

BSA/AML and OFAC Compliance – Higher Stakes and Greater Consequences for Banks

BY KEVIN L. PETRASIC, MICHAEL A. HERTZBERG & CARLA LAROCHE

Since the start of the 2008 financial crisis, the Federal Banking Agencies (“FBAs”) have keenly focused on balance sheet issues, on both an institutional and systemic basis. As a consequence, supervisory attention directed at compliance areas such as enforcement of the Bank Secrecy Act (“BSA”), anti-money laundering (“AML”) laws, and regulations governing economic and trade sanctions issued by the Office of Foreign Assets Control (“OFAC”) has not been as prominent. About a year ago, this trend came to an abrupt halt and, since then, we have seen a number of high profile supervisory and enforcement actions involving BSA/AML compliance issues, and several notable OFAC-related compliance actions. These enforcement actions have been accompanied by a series of steadily increasing, stern warnings by regulators, both publicly and during examinations, indicating that BSA/AML and OFAC compliance issues are now central issues that the FBAs are extensively reviewing at all insured depository institutions (“IDIs”) and, most notably, at various card-based programs and money service businesses (“MSBs”) supported by IDIs. Financial institutions, from multinational bank holding companies to regional and community banks to non-bank financial services companies, should be prepared for stepped up scrutiny of their existing BSA/AML and OFAC compliance programs.

Headlines and details of some of the recent actions provide a compelling view of federal regulators’ current mind-set, as well as where we are heading with respect to the FBAs’ supervision and enforcement of our increasingly complex globalized financial system.

Recent High-Profile Enforcement Activity

In the aftermath of the 2008 financial crisis, the FBAs focus shifted from issues such as BSA/AML and OFAC compliance to activities directly related to the causes of the financial crisis, such as capital, credit quality, residential mortgage lending practices, the adequacy of loan loss reserves, and broader systemic issues highlighted by various provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. FBA enforcement actions related to BSA/AML violations dropped off significantly between 2007 and 2011, from over 40 per year in 2006 and 2007 to just seven in 2011.¹ Similarly, other than in 2008, the trend for OFAC-related enforcement actions has been relatively flat, although the amount of fines has escalated dramatically in recent years.² In the last year, however, the FBAs have indicated a renewed focus on BSA/AML and OFAC compliance. For example, in 2012, the FBAs brought approximately 30 significant enforcement actions involving BSA/AML violations, several of which included OFAC-related compliance issues as well.

This renewed focus on identifying and addressing deficiencies in BSA/AML and OFAC compliance programs has resulted in significant enforcement actions against several large multinational financial institutions, including the imposition of substantial Civil Money Penalties (“CMPs”) in certain cases. Among the more notable enforcement actions highlighting the FBAs’ interest in and attention to BSA/AML and OFAC issues are the following:

- In April 2012, the Office of the Comptroller of the Currency (“OCC”) entered into a consent cease and desist order with a national bank based on deficiencies in the institution’s BSA/AML compliance program.³ While the OCC action did not result in fines or other CMPs, the agency noted that the bank exhibited general weaknesses in its internal controls, independent testing and auditing, and due diligence of foreign correspondent bank customers. In addition, the agency was critical of the bank’s monitoring program, which resulted in the delinquent filing of Suspicious Activity Reports (“SARs”) for its remote deposit capture/international cash letter instrument transactions.

In order to address these concerns, the OCC directed the bank to take various corrective measures, including establishing an independent BSA/AML compliance team with clear responsibilities and authority- hiring an independent consultant to conduct an enterprise-wide assessment of the bank’s BSA/AML compliance program; developing an automated customer due diligence process; implementing an effective policy on the use of cash letter and remote deposit capture services; retaining an independent consultant to coordinate with examiners in reviewing account and transaction activity; and ensuring the bank’s compliance program is structured to vet and manage risks associated with new products, services, or lines of business.

- In a June 2012 settlement, characterized as the largest-ever settlement reached in an OFAC sanctions case, OFAC, the U.S. Department of Justice (“DOJ”), and the New York County District Attorney’s Office entered into an agreement with a bank that paid a \$619 million fine based on repeated violations dating back to the mid-1990s of the Cuban Assets Control Regulations and other OFAC programs.⁴ Complicating the picture for the bank were allegations that certain senior bank management was aware of and complicit in the activity and efforts to cover-up detection of the violations.

