

# To Infinity and Beyond: U.S. Dollar-Based Jurisdiction in the U.S. Sanctions Context

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*The power to print the world's dominant currency gives the United States enormous leverage in pursuing its geopolitical objectives. This is particularly evident in the sanctions context, where the mere "use" of the U.S. financial system will pull parties into U.S. jurisdiction even if they are located outside the United States. This article highlights the recent extensions of jurisdictional*

*assertion by the U.S. authorities. It will then focus on the mechanics of an international U.S. dollar transaction in order to explain how these transactions, as a matter of principle, involve conduct inside the United States. It will then explore whether there are viable alternatives to break the territorial nexus of U.S. dollar payments – the answer to this question being negative.*

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## I. Introduction

On 18 December 2018, *Meng Wanzhou*, the daughter of Huawei founder *Ren Zhengfei* and herself Chief Financial Officer of the company, was arrested at Vancouver International Airport on a U.S. warrant. The charge was that *Meng* had violated U.S. sanctions by using the U.S. financial system to execute U.S. dollar payments to Iran. Nine days after *Meng's* arrest, China detained two Canadian citizens, *Michael Spavor* and *Michael Kovrig*, on charges of espionage. *Michael Spavor* was sentenced to 11 years in prison in August 2021. On 24 September 2021, *Meng Wanzhou* left Canada after a deal with U.S. prosecutors. The broadcast of her landing showed flag-waving crowds – much like the welcoming back of an Olympian medalist. Only hours after her release, *Michael Spavor* and *Michael Kovrig* were flying home as well. They were greeted at Vancouver airport by Prime Minister *Justin Trudeau*.<sup>1</sup>

The blunt hostage diplomacy used by China was not an option for Turkey, a U.S. ally and NATO partner, when two prominent Turkish citizens were arrested by U.S. authorities in 2016 and 2017 on charges that they had violated U.S. sanctions. *Reza Zarrab*, a wealthy Turkish businessman with close ties to Turkish President *Recep Tayyip Erdogan*, was arrested in March 2016 while on a family trip to Disney World.

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<sup>1</sup> An excellent and comprehensive analysis is provided online by Chance Bridge Partners in a paper which consists of four parts. Part 1: Tracing the Origins of the Case Against Huawei CFO Meng Wanzhou; Part 2: The Case Against Huawei CFO Meng Wanzhou; Part 3: The Defense of Huawei CFO Meng Wanzhou; Part 4: Learning from the Huawei CFO Meng Wanzhou Case. For a shorter version see *The Economist*, online version, 25 September 2021 (As Canada frees a Huawei boss, China lets two Canadians out of jail); 2 October 2021 (When China wants to be feared).

*Mehmet Hakan Atilla*, deputy CEO of the state-owned Turkish Halkbank, was arrested upon arrival at JFK International Airport in New York in September 2017.<sup>2</sup>

As in the Huawei case, the core of the charge was that *Zarrab* and *Atilla* had facilitated U.S. dollar payments to Iran by using the U.S. financial system. And as in the Huawei case, the arrests were decried by the Turkish government as a political attack. President *Erdogan* is said to have intervened at highest levels of both the *Obama* and *Trump* administration to have the two men released. Two members of *Zarrab's* defense team, Trump advisor *Rudy Giuliani* and *Michael Mukasey*, Attorney General under President *George W. Bush*, travelled to Turkey to find a diplomatic solution to the case. But when the diplomatic solution did not materialize, *Zarrab* decided to plead guilty and to serve as an expert witness in the case against *Atilla*, exposing not only *Atilla's* implication in the dealings with Iran, but also how the scheme involved the Turkish government at the highest levels. *Zarrab* had his assets frozen by the Turkish government the day after his appearance in court and seems to have gone into some kind of witness protection program. *Atilla* was sentenced to 32 months in prison. Upon his return to Istanbul, he was greeted at the airport with flowers and a hug from the Turkish Treasury and Finance Minister.<sup>3</sup> He was later appointed as head of Istanbul's stock exchange.

There is an obvious discrepancy on how the U.S. on the one hand and China and Turkey on the other hand view the issue of U.S. sanctions violations. From a U.S. perspective, *Meng Wanzhou*, *Reza Zarrab* and *Mehmet Atilla* are criminals who belong in jail. For China and Turkey, they are victims of a jurisdictional overreach by the United States, being subjected to a national law that does not apply to them. Non-U.S. corporations, especially banks, have long experienced the expansive enforcement of U.S. sanctions regulations. A prominent example is the French headquar-

tered BNP Paribas who paid roughly 8.9 billion U.S. dollars in settlement fines in 2014. In this case as well, the French government decried the U.S. enforcement action as illegal extraterritorial action.<sup>4</sup>

At the heart of the controversy lies the question whether the United States has jurisdiction to impose its domestic sanctions law, including the civil and criminal penalties provided therein, to the conduct of foreign individuals and companies acting outside the United States. In the U.S. view, jurisdiction is triggered when a payment in U.S. dollars took place and the U.S. financial system was *used* for this purpose. Since this "use" regularly involves the services of U.S. correspondent banks, one also speaks of "correspondent account jurisdiction".<sup>5</sup> According to the predominant view, a U.S. jurisdictional claim is not justified under customary international law when the only connection to the U.S. is the processing of a transaction via the U.S. correspondent banking system.<sup>6</sup>

This article will not focus on the international law perspective. Instead, it will address the question what it means to *use* the U.S. financial system in the sanctions context. It starts with an overview of the recent enforcement actions by the U.S. authorities, putting into evidence the ongoing extensions of the

<sup>2</sup> For an account of the *Zarrab* and the *Atilla* cases see *Susan Emmenegger/Thirza Döbeli*, The Extraterritorial Application of U.S. Sanctions Law, in: *Andrea Bonomi/Krista Nadakavukaren Schefer* (eds), *US Litigation Today: Still a Threat for European Businesses or Just a Paper Tiger?* (2018), 231–257, 231 *et seq.* The case has been highly publicized in the press. See for example *The New Yorker*, 14 April 2017 (A Mysterious Case Involving Turkey, Iran and Rudy Giuliani).

<sup>3</sup> Reuters, 24 July 2019 (Halkbank executive returns to Turkey after serving U.S. sentence).

<sup>4</sup> See *Susan Emmenegger*, Extraterritorial Economic Sanctions and Their Foundation in International Law, in: *Arizona Journal of International & Comparative Law*, Vol. 33 No. 3 (2016), 631–660, 635 *et seq.*

<sup>5</sup> *Emmenegger/Döbeli* (note 2), at 244.

<sup>6</sup> *Régis Bismuth*, Pour une appréhension nuancée de l'extraterritorialité du droit américain – Quelques réflexions autour des procédures et sanctions visant Alstom et BNP Paribas, in: *Annuaire français de droit international*, Vol. 61 (2015), 785–807, 798; *Emmenegger* (note 4), at 654 *et seq.*; *Tom Ruys/Cedric Ryngaert*, Secondary Sanctions: A Weapon out of Control? The International Legality of, and European Responses to, US Secondary Sanctions, in: *British Yearbook of International Law* (2020), 1–116, 22 with further references; *Patrick Terry*, Enforcing U.S. Foreign Policy by Imposing Unilateral Secondary Sanctions: Is Might Right in Public International Law?, in: *Washington International Law Journal*, Vol. 30 No. 1 (2020), 1–27, 11; *Laurent Hoff*, Transaktionen in US-Dollar und sekundäre Sanktionen, in: *Schriften zur Europäischen Integration und Internationalen Wirtschaftsordnung* (2019), 139 *et seq.* In fact, international legal scholarship is highly critical of secondary sanctions in general. For an overview on the literature see *Jeffrey A. Meyer*, Second Thoughts on Secondary Sanctions, in: *University of Pennsylvania Journal of International Law*, Vol. 30 No. 3 (2009), 905–968, 932 *et seq.* (holding the contrary view).

U.S. jurisdictional assertion (II). It will then focus on the mechanics of the U.S. payment system in order to explain how cashless dollar-denominated payments, as a matter of principle, *touch* the United States territory (III). The question which then remains is whether there are viable alternatives to break the territorial nexus of U.S. dollar-denominated payments – the answer to this question being negative (IV).

## II. Dollar-Based Jurisdiction in Action

Enforcement actions against foreign parties where the only U.S. connection is the use of the U.S. financial system have been reported for a number of years. A highly publicized series of settlements between foreign banks and U.S. authorities were concluded in 2009. Since then, the music has not stopped. All cases involved correspondent account services provided by U.S. banks to foreign entities, mostly banks.

