

To Our Clients and Friends

Memorandum



friedfrank.com

State Pension Plan Files Claim Seeking \$88.3 million OFAC Penalty

Introduction

On September 6, 2011, the Louisiana Municipal Police Employees Retirement System filed a shareholder derivative action in the Southern District of New York against JPMorgan Chase Bank, N.A. (“JPMC”) and 11 of its officers and directors seeking repayment of an \$88.3 million civil penalty paid by JPMC as part of its settlement with the Office of Foreign Assets Control (“OFAC”) of the U.S. Department of the Treasury for alleged violations of OFAC’s sanctions regulations.¹ The derivative lawsuit alleges, among other things, that by “permitting these violations of law to continue for over a prolonged period after being put on notice numerous times, the Board utterly failed to exercise adequate oversight over [JPMC], and thus face a substantial likelihood of liability for much of the conduct complained of herein.”² The lawsuit further alleges that the individual defendants “knowingly allowed and rewarded” JPMC’s sanctions violations.³ Many of the allegations in the lawsuit are taken directly from OFAC’s press release announcing the settlement.⁴

JPMC is not the first major financial institution alleged to have violated U.S. sanctions

On August 25, 2011, JPMC agreed to pay \$88.3 million to settle alleged violations of U.S. economic and trade sanctions regulations.⁵ This is the largest settlement penalty to date obtained by OFAC against a U.S. financial institution. This is, however, not the first time a well-known financial institution has agreed to settle allegations of U.S. sanctions violations with a significant fine. JPMC is, in fact, merely the latest alleged violator in a line of OFAC enforcement actions against leading financial institutions. Among the most notable (and largest) recent settlements with OFAC are the following:

- In August 2010, Barclays Bank PLC settled allegations of multiple violations of OFAC regulations as part of a global settlement that also involved the U.S. Department of Justice and the New York County District Attorney’s office for intentionally bypassing filters designed to detect violations of OFAC-administered sanctions.⁶ As a result of Barclays’ alleged

¹ See Complaint, Louisiana Municipal Police Employees Retirement System v. Dimon et al. (S.D.N.Y. Sept. 6, 2011) (“Complaint”); Dan McCue, *Pension Fund Wants JPMorgan Bosses to Pay*, COURTHOUSE NEWS SERVICE, Sept. 8, 2011, available at <http://www.courthousenews.com/2011/09/08/39631.htm>.

² Complaint at ¶ 28.

³ Complaint at ¶ 1.

⁴ Press Release, U.S. Dep’t of Treasury, JPMorgan Chase Bank N.A. Settles Apparent Violations of Multiple Sanctions Programs, (Aug. 25, 2011), available at <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20110825.aspx>.

⁵ *Id.*

⁶ Press Release, U.S. Dep’t of Treasury, Barclays Bank PLC Settles Allegations of Violations of Multiple Sanctions Programs, (Aug. 18, 2010), available at <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20100818.shtml.aspx>.

violations, over \$112 million, through 1,285 separate transactions, was transferred for the benefit of individuals and entities in countries such as Cuba, Iran, and Sudan in violation of U.S. sanctions against those countries. Barclays settled with OFAC for \$176 million (which was deemed satisfied as a portion of Barclays' payment of \$298 million in the global settlement) and agreed to retain an independent corporate monitor to review Barclays' OFAC compliance program.

- In December 2009, OFAC announced its largest penalty settlement in history, a \$536 million global settlement with Credit Suisse AG that also involved the U.S. Department of Justice and the New York County District Attorney's office for knowingly processing transactions that concealed the identity of sanctioned parties in violation of various OFAC sanctions programs.⁷

The JPMC OFAC Settlement

The JPMC settlement involved alleged violations of numerous OFAC sanctions programs, including those imposed against Cuba, Iran, and Sudan. In its press release, OFAC highlighted three of these alleged violations as "egregious." Under OFAC's Economic Sanctions Enforcement Guidelines (the "Guidelines"), an egregious case "indicates that the case represents a particularly serious violation of the law calling for a strong enforcement response" in the form of a civil monetary penalty.⁸ For additional information regarding OFAC's Enforcement Guidelines, please see our previous [client memorandum](#), "Lessons Learned from Recent OFAC Enforcement Cases."

The first alleged egregious violation by JPMC involved the Cuban Assets Control Regulations ("CACR"). According to OFAC, JPMC processed 1,711 wire transfers totaling \$178.5 million involving Cuban nationals in violation of the CACR. After being alerted to the violative conduct by a third party, JPMC undertook an investigation that confirmed the transfers were for the benefit of Cuban nationals, but failed to take adequate steps to prevent future improper transfers. JPMC also failed to voluntarily disclose the CACR violations to OFAC.

The second alleged egregious violation involved the Weapons of Mass Destruction Proliferators Sanctions Regulations ("WMDPSR").⁹ OFAC alleged that JPMC made a trade loan to the bank issuer of a letter of credit, the underlying transaction of which involved a vessel affiliated with an Iranian shipping company. When JPMC realized the trade loan was in violation of WMDPSR, it decided to voluntarily disclose the transaction to OFAC, but waited three months to mail the disclosure. The OFAC disclosure was mailed three days before JPMC was to receive repayment for the loan. JPMC also failed to provide complete information in response to an OFAC administrative subpoena regarding the transaction.

