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ENFORCEMENT**Make No Mistake: The “New Normal” of Aggressive Anti-Money Laundering Enforcement Against Financial Institutions**

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In March 2015, Germany’s second largest bank, Commerzbank AG, along with its New York-based affiliate, agreed to pay a total of \$1.45 billion in fines and penalties to settle charges under the Bank Secrecy Act’s (“BSA”) anti-money laundering provisions (13 CARE

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750, 4/10/15)¹ and the International Emergency Economic Powers Act (“IEEPA”).² While Commerzbank admitted to serious violations of law, such billion dollar fines are emerging as a “new normal” for AML enforcement involving large financial institutions. Indeed, despite the Commerzbank settlement’s staggering dollar amount, it does not even make the list of top-three such U.S. enforcement pay-outs over the last three years.

Commerzbank admitted that it knowingly and willfully moved \$263 million through the U.S. banking system on behalf of Iranian and Sudanese entities subject to economic sanctions. Specifically, Commerzbank instructed Iranian and Sudanese entities how to structure transactions to avoid detection by both the U.S. government and the internal filtering system used by Commerzbank’s own New York-based affiliate. Additionally, Commerzbank acknowledged that its failure to report suspicious activity, including more than \$1.6 billion in questionable wire transfers, furthered an accounting fraud scheme perpetrated by one of the bank’s customers to inflate the customer’s net worth by \$1.7 billion.

Commerzbank joins the growing ranks of major financial institutions facing serious charges for failing to maintain effective anti-money laundering programs. No longer content to sit on the sidelines as the federal gov-

¹ 31 U.S.C. § 5311 *et seq.*

² 50 U.S.C. §§ 1701–1707.

ernment ramps up its scrutiny of financial institutions, state governments such as New York are also aggressively joining the enforcement landscape. Indeed, the leading New York State regulator plans to implement proactive monitoring measures, including random audits and attestation requirements for regulated entities within its purview.

With enforcement settlements in the *billions* of dollars becoming increasingly commonplace, and the breadth and scope of oversight expanding at all levels of government, this “new normal” of intense compliance enforcement elevates the “straight-and-narrow” that financial institutions must follow to an entirely new level.

I. Ramp-Up of AML Policing By Both Federal and State Authorities

Federal regulators traditionally have taken the lead in pursuing enforcement actions against financial institutions, and the industry has seen a substantial upswing in such enforcement in recent years, particularly for AML violations. Just days after Commerzbank and the Department of Justice agreed to a deferred prosecution agreement, Assistant Attorney General Leslie Caldwell, head of the DOJ’s Criminal Division, addressed financial institution representatives, regulators and law enforcement personnel at the annual Anti-Money Laundering and Financial Crime Conference (13 CARE 592, 3/20/15), hosted by the Association of Certified Anti-Money Laundering Specialists (the “ACAMS Conference”). In no uncertain terms, Caldwell promised that the government would continue to “prosecute banks and other financial institutions for willful failures to maintain effective anti-money laundering programs and for other financial crimes.”³

Now, state regulators are joining the charge. Particularly since the creation of the New York State Department of Financial Services (“NYDFS”) in 2011, state and federal authorities have joined forces in actively pursuing financial institutions for AML and sanctions violations. Indeed, Commerzbank’s settlement was as much with the NYDFS as it was with the DOJ: of the total \$1.45 billion settlement under Commerzbank’s DPA, \$610 million will be paid to NYDFS, with \$642 million going to the DOJ and \$200 million to the Board of Governors of the Federal Reserve System.⁴

³ Leslie R. Caldwell, Assistant Attorney General for the Criminal Division, U.S. Dept. of Justice, Remarks at the ACAMS Anti-Money Laundering & Financial Crime Conference (Mar. 16, 2015), *available at* <http://www.justice.gov/opa/speech/assistant-attorney-general-caldwell-remarks-acams-anti-money-laundering-financial-crime>.

⁴ The Office of Foreign Assets Control (“OFAC”) also assessed a penalty of \$258.6 million, which will be satisfied by the sum paid to the DOJ.