Whereas in the early cases the conduct giving rise to the jurisdictional claim consisted of the straightforward use of a U.S. correspondent bank on behalf of a sanctioned entity, the later cases involved conduct which was much further removed from the United States. This did not stop the enforcement appetite of the U.S. authorities – namely the Office of Foreign Asset Control (OFAC). The jurisdictional claim in those cases is that a sanctions-related dollar transaction which was processed *outside* the United States *correlated* with a transaction processed *in* the United States.

### 1. The Jurisdictional Claim

The core argument for the jurisdictional claim by the U.S. authorities is that the processing of a dollar payment by a U.S. correspondent bank on behalf of foreign client constitutes an *export* of financial services *from* the United States and this is prohibited conduct under various sanctions laws and regulations.<sup>7</sup> A for-

eign client who instructs this type of transaction is considered to be acting *inside* the United States, thus triggering domestic jurisdiction.<sup>8</sup> Another argument is that the foreign party who initiates a transaction which is processed in the U.S. *conspires or causes a violation of a U.S. sanctions measure* – and this constitutes prohibited conduct as well.<sup>9</sup>

The predominant view in legal scholarship is that both jurisdictional claims are unlawful under the principles of jurisdiction in international customary law.<sup>10</sup> But this has been discussed elsewhere and is not an issue addressed in this article. In the U.S. courts, there have been very few jurisdictional challenges. Corporate defenders will invariably choose to settle. The situation is different for natural persons because even a plea bargain will not necessarily dispense them from imprisonment. In fact, both *Reza Zarrab* and *Mehmet Atilla* challenged the jurisdiction of the U.S. courts, as did *Atilla's* employer, the Turkish state-owned bank Halkbank (as a notable exception to the rule that corporate defenders will not challenge jurisdiction). The district court rejected all

above). A recent example is Mashreqbank PSC (2021) (documents available online at <[www.treasury.gov](http://www.treasury.gov)>).

<sup>8</sup> Decision, *United States v. Atilla*, 18-1589 (2d Cir. 2020), 4 *et seq.*; Superseding Indictment, *United States vs. Zarrab et al.*, S1 15 Cr. 867 (SDNY 2016), paras. 12, 16; Statement of Facts, *United States vs. BNP Paribas*, 14 Cr. (SDNY 2014), para. 5 [hereinafter BNPP, Statement of Facts]. See also Richard Gordon/Michael Smith/Tom Cornell, *Sanctions Law* (2019), 113.

<sup>9</sup> Continuing with the Iranian Transactions and Sanctions Regulations mentioned above, see 31 C.F.R. § 560.203(a) (ITSR) which prohibits “any transaction [...] that evades or avoids, has the purpose of evading or avoiding, *causes a violation of*, attempts to violate any of the prohibitions set forth in this part [eg. the exportation of services]”. For an enforcement example see Department of the Treasury, Settlement between OFAC and CSE Global Limited and CSE TransTel Pte. Ltd., ENF 41441, 27 July 2017. The language of *causing a violation* was also included in the 2007 revision of the International Emergency Economic Powers Act (IEEPA), one of the main statutory bases for U.S. sanctions. See 50 U.S.C. § 1705(a). See also Christine Abely, *Causing a Sanctions Violation with U.S. Dollars: Differences in Regulatory Language across Sanctions Programs*, in: Georgia Journal of International and Comparative Law, Vol. 48 No. 1 (2019), 30–83, 31 *et seqq.* for a comprehensive discussion (including a list of regulatory provisions) operating with the so-called “causation provisions” in U.S. sanctions law.

<sup>10</sup> See *supra* note 6.

<sup>7</sup> For an example see the Iranian Transactions and Sanctions Regulations (ITSR) at 31 C.F.R. § 560.204, which states that the “exportation, reexportation, sale, or supply, directly or indirectly, from the United States, or by a United States person, wherever located, of any goods, technology, or services to Iran or the Government of Iran is prohibited [...]”. Cases which reference the “export” liability were Loyds TBS (2009), Credit Suisse (2009), BACB Bank (2019) (discussed below) and BNP Paribas (2014) (discussed

three motions to dismiss.<sup>11</sup> *Zarrab* reached a deal with the prosecution and did not appeal, *Atila* did not raise the issue on appeal, and the Halkbank trial is still pending.<sup>12</sup>

It should also be noted that the Swiss Financial Market Supervisory Authority (FINMA) has provided legal assistance to the U.S. authorities and has undertaken its own enforcement actions against Swiss banks who were involved in similar operations, notably in the Credit Suisse and the BNPP case.<sup>13</sup> This may seem surprising since FINMA confirmed that it found no indication that Swiss sanctions regulations had been breached. But it did find the Swiss banks in breach of Swiss bank supervisory law. Namely, the banks failed to establish an appropriate risk management and breached duty to ensure the banks' business safety and soundness. The Swiss supervisor did not outright declare U.S. law to be directly applicable in Switzerland, but it came exceedingly close.

## 2. Direct Transactions involving the U.S. Financial System

The classic case of liability for *using* the U.S. financial system regards enforcement actions against non-U.S. banks who instructed a dollar-denominated payment on behalf of a sanctioned client, and this payment “passed through” the United States because it was processed by a U.S. correspondent bank.

The first settlements involving this type of action were concluded in 2009 and they involved Lloyds TBS, Credit Suisse, ABN AMRO, Australia and New Zealand Banking Group.<sup>14</sup> The banks had sent payment instructions for dollar-denominated payments to their U.S. correspondent bank for clearing purposes. The payments were made on behalf of clients who were on U.S. sanctions lists. In order to avoid the blocking of such payments by the sanctions filters installed by the U.S. correspondent banks, the banks removed any reference to the sanctioned parties – i.e. customer names, bank names and addresses – in their SWIFT payment instructions. This allowed the payments to pass undetected through the filters of the U.S. banks. Lloyds TBS, one of the banks engaged in this conduct, had internal documents which referred to this method as “repairing” or “stripping” – the latter has become the name commonly used for this practice.

OFAC still reports cases which involve this type of conduct.<sup>15</sup>

## 3. Correlated Transactions involving the U.S. Financial System

Whereas the practice of “stripping” is the classic and most direct practice of circumventing U.S. sanctions, non-U.S. banks soon attempted to further distance themselves from the U.S. payment system. Almost all of these attempts involved the process of internal bookings. In other words, the non-U.S. banks tried – to a smaller or larger extent – to conduct the dollar transactions outside the United States.

As the following case studies show, this did not stop the U.S. enforcement actions. To conduct dollar transactions outside the United States will not shield foreign banks (and foreign companies) from U.S. sanctions liability. In the view of U.S. authorities, even the indirect use of the U.S. financial system will

<sup>11</sup> Decision and Order, *United States v. Zarrab*, 15 Cr. 867 (RMB) (SDNY 2016), 4 *et seq.*, 8 *et seq.*; Decision and Order, *United States v. Atila*, 15 Cr. 867 (RMB) (SDNY 2018), 12 (available online at <[www.casetext.com](http://www.casetext.com)>); Decision and Order, *United States v. Halkbank*, 15 Cr. 867 (RMB) (SDNY 2020), 6 *et seq.*, 16 (available online at <[www.casetext.com](http://www.casetext.com)>).

<sup>12</sup> Halkbank also raised the defense of foreign sovereign immunity. This defense was rejected on appeal, *see* Decision, *United States v. Türkiye Halk Bankası A.Ş.*, 20-3499-cr (2d Cir. 2021), 3. This means that the trial will continue (if Halkbank does not settle).

<sup>13</sup> FINMA, Processing of USD payments for countries and persons sanctioned under the OFAC-Rules – Settlement between Credit Suisse and the U.S. authorities, 16 December 2009, 7 *et seq.* [hereinafter FINMA, Credit Suisse Settlement]; FINMA, Press Release (Inadequate risk management of US sanctions: FINMA closes proceedings against BNP Paribas [Suisse]), 1 July 2014, available online at <[www.finma.ch](http://www.finma.ch)>. In the case of BNPP, FINMA ordered additional capital for operational risks and banned the bank from conducting business with companies and persons subject to EU and US sanctions.

<sup>14</sup> The press releases and the settlement agreements are available online at <[www.treasury.gov](http://www.treasury.gov)>. For a summary of the Lloyds and Credit Suisse cases: *Abely* (note 9), 46 *et seqq.* For the Credit Suisse case *see also* FINMA, Credit Suisse Settlement (note 13), at 5 *et seqq.*; *Laurence Devun Turner*, L'impact des sanctions financières internationales sur le trafic des paiements bancaires, in: *GesKR Vol. 1* (2011), 44–56, 53.