In addition to the fine, the settlement agreement required the bank to conduct a review of its OFAC policies and procedures and implementation, and a risk-focused sampling of USD payments to ensure that the bank’s OFAC compliance program is functioning effectively.

- In a similar settlement six months later with OFAC, DOJ, the New York State Department of Financial Services, and the New York County District Attorney’s Office, another bank paid \$132 million to settle civil liability claims based on payment practices that violated OFAC sanctions and related laws.⁵ As with the preceding case, bank conduct included aggravating factors highlighting deliberate and deceptive actions by bank personnel to circumvent relevant laws. Pursuant to the settlement, the bank was required to put in place and maintain policies and procedures to minimize the risk of recurrence of any such future conduct. In addition, the bank was required to consult and cooperate with OFAC in connection with the bank’s OFAC compliance review by the Board of Governors of the Federal Reserve System (“FRB”).

- In December 2012, in one of the most significant BSA/AML-related enforcement actions to date, the OCC and FRB entered into consent cease and desist orders and consent orders for CMPs of \$500 million and \$165 million, respectively, for BSA/AML violations by a national bank and its holding company and affiliates.⁶ Representing the largest combined bank settlement in U.S. history,⁷ the multi-agency settlement included \$1.9 billion in penalties against the bank and its holding company and affiliates levied by the OCC, the FRB, the U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN"), OFAC, and the DOJ.

In addressing BSA/AML deficiencies that the U.S. Treasury Department characterized as "particularly egregious," the magnitude of the combined agency response was, in large part, due to the institution's failure to heed the BSA/AML compliance requirements of a previous cease and desist order issued by the OCC in 2010.⁸ In particular, the OCC determined that the bank's BSA/AML program continued to fail in identifying, monitoring, and reporting illicit financial activities, which had a direct impact on the ability of law enforcement to combat transnational criminal activity.

Pursuant to the 2012 OCC and FRB orders, the bank and its holding company agreed to undertake various remedial actions to implement the necessary internal controls, staff training, and resources to assess BSA/AML violations in high-risk transactions; establish and maintain a BSA/AML compliance committee that meets at least monthly; and implement an enterprise-wide BSA/AML compliance program.

- In a more recent action in January 2013, the OCC entered into a consent cease and desist order with a national bank and its affiliates to address deficiencies in the bank's BSA/AML compliance program.⁹ In particular, the agency alleged that the bank failed to maintain an adequate BSA/AML compliance program to identify, monitor, and report suspicious activities in a timely manner. As with the OCC's April 2012 action, the OCC did not impose CMPs, but required the bank to improve its BSA/AML compliance programs and practices. In particular, the OCC order required the bank to develop an independent BSA/AML compliance staff, conduct a high-level risk review of all new products and services, automate its customer due diligence process, hire an independent consultant to review account and transaction activity to assess SARs compliance, and maintain independent audits of all BSA/AML-related activities.¹⁰

In addition to the above actions involving banks operating on a national and international basis, the FBAs have imposed significant CMPs for BSA/AML and OFAC violations against a number of smaller institutions, as well as individual officers and directors. These include:

- In November 2012, the FDIC and FinCEN not only imposed a \$15 million CMP on a state chartered bank for BSA/AML violations and sanctions but also worked with the state regulator and invoked the so-called "death penalty" by revoking the institution's charter. This action was prompted by significant BSA/AML violations involving inadequate internal controls, ineffective independent testing, the lack of a BSA officer to oversee day-to-day compliance activities, and unsatisfactory training of compliance personnel.¹¹

Similar to the multi-agency settlement in December 2012 (discussed above), the bank in this instance apparently repeatedly ignored "red flag indicators" regarding its third-party payment processors and violated its written BSA/AML compliance policy in accepting high-

risk payment processors and merchant customers. In addition, the FDIC and FinCEN were critical of what they described as the bank's ineffective monitoring of high-risk MSBs. In this regard, while the bank apparently conducted independent audits of its non-traditional banking products, services, and business lines, in the regulators' view the testing did not sufficiently and effectively identify high-risk transaction activity. Certainly, one of the complicating factors that did not help the institution was the fact that, from at least 2008 through May 2011, the bank did not have a BSA compliance officer to manage its BSA/AML program on a day-to-day basis.