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Benjamin Lawskey, superintendent of the NYDFS, delivered that message when he spoke at Columbia Law School in February 2015 (13 CARE 432, 2/27/15). Lawskey recognized that regulators at the federal level “are exceptionally talented” and “often have expertise and resources that state regulators simply cannot match.”⁵ However, he emphasized that states serve an important role in financial regulation, and encouraged state regulators to “strive . . . for a collaborative and cooperative relationship with our federal partners,” but to “not be afraid to speak up and act if we spot new risks emerging in the market.”

Superintendent Lawskey emphasized his state’s particular focus on the effectiveness of automatic filtering and monitoring programs used by financial institutions to flag suspicious transactions. He explained: “Transaction monitoring works by running transactions through various detection scenarios that are designed to create alerts that show patterns of money laundering or red flags, such as high-volume transaction activities.” He continued, “[b]ut—and this is a truly frightening question to ask—what if those monitoring and filtering systems are flawed or ineffective?”

Lawskey recognized that such systems may be flawed due to inadequate design, or they may be ineffective because companies are willfully altering the sensitivity of the systems such that suspicious transactions remain undetected. Either way, the State is no longer willing to take “[a] whack-a-mole approach.” The NYDFS seeks to increase regulatory pressure on financial institutions by conducting random audits of regulated entities. Rather than relying on financial institutions to self-report, the state will proactively test the effectiveness of banks’ filtering systems by running the company’s transactions through the State’s own filtering system. NYDFS also is considering requiring attestation by senior executives to the robustness of the bank’s monitoring and filtering systems—an idea modeled on a similar requirement under the Sarbanes-Oxley Act aimed at preventing accounting fraud.

Of course, financial institutions like Commerzbank, which already are cooperating with the government under the terms of a DPA, are subject to all the more scru-

⁵ Benjamin M. Lawskey, Superintendent, Department of Financial Services for the State of New York, Remarks on Financial Regulation in New York City at Columbia Law School (Feb. 25, 2015), *available at* http://www.dfs.ny.gov/about/speeches_testimony/sp150225.htm.

tiny and immediately face higher penalties for recidivism. As Assistant Attorney General Caldwell warned at the ACAMS Conference:

Make no mistake: the [DOJ's] Criminal Division will not hesitate to tear up a DPA or NPA and file criminal charges, where such action is appropriate and proportional to the breach.¹⁰

While Caldwell declined to name specific financial institutions, she indicated that several may be at risk of losing the benefit of their agreements.

II. Paying the Cost

Like the financial institutions that came before it, Commerzbank is being punished for failing to maintain an effective AML program, including failing to file suspicious activity reports and failing to establish due diligence for foreign correspondence accounts.¹¹

While substantial, Commerzbank's \$1.45 billion settlement is relatively low when compared to the blockbuster penalties and fines assessed under recent AML/OFAC DPAs. This difference may be explained by the fact that Commerzbank's conduct involved fewer actual dollars being processed through the U.S. banking system on behalf of sanctioned entities as compared with the financial institutions settling similar charges in the past. For instance, one recent settlement neared \$2 billion; however, that institution's allegedly deficient controls allowed more than double the amount in OFAC-prohibited transactions than the \$263 million in unlawful transactions allowed by Commerzbank.

Of course, banks that fail to reach an agreement with the government face consequences of an entirely other level. To date, the \$8.9 billion penalty paid by French bank BNP Paribas in June 2014 after pleading guilty under the IEEPA to violating sanctions against Sudan, Cuba and Iran remains the high-water mark for AML/OFAC prosecutions (12 CARE 840, 7/25/14).