<sup>15</sup> For a recent example *see* OFAC, Enforcement Release (OFAC Issues a Finding of Violation to Mashreqbank PSC for Violations of the Sudanese Sanctions Regulations), 9 November 2021, *supra* note 7.



trigger U.S. jurisdiction if there is a *correlation* between a sanctions-related dollar transaction conducted *outside* the United States and a dollar transaction which was processed *inside* the United States. To understand how this correlation can become visible for the authorities, one should remember that each settlement produces information on the business partners of the foreign party who is settling its case, and this again is likely to encourage other foreign entities to voluntarily notify the authorities on possible sanctions violations.<sup>16</sup>

### 3.1 Satellite Banks

One attempt to put more distance between the sanctioned clients of a non-U.S. bank and the U.S. financial system was to add another non-U.S. bank (a “satellite bank”) to the payment process. The two non-U.S. banks would then formally send and receive dollar payments on behalf of each other, when in reality the transaction was made on behalf of a sanctioned client.

The satellite bank scheme is described in detail in the statement of facts concerning the 2014 settlement between BNP Paribas (BNPP) and the U.S. authorities.<sup>17</sup> In that particular case, it was used to facilitate U.S. dollar transactions on behalf of Sudanese sanctioned entities. One of the satellite banks was presumably UK based British Arab Commercial Bank (BACB).<sup>18</sup> BACB operated dollar accounts for several Sudanese banks, including the Sudanese Central Bank. It also maintained a dollar account with BNPP Geneva.

When a Sudanese client of BACB London wanted to make a dollar payment, BACB London would debit

the client’s account in London, but it would use its own account with BNPP Geneva to initiate the payment process. From the perspective of the U.S. correspondent bank, this looked like a payment instruction by BNPP Geneva on behalf of its client, BACB London. When a Sudanese client needed to receive a dollar-denominated payment, BNPP Geneva would (formally) receive this payment on behalf of its client, BACB London. BACB London would then internally credit the Sudanese client’s account in the amount of the funds received.

Due to the correlation of the payments, the U.S. authorities found relevant domestic conduct in the sense of U.S. sanctions jurisdiction. As a result, the satellite bank scheme did not shield the banks from a sanctions liability.

### 3.2 Bulk Fundings

The bulk funding mechanism constitutes another (unsuccessful) attempt to reduce the connections with the U.S. payment system. In this case, the basic idea was to establish a dollar-denominated correspondent account system outside the United States. Non-U.S. banks and other parties would open a dollar account at one bank, and this bank would then internally settle the dollar-transactions between the account holders.

The bulk funding mechanism is described in detail in the BACB settlement.<sup>19</sup> In order to serve its Sudanese clients, BACB opened an account with Bank B – presumably a Chinese bank.<sup>20</sup> By offering dollar accounts to banks and businesses who were trading with Sudan, Bank B created a closed circuit for dollar-denominated payments between its clients. Credits and debits could be transferred by a simple internal booking from one account to the other and without using the U.S. payment system. A bank such as BACB could use its Bank B account to send and receive USD payments on behalf of its Sudanese customer while mirroring the transactions on the Sudanese client accounts at BACB London. In fact, Bank B

<sup>16</sup> An example is the BACB settlement (discussed in this chapter). BACB was a business partner of BNPP in the Sudan transactions. It notified OFAC in December of 2014 about possible sanctions violations. This was shortly after the BNPP settlement was announced in June 2014. Another case of a voluntary disclosure is the case of Union de Banques Arabes et Françaises (discussed in this chapter).

<sup>17</sup> See BNPP, Statement of Facts (note 8), at paras. 23–26. The term “satellite banks” was used in internal documents of BNPP to describe the process.

<sup>18</sup> This can be deduced from the BNPP, Statement of Facts (note 8), at paras. 32, 40 and the settlement between OFAC and BACB. For the latter see Department of the Treasury, Settlement between OFAC and British Arab Commercial Bank plc., COMPL-2015-212138, 3 September 2019, paras. 7, 12 [hereinafter BACB Settlement]. In fact, BACB notified OFAC of possible historical sanctions violations shortly after the BNPP settlement.

<sup>19</sup> BACB Settlement (note 18), at paras. 7–18. BACB was also involved in the satellite scheme with BNPP regarding Sudan. But this system had come to an end in 2007, and this is why BACB was looking for new ways to serve its Sudanese clients.

<sup>20</sup> China rapidly became the main trading partner of Sudan after the imposition of U.S. sanctions in 1997. This is especially true for the oil business – a business which is traditionally conducted in U.S. dollars.

had given BACB assurances that it had “an internal USD clearing system and [could] settle USD in [the country of Bank B] without going through New York [i.e. the United States].”<sup>21</sup>

However, the purely internal USD clearing had one limit: BACB’s Bank B account needed occasional replenishing. In order to achieve this, BACB wired large amounts of U.S. dollars (bulk funds) from its dollar accounts at other banks to its account at Bank B. Initially, BACB used its accounts with two U.S. banks, but it soon switched to European banks. But this changed things only marginally. Just as the U.S. banks, the European banks used the standard procedure for a dollar transaction: It transferred the dollar amounts via the U.S. correspondent banking system.

According to the settlement document, 72 bulk funding transactions totaling 1.97 billion dollars over a period of four years *corresponded* with several hundred Sudan-related payments totaling slightly more than the 1.97 billion dollars during the same date range.<sup>22</sup> The *correlation* between the bulk transactions processed *in* the United States and the single transactions processed *outside* the United States formed the jurisdictional basis for BACB’s sanctions liability in terms of “directly or indirectly exporting services *from* the United States”.<sup>23</sup>

### 3.3 Subsequent Transfers by Non-Sanctioned Clients

The French Bank Union de Banques Arabes et Françaises (UBAF) provides another case study on how a transaction in U.S. dollars outside the United States will be pulled into U.S. jurisdiction because of its *correlation* with a transaction which was processed inside the United States.

The UBAF settlement includes several types of transactions which are of interest from a jurisdictional point of view.<sup>24</sup> One type of transaction regarded internal dollar transfers between two UBAF clients: one sanctioned Syrian client and one non-sanctioned

client. The transfers took place at UBAF France and therefore outside the United States. But following the internal transfer from the sanctioned client to the non-sanctioned client, UBAF instructed “one or more” dollar payments on behalf of the non-sanctioned client. According to the settlement document, these payments were “cleared” through a U.S. bank, and they “correlated closely” to the internal transfers between the sanctioned and the non-sanctioned client.<sup>25</sup> It remains unclear from the settlement release how “closely correlated” the U.S. processed payments and the internal bookings really were – and for how many of the relevant 45 transactions the close correlation was found. The settlement speaks of “one or more”.<sup>26</sup> This correlation was sufficient to pull UBAF into U.S. jurisdiction.

### 3.4 Back-to-Back Letters of Credit

The UBAF settlement includes another example for a jurisdictional claim based on the correlation theory. The example involves back-to-back letters of credit.<sup>27</sup> UBAF had issued two types of letters of credit on behalf of sanctioned Syrian entities: Either the sanctioned clients were beneficiaries of export letters of credit, or they were applicants for import letters of credit. Both instruments did not involve U.S. clearing – presumably, they were issued in Euro (given that UBAF is a French bank). However, the *intermediary* – i.e. the (non-sanctioned) party who was in charge of the second set of letters of credit – entered into or received one or more corresponding dollar-denominated letters of credit.<sup>28</sup> In other words: the non-USD letters of credit issued by UBAF were backed by USD letters of credit which had been issued by the

<sup>21</sup> BACB Settlement (note 18), at para. 14.

<sup>22</sup> *Id.*, at para. 22.

<sup>23</sup> *Id.*, at para. 23.

<sup>24</sup> Department of the Treasury, Enforcement Release (OFAC Enters into \$ 8,572,500 Settlement with Union de Banques Arabes et Françaises for Apparent Violations of Syria-Related Sanctions Program), 4 January 2021 [hereinafter USDT Release, UBAF Settlement]. The settlement resulted from a voluntary disclosure of apparent sanctions violations.

<sup>25</sup> USDT Release, UBAF Settlement (note 24), at 1.

<sup>26</sup> *Id.*; see also the critical note on this case by Peter Jeydel/Jack Hayes/Brian Egan, OFAC asserts Jurisdiction over French Bank’s Internal Transfers and Foreign Exchange Transactions, 15 January 2021, Steptoe International Compliance Blog (available online).

