, as described below, OFAC has already taken steps to implement this provision by designating certain North Korean banks and individuals, to date, no guidance has been provided as to what may qualify as a “significant importation from or exportation to North Korea” as that provision was not implicated by OFAC’s most recent actions.)

Section 3(a) blocks funds that originate from, are destined for, or pass through a foreign bank account that the U.S. Secretary of the Treasury has determined is owned or controlled by a North Korean person or has been used to transfer funds in which a North Korean person has an interest. Section 3(b) prohibits U.S. persons from approving, financing, facilitating or guaranteeing any transaction by a foreign person if the transaction would be prohibited under Section 3(a) if performed by a U.S. person or person within the U.S. According to a new FAQ released by OFAC concurrent with E.O. 13810, until it releases further notice and guidance, no action is required by U.S. persons to comply with this provision.[7]

Section 4 concerns foreign financial institutions that the Secretary determines have, on or after September 21, 2017, knowingly conducted or facilitated any significant transaction on behalf of any person whose interests are blocked pursuant to E.O. 13810 or prior Executive Orders 13551, 13687, 13722, and 13382 (to the extent the designation was based on North Korea-related activities) or knowingly conducted or facilitated any significant transaction in connection with trade with North Korea.[8]

“Foreign financial institution” is broadly defined and includes, among other things, foreign entities engaged in the business of purchasing or selling securities and securities broker dealers, investment companies, banks, money service businesses, employee benefit plans, and holding

companies, affiliates or subsidiaries of any entity itself considered a foreign financial institution.[9] The extent of the sanctions applicable to a foreign financial institution designated under Section 4 is left to the discretion of the U.S. Secretary of the Treasury. The Secretary may (1) block the foreign financial institution's property and interests in property or (2) prohibit the opening or maintenance or impose strict conditions on the maintenance of correspondent or payable-through accounts in the U.S. for the foreign financial institution.

E.O. 13810 also prohibits donations of articles, such as food, clothing and medicine, intended to be used to relieve human suffering to persons whose property or interests in property are blocked pursuant to Sections 1 and 4,[10] and imposes prohibitions on certain vessels and aircraft. With respect to aircraft and vessels, Section 2 provides that no aircraft or vessel in which a foreign person has an interest may land at a place or call at a port in the United States within 180 days of departure from North Korea, and no vessel that has engaged in a ship-to-ship transfer with such a vessel may call at a port in the United States.

Implementation by OFAC

Concurrent with the release of E.O. 13810, OFAC issued two general licenses, one related to the Order's prohibitions involving certain aircraft and vessels,[11] and the other replacing General License 3 so that the authorizations in General License 3 related to normal service charges in blocked accounts will now also apply to accounts blocked pursuant to E.O. 13810.[12]

On Sept. 21, 2017, OFAC also released revised FAQs that provide guidance as to the impact of E.O. 13810 on the existing sanctions involving North Korea.[13] In the first of two new FAQs, OFAC notes that, with the exception of General Licenses 2 and 9, the existing general licenses issued in connection with Executive Order 13722 are not applicable to sanctions imposed pursuant to E.O. 13810.[14] As noted above, the second new FAQ makes clear that the provisions in Section 3 of E.O. 13810 do not require any immediate action by U.S. persons.[15]

Less than a week after the issuance of E.O. 13810, on Sept. 26, 2017, OFAC added a total of 36 banks and individuals related to North Korea to its Specially Designated Nations ("SDN") List.

First, OFAC identified two[16] banks as blocked agencies, instrumentalities, or controlled entities of the Government of North Korea,

pursuant to Executive Order 13722, issued on Mar. 15, 2016.[17]

Second, in its first steps implementing E.O. 13810, OFAC designated eight North Korean banks linked to North Korea's financial services industry and 19 individuals determined to be representatives of North Korean banks operating in China, Russia, Libya, and the United Arab Emirates. These designations were made pursuant to E.O. 13810, and were not accompanied by any new or revised General Licenses. Therefore, as noted in the FAQ discussed above, the General Licenses issued in connection with prior Executive Orders, with the exception of General Licenses 2 and 9, are not applicable to such persons.

Finally, pursuant to Executive Order 13687, issued on January 2, 2015,[18] OFAC designated seven additional individuals located in China and Libya who serve as representatives of North Korean banks, as well one individual otherwise designated pursuant to E.O. 13810.

Venezuela Sanctions Update

In late August of this year, the U.S. expanded the scope of its sanctions against the Government of Venezuela by prohibiting U.S. persons from dealing in securities of the Government of Venezuela, including certain Venezuelan-issued bonds.[19] In connection with those sanctions, OFAC, on Sept. 1, 2017, released two new FAQs designed to provide further guidance concerning General License 3 related to Venezuelan-issued bonds, which OFAC had issued concurrent with the implementation of the Aug. 24, 2017 Executive Order.