Finally, fines and penalties are only the beginning for corporate defendants faced with AML or OFAC charges. Such institutions are routinely subjected to additional forms of government oversight. As a primary condition of settlement under DPAs, both the DOJ and NYDFS have required financial institutions to install an independent corporate monitor to police the bank's progress. Taking one example, Standard Chartered Bank, whose DPA was initiated in 2012 and then extended at the end of 2014 (12 CARE 1707, 12/12/14), will be subject to the ongoing scrutiny and reporting requirements of an independent monitor through December 2017.¹² Commerzbank likewise must engage an independent monitor, which will report directly to NY-

¹⁰ Leslie R. Caldwell, Assistant Attorney General for the Criminal Division, U.S. Dept. of Justice, Remarks at the ACAMS Anti-Money Laundering & Financial Crime Conference (Mar. 16, 2015), available at <http://www.justice.gov/opa/speech/assistant-attorney-general-caldwell-remarks-acams-anti-money-laundering-financial-crime>.

¹¹ Deferred Prosecution Agreement, United States v. Commerzbank AG, available at http://www.justice.gov/sites/default/files/opa/press-releases/attachments/2015/03/12/commerzbank_deferred_prosecution_agreement_1.pdf.

¹² United States v. Standard Chartered Bank, No. 1:12-cr-00262-JEB, ECF No. 8 (D.D.C. Dec. 9, 2014), available at <http://www.mainjustice.com/wp-admin/documents-databases/208-1-U.S.-v.-Standard-Chartered-Bank---Filing---Dec.-9-2014.pdf>.

DFS, for a period of at least two years.¹³ Data on the costs of monitorships are scarce, but even ignoring direct monitorship costs, remediating an inadequate AML compliance program is expensive.¹⁴ A recent report by KPMG stated that 78 percent of survey respondents had increased their investment in AML activities over the last three years, and 74 percent of respondents predicted that the cost would continue to increase over the next three years.¹⁵

In short, the aggregate costs of non-compliance—a DPA settlement, combined with remediation, a monitorship and any subsequent fines incurred for failure to live up to the DPA—could very well break the bank. Banks also face material reputational harm, as recent years' media coverage of these enforcement actions makes clear.

III. What Should Financial Institutions Do?

Under the BSA, financial institutions must establish and maintain an AML compliance program that at a minimum provides for (1) internal controls to assure ongoing compliance; (2) independent compliance testing; (3) designation of person(s) responsible for coordinating and monitoring day-to-day compliance; and (4) employee training.¹⁶

Additionally, financial institutions must file Suspicious Activity Reports ("SARs") with the Financial Crimes Enforcement Network ("FinCEN"). Reporting is mandatory for transactions that (1) were "conducted or attempted by, at, or through the bank"; (2) involved at least \$5,000; and (3) where the bank at a minimum "has reason to suspect" that either "[t]he transaction involves funds derived from illegal activities," or "[t]he transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage."¹⁷

Commerzbank, for instance, was cited for failing to report concerns about its customer's accounting structure despite multiple compliance officers' elevating such concerns. One compliance officer described the structure as "a very complicated structure without any economical rationale,"¹⁸ and another recommended that Commerzbank "meet with multiple [customer] officials 'to ensure that in case there is any fraud (I am not saying there is), this should flush it out.'"¹⁹ Instead of following up on these red flags, Commerzbank "act[ed]

¹³ Consent Order, NYDFS, In the Matter of Commerzbank AG and Commerzbank AG New York Branch, <http://www.dfs.ny.gov/about/ea/ea150312.pdf>.

¹⁴ See generally KPMG, *Global Anti-Money Laundering Survey 2014*, available at <http://www.kpmg.com/KY/en/IssuesAndInsights/ArticlesPublications/PublishingImages/global-anti-money-laundering-survey-v3.pdf>.

¹⁵ *Id.* at 13.

¹⁶ 31 U.S.C. § 5318(h)(1); 12 C.F.R. § 21.21.

¹⁷ Note that banks are protected from liability, and enjoy a discovery and evidentiary privilege, relating to disclosures made in their SARs. 31 U.S.C. § 5318(g)(3); e.g., *Weil v. Long Island Sav. Bank*, 195 F. Supp. 2d 383, 389 (E.D.N.Y. 2001).