<sup>27</sup> A letter of credit is an instrument used in (international) trade to create more security among the trading partners. A “simple” letter of credit is a guarantee by a bank that a buyer’s payment will be received by the seller on time and in the correct amount. A back-to-back letter of credit involves two letters of credit which are used together. They come into play when there is an intermediary between the seller and the buyer or when the seller must first purchase the goods which he is selling.

<sup>28</sup> USDT Release, UBAF Settlement (note 24), at 1.

intermediary's bank. And because these letters of credit regarded the purchase or sale of the same goods as the first letters of credit issued by UBAF, the dollar transaction by the intermediary pulled UBAF into the U.S. sanctions jurisdiction.

### 3.5 Foreign Exchange Transaction in Non-USD

Lastly, the UBAF settlement includes a third example of "correlated transaction jurisdiction".<sup>29</sup> The bank conducted foreign exchange (FX) transactions on behalf of a sanctioned Syrian client (a Syrian bank) on its own books in France. These transactions did *not* involve U.S. dollars. As an example, such a transaction could be to debit the Euro account of the sanctioned client and credit the British Pound account of the same client. UBAF then conducted another FX transaction from its own account with a non-sanctioned third party, and this transaction was (again) *not* in U.S. dollars. As an example, the transaction could have been the exchange of British Pounds against Hong Kong Dollars. In summary and by way of example: UBAF internally exchanged Euros against British Pounds in the respective accounts of the sanctioned client. It then exchanged British Pounds against Hong Kong Dollars with a non-sanctioned third party by using its own account.

So where is the jurisdictional hook in this case? It lies in the fact that the second FX-transactions – although not involving U.S. dollars – were "cleared" in the United States, and that they "correlated closely" with the transactions regarding UBAF's sanctioned client.<sup>30</sup> Thus, even a non-U.S. dollar transaction can trigger a U.S. jurisdictional claim by way of clearing in the United States. A U.S.-cleared transaction is easily conceivable. UBAF could have used a regulated market (Nasdaq) or conducted an Over-the-Counter transaction with a U.S. counterparty through its U.S. correspondent accounts. Or the transaction could have been processed by the Continuous Linked Settlement (CLS) payment system. CLS is the world's largest international payment system. The company who manages the system and across whose accounts transactions are settled is CLS Bank International, a New York-based bank regulated by the Federal Reserve Bank of New York.<sup>31</sup>

## 4. Special Case: Misrepresenting a Corporate Connection (Huawei)

The most far-reaching case of U.S. jurisdictional assertion to date may well be the case of Huawei's *Meng Wanzhou*. The official wording is that *Meng* had a "principal role in a perpetrating scheme to defraud a global financial institution" and that "as a result the financial institution continued to do business with Huawei in violation of U.S. law."<sup>32</sup>

The saga of *Meng Wanzhou* and the background of the extradition proceeding would fill a several books. Much of it would be about geopolitics. Other aspects would include the role of banks who, like HSBC, are operating under a Deferred Prosecution Agreement with U.S. authorities and are keen on co-operating to the widest extent possible. One way to tackle this complex story is to start with Skycom. Skycom was a Hong Kong based telecommunications company who primarily operated in Iran. Between 2010 and 2014, Skycom was engaged with a UK staffing company to provide engineers in Iran to support Skycom's work there. To pay the Iran-based contractors, Skycom sent a total of about USD 7.5 million to the UK staffing company's bank in the UK from its HSBC account in Hong Kong. The payments were cleared in the U.S. by HSBC New York. It is alleged (although not clearly stated) that the Iran operations were in violation of U.S. sanctions law.

In late 2012 and early 2013, news organizations reported that Skycom was engaged in transactions which potentially violated U.S. export controls law. The allegations were not about the staffing company, they regarded the sale of "embargoed" computer equipment from U.S.-based HP. Also, as the news organizations reported and as was later confirmed: Skycom was wholly owned by a Huawei subsidiary and was therefore controlled by Huawei.

Enters *Meng Wanzhou*. *Meng* had been the Secretary of the Huawei subsidiary which wholly owned Skycom. She had also briefly been on the board of Skycom. The news about Skycom and Huawei prompted HSBC, who provided global banking services for Huawei, to inquire about this connection. In response

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> On the CLS group, see <[www.cls-group.com](http://www.cls-group.com)>.

<sup>32</sup> U.S. Department of Justice, Office of Public Affairs, Press Release (Huawei CFO Wanzhou Meng Admits to Misleading Global Financial Institution), 24 September 2021 [hereinafter DOJ Release, *Meng Admits to Misleading Global Financial Institution*].

to this enquiry, *Meng* made the false representation to an executive at HSBC Hong Kong that Skycom and Huawei maintained a normal business relationship. The representation was accompanied by a Power Point presentation.

*Meng's* false representation, made in 2013 in the Hong Kong office of HSBC vis-a-vis a senior HSBC executive, is the sole basis of the enforcement action against *Meng* which led to her arrest in December of 2018. It is not alleged that *Meng* personally instructed dollar-denominated transactions by Skycom. The argument is that by misrepresenting Huawei's relationship to Skycom, *Meng* caused HSBC to continue its relationship with Huawei when HSBC would otherwise have terminated this relationship: "The truth about Huawei's business in Iran, which *Meng* concealed, would have been important to the financial institution's decision to continue its banking relationship with Huawei."<sup>33</sup>

## 5. Financial Institutions as First Line of Defense

The U.S. dollar is the world's most frequently used currency in global trade.<sup>34</sup> This dominance greatly enhances the ability of the United States to ensure compliance with its financial sanctions framework. As the examples in this chapter show, foreign parties who transact in U.S. dollars will not be shielded from a U.S. jurisdiction claim even when the originator and the receiver of the payment are located outside the United States. This is because, as a standard procedure, U.S. dollar payments are processed via the U.S. correspondent banking system. In the view of the U.S. authorities, this constitutes conduct which triggers U.S. domestic jurisdiction. By relying on the concept of the "correlated transaction", the U.S. have expanded the jurisdictional claim even further: If a U.S.-processed transaction can be linked to a sanc-

tioned party, however tenuous this link may be, the U.S. will assert jurisdiction. In addition, the role of the U.S. as a major financial center means that the U.S. also play a key role in the foreign exchange market. Thus, a U.S. clearing can take place even for currency exchanges which are not denominated in U.S. dollars.

When foreign parties send and receive dollar-denominated payments, they will do so by using their domestic banks. This puts non-U.S. banks in the cross-hairs of U.S. authorities: "Financial institutions are our first line of defense in maintaining the safety and security of the U.S. financial system."<sup>35</sup> This statement, taken from the public release of the *Meng Wanzhou* settlement, makes it clear that the United States see a role for *all* financial institutions when it comes to the enforcement of unilateral U.S. sanctions.

## III. The Territorial Nexus of Dollar-Denominated Payments

The way in which the territorial nexus of U.S. dollar payments is described in the various settlement documents differs. The enforcement actions based on the use of the U.S. financial system invariably involve a U.S. correspondent account. The terminology itself varies. Some cases speak of U.S. dollar payments which were "cleared"<sup>36</sup> or "processed"<sup>37</sup> in the United States; others mention that the payments in question "passed through"<sup>38</sup> the United States. But how exactly is the U.S. financial system *used* in the case of a dollar-denominated payment via the U.S. correspondent banking system? In other words: What happens on American soil? In order to understand what conduct takes place in the event of a transaction via the U.S. correspondent banking system, it is helpful to keep in mind how such a transaction usually works.

<sup>33</sup> DOJ Release, *Meng Admits to Misleading Global Financial Institution* (note 32), at 1.

<sup>34</sup> According to a Federal Reserve Bank study regarding the period 1999–2019, the dollar accounted for 96% of trade invoicing in the Americas, 74% in the Asia-Pacific region, and 79% in the rest of the world. The only exception is Europe, where the euro is dominant and the market share of the U.S. dollar was 23% in the relevant time period. Carol C. Betraut/Bastian von Beschwitz/Stephanie E. Curcuru, *The International Role of the U.S. Dollar*, FEDS Notes, 6 October 2021 (available online).

<sup>35</sup> DOJ Release, *Meng Admits to Misleading Global Financial Institution* (note 32), at 1.

<sup>36</sup> See Deferred Prosecution Agreement, Attachment A, Statement of Facts, *United States v. Wanzhou Meng*, Cr. 18-457 (S-3) (AMD) (EDNY 2021), 2 *et seq.*

<sup>37</sup> See USDT Release, *UBAF Settlement* (note 24), at 1.