As a result of these violations and other infractions, the State Banking Commissioner stripped the bank of its bank charter, and another institution purchased the bank's assets and liabilities the same day the CMP was imposed.

- In a series of actions against the officers and directors of a bank in January 2013, the OCC issued personal cease and desist orders and imposed CMPs on five individuals based on the agency's determination that they all failed to ensure the bank's compliance with various BSA/AML requirements, including timely SARs filings and identifying and monitoring high-risk accounts.¹² Additionally, two individuals were sanctioned for seeking out high-risk lines of business, even though they knew, or should have known, the bank did not have an adequate BSA/AML compliance program capable of handling the proposed transactions.
- In another action several weeks later, the OCC entered into a consent cease and desist order and assessed a \$10 million CMP against a national bank for BSA/AML violations.¹³ Of particular concern were compliance failures related to identifying, monitoring, and reporting suspicious activity in an effective and timely manner. More specifically, the bank failed to timely file SARs for \$70 million worth of transactions indicative of structuring, involving wire transfers with inadequate information, and other transactions involving suspicious information.¹⁴ Complicating the picture were OFAC lapses in which bank personnel failed to report transactions of potential terrorist financing activities in SARs submissions, despite being specifically identified by the bank's internal controls as such.

Renewed Regulatory Focus

Increased BSA/AML and OFAC supervision by the FBAs is evident not just from recent enforcement activity, but also from statements by FBA officials. In several speeches and Congressional testimony,¹⁵ Comptroller of the Currency Thomas Curry noted that, based on reviews of BSA/AML compliance at large multinational bank holding companies, the OCC (and other FBAs) will be focusing greater attention on BSA/AML compliance in upcoming examinations. It is safe to assume that this scrutiny will also include greater attention to OFAC-related compliance issues.

Comptroller Curry noted several important trends that warrant closer attention from both banking regulators and financial institutions. First is a failure by institutions to commit adequate resources to BSA/AML compliance programs, due to either cost-cutting measures or a failure to keep pace with an institution's growth.¹⁶ Second are the risks posed by high-risk international financial activities, such as foreign correspondent banking, cross-border funds transfers, bulk cash repatriation, remote deposit capture, and embassy banking – areas that some banks have not effectively managed.¹⁷ Third is the failure by institutions to manage and supervise third-party service providers and payment processors.¹⁸ Finally, the rapid growth of new technologies, such as mobile banking, prepaid cards,

and internet cloud-based payment processors, presents special and unique challenges to BSA/AML (and OFAC) compliance programs.¹⁹

Curry suggests that these trends stem from four root causes: (i) the strength of an institution's compliance culture; (ii) an institution's willingness to commit sufficient resources; (iii) the strength of an institution's information technology and monitoring processes; and (iv) the institution's risk management systems.²⁰ Weaknesses in corporate governance at certain institutions appear to reflect an imbalance in both the independence of the compliance function and organizational incentives that "emphasize revenue and growth over balanced risk management."²¹ A lack of sufficient resources has resulted from inappropriate cost cutting of staff and resources in the BSA/AML arena and from the failure of bank compliance staff to remain apace with the growth of an institution.²²

Comptroller Curry highlighted efforts by the OCC and other FBAs to address these compliance challenges, including the preparation of "detailed guidance to banks on sound corporate governance processes," targeted at the four root causes discussed above.²³ This guidance is expected to discuss, among other things, business line accountability for BSA/AML compliance and the independence of the compliance function. According to Curry, the OCC has not determined whether to promulgate a regulation or issue other guidance to enhance its oversight and enforcement of BSA/AML compliance programs. Regardless of the form of the guidance, it is clear that the FBAs are focused on ensuring senior management and boards of directors are held accountable for ensuring the effectiveness of BSA/AML and OFAC compliance programs, including bearing responsibility for BSA/AML and OFAC lapses.