¹⁸ Deferred Prosecution Agreement ¶ 74, United States v. Commerzbank AG, available at http://www.justice.gov/sites/default/files/opa/press-releases/attachments/2015/03/12/commerzbank_deferred_prosecution_agreement_1.pdf.

¹⁹ *Id.* ¶ 74.

on the basis that one is innocent until proven guilty” and swept the warning signs under the rug.²⁰

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Now more than ever, prompt reporting and investigation of suspicious activity enterprisewide is mandatory. Further, financial institutions must pressure test their compliance program and policies to ensure robust monitoring systems, proper training and accountability. While acknowledging that a strong compliance program is uniquely tailored to each financial institution, Assistant Attorney General Caldwell recommended the following best practices:

- directors and senior managers should provide “strong, explicit, and visible support” for the compliance program;
- compliance policies should be clear, written and translated to all languages spoken in the financial institution’s areas of operation;
- policies should be communicated effectively and easily accessible to all employees, and employees should receive repeated training on how to handle issues reasonably anticipated to arise;
- policies should be reviewed regularly “to keep them up to date with evolving risks and circumstances,” and all compliance policies should be reviewed or revised when “a U.S.-based entity acquires or merges with a foreign entity”;
- discipline for policy violations should be applied even-handedly because “[t]he department does not look favorably on situations in which low-level employees who may have engaged in misconduct are terminated, but the more senior people who either directed or deliberately turned a blind eye to the conduct suffer no consequences”;
- financial institutions should “sensitize third parties . . . to the company’s expectation that its partners are also serious about compliance,” and willingly “terminat[e] a relationship [] if a partner

²⁰ *Id.* ¶ 73.

demonstrates a lack of respect for laws and policies.”²¹

Financial institutions currently operating under a DPA must be especially vigilant lest the DOJ “tear up” the agreement in favor of pursuing criminal charges and/or additional sanctions. For example, in August 2014, NYDFS fined Standard Chartered \$300 million for failing to comply with its 2012 DPA.²² That hefty additional fine represented almost half of Standard Chartered’s original settlement amount. Of course, it is likely that the consequences of a regulator’s decision to revoke the DPA entirely and prosecute the entity would be far direr.

IV. Conclusion

Assistant Attorney General Caldwell closed her remarks at the ACAMS Conference with the following:

I strongly encourage the representatives of banks and other financial institutions . . . to reflect on whether your institutions have effective anti-money laundering programs and other compliance policies and practices to prevent or mitigate financial crime. The integrity and viability of the global financial system require that you do.²³

Under the “new normal”—where both state and federal agencies aggressively identify and prosecute AML and sanctions violations—financial institution representatives should take this advice to heart. In reflecting on their own programs and practices, financial institutions would be wise to learn from the mistakes made by Commerzbank and others. The price for failing to do so, which includes fines and penalties, monitorship costs and reputational harm, will be steep. Robust prospective compliance can avoid these great costs and other burdens to business resulting from an AML or OFAC enforcement action—not to mention exhibit the institution’s positive impact on the integrity of the global financial system more broadly.

²¹ Leslie R. Caldwell, Assistant Attorney General for the Criminal Division, U.S. Dept. of Justice, Remarks at the ACAMS Anti-Money Laundering & Financial Crime Conference (Mar. 16, 2015), *available at* <http://www.justice.gov/opa/speech/assistant-attorney-general-caldwell-remarks-acams-anti-money-laundering-financial-crime>.

²² Ben Protesse & Chad Bray, *Caught Backsliding, Standard Chartered Is Fined \$300 Million*, N.Y. TIMES, Aug. 19, 2014, <http://dealbook.nytimes.com/2014/08/19/standard-chartered-in-deal-with-new-york-regulator/>.

²³ Leslie R. Caldwell, Assistant Attorney General for the Criminal Division, U.S. Dept. of Justice, Remarks at the ACAMS Anti-Money Laundering & Financial Crime Conference (Mar. 16, 2015), *available at* <http://www.justice.gov/opa/speech/assistant-attorney-general-caldwell-remarks-acams-anti-money-laundering-financial-crime>.