<sup>38</sup> See BNPP, *Statement of Facts* (note 8), at para. 53.



## 1. Example: Standard U.S. Correspondent Transaction

Let us assume that A has a bank account with Bank AX in Switzerland and B has an account with Bank BY in Spain. A wants to transfer a U.S. dollar amount from his AX account in Switzerland to B's BY account in Spain. If one discounts the theoretical possibility that an employee of Bank AX travels to Spain with a suitcase full of dollar banknotes and delivers the suitcase to Bank BY, the standard way to execute the payment is through the U.S. correspondent banking system.

## 2. The Role of U.S. Correspondent Banks

The standard procedure to process the dollar payment described in the example above is that both banks use the services of their respective U.S. correspondent banks. In very general terms, correspondent banking is "the provision of banking services by one bank (the correspondent bank) to another bank (the respondent bank)".<sup>39</sup> More specifically and in the context of dollar-denominated payments, a correspondent banking arrangement means that a foreign respondent bank has an account with a U.S. correspondent bank for payment purposes. This account is called a *nostro* account from the respondent bank's point of view, as it reflects what the correspondent bank owes to the respondent bank.

### 2.1 The Transfer Mechanism

When a foreign bank wants to make a USD payment to another foreign bank, it will instruct its U.S. correspondent bank to transfer the funds to the U.S. correspondent bank of the receiving bank. By issuing a payment instruction, the foreign bank authorizes its U.S. correspondent to debit its *nostro* account in the amount of the transferred funds. The funds are then received by the U.S. correspondent of the receiving bank and credited to the receiving bank's *nostro* account.

In our example, the Swiss Bank AX and the Spanish Bank BY (the respondent banks) each have an account with a U.S. bank for payment purposes – Bank ACorr in the case of Bank AX and Bank BCorr for

Bank BY. In order to go forward with the payment on behalf of its customer A, Bank AX will instruct its U.S. correspondent bank ACorr to transfer the required amount to BY's U.S. correspondent Bank BCorr. This is an authorization to debit AX's *nostro* account at Bank ACorr. Once the transfer has taken place, BCorr will credit Bank BY's *nostro* account. Finally, Bank BY will ensure that customer B's account in Spain will reflect the amount Bank BY received on its *nostro* account in the U.S.<sup>40</sup> Accordingly, customer B's account in Spain will show a fund entry (credit).

In our example, we are assuming that Bank AX and Bank BY have a correspondent bank account. This is obviously not the case for all foreign banks. If a foreign bank lacks a correspondent banking relationship with a U.S. bank, it needs to partner with a bank who does. Most likely, it will be an internationally active bank in the same country. These transactions happen outside the United States and are not relevant for the question regarding what action takes place within U.S. territory.

We have also suggested in our example that the U.S. correspondent banks ACorr and BCorr are banks who have no specific corporate ties with their foreign account holders. Even if Bank ACorr were a subsidiary of Bank AX and Bank BCorr were a branch of Bank BY, this would not make a difference from the point of view of the territorial nexus. The actions are still taken by a local U.S. financial institution.

Finally, customer A and customer B are said to have accounts in two different non-U.S. countries, Switzerland and Spain. In fact, the same pattern is likely to be followed if customer A and customer B are next door neighbors.

### 2.2 The Territorial Nexus

So, what happens on American soil in the event of a dollar-denominated payment? The answer is: quite a bit. As was shown above, the U.S. dollar payment takes place between two U.S. correspondent banks, and the funds which are transferred are held in the United States: They originate in a U.S. bank account and terminate at a U.S. bank account. Thus, the process occurs *inside* the United States. The image of a payment which originates in a foreign country, then "enters" the United States and "leaves" the United

<sup>39</sup> Bank for International Settlements, Committee on Payments and Market Infrastructures, *Correspondent Banking* (2016), 9 (available online).

<sup>40</sup> We are disregarding the (sometimes quite egregious) fees that this transfer will generate.

States again to reach its final destination in a foreign country is not an accurate one. Rather, the payment process operates as a closed circuit, and the funding of a correspondent bank account is achieved by payments which originate in the United States. Outside the United States, the foreign banks will of course take the U.S. transactions into account. But this is an internal booking process handled by the foreign bank; neither the debiting nor the crediting of a correspondent bank account triggers a “real” cross-border money transfer to or from the United States. If the ultimate beneficiary of a U.S. dollar transaction were to ask for the payment in cash at his foreign bank, the cash would not be in the bank’s vault because it was sent there as a result of that specific transaction.

In sum, a U.S. dollar payment involves the activity of at least two U.S. banks and the transfer of funds held in U.S. bank accounts. Also, these funds do not leave the United States. Rather, they remain in the United States and are used for further U.S. dollar transactions. Undoubtedly, this process creates numerous connection points to the United States territory. On the other hand, the separation of the U.S. payment process from the foreign payment process works both ways: If the U.S. processing of a payment is a wholly internal affair, the payment process outside the United States is a wholly separate affair as well. And if the funds transferred in the United States remain in the United States, they do not *directly* benefit a recipient outside the United States. In other words: Dollar payments which are processed *in* the United States do not flow *from* the United States territory to the foreign recipient.

### 3. The Role of the U.S. Interbank Payment System

It was mentioned above that the transfer of the dollar amount reflecting the original payment instruction by customer A of Swiss Bank AX will take place between two U.S. correspondent banks. The two U.S. banks need to be linked by an intermediary to execute the payment. If one discounts the unlikely possibility that both ACorr and BCorr maintain a bank account at a third U.S. bank and use these accounts to transfer money among themselves, the intermediary function will be provided by an interbank payment system. The U.S. has three such systems: Fedwire, the Clearing House Interbank Payment System (CHIPS), and the Automated Clearing House (ACH). In the

context of international payments, only Fedwire and CHIPS play a significant role; ACH is primarily used for domestic low-value transactions such as pre-authorized customer transactions, check conversions and e-commerce transactions.<sup>41</sup>

#### 3.1 Fedwire

Fedwire Funds Service (Fedwire) is an interbank payment system operated by the twelve U.S. Federal Reserve Banks which together form the United States Central Bank system.<sup>42</sup>

To process a payment via Fedwire, both the sending and receiving bank must hold an account with a Federal Reserve Bank. The sending bank can then issue a payment order to its Federal Reserve Bank. The order itself will be processed by Fedwire. The bank identified on the payment instruction as the receiving bank will be credited by the Federal Reserve Bank that holds the receiving bank’s account. In (very) simple terms: The Federal Reserve Banks operate as one bank for the participating banks with the help of the Fedwire system. This allows for an internal account-to-account transfer of funds.

Federal Reserve accounts can be obtained by national or state banks<sup>43</sup> and by branches or agencies of foreign banks.<sup>44</sup> Returning to our example, the two foreign banks, AX Bank (Switzerland) and BY Bank (Spain) do not have a Federal Reserve account and cannot directly participate in the Fedwire system from outside the United States. They can only access the Fedwire payment system through their U.S. correspondent banks.

As will be explained below, international payments are more likely to be processed via CHIPS than

<sup>41</sup> James McAndrews, *The Automated Clearinghouse System: Moving Toward Electronic Payment*, in: Federal Reserve Bank of Philadelphia, *Business Review*, July/August 1994, 15–23, 16; *see also* The Federal Reserve, *Automated Clearinghouse Services* (available online).

<sup>42</sup> For an overview *see* Hal Scott/Anna Gelpern, *International Finance, Transactions, Policy and Regulation*, 23<sup>rd</sup> Edition (2020), 714 *et seq.*

<sup>43</sup> Section 19b (1) (A) (i) of the Federal Reserve Act; Section 3a (1) (A) of the Federal Deposit Insurance Act.

<sup>44</sup> 12 U.S.C. § 347d; the debate on who is entitled to hold an account at one of the twelve Federal Reserve Banks (so called master account) is still ongoing today. *See* Board of Governors of the Federal Reserve System, *Press Release, Proposed Guidelines for Evaluating Account and Services Requests*, 5 May 2021 (available online).

via Fedwire. Nevertheless, payments can be processed via Fedwire as well. In terms of conduct taking place within U.S. territory, a Fedwire transfer means that one or two Federal Reserve Banks and a U.S. interbank payment system have provided services. In the unlikely event that ACorr or BCorr do not have a Fed account, a Fedwire transfer will require that ACorr or BCorr partner with a bank who has such an account. In connection with the question of conduct within U.S. territory, this would add another service by another U.S. actor to the list.