The final egregious violation alleged by OFAC was a violation of the Reporting, Procedures, and Penalties Regulations ("RPPR"). OFAC allegedly issued JPMC an administrative subpoena requiring JPMC to produce documents related to a specific wire transfer. JPMC failed to produce several of the documents, while asserting that it had no additional responsive documents. It was not until OFAC presented JPMC with documents that OFAC had received from a third party that JPMC produced an additional 20 responsive documents.

In finding the above alleged violations egregious, OFAC consulted the General Factors Affecting Administrative Action ("General Factors") in the Guidelines and determined that JPMC's violations were reckless acts or omissions, and thus egregious. OFAC considered the individual characteristics of JPMC

⁷ Press Release, U.S. Dep't of Treasury, U.S. Treasury Department Announces Joint \$536 Million Settlement with Credit Suisse AG, (Dec. 16, 2009), available at <http://www.treasury.gov/press-center/press-releases/Pages/tg452.aspx>.

⁸ Economic Sanctions Enforcement Guidelines, 74 Fed. Reg. 57593, 57605 (Nov. 9, 2009) (Codified at 31 C.F.R. pt. 501, App. A).

⁹ In addition to its country-based sanctions, OFAC also maintains sanctions programs, codified into regulations, with respect to persons engaged in a variety of conduct harmful to the national security, foreign policy, and other interests of the United States.

and found that its large size and commercial sophistication as a financial institution weighed in favor of a determination that JPMC's behavior was egregious. OFAC also looked at management's conduct and determined that JPMC managers acted knowingly and recklessly with respect to JPMC's obligations under the U.S. sanctions programs.

The \$88.3 Million Mitigated Penalty

The OFAC settlement press release noted that the total base penalty for the egregious violations was over \$114 million – far greater than the \$88.3 million penalty JPMC ultimately agreed to in the settlement. OFAC cited three factors that mitigated the total penalty in JPMC's favor. First, JPMC provided substantial cooperation during the investigation, including an extensive transaction review, and entered into agreements that tolled the statute of limitations. Second, JPMC had a commendable sanctions compliance history and had not been the subject of an OFAC Penalty Notice or Finding of Violation within five years preceding the violative conduct. Finally, the fact that JPMC settled the enforcement action was also taken into account as a mitigating factor.

Key Takeaways

1. *Even sophisticated institutions with significant institutional OFAC experience can run afoul of the OFAC regulations, but proactive cooperation with OFAC can significantly mitigate the consequences.*

Like Barclays and Credit Suisse before it, JPMC is a sophisticated financial institution that had compliance policies and procedures, and experienced in-house staff, in place to detect and prevent OFAC violations. In two of the alleged egregious violations noted above, JPMC succeeded in identifying the violative conduct, but either failed to take adequate steps to prevent further violations or failed to follow up with prompt disclosure to OFAC. In the third egregious violation alleged by OFAC, JPMC's compliance department failed to produce in a timely manner documents responsive to an OFAC subpoena.

Cooperation with OFAC is one of the General Factors OFAC considers when assessing a civil penalty, including specifically whether the company voluntarily self-disclosed the violation in a timely manner and whether the company responded promptly to requests for information. While, as noted below, JPMC did receive some cooperation credit, had JPMC fully and promptly self-disclosed each alleged violation and fully and promptly complied with OFAC's document subpoena, the company undoubtedly could have settled the action with a substantially lower penalty.

2. *Companies can take steps to mitigate OFAC sanctions, both before and after the alleged violation occurs.*

As a result of its allegedly violative conduct, JPMC faced a potential total penalty of \$114 million. Because of steps JPMC took, both before and after the alleged violations occurred, the Company paid a mitigated penalty of only \$88.3 million.

OFAC noted several General Factors that mitigated JPMC's penalty downwards. First, OFAC took into account JPMC's conduct prior to the alleged violations to establish and maintain compliance programs, policies, and procedures, and noted that JPMC had not been the subject of an OFAC violation during the five years preceding the alleged non-compliances. Second, OFAC credited JPMC with both cooperating with the investigation and settling the enforcement action. Had JPMC not had a clean historic OFAC compliance record or not cooperated (albeit not entirely) with the investigation, no doubt JPMC would have faced a higher penalty.

3. *OFAC violations can have significant follow-on consequences for not only the company – but officers and directors as well.*

While a company may think that an OFAC press release announcing settlement with the company marks the end of the company's economic and trade sanction woes, sometimes it is just the beginning. As demonstrated in the instance of JPMC, the press release describing an OFAC settlement (particularly one alleging egregious violations) can spark the attention of shareholders and result in the filing of a derivative lawsuit to hold officers and directors liable for repayment of any amounts paid in settlement. Should the derivative suit be successful, JPMC (and/or its managers) faces the unhappy prospect of being required to pay not once, but twice, for the alleged non-compliance with the broad panoply of OFAC sanctions rules.

Fried, Frank, Harris, Shriver, and Jacobson LLP's [International Trade and Investment](#) team has extensive experience in designing OFAC and other trade compliance programs, providing regulatory support for transactions, conducting compliance audits, and defending clients in sanctions-related enforcement actions, including filing voluntary disclosures with the U.S. government.

* * *

Authors:

Mario Mancuso

Jay R. Kraemer

Kimberly A. Cain

Melissa D'Arcy

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or the authors listed below:

Contacts:

Mario Mancuso

Partner

1.202.639.7055

mario.mancuso@friedfrank.com

Jay R. Kraemer

Of Counsel

1.202.639.7060

jay.kraemer@friedfrank.com