In the first of the two new FAQs, OFAC reaffirms that, in addition to authorizing transactions related to the bonds included on the Annex to General License 3 (the "Annex"), General License 3 authorizes transactions related to bonds issued prior to Aug. 25, 2017 that were issued by U.S. person entities owned or controlled, directly or indirectly, by the Government of Venezuela, regardless of whether such bonds were included on the Annex.[20] In this FAQ, OFAC also confirms that the Venezuela Government International Bond issued on December 29, 2016 (ISIN USP97475AQ39, CUSIP AM1108092), which OFAC understands was solely issued by and is solely held by the Government of Venezuela, was intentionally excluded from the Annex.[21]

In its second new FAQ, OFAC clarifies that General License 3, by authorizing *all* transactions related to certain Venezuela-related bonds,

authorizes U.S. persons to engage in derivative transactions, including credit default swaps, involving the covered Venezuela-related bonds.[22]

FinCEN Advisory

In addition to the recent sanctions-related actions taken by the U.S. Department of Treasury in connection with the deteriorating situation in Venezuela, on Sept. 20, 2017, FinCEN, Treasury's financial crimes enforcement arm, published an Advisory warning financial institutions of widespread public corruption in Venezuela.[23] In the Advisory, FinCEN identifies red flags that may indicate Venezuelan public corruption and reminds firms of ways in which they might encounter those indicators and others when fulfilling their existing regulatory obligations.

According to FinCEN, based in part on its analysis of suspicious activity reports ("SARs") filed by U.S. financial institutions in recent years, all Venezuelan government agencies and bodies, including state-owned enterprises, appear to be susceptible to corruption and money laundering, particularly through the abuse and manipulation of government contracts. Moreover, given OFAC's recent sanctions against certain Venezuelan government officials, it is increasingly likely that non-designated Venezuelan government officials may engage in transactions designed to protect their assets, which may include the proceeds of corruption, from future blocking actions.

In the Advisory, FinCEN identifies a number of red flags that may indicate corruption involving government contracts, including trade-based money laundering schemes involving export businesses in South Florida and the use of shell corporations and third parties, or brokers, to transact with government entities. These include the following:

- Transactions involving Venezuelan government contracts that: (a) are directed to personal accounts; (b) originate with, or are directed to, entities that are shell corporations, general "trading companies," or companies that lack a general business purpose; or (c) are directed to companies that operate in an unrelated line of business;
- Transactions where the corroborating documentation (*e.g.*, invoices) reflect charges at substantially higher prices than market rates or include overly simple documentation or lack traditional details;
- Transactions in which the payments involving Venezuelan government contracts originate from non-official Venezuelan accounts, particularly

accounts located in jurisdictions outside of Venezuela (*e.g.*, Panama or the Caribbean), or from third parties that are not official Venezuelan government entities; and

- Cash deposits instead of wire transfers in the accounts of companies with Venezuelan government contracts.

Another possible indicator of Venezuelan government corruption that FinCEN identifies is the purchase of real estate, particularly in South Florida and Houston, Texas, by Venezuelan government officials or their family or associates that are not commensurate with their official salaries.

To the extent a financial institution suspects that a transaction or series of transactions involves Venezuelan public corruption and warrants the filing of a SAR, FinCEN requests that the institution select Field 35(l) on the SAR form and reference the Advisory by including in both the SAR narrative and Field 35(z) the key term, “Venezuelan Corruption.”

FinCEN also reminds financial institutions of their obligations under Section 312 of the USA PATRIOT Act, 31 U.S.C. § 5318(i), and the implementing regulations thereunder, and notes that, in conducting the due diligence required by that provision, financial institutions should remain alert to signs that funds or other assets may have originated from Venezuelan public corruption.

Finally, FinCEN encourages financial institutions to incorporate the information provided in the Advisory into their risk-based approaches to compliance, but counsels that firms should not use this warning as a basis for engaging in “wholesale or indiscriminate de-risking.” Indeed, according to FinCEN, “normal business and other transactions involving Venezuelan nationals and businesses do not necessarily represent the same risk as” the types of transactions and relationships described in the Advisory.

Conclusion

Firms should continue to monitor for updates and releases from OFAC as it continues to implement the sanctions authorized by E.O. 13810, and should be aware that any of their current or future business dealings with persons that transact with North Korea may be impacted by such implementation. Similarly, firms should remain alert for any further sanctions-related actions targeting the Government of Venezuela and its officials. As the political situation in Venezuela continues to deteriorate, firms, and particularly financial services businesses, should carefully

scrutinize customers and transactions that may be connected to public corruption reportedly occurring in Venezuela.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] See Executive Order 13810, Imposing Additional Sanctions with Respect to North Korea, (Sept. 20, 2017).

[2] See Remarks Delivered at United Nations General Assembly Press Briefing by Steve Mnuchin, U.S. Treasury Secretary (Sept. 21, 2017).