### 3.2 Clearing House Interbank Payment System (CHIPS)

Whereas Fedwire is primarily focused on domestic payments, the Clearing House Interbank System (CHIPS) is the primary interbank system used to clear and settle international high value U.S. dollar wire payments.<sup>45</sup> Approximately 70 per cent of all CHIPS payments originate outside the U.S.<sup>46</sup>

To process a payment via CHIPS, both the sending and receiving banks must be CHIPS participants. In highly simplified terms, the service that CHIPS provides consists in the provision of a computer algorithm that acts as an intermediary between all CHIPS participants and is programmed to efficiently identify and mutually offset matching payment orders during

the business day.<sup>47</sup> This allows the system to consolidate all pending payments into fewer single transactions as soon as the payment orders have been matched. This process is called intraday netting.<sup>48</sup>

CHIPS is a privately owned payment system.<sup>49</sup> The liquidity to facilitate the working of the intraday netting system must be provided by CHIPS participants themselves. Each day, each CHIPS participant is required to deposit a predetermined amount (security deposit) into a designated CHIPS account.<sup>50</sup> This is where the Federal Reserve gets involved once again: These CHIPS accounts are maintained by the Federal Reserve Bank of New York (FRB-NY). Thus, the main way for CHIPS participants to prefund their CHIPS accounts at FRB-NY is via a Fedwire transfer. This implies that CHIPS is not only a competitor, but also a customer of Fedwire.

CHIPS participation is only granted to national or state banks<sup>51</sup> and to U.S. branches and agencies of foreign banks.<sup>52</sup> Returning to our example, the two foreign banks AX (Switzerland) and BY (Spain) cannot directly access CHIPS from outside U.S. territory. Rather, they must (again) rely on the services of their U.S. correspondent banks ACorr and BCorr, who are likely to be CHIPS participants.

In sum, an international payment via CHIPS triggers conduct by a number of actors who are located in the United States: First, there is a sending and a receiving U.S. correspondent bank and their transaction via CHIPS. But there is more activity in the background: The CHIPS participants must have an account with the New York Federal Reserve Bank, and this account is funded via Fedwire, the other interbank payment system – one which involves the respective Federal Reserve Bank of the two U.S. correspondent banks.

<sup>45</sup> In 2021, CHIPS processed over 500 000 transactions worth an aggregate of USD 1.7 trillion on an average business day with the average transaction amount exceeding USD 3.5 million. A summary of annual CHIPS activity from 1970 to the last calendar year is available online at <[www.theclearinghouse.org](http://www.theclearinghouse.org)>. On a technical level, any CHIPS transaction could also be handled by Fedwire. Still, financial institutions often transfer a payment via CHIPS due to the systems' cost structure. CHIPS places a higher up front fixed-cost burden on participants but these costs are offset by a lower transaction cost. Therefore, high volume users – especially international financial institutions with little domestic U.S. business – generally prefer CHIPS. See Robert T. Clair, *The Clearinghouse Interbank Payments System: A Description of its Operation and Risk Management*, Federal Reserve Bank of Dallas, Research Paper (1989), 23 *et seq.*

<sup>46</sup> See The Clearing House, *CHIPS – Public Disclosure of Legal, Governance, Risk Management and Operating Framework*, 3 June 2020, 5 (available online) [hereinafter CHIPS, Public Disclosure]. The approximation is based on the data of the fourth quarter of 2019.

<sup>47</sup> A “payment order” is an electronic message that, when released, instructs the receiving bank to pay or cause another bank to pay a fixed amount of money to a beneficiary.

<sup>48</sup> CHIPS, Public Disclosure (note 46), at 15.

<sup>49</sup> CHIPS is wholly owned by The Clearing House Payments Company L.L.C.

<sup>50</sup> CHIPS, Public Disclosure (note 46), at 6.

<sup>51</sup> 12 U.S.C. § 4402 (9).

<sup>52</sup> Rules Governing the Clearing House Interbank Payment System, Article 19 (a) and (b).

### 3.3 The Territorial Nexus

The interbank payment system provides another layer of connection points to the United States territory: Both systems are located in the United States and their use requires a permanent local presence. In this regard, the U.S. payment system is not exceptional in its participation requirements: Domestic interbank payment systems generally require financial institutions to have a permanent presence in order to become direct participants. For instance, to access the European Union's core payment system TARGET2, a financial institution must either be incorporated, or have a permanent presence in the European Economic Area (EEA).<sup>53</sup> Similarly, the Swiss payment system SIX Interbank Clearing System (SIC) is, in general terms, reserved for financial intermediaries under the supervision of the Swiss financial authorities – and this requires a permanent presence in Switzerland.<sup>54</sup>

With regard to the question of territorial conduct, both interbank payment systems provide for the clearing and settlement of the (foreign originated) payments. The U.S. authorities often use the term “clearing”<sup>55</sup> and do not mention the term “settlement”.<sup>56</sup> However, clearing and settlement are necessarily linked. A transaction cannot be final<sup>57</sup> until it is settled, and settlement cannot take place before the transac-

tion has been cleared.<sup>58</sup> And if one considers the mechanisms employed by Fedwire and CHIPS, it is evident that they provide both functions.

Fedwire is a real-time gross settlement system (RTGS). This means that Fedwire immediately issues an irrevocable transfer of central bank money from the sending bank to the receiving bank for every individual payment order that it receives during its operating hours.<sup>59</sup> Therefore, clearing and settlement happen (almost) simultaneously. This simultaneity is why, oftentimes, both terms are used interchangeably.

CHIPS, on the other hand, is a classic example of a net settlement system. As we have already seen in the previous chapter, the CHIPS algorithm matches and offsets compatible payment orders. This clearing process then results in the calculation of a so called “net position” which is then settled in one single payment later in time. Accordingly, the clearing and settlement of a CHIPS transaction take place after each other.

In sum, the conduct by U.S. interbank payment systems in the United States encompasses the clearing and the settlement of the payment instructed by the foreign bank.

## 4. Conduct in the United States

In a standard setting, a dollar-denominated payment will involve multiple service providers acting inside the United States, even if the originator and the receiver of the payment are located abroad. This is because virtually all dollar-denominated payments are processed via the U.S. correspondent banking system. The processing of the payment encompasses the activity of a sending and a receiving U.S. correspondent bank and the transfer of the funds via the interbank payment system, which, in turn, involves several Federal Reserve banks and often both the Fedwire and the CHIPS system.

It has also become evident that a foreign bank cannot leapfrog into the U.S. payment system and avoid the contact with U.S. correspondent banks. The use of the payment system is reserved for members – and membership is reserved for U.S. financial

<sup>53</sup> See European Central Bank, Information Guide for TARGET2 users, Version 15.0, November 2021, 49 (available online).

<sup>54</sup> For further information on the technical features of SIC, see Swiss National Bank, The Swiss Interbank Clearing (SIC) payment system, November 2019, 3 *et seqq.* (available online).

<sup>55</sup> The term “clearing” describes the first stage in the payment process. It includes the transmission, reconciliation and, in some cases, confirmation of payment orders. See Committee on Payment and Settlement Systems, A glossary of terms used in payments and settlement systems (2015) (available online).

<sup>56</sup> “Settlement” refers to the final stage of a payment process, i.e. the actual transfer of funds from the originator's bank account to the receiver's bank account. See Bruce J. Summers/R. Alton Gilbert, Clearing and Settlement of U.S. Dollar Payments: Back to the Future?, in: Federal Reserve Bank of St. Louis Review, September/October 1996, 3–27, 6.

<sup>57</sup> The moment when a transaction becomes legally irrevocable is referred to as settlement finality. See David Mills *et al.*, Distributed ledger technology in payments, clearing, and settlement, Divisions of Research & Statistics and Monetary Affairs, Federal Reserve Board, Finance and Economics Discussion Series, No. 095, December 2016, 5.

<sup>58</sup> Scott/Gelpert (note 42), at 752; Dominique Rambure/Alec Nacamuli, Payment Systems – From the Salt Mines to the Board Room (2008), 5 *et seq.*

<sup>59</sup> Christian Vital, The Architecture of Real Time Gross Settlement Systems, in: SNB (ed.), Geld, Währung und Konjunktur (Quartalsheft), 1997/4, 319–337, 319.



institutions or U.S. branches of foreign financial institutions.<sup>60</sup>

Let us repeat that we do not address the question whether this link is sufficient to actually *justify* jurisdiction under international customary law. In fact, we are of the opinion that the processing of a payment in the United States does not meet the test of a substantial territorial connection. Our aim is to explain what actually happens within the United States, i.e. what actors and what conduct are involved when an international dollar transaction on behalf of a foreign bank takes place.