While these issues raise particular challenges for larger banks and multinational bank holding companies, smaller institutions must also be vigilant in monitoring and addressing BSA/AML and OFAC compliance program issues.²⁴ While smaller institutions do not have the broad global footprint of large multinational bank holding companies and do not engage in significant international financial activities posing higher BSA/AML and OFAC compliances risks, smaller institutions have their own set of risks and challenges. For example, smaller banks may face BSA/AML and OFAC compliance risks arising from the use of third-party service providers and the rapid growth of mobile banking and payments technology. Unlike larger banks that have made significant investments and upgrades in risk management systems and technology to address potential concerns with BSA/AML and OFAC, smaller institutions are subject to significant cost pressures that limit their ability to allocate such resources and quickly ramp up investments to address potential compliance risks. Another risk factor for smaller institutions is that, as larger institutions beef-up their BSA/AML and OFAC compliance programs and jettison higher-risk lines of business, money launders and other marginal or bad actors may migrate to smaller institutions that do not yet have the sophistication or capability to detect and resist complex money laundering and/or terrorist financing schemes.²⁵

Certainly, this renewed focus on BSA/AML and OFAC compliance is not unique to U.S. regulators, which highlights the extent of the challenges for both domestic and international regulators to detect and eradicate money laundering and terrorist financing activities across borders in our increasingly globalized and co-dependent financial systems. Ultimately, regulatory and supervisory efforts will only be as strong as the weakest links in the system, particularly given the extent to which traditional and nontraditional banking and payments systems continue to rapidly evolve and adapt to new and tougher laws and standards, and to identify and exploit system weaknesses.

Action Plan for Financial Institutions

All of these factors suggest that it is imperative for banks, thrifts, and other financial institutions to develop and implement an action plan to address the heightened regulatory scrutiny and program risks presented with BSA/AML and OFAC compliance. This requires an enterprise-wide review and assessment of BSA/AML and OFAC risk, regardless of the size and complexity (or lack thereof) of an institution's operations. We recommend, at a minimum, that your action plan include the following:

- Ensure a Strong Compliance Culture at the Top: A clear message highlighted in all of the recent BSA/AML and OFAC enforcement actions taken against financial institutions is the importance of involvement by bank senior officers and directors in understanding and overseeing an institution's BSA/AML and OFAC compliance programs. In particular, an institution's senior management and the board of directors should consider the following:
 - Building BSA/AML and OFAC compliance measures into the performance criteria for senior bank and business unit managers. It is not solely the responsibility of the compliance function to be accountable for BSA/AML and OFAC compliance; accountability and program oversight must be assumed by business unit management, with clear lines of communication established with senior management. In addition, directors must be active participants in reviewing and overseeing the institution's compliance function and activities.
 - To ensure senior management accountability for BSA/AML and OFAC compliance, institutions should consider ways to ensure that responsibility for oversight is assumed at the highest levels of an organization, including imposing claw-back provisions for senior officers in the event that BSA/AML and OFAC violations occur.
 - To ensure the independence of senior compliance and/or BSA/AML and OFAC compliance officials, include clearly defined channels for informing the board of directors, a committee of the board, and/or senior management of potential compliance deficiencies.
 - Conducting thorough board reviews of BSA/AML and OFAC compliance lapses, including where they were self-identifiable, to assess program weaknesses and determine whether additional board action may be warranted to address compliance program deficiencies.
- Commit Sufficient Resources to Ensure a Strong Compliance Program: An institution must be able to demonstrate to regulators that it has committed the necessary resources – and is willing and able to invest additional resources, as appropriate – to establish and maintain a robust BSA/AML and OFAC compliance program, including investments in technology, staff, training, and monitoring capabilities. While institutions are continually facing pressures to reduce overhead and expenses, particularly as revenue growth slows, BSA/AML and OFAC compliance efforts should not be part of any planned cost-cutting measures. For example, following the imposition of CMPs on one of the banks referenced above, the institution reportedly increased spending on AML technology and processes by 900 percent, including hiring ten times as many staff dedicated to BSA/AML monitoring.²⁶ While such measures may not be necessary for institutions with BSA/AML and OFAC compliant programs, certainly institutions should expect to continue to fund and expand compliance capability where necessary and appropriate to do so. The cost of committing adequate resources up-front will

produce benefits in terms of reduced risk exposure and potential remedial costs and fines for failing to take the necessary actions to achieve and maintain BSA/AML and OFAC compliance. At a minimum, employing an experienced and knowledgeable BSA officer and support staff, as appropriate, as well as experienced OFAC compliance staff, is critical.