[3] See Press Release, Treasury Sanctions Banks and Representatives Linked to North Korean Financial Networks (Sept. 26, 2017).

[4] See OFAC FAQs at Nos. 523 and 524 (Sept. 1, 2017), https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_other.aspx.

[5] See FinCEN, Advisory on Widespread Public Corruption in Venezuela, FIN-2017-A006, <https://www.fincen.gov/sites/default/files/advisory/2017-09-20/FinCEN%20Advisory%20FIN-2017-A006-508%20Compliant.pdf>.

[6] Other persons subject to Section 1(a) include those that the U.S. Secretary of the Treasury determines: (1) own, control or operate any port in North Korea; (2) are a North Korean person, as defined in Section 8(d) of E.O. 13810; (3) have materially assisted, sponsored or provided financial, material or technological support for, or goods or services to or in support of, any person blocked pursuant to E.O. 13810; or (4) are owned or controlled by, or have acted or purported to act for or on behalf of, directly or indirectly, any person blocked pursuant to E.O. 13810.

[7] OFAC FAQs at No. 526 (Sept. 21, 2017) (noting that, with respect to Section 3 of E.O. 13810, until OFAC “clarif[ies] its expectation for implementation ... this provision does not create any immediate compliance obligations on U.S. persons”).

[8] “Significant transaction” is not defined in E.O. 13810.

[9] The full definition of foreign financial institution includes: “any foreign entity that is engaged in the business of accepting deposits, making, granting, transferring, holding or brokering loans or credits, or purchasing or selling foreign exchange, securities, commodity futures or options, or procuring purchasers and sellers thereof, as principal or agent [and] ... includes, among other entities, depository institutions; banks; savings banks; money service businesses; trust companies; securities brokers and dealers; commodity futures and options brokers and dealers; forward contract and foreign exchange merchants; securities and commodities exchanges; clearing corporations; investment companies; employee benefit plans; dealers in precious metals, stones, or jewels; and holding companies, affiliates or subsidiaries of any of the foregoing[.]” with limited exceptions for certain international financial institutions. E.O. 13810 at 8, § 8(e).

[10] According to a revised FAQ released concurrent with the Order, E.O. 13810 does not modify the authorizations granted to nongovernmental organizations by General License 5 in connection with Executive Order 13722. *See* OFAC, FAQs No. 463 (Sept. 21, 2017).

[11] Pursuant to General License 10, aircraft or vessels covered by E.O. 13810 may land at a place or call at a port in the U.S. under certain specified circumstances. *See* General License 10, Calling of Certain Vessels and Landing of Certain Aircraft Authorized (Sept. 21, 2017), https://www.treasury.gov/resource-center/sanctions/Programs/Documents/nk_gl10.pdf.

[12] *See* General License 3-A, Entries in Certain Accounts for Normal Service Charges Authorized (Sept. 21, 2017), https://www.treasury.gov/resource-center/sanctions/Programs/Documents/nk_gl3a.pdf;

[13] *See* OFAC FAQs at Nos. 456-57, 459-61, 463-65, and 525-26 (Sept. 21, 2017), https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_other.aspx.

[14] *See* OFAC FAQs at No. 525 (“The general licenses previously issued with E.O. 13722 do not apply to transactions prohibited by the new E.O. Imposing Additional Sanctions with Respect to North Korea, except for General Licenses 2 and 9 with respect to legal services and emergency medical services, respectively.”).

[15] See note 7, above.

[16] While one of the two banks identified pursuant to Executive Order 13722 had already been included on the SDN List pursuant to Executive Order 13382 in connection with its facilitation of transactions on behalf of North Korea's weapons of mass destruction proliferation network, that bank is now duly designated and OFAC updated the entry on the SDN List for the bank so that it includes additional alternate names.

[17] See Executive Order 13722, Blocking Property of the Government of North Korea and the Workers' Party of Korea, and Prohibiting Certain Transactions With Respect to North Korea (Mar. 15, 2016).

[18] See Executive Order 13687, Imposing Additional Sanctions With Respect to North Korea (Jan. 2, 2015).

[19] See SRZ Alert, Sanctions Update: U.S. Imposes Immediate Restrictions Relating to Venezuelan Securities (Aug. 28, 2017).

[20] See OFAC FAQs at No. 523 (Sept. 1, 2017).

[21] According to the FAQ, this was the only bond that OFAC identified and purposefully omitted from the Annex, but parties are invited to email OFAC in the event they identify other bonds they believe should be added to the Annex. See *id.*

[22] See *id.* at No. 524 (Sept. 1, 2017).

[23] See FinCEN, Advisory on Widespread Public Corruption in Venezuela, FIN-2017-A006, <https://www.fincen.gov/sites/default/files/advisory/2017-09-20/FinCEN%20Advisory%20FIN-2017-A006-508%20Compliant.pdf>.

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