

banks licensed by Nauru. In response to FATF pressure, on December 6, 2001, Nauru passed amendments to its AML Act. Nonetheless, according to FATF, the revised anti-money laundering law that now exists provides for a wholly inadequate anti-money laundering (AML) legislative and regulatory regime. In addition, Nauru has not yet addressed the remaining and most important deficiency of its AML legislation, that is, the inadequate procedures for licensing, regulating, and supervising its offshore banks. Thus, despite repeated warnings by FATF of its concern with Nauru's practices, and the clear consequences of not amending its practices, Nauru has not shouldered its responsibility to establish a sufficient AML regime.

On July 22, 2002, FATF wrote Nauruan officials to express FATF's concern about the practice in Nauru of issuing licenses to offshore shell banks and asked Nauru to cease licensing such entities. Nauru, however, has not ceased this activity.

D. Designation of Nauru as a Primary Money Laundering Concern and Imposition of Counter-Measures

After reviewing Nauru in light of the statutory factors set forth above, on December 20, 2002, the Treasury designated Nauru as a country of primary money laundering concern under section 5318A of the BSA.⁵ As a result of this designation, and based upon an analysis of the entirety of circumstances in Nauru, Treasury has determined that grounds exist for the imposition of a special measure upon Nauru. Based upon its consideration of the following factors, Treasury intends to impose on Nauru the fifth special measure authorized by section 5318A.

E. Factors To Consider in Imposing Special Measures Under Section 5318A

1. Whether Similar Action Has Been or Is Being Taken by Other Nations or Multilateral Groups

As a result of FATF's call on December 5, 2001, for the imposition of counter-measures against Nauru, 27 FATF member countries, including all G-7 countries, have taken action against Nauru.⁶

2. 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

Imposing sanctions against Nauru under section 5318A should not result in any competitive disadvantage, including any undue compliance cost or burden, to financial institutions in the United States. First, FATF member countries and the G-7 countries have already responded to FATF's call for the imposition of counter-measures against Nauru. Second, BSA section 5318(j) already requires the termination of correspondent accounts maintained by U.S. depository institutions and securities broker-dealers for foreign shell banks.⁷ As a result, since we understand that most, if not all, Nauru-licensed banks are shells (other than the Central Bank of Nauru), most transactions between Nauru and U.S. financial institutions have or should already have ceased.

3. 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 Jurisdiction, Institution, or Class of Transactions

The action against Nauru should have no significant adverse systemic impact on the international payment system or on legitimate business activities because of the small size of the economy and the absence of any meaningful, legitimate international business.

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

The action is expected to have virtually no effect on United States national security or foreign policy.

The Secretary intends to impose the fifth special measure against Nauru pursuant to section 5318A. That special measure will prohibit covered U.S. financial institutions from opening or maintaining in the United States any correspondent account, or payable-through account, for a foreign financial institution if that account is maintained

representative offices of banks from Nauru, the country take into account the fact that the applicant bank is from an NCCT. Last, the countries have issued warnings to non-financial sector businesses that transactions with entities within NCCTs might run the risk of money laundering. (Source: FATF Reports).

⁷ See Part III.A. *infra*.

for, or on behalf of, a Nauru financial institution.

III. Section-by-Section Analysis

A. Overview

This proposed rule is designed to deny Nauru financial institutions access to the U.S. financial system through correspondent accounts. The proposed rule would prohibit certain U.S. financial institutions from maintaining correspondent accounts for, or on behalf of, a Nauru financial institution. Furthermore, if a U.S. financial institution covered by this proposed rule learns that a correspondent account that it maintains for a foreign bank is being used to provide services indirectly to a Nauru financial institution, the U.S. financial institution must terminate the correspondent account of the foreign bank.

On September 26, 2002, Treasury published in the **Federal Register** a final rule implementing sections 313 and 319(b) of the Act (the Section 313/319 Rule).⁸ That rule, among other things, prohibits certain financial institutions from providing correspondent accounts to foreign shell banks, and requires such financial institutions to take reasonable steps to ensure that correspondent accounts provided to foreign banks are not being used to provide banking services indirectly to foreign shell banks. There will be significant overlap between the Section 313/319 Rule and this proposed rule for those financial institutions covered by the Section 313/319 Rule, although they are quite distinct, as described below.

B. Section 103.184 Definitions

Correspondent account. Section 103.184(a)(1) of the proposed rule's definition of correspondent account is the definition contained in 31 U.S.C. 5138A(e) (as added by section 311 of the Act). Section 5138A(e) defines the term to mean an account established to receive deposits from, make payments on behalf of, a foreign financial institution, or handle other financial transactions related to such institution. 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 financial institution, including payable-through accounts. In the case of securities broker-dealers, futures commission merchants, introducing brokers, and mutual funds, a correspondent account would include any account that permits the foreign financial institution to

⁸ 67 FR 60562 (September 26, 2002) (codified at 31 CFR 103.177).

⁵ *Supra* n1.

⁶ Specifically, the countries have imposed stringent requirements for identifying clients and beneficial owners before business relationships are established with individuals or companies from Nauru. In addition, the countries have required enhanced and systematic reporting of financial transactions involving Nauru. Also, the countries have required that, in considering requests for approving the establishment in FATF member countries of subsidiaries or branches or