- Maintain the Strength of Information Technology (“IT”) and Monitoring Processes: In addition to maintaining updated IT software and programs, management and the board of directors of an institution should ensure adequately trained staffing to monitor and supervise these processes and programs. Examiners may probe IT systems and back-end analytical departments to ensure that case management processes for unique or unusual transactions are supported by reasonable financial intelligence.
- Risk Management: Banking regulators will examine institutions with a focus on ensuring that senior management and boards of directors have taken the time to identify the particular risks posed by an institution’s business model and have designed a BSA/AML and OFAC compliance program that addresses such risks. For example, an institution with a large foreign correspondent banking practice or a significant prepaid card presence should have risks particular to those lines of business reflected in its BSA/AML and OFAC programs, policies, and procedures. Depending on the business profile of the institution, this may also include customer-focused risks management. For example, an institution with an active customer base among local immigrants may have increased risks relating to remittance transfers and other outbound transactions.
- Small Institution Risks: Smaller institutions should identify particular lines of business or geographic regions that pose higher risks, and ensure such risks are specifically reflected and addressed in their BSA/AML and OFAC compliance program, policies, and procedures. For example, smaller institutions may not have a significant foreign presence, but may engage in issuing prepaid cards, supporting cash intensive businesses, have significant mobile banking platforms, and/or may serve particular groups of high-risk customers, all of which increase the institution’s overall BSA/AML and OFAC risk profile.



Paul Hastings attorneys are actively assisting clients with a variety of matters involving BSA/AML and OFAC regulatory and supervisory matters and are available to address any questions or issues regarding compliance program risks, as well as to assist you regarding establishing and maintaining your BSA/AML and OFAC compliance programs.

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Atlanta

Chris Daniel
1.404.815.2217
chrisdaniel@paulhastings.com

Heena A. Ali
1.404.815.2393
heenaali@paulhastings.com

Todd W. Beauchamp
1.404.815.2154
toddbeauchamp@paulhastings.com

Kevin Erwin
1.404.815.2312
kevinerwin@paulhastings.com

Diane Pettit
1.404.815.2326
dianepettit@paulhastings.com

Palo Alto

Cathy S. Beyda
1.650.320.1824
cathybeyda@paulhastings.com

San Francisco

Thomas Brown
1.415.856.7248
tombrown@paulhastings.com

Stanton R. Koppel
1.415.856.7284
stankoppel@paulhastings.com

Kristin M. Hall
1.415.856.7071
kristinhall@paulhastings.com

Samuel Zun
1.415.856.7206
samuelzun@paulhastings.com

Washington, D.C.

