Compliance challenges: Cartels designated as foreign terrorist organizations (FTOs)

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Background and implications:

The US government's recent Executive Order 14157 designating certain drug cartels as foreign terrorist organizations (FTOs) will present significant compliance challenges for financial institutions due to the introduction of complex due diligence requirements and the heightened exposure of litigation for material support charges under the Anti-Terrorism Act. Highlighting this focus on cartel activity, the Attorney General has directed the Department of Justice's (DOJ) Foreign Corruption Practices Act (FCPA) unit to prioritize cases of foreign bribery that facilitate cartel operations and transnational criminal operations.

Now financial institutions will have to evaluate whether any activity provides an indirect or unintended benefit to a designated party – an individual or entity that is blocked pursuant to sanctions programs administered by the Office of Foreign Asset Controls (OFAC). Failing to identify material support for a FTO is a criminal liability, and the challenge of determining whether parties involved in an activity are agents of a cartel for a financial institution are considerable. Even individuals already listed on the U.S. Treasury's Specially Designated Nationals (SDN) list, whose activities must be reported to OFAC, now also need to inform the DOJ.

Due to the limited exceptions associated with an FTO designation, payments made for protection, extortion or ransom could still be interpreted as material support for terrorism. In countries like Mexico, businesses often find themselves compelled to pay protection fees, as cartels are deeply embedded in legitimate enterprises and protection rackets, forcing many companies to comply.

Moreover, there are significant reputational risks associated with involvement in supporting terrorist activities, as well as potential exposure to the Anti-Terrorism Act, which permits victims of FTOs to seek damages from those considered to have supported terrorist organizations.

Challenges of identifying cartel activity for a financial institution:

Drug cartels have long shown a tendency to avoid new laws and oversight trends as they adapt to law enforcement techniques and changes in the global financial system. Based on recent trends and events, cartels have expanded their technological capabilities and have hired the expertise needed to navigate the financial system and its associated controls. These and other recent cartel trends make it challenging for financial institutions to identify their activity.

- **Professional money launderers** — Cartels are hiring professionals to help identify loopholes in the financial system, including roles such as lawyers, accountants and even business associates that create invoices.
- **Use of financial services/cryptocurrency** — Cartels use financial services companies (cryptocurrency, precious metals, Money Service Businesses (MSB)) and stock exchanges in poorly regulated jurisdictions to rapidly move funds from foreign jurisdictions using multiple mediums (wires, cash, cryptocurrency, counterfeit goods), making it difficult to trace.
- **Fake or shell companies** — Cartels often use fake or shell companies as intermediaries to layer funds. These companies, which are often foreign domiciled, can be identified by a lack of a clear business purpose or exhibiting indicators of illegitimacy upon closer inspection. This may include company websites that appear legitimate on the surface but have broken links, minimal content and/or replicated content. Other potential signs could include companies falsely claiming to be registered with official government bodies or shared controlling parties across multiple transacting parties, suggesting funds were not moved for business reasons.

- **Integration with legitimate activity** — Cartels leverage legitimate businesses, charities, sports teams and well-known organizations to commingle funds, making it challenging to discern activity explainable by business operations, including internal transactions between operational accounts resulting in layering. Importantly, many otherwise legitimate companies are forced to pay ransoms, extortion or protection fees to cartels, which could now qualify as potentially terrorist financing.
- **Bank involvement** — Cartels with insider information or who have compromised bank employees have successfully opened accounts, on-boarded shell companies, and processed money movements, thus avoiding certain regulatory reporting. Cartel-compromised employees can exploit deficient bank controls and technology to set up a network of accounts on behalf of criminal organizations and refuse to record key individuals in Currency Transaction Reports (CTRs) physically present during cash deposits.
- **Intermediaries with money mules** — Cartels use accounts nominally held by conspirators and/or victims to avoid being reported on in CTRs and internal bank records. Surges in funnel accounts and ATM activity in poorly regulated jurisdictions are a key indicator of potential money mule accounts.
- **High-risk jurisdictions/regions** — Cartels have shown a tendency to take advantage of and focus efforts within particular regions or countries, which are susceptible to becoming hubs of criminal activity and money laundering, due to corrupt or lax oversight, controls and law enforcement. For instance, the Sinaloa Cartel and the Jalisco New Generation Cartel influence many regions of Mexico, including the states of Sinaloa, Baja California, and Chihuahua. Academic institutions, law enforcement and regulatory agencies regularly report and update known regions of cartel influence.

Act now

Financial institutions can take measures to assess and prepare their compliance program. Below are a few suggestions to get started:

- **Collaboration between the general counsel, compliance team and senior leadership** — Effective communication among legal counsel, compliance and leadership is essential for managing liabilities and risks. It is important to provide legal counsel and compliance with the necessary resources and prioritize their efforts to identify the firm's risks and recommend appropriate actions. In addition to legal obligations, assess any potential reputational risks to the firm.

- **Background checks and risk assessments** — Conduct background checks and risk assessments on potential partners, suppliers, employees and clients to help ensure no direct or indirect connections to potential FTOs and monitor for changes in ownership, financial health and legal standing. Consider potential insider threat assessments for potentially compromised employees, particularly at branches in high-risk regions associated with cartel influence.

- **Identify third-party relationships** — Identify and monitor third-party relationships for potential associations to FTOs. Update know your customer (KYC) procedures to identify these relationships and/or close any potential loopholes that may obfuscate the true beneficiaries of an account, such as trust companies that may be acting on behalf of hidden beneficiaries. Likewise, update transaction monitoring procedures and alert scenarios to identify potential third parties, such as those named in originator, beneficiary and correspondent fields or identified through due diligence research.

- **Evaluate subjects of law enforcement inquiries and Patriot Act 314(b) requests by other financial institutions** — Any subject under investigation by other financial institutions and/or by law enforcement agencies should be considered a red flag for potentially illicit activity. The subjects should be (re-)evaluated with a lowered risk appetite for any possible links to cartel activity. Be sure when conducting investigations on these subjects to stay aware of the latest cartel news, known regional cartel activity, law enforcement bulletins and other relevant sources of information.

- **Monitor high-risk branches and ATM activity** — Identify high-risk branches that necessitate additional monitoring and potential on-site visits from risk/compliance team. Routinely flag changes in cash activity at high-risk ATM or branch locations for further inquiry and monitoring of adherence to CTR filing requirements.

- **Assess controls in place to counter cartel activity** — Understanding the operations of cartels, consider the controls in place that could lessen the risk posed by the themes described above and as law enforcement and regulatory agencies share updates.

- **Refresh customer and non-customer watchlists** — Regularly update government and internal watchlists for customers and non-customers for preventive monitoring.

- **Target trainings and update procedures** — Educate employees on recent trends, offer targeted training on topics identified from alerts or referrals, and consider revising scenarios to capture new trends and potential cartel involvement.

- **Update databases and technology** — Regularly update internal databases, cross-referencing with Office of Foreign Assets Control (OFAC) and other international sanctions lists, and utilize advanced screening tools for continuous monitoring. Maintain detailed financial records and properly document all payments made in complex environments. Evaluate for data vulnerabilities such as truncated account names that may hinder the identification of sub-account names during investigations and other assessments of the accounts or activity.

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