

MONEY LAUNDERING

A New Anti-Money Laundering Enforcement Paradigm: Questions & Lessons From JPMorgan's Deferred Prosecution



BY ASHEESH GOEL, NICHOLAS M. BERG AND
TIMOTHY R. FARRELL

The \$2.6 billion settlement between the U.S. government and JPMorgan Chase & Co., announced in January, marks the largest penalty ever imposed under the Bank Secrecy Act's anti-money laundering (AML) provisions.¹ It also underscores the government's more aggressive use of the BSA to promote financial institutions' greater scrutiny of questionable conduct by their customers—now a policy imperative in the wake of Bernard L. Madoff's massive Ponzi scheme.

The JPMorgan settlement, centered on allegations that the bank should have caught and reported warning signs from its interactions with Madoff's securities business, signals that financial institutions may be punished for not reporting activity that, in isolation, may not raise alarm bells and that arguably appears more suspicious only with the benefit of hindsight.²

The settlement is also a stark reminder that the government now views financial institutions as being deputized by the BSA to probe and report any and all suspect activity touching their operations and that proactive

compliance is the best insurance policy against costly government AML enforcement.

BSA/AML Requirements For Financial Institutions

Prosecutors historically employed the BSA as a “hook” against drug traffickers and others using U.S. banks to further or conceal their criminal activity. However, the recent string of AML enforcement against the banks themselves signals a trend of AML compliance enforcement for its own sake. As one official asserted in 2012:

Banks are the first layer of defense against money launderers and other criminal enterprises who choose to utilize our nation's financial institutions When a bank disregards the [BSA's] reporting requirements, it [makes] it more difficult to identify, detect and deter criminal activity.³

³ Department of Justice press release, *HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement* (Dec. 11, 2012), available at <http://www.justice.gov/opa/pr/2012/December/12-crm-1478.html>.

¹ 31 U.S.C. § 5311 et seq.

² 09 WCR 5 (1/10/14).

Financial institutions are conscripted into providing this layer of defense through the BSA, and banks are not alone in this mandate. The BSA's AML requirements also apply to financial holding companies, securities brokers and dealers, insurers and other financial businesses.⁴

Principal among the BSA's provisions are two requirements central to JPMorgan's deferred prosecution agreement. First, firms must file Suspicious Activity Reports (SARs) with the Treasury Department's Financial Crimes Enforcement Network, or FinCEN. Reporting is mandatory for transactions that (1) were "conducted or attempted by, at, or through the bank" and (2) involved at least \$5,000, and (3) where the bank at least "has reason to suspect" that either (a) "the transaction involves funds derived from illegal activities" or (b) "the transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage."⁵ SARs must be filed within 30 days of detection.⁶

Second, 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.⁷

Violations constitute a felony, carrying a potential five-year prison sentence and a \$250,000 fine. Critically, proceeds allegedly traceable to underlying crimes such as securities fraud—e.g., \$1.7 billion worth of JPMorgan's DPA—are also subject to forfeiture by the government, irrespective of any fines imposed.⁸

Increasing BSA/AML Enforcement

The trend of AML enforcement against financial institutions by no means began with JPMorgan. TD Bank NA faced a scenario similar to JPMorgan's, albeit on a smaller scale, when in 2013 it settled charges that it failed to file timely SARs regarding suspicious transactions tied to a Florida Ponzi scheme.⁹ And HSBC Holdings Plc's \$1.92 billion settlement in 2012 for alleged AML compliance failures was then the largest U.S. penalty against a bank.¹⁰ These are just examples of the multiple financial institutions that U.S. regulators have recently penalized or cited for alleged BSA/AML violations, principally for shortcomings in their AML compliance programs.¹¹

Past is prologue for this trend: Mythili Raman, the acting head of the DOJ's Criminal Division, recently stated publicly, "There's more to come, and that suggests to me that there are still banks that haven't gotten the message."¹²

Lessons From the JPMorgan DPA

The JPMorgan DPA represents the government's strongest stance yet on how proactively it expects private financial institutions to scrutinize questionable customer activity. On the other hand, many of the allegations in JPMorgan's DPA raise the question whether

⁴ See generally 31 C.F.R. Ch. X.

⁵ 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).

⁶ 31 U.S.C. § 5318(g); 31 C.F.R. §§ 1020.320; 12 C.F.R. § 21.11.

Asheesh Goel is a Securities Enforcement partner resident in the Chicago and Washington offices of Ropes & Gray LLP, managing partner of the firm's Chicago office and co-chair of Ropes & Gray's award winning global anti-corruption and international risk practice. Asheesh focuses on securities enforcement matters, including internal investigations, government investigations and enforcement actions. Over his career, he has developed substantial depth advising clients on the Bank Secrecy Act, the Foreign Corrupt Practices Act, the U.K. Bribery Act and other related anti-money laundering and anti-corruption laws, financial statement and disclosure issues, insider trading, auditor issues and industry matters.

Nicholas Berg and Timothy Farrell are associates in the Chicago office of Ropes & Gray and focus their practice on the same core areas as Goel. In addition, both Berg and Farrell have particular expertise advising clients in securities litigation, shareholder litigation and bet-the-company commercial litigation disputes.

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

⁸ 18 U.S.C. § 981.

⁹ FinCEN press release, *FinCEN Fines TD Bank for Failing to Report Nearly \$1 Billion in Suspicious Transactions Related to Florida Ponzi Scheme* (Sept. 23, 2013), available at http://www.fincen.gov/news_room/nr/pdf/20130923.pdf.