V. Gerard Comizio
1.202.551.1272
vgerardcomizio@paulhastings.com

Behnam Dayanim
1.202.551.1737
bdyanim@paulhastings.com

Kevin L. Petrasic
1.202.551.1896
kevinpetrasic@paulhastings.com

Erica Berg-Brennan
1.202.551.1804
ericaberg@paulhastings.com

Lawrence D. Kaplan
1.202.551.1829
lawrencekaplan@paulhastings.com

Ryan A. Chiachiere
1.202.551.1767
ryanchiachiere@paulhastings.com

Michael A. Hertzberg
1.202.551.1797
michaelhertzberg@paulhastings.com

Amanda M. Jabour
1.202.551.0376
amandajabour@paulhastings.com

Carla Laroche
1.202.551.1768
carlalaroche@paulhastings.com

Helen Y. Lee
1.202.551.1718
helenlee@paulhastings.com

Lily Woodland
1.202.551.1977
lilywoodland@paulhastings.com

- ¹ See "Regulators Gearing Up for New Bank Secrecy Push," Rachel Witkowski, *American Banker* (Apr. 16, 2012).
- ² The number of enforcement actions was 104 in 2008, 27 in 2009, 27 in 2010, 21 in 2011, and 16 in 2012; however, the dollar amount of fines has increased significantly, with \$3.5 million in 2008, \$770 million in 2009, \$200 million in 2010, \$91 million in 2011, and \$1.1 billion in 2012.
- Since 2007, OFAC has stepped up enforcement of compliance with U.S. economic sanctions programs, and has leveled exponentially larger fines against violators, especially large, multinational financial institution, which have risen from a total \$3.5 million in 2008 to \$1.1 billion in 2012."
- ³ See OCC EA 2012-052, AA-EC-12-18 (April 5, 2012), available at <http://www.occ.gov/static/enforcement-actions/ea2012-052.pdf>.
- ⁴ See OFAC Settlement Agreement (June 10, 2012), available at http://www.treasury.gov/resource-center/sanctions/CivPen/Documents/06122012_ing_agreement.pdf.
- ⁵ See OFAC Settlement Agreement (December 10, 2012), available at http://www.treasury.gov/resource-center/sanctions/CivPen/Documents/121210_SCB_Settlement.pdf.
- ⁶ See OCC EA 2012-261, AA-EC-2012-140 (Dep't of Treasury, Dec. 4, 2012), available at <http://www.occ.gov/static/enforcement-actions/ea2012-261.pdf>; and FRB Docket Nos. 12-062-CMP-FB, 12-062-CMP-HC, and 12-062-B-FB, 2-4 (December 11, 2012), available at <http://www.federalreserve.gov/newsevents/press/enforcement/enf20121211a2.pdf>.
- ⁷ See Press Release, U.S. Treasury Department (December 11, 2012), available at <http://www.treasury.gov/press-center/press-releases/Pages/tg1799.aspx>.
- ⁸ See OCC EA 2010-199, AA-EC-10-98 (October 6, 2010), available at <http://www.occ.gov/static/enforcement-actions/ea2010-199.pdf>.
- ⁹ See OCC EA 2013-001, AA-EC-13-01 (January 14, 2013), available at <http://www.occ.gov/static/enforcement-actions/ea2013-002.pdf>.
- ¹⁰ *Id.* at 4-22.
- ¹¹ See FinCEN Matter No. 2012-01 (November 19, 2012), available at http://www.fincen.gov/news_room/ea/.
- ¹² The individuals included three former directors and two former officers, both of who served as president, CEO, and chairman of the board of the bank. See OCC EA 2013-009, AA-EC-12-98 (January 2, 2013) available at <http://www.occ.gov/static/enforcement-actions/ea2013-009.pdf>; OCC EA 2013-010, AA-EC-12-99 (January 2, 2013) available at <http://www.occ.gov/static/enforcement-actions/ea2013-110.pdf>; OCC EA 2013-011, AA-EC-12-96 (January, 2013) available at <http://www.occ.gov/static/enforcement-actions/ea2013-111.pdf>; OCC EA 2013-008, AA-EC-12-95 (January 3, 2013) available at <http://www.occ.gov/static/enforcement-actions/ea2013-008.pdf>; and OCC EA 2013-007, AA-EC-12-94 (January 2, 2013) available at <http://www.occ.gov/static/enforcement-actions/ea2013-007.pdf>.
- ¹³ See OCC EA 2013-003, AA-EC-2012-155 (January 24, 2013), available at <http://www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-18a.pdf>.
- ¹⁴ *Id.* at 2.
- ¹⁵ See Comptroller of the Currency Thomas J. Curry, Remarks before the Institute of International Bankers (Mar. 7, 2013) ("Curry March 4 Speech"); see also Testimony of Comptroller of the Currency Thomas J. Curry before the Senate Committee on Banking, Housing and Urban Affairs (Mar. 7, 2013) ("Curry March 7 Testimony").
- ¹⁶ See "Curry March 4 Speech."
- ¹⁷ *Id.*
- ¹⁸ *Id.*
- ¹⁹ *Id.*
- ²⁰ See "Curry March 7 Testimony."
- ²¹ *Id.*
- ²² *Id.*
- ²³ *Id.*
- ²⁴ See "Curry March 7 Testimony."
- ²⁵ See "Curry March 4 Speech."
- ²⁶ John Adams, "Why HSBC's Money Laundering Settlement Could Benefit IT," *American Banker* (Dec. 14, 2012).