#### IV. Breaking the Nexus by Using Offshore Payment Systems?

So far, we have found that, as a standard procedure, dollar-denominated payments will be processed in the United States. Furthermore, the U.S. authorities pull almost any U.S. dollar transaction into U.S. sanctions jurisdiction via the concept of the “correlated transaction”.<sup>61</sup>

What we have thus far not considered is whether it is possible to avoid the territorial nexus to the United States altogether by processing U.S. dollar payments via a payment system located outside U.S. territory. In other words: Could a foreign Central Bank or a foreign private provider set up an offshore payment system for a foreign currency – notably the U.S. dollar? And if it is possible to avoid the territorial nexus by conducting (large) U.S. dollar transactions completely outside the U.S. territory in a regular transaction process: Might there be other jurisdictional links which will operate as a substitute for the territoriality nexus?

##### 1. Non-U.S. Central Banks

We have seen in our brief rundown of Fedwire and CHIPS that both systems only process payments denominated in U.S. dollars. This is not unusual. In fact, the vast majority of payment systems worldwide will only process one currency and only operate within the territory where the currency in which it is denominated is recognized as legal tender.<sup>62</sup> But what is the

reason for this restriction? Why could a Non-U.S. Central Bank not launch another payment system that is denominated in U.S. dollars?

The first reason is practicality. The operation of a full payment system requires huge reserves in the currency that is being processed. Only the Central Bank which issues that currency will have the capacity to put these reserves at the disposal of the participants of the payment system.

In addition (and even more importantly): No national government would allow the vast operation of such a parallel system outside its jurisdiction. Central Banks have the monopoly on their “own” currency because this is how they conduct the monetary policy. They can tighten the money supply or expand it, and thus maintain price stability. If a payment system is operated outside of the Central Bank’s reach, and this payment system operates on its own reserve of the foreign currency, it could interfere with the monetary policy of the Central Bank.<sup>63</sup>

Finally, Central Banks have the legal mandate to provide payment systems for *their* currency, and not for any other currency.<sup>64</sup> Therefore, they simply lack the incentive to operate additional payment systems in foreign currencies when these systems have already been established by the relevant Central Bank and are accessible via correspondent banks.

##### 2. Other Offshore Payment Systems

Whereas most payment systems involve a central bank, there are also some that are privately operated, as we have previously seen in the example of CHIPS. With regard to the U.S. dollar, there even exist *official* U.S. dollar payment systems outside the U.S. territory. These so-called “offshore payment systems” are located in Hong Kong, Singapore, Manila, and Tokyo.

In addressing the question of whether a U.S. territorial nexus can be avoided by transferring funds

<sup>60</sup> See III.3.3 (The Territorial Nexus).

<sup>61</sup> See II. (Dollar-Based Jurisdiction in Action).

<sup>62</sup> See *Rambure/Nacamuli* (note 58), at 43.

<sup>63</sup> For further information on the history of central bank objectives, see C. A. E. Goodhart, The changing role of central banks, in: *Financial History Review*, Vol. 18 No. 2, August 2011, 135–154, 135 *et seqq.*

<sup>64</sup> The legal basis of the Federal Reserve’s monetary policy tasks is stated in Article 2A of the Federal Reserve Act. With regard to the Swiss National Bank, these tasks are laid down in Article 99 of the Federal Constitution and in Article 5 of the National Bank Act, and for the ECB, these objectives are set out in Article 2 of the Statute of the European System of Central Banks and of the European Central Bank.

via these offshore systems, a special focus will be given on the Hong Kong U.S. dollar payment system USD-CHATS, which played a prominent role in the defense strategy during the extradition proceeding of Huawei's CFO *Meng Wanzhou*.

## 2.1 Hong Kong

In the *Meng Wanzhou* extradition case, the basis for the U.S. jurisdictional assertion was that the payment instructions which originated at Skycom's HSBC account and were directed to the U.K. staffing company's U.K. bank account were *cleared* by HSBC's New York subsidiary.<sup>65</sup>

As part of their defense strategy *Meng's* attorneys claimed that bank customers are never in a position to dictate how their banks technically process payments. It was therefore not reasonable to expect that *Meng* as HSCB's customer was ever in a place to cause or prevent HSBC from using its U.S. correspondent bank to process the payment. Moreover, *Meng's* defense also claimed that it would have been possible for HSBC to avoid any jurisdictional links to the United States by processing the payment via USD-CHATS in Hong Kong.<sup>66</sup> But is this true? Could a transaction via USD-CHATS have sufficiently loosened the USD payments' territorial nexus? To answer this question, we first need to take a brief look at how Hong Kong's USD-CHATS payment system is set up.

USD-CHATS is a separate, closed-circuit branch of Hong Kong's RTGS payment system CHATS. The system is fully owned by HSBC Hong Kong, who was also appointed to be its settlement institution by

Hong Kong's Central Bank HKMA.<sup>67</sup> HSBC itself is headquartered in London.<sup>68</sup>

In order to directly process a payment via USD-CHATS, a bank must maintain a settlement account with HSBC Hong Kong.<sup>69</sup> During the business day, all USD-CHATS transactions are then continuously settled in the books of HSBC Hong Kong, as long as there is a sufficient balance on the sending bank's settlement account.<sup>70</sup> To mitigate credit risk, HSBC Hong Kong provides intraday dollar liquidity for all direct USD-CHATS participants. This is made possible with the help of HSCB New York. HSCB New York is a sister company of HSBC Hong Kong and HSBC Hong Kong's U.S. correspondent bank. All members who receive intraday liquidity must repay HSBC New York at the end of the day by sending funds to its CHIPS account at the Federal Reserve Bank of New York.<sup>71</sup> In a second step, HSBC New York then credits HSBC Hong Kong's USD nostro account with the received funds.

Before we return to the Huawei case, let us summarize: USD-CHATS is a privately operated USD payment system. Settlement is provided in the books of HSBC Hong Kong. HSBC Hong Kong also provides direct USD-CHATS participants with intraday liquidity that must be repaid at the end of each business day via the CHIPS account of its U.S. correspondent Bank HSBC New York.

So, is it possible to avoid a territorial nexus to the United States by processing the payment via USD-CHATS? Technically speaking, the answer is "yes". As

<sup>65</sup> See II.3 (Special Case: Misrepresenting a Corporate Connection [Huawei]).

<sup>66</sup> Chance Bridge Partners, Part 3 of 4 – The Defense of Huawei CFO Meng Wanzhou (note 1), at 4.

<sup>67</sup> Committee on Payment and Settlement Systems (CPSS), Payment Systems in Hong Kong, in: Red Book – Payment, clearing and settlement systems in selected countries, April 2003, 183–211, 197 [hereinafter CPSS, Payment Systems in Hong Kong]; Hong Kong Monetary Authority (HKMA), Assessment of US Dollar CHATS against the Principles for Financial Market Infrastructures, June 2016, 4 (available online) [hereinafter HKMA, USD-CHATS Assessment]; Morten L. Bech/Umar Faruqi/Takeshi Shirakami, Payments Without Borders, in: Bank for International Settlement Quarterly Review, March 2020, 53–65, 55.

<sup>68</sup> For HSBC's material legal entities, see <www.hsbc.com>. Regarding CHATS, see CPSS, Payment Systems in Hong Kong (note 67), at 197; HKMA, USD-CHATS Assessment (note 67), at 4; Abely (note 9), at 61 *et seq.*

<sup>69</sup> The system also accepts overseas members, as long as they are approved by the HKMA and HSBC Hong Kong, see HSBC, Principles for Financial Market Infrastructures: Disclosure for USD CHATS, 5 (available online).

<sup>70</sup> CPSS, Payment Systems in Hong Kong (note 67), at 197.

<sup>71</sup> *Id.*

long as a bank does not receive intraday liquidity via HSBC New York, U.S. dollar payments processed from one foreign bank to another via USD-CHATS do not trigger any conduct on U.S. territory. However, as soon as a bank receives intraday liquidity, a territorial nexus will be established because the receiving bank must repay the funds to HSBC via HSBC New York's CHIPS account. As we have already explained, a CHIPS transaction triggers the conduct of a number of actors who are located *in* the United States.

Now, what does this mean with regard to Hua-wei? Here, the situation is even more complex because HSBC Hong Kong is (1) the USD-CHATS' settlement institution, and (2) it served as Skycom's commercial bank. It is not clear whether HSBC Hong Kong maintains a separate settlement account for its own clients' CHATS transactions, or whether intraday liquidity is automatically provided via its correspondent account with HSBC New York. The second approach seems to be the more plausible one.