¹⁰ 07 WCR 939 (12/14/12). See also DOJ press release, *HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement* (Dec. 11, 2012).

¹¹ E.g., Assessment of Civil Money Penalty, *In re First Bank of Delaware*, No. 2012-01, FinCEN, No. 2012-01 (Nov. 15, 2012) available at <http://www.fdic.gov/news/news/press/2012/pr12135a.pdf>; see BankersOnline.com, *Compilation of BSA/AML Penalties*, available at <http://www.bankersonline.com/security/bsapenaltylist.html#bsa2011>.

¹² Andrew Grossman, *Banks Face New U.S. Moves Against Laundering*, WALL ST. J. (Jan. 9, 2014).

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the alleged compliance lapses would constitute grounds for enforcement, much less a multibillion-dollar settlement, without the benefit of what we know now about the scope of Madoff's massive fraud.

JPMorgan's U.S.-Facing Custodial Bank. Take, for instance, the allegations directed at JPMorgan's broker-dealer banking group, the U.S.-facing business that actually oversaw and interacted with Madoff's demand deposit account (the "703 Account"). The DPA cites two occasions when the 703 Account's activity triggered "alerts" from JPMorgan's computerized AML surveillance system, both of which JPMorgan's AML personnel investigated. The DPA suggests that those transactions were anomalous against the backdrop of the prior 90-day period, but it does not contest JPMorgan's investigators' conclusion that the alerted transactions were not unusual in the context of the account's complete activity history. Additionally, the government alleges that JPMorgan's relationship banker for Madoff Securities regularly signed compliance certificates for the Madoff relationship despite his inaccurate understanding of the 703 Account. The DPA also notes that the 703 Account's funds were never used to purchase securities or transferred to other broker-dealers. However, the government does not make plain why JPMorgan should have expected otherwise at the time.

These and other allegations often appear to conflict with the fact that the AML regulations themselves allow room for financial institutions to "examin[e] the available facts" and conclude that there actually may be a "reasonable explanation for the transaction" under review, based on the background and possible purpose of the transaction.¹³ How much deference the government will grant a financial institution's good-faith judgment after the fact will always be case-specific. But the government's aggressive posture in JPMorgan's case counsels that, when in doubt, financial institutions are simply better off investigating and reporting any and all suspicious activity.

JPMorgan's Other Business Units. The bulk of the DPA's remaining terms focus on JPMorgan's other business units' alleged failure to communicate concerns about Madoff to the bank's U.S. AML personnel. From 1993 through 2007, a number of JPMorgan business units performed diligence to assess Madoff's securities as a potential investment. Each business unit concluded its diligence citing concerns about Madoff's lack of transparency and the inability to explain Madoff's posted returns. Specifically, JPMorgan's London-based equity exotics desk conducted a risk assessment of Madoff in 2007 and 2008, ultimately redeeming much of JPMorgan's own positions in Madoff-related funds based on its concerns. In conjunction with its redemptions, JPMorgan's European AML officer filed a report with U.K. regulators, explaining its redemptions and its concerns that Madoff's performance was "so consistently and significantly ahead of its peers . . . as to appear too good to be true—meaning that it probably is."

The crux of the government's charge is that these business units also should have communicated their

concerns with JPMorgan's U.S. AML personnel and filed SARs with U.S. regulators. But these "failure to communicate" allegations also raise questions about AML enforcement going forward.

JPMorgan's business units performed diligence on Madoff—e.g., through their own risk analyses, review of investment performance and consultation with external sources. At least according to the DPA, the business units' concerns were drawn from that diligence, not from any identifiable Madoff transaction conducted through JPMorgan. So whereas the BSA requires reporting of suspicious "transactions," the government penalized JPMorgan for not reporting its internal diligence conclusions that raised concerns about Madoff. Thus, the government could be seen as reading the BSA's reporting obligations more broadly than the law's own definition of "transaction,"¹⁴ to include any reason for suspicion, whether or not based in a formal transaction with the bank.

Such a broad reading may imply a potential new duty for financial institutions to perform a dual role whenever performing diligence for their own account: first, to account for red flags in furtherance of their own business interests and, second, to review and report those red flags as an agent of law enforcement. More likely, these "failure to communicate" allegations—which the government has emphasized in past BSA enforcement, such as in HSBC's DPA—simply underscore the government's expectation that financial institutions maintain uncompromising AML reporting mechanisms horizontally and vertically throughout the organization.

Conclusion

It remains to be seen whether the government's aggressive posture in the JPMorgan case is a new norm or rather a function of the scope of Madoff's fraud and the ensuing public outcry. However, the allegations do stand as a warning that the government may scrutinize and aggregate perceived compliance gaps after the fact when high-profile criminal conduct slips through a financial institution's compliance net.

With BSA/AML enforcement on the rise, it is critical for financial institutions to maintain and pressure-test their compliance program and policies to ensure robust monitoring systems, proper training and accountability, and prompt reporting and investigation of suspicious activity enterprise-wide.

¹⁴ 31 C.F.R. § 1010.100 (transaction defined as "a purchase, sale, loan, pledge, gift, transfer, delivery, or other disposition, and with respect to a financial institution includes a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument, security, contract of sale of a commodity for future delivery, option on any contract of sale of a commodity for future delivery, option on a commodity, purchase or redemption of any money order, payment or order for any money remittance or transfer, purchase or redemption of casino chips or tokens, or other gaming instruments or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected").

¹³ E.g. 31 C.F.R. § 1020.320.