Payment systems are highly technical. Also, the U.S. authorities are likely to assert jurisdiction even if no intraday liquidity was provided via a New York correspondent bank. However, the point here is to show that even a system that appears, at first glance, to be completely detached from the United States, might still require services provided by U.S. entities *within* U.S. territory to properly operate on a daily basis.

## 2.2 Manila

The Philippine Domestic Dollar Transfer System (PDDTS) in Manila is a privately owned<sup>72</sup> RTGS payment system used to transfer U.S. dollars from one Philippine bank to another without using a U.S. correspondent bank.<sup>73</sup> The settlement for all PDDTS transactions is provided by Citibank's Philippine Branch (Citibank Manila).<sup>74</sup>

Citibank is a U.S. bank.<sup>75</sup> Since a branch is not a separate legal entity, Citibank's Philippine branch can

be considered as U.S. person under customary international law – it certainly is considered as such under the U.S. sanctions regime.<sup>76</sup> But this personal jurisdiction does not extend to the branch clients. Also, the question addressed here is whether there is a territorial nexus between Citibank Manila's clients and the United States. This largely depends on the details of the payment process. Whereas the settlement for all PDDTS transactions is provided by Citibank Manila,<sup>77</sup> it is very likely that the intraday liquidity is provided by Citibank USA. This means that some territorial nexus remains, although this nexus is weak. In practical terms, a U.S. bank will have a full-fledged sanctions screening in place, so that a large-scale avoidance of the U.S. sanctions regime via the Manila offshore dollar payment system is hardly conceivable.

## 2.3 Tokyo

In Japan, dollar-denominated payments can be processed via JP Morgan Chase's<sup>78</sup> private Tokyo Dollar Clearing (TDC) Services.<sup>79</sup> Final Settlement is guaranteed by JP Morgan Chase's New York branch.<sup>80</sup> Like CHIPS, TDC is a net settlement system. This means that at the end of every business day, JP Morgan Chase's Tokyo branch calculates every participant's net position and forwards them to Chase New York where they are finally settled via internal bookings or through one of the U.S. payment systems.<sup>81</sup>

When compared to the offshore system in the Philippines, the U.S. nexus appears to be more pronounced for payments made via the TDC system in Tokyo. This is because settlement for net positions is facilitated directly by Chase's New York branch. The bank might even use U.S. interbank payment systems for settlement purposes. In sum, this is almost the same situation (from a territorial point of view) as if

and existing under the laws of the U.S. (Certificate of Incorporation available at <[www.citigroup.com](http://www.citigroup.com)>).

<sup>72</sup> The system is operated by the Bankers Association of the Philippines (BAP), the Philippine Central Depository (PCD) and the Philippine Clearing House Corporation (PCHC).

<sup>73</sup> *Wilhelmina C. Mañalac/Agnes M. Yap /Magno Torreja*, Real Time Gross Settlement System and its Implications for Central Banking, in: *Bangko Sentral Review*, January 2003, 23–38, 30.

<sup>74</sup> *Abely* (note 9), at 62.

<sup>75</sup> Citibank N.A. is a U.S. banking association wholly owned by Citigroup Inc. a bank holding company, also organized

<sup>76</sup> See e.g. C.F.R. § 560.314.

<sup>77</sup> *Abely* (note 9), at 62.

<sup>78</sup> JP Morgan Chase & CO is a multinational investment bank and financial services holding company incorporated in Delaware (Certificate of Incorporation available at <[www.jpmorganchase.com](http://www.jpmorganchase.com)>).

<sup>79</sup> *Scott/Gelpern* (note 42), at 742 *et seq.*

<sup>80</sup> See JP Morgan Chase & CO's material legal entities at: <[www.jpmorganchase.com](http://www.jpmorganchase.com)>.

<sup>81</sup> *Scott/Gelpern* (note 42), at 742 *et seq.*

a bank would transfer its USD payments “directly” via a U.S. correspondent bank.

## 2.4 Singapore

In Singapore, dollar-denominated payments can only be directly processed via the private U.S. Dollar Check Clearing System (USDCCS).<sup>82</sup> The system was launched to clear and settle USD-denominated checks drawn on banks in Singapore. As indicated by its name, the USDCCS only processes USD checks, therefore the system does not provide for the electronic transaction of funds.<sup>83</sup> Final settlement for all USDCCS transactions is facilitated by Citibank N.A (Citibank USA).<sup>84</sup>

Even if one disregards the fact that nowadays large sums are no longer transferred in the form of paper checks, the dollar payment system in Singapore still does not avoid a U.S. territorial nexus. Because here, too, a U.S. bank serves as the settlement institution, which immediately establishes the territorial nexus to the United States.

## 3. U.S. Nexus Remains

At the beginning of this chapter, we raised the question whether a Non-U.S. Central Bank or a foreign private provider could set up an offshore payment system for (large-volume) U.S. dollar transactions. And, if this were possible, whether these systems would allow the processing of dollar-denominated payments without a nexus to the U.S. territory.

As far as non-U.S. Central Banks are concerned, this is not a realistic possibility. To set up a dollar-based payment system is not part of their mandate, and they would not have the necessary currency reserves in the first place. Moreover, it would create significant political tensions if a foreign government were to interfere with another country’s currency monopoly by creating an offshore payment system in that country’s currency.

Privately operated payment systems would not be constrained by the typical Central Bank mandate, but they would encounter the same political and practical difficulties if they were to establish an independent offshore dollar payment system. In fact, the dollar payment systems described in this chapter all connect to a U.S. bank at some point – and this connection entails the access to the U.S. Federal Reserve Bank system. In Singapore and Tokyo the connecting point is the settlement, in Manila and Hong Kong it is the liquidity provision.

The fact that some territorial nexus persists for all U.S. dollar offshore systems is not surprising. These systems were established at a time when the electronic processing of U.S. dollar transactions via Fedwire was restricted to standard U.S. business hours.<sup>85</sup> Only the establishment of local offshore payment systems in Asia enabled dollar payments to be continuously processed during Asian opening hours as well. From a U.S. point of view, there was a strong financial and political incentive not only to establish these systems, but to provide them with sufficient liquidity by connecting them to the preexisting U.S. dollar systems as well. This political approval is the reason why all four systems are still referred to as *official* offshore U.S. dollar payment systems.

## V. Conclusion

The power to print the world’s dominant currency gives the United States enormous leverage in pursuing its geopolitical objectives. This is particularly evident in the sanctions context, where denominating a transaction in U.S. dollars has become tantamount to the application of domestic sanctions law even when the sending and the receiving party are located outside the United States.

As we have explained in this article, virtually all dollar-denominated transactions are processed by U.S. correspondent banks and the U.S. payment system. Offshore payment systems exist, but they all connect to the U.S. banking system at some point, albeit in varying degrees of intensity. The U.S. view is that the use of the U.S. payment system triggers U.S. sanctions jurisdiction. The “correlation theory” has extended the jurisdictional claim even further: ac-

<sup>82</sup> See CPSS, Payment Systems in Singapore, in: Red Book – Payment, clearing and settlement systems in the CPSS countries, Vol. 1, September 2011, 329–355, 331.

<sup>83</sup> For a detailed description of the USDCCS clearing and settlement process, see *Abely* (note 9), at 60 *et seq.*

<sup>84</sup> See Citibank’s material legal entities at: <[www.citigroup.com](http://www.citigroup.com)>.

<sup>85</sup> Today, the Fedwire business day begins at 9 p.m. ET on the preceding calendar day and ends at 7 p.m.



According to this theory, jurisdiction exists if a payment processed in the United States can be linked to a sanctions-related payment processed outside the United States. This casts a very wide net over international business relationships.

Using the dollar to extend the reach of American law is seen as an abuse of power by America's friends and foes alike. It is also an unlawful exercise of extra-territorial jurisdiction according to the predominant view in legal scholarship.

This article did not focus on the legality of the U.S. currency-based jurisdictional claim. Instead, it examined the mechanics of the payment process in order to understand the extent of the territorial con-

nection when an international transaction is denominated in U.S. dollars. Without any doubt, these connection points exist. However, a closer look at the payment mechanisms also revealed that the transfer of funds in the United States is detached and separate from the transfer of funds outside the United States: There is no direct flow of money from the U.S. territory to the parties which initiated and received the payment. Rather, the payment process in an international transaction consists of multiple actions in different territories. This puts the issue of the U.S. territorial nexus into another perspective – one which has to be examined further.