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AML: A Corporate Governance Issue

RUSSELL J. BRUEMMER AND ELIJAH M. ALPER

This article begins with a brief overview of anti-money laundering statutory and regulatory developments written with a board director in mind. It then lays out steps and actions the board should take to ensure that its knowledge stays current, responsibilities and lines of authority are clear, and monitoring and accountability become part of the institution's culture.

Estimates place the amount of money illegally "laundered" through United States banks in the hundreds of billions of dollars each year.[1] For more than five decades, the U.S. government has attacked money laundering, in part, through anti-money laundering ("AML") disclosure, monitoring, and reporting requirements placed on financial institutions. Although it is a rare occurrence that a U.S. bank or other major financial institution is knowingly complicit in money laundering, numerous banks and other financial institutions have been sanctioned or otherwise punished for failure to meet those requirements.

While intensity of AML efforts has varied over the decades since the Bank Secrecy Act ("BSA") was passed, there is no doubt those efforts have picked up intensity in recent years and that this increased focus will continue. Indeed, the comptroller of the currency has said that "[i]n the wake of the financial crisis, too many banks inappropriately cut staffing and spending for BSA and anti-money laundering compliance as austerity measures."[2] Former Department of Justice ("DOJ") prosecutor Jennifer Shashky Calvery was appointed the new director of the U.S. Treasury Department's Financial Crimes

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Enforcement Network ("FinCEN") in August 2012, becoming the first prosecutor to fill that role and raising speculation of an increased enforcement focus.

The U.S. government is following through on this enforcement threat. In 2012 alone, FinCEN, the banking and securities regulators, and the U.S. Department of Justice issued more than 100 AML enforcement actions against banks, broker-dealers, and other financial institutions or their employees, and this trend continues into 2013. The total fines and settlements levied against institutions under 2012 enforcement actions and deferred prosecution agreements reached $3.5 billion, a 130-fold increase over 2011 amounts.[3]

At the same time, Congress is telling the agencies that their efforts to date are not enough. Several members of Congress are pressuring the agencies, through hearings and public statements, to expand their enforcement efforts and strengthen their penalties.[4]

In response, FinCEN and the prudential regulators are not only increasing their enforcement and penalties, but they have taken steps towards targeting boards of directors and senior corporate leadership, citing these groups for failing to prevent AML weaknesses and forcing boards and management to take specific corrective action. Every one of the major 2012 and early 2013 AML enforcement actions cited insufficient corporate governance.[5] In light of increasing regulatory pressures, prudent boards may wish to become more aware of their existing AML responsibilities and oversight responsibilities.

The increased focus on board of director responsibilities is becoming apparent in recent AML enforcement actions, as the comptroller of the currency recently told the Senate Banking Committee.[6] While both AML and non-AML enforcement actions against financial institutions have required bank boards of directors to form compliance committees composed of outside directors,[7] some 2012 and 2013 AML enforcement actions have imposed even more board and senior management requirements. For example, the Office of the Comptroller of the Currency ("OCC") inserted an unusual "Management and Accountability" article into one recent enforcement order.[8] That article requires the bank to ensure that AML compliance functions have sufficient authority and independence and orders the bank's board of directors to incorporate AML and economic sanctions compliance into the performance evaluations of senior management. More recently, Federal Reserve AML

enforcement orders issued earlier this year against bank holding companies requiring the boards of those holding companies to "improve firmwide compliance risk management" with regard to AML and require the companies to outline the steps the board will take to comply.[9] Apparently unsatisfied with the directors' AML performance and accountability, the OCC has promised "specific guidance on what the expectations are for board and management accountability."[10]

Current and future obligations on board members are not limited to the largest banks. For example, a smaller Florida state bank was ordered in August 2011 to hold monthly board meetings on BSA/AML issues, and the FDIC and Florida banking regulator ordered that they would have the right to determine whether current future senior management and directors are "qualified."[11]

Other recent AML enforcement actions have identified compliance failures in areas that are the primary responsibility of the board of directors, even without calling out the board in the public order. For example, the OCC said that one recent major AML enforcement action arose in part because business units ignored the AML problems identified by the bank's independent compliance function.[12] Similarly, a 2012 Senate Permanent Subcommittee on Investigations (PSI) report criticized the board and senior management of one major bank for ignoring internal warnings that AML resources were inadequate.[13] These findings may foreshadow FinCEN and other regulators citing the board directly and publicly for failures by business lines or senior management to heed compliance advice.

Another expansion trend is emerging. In the past, public AML enforcement typically focused on large foreign banks and broker-dealers with inadequate controls,[14] and smaller money transmitters with little, if any, AML controls.[15] Recent enforcement actions have shown a shift not only towards smaller domestic banks but also towards larger nonbank financial institutions. For example, in November 2012 the Department of Justice (and not FinCEN)[16] required the world's second largest money transmitter to forfeit $100 million and enter into a deferred prosecution agreement for BSA/AML violations and related fraud findings.

Importantly for nonbanks, the intensified enforcement trend is not limited to federal regulators. For example, the Arizona State Attorney General

entered into a $94 million settlement with a major money transmitter for AML deficiencies in February 2010.[17] And in August 2012, a major foreign bank paid a $340 million civil money penalty for AML and OFAC failures and, according to the regulator, "apparent grave violations of law and regulation."[18] What is unusual was not that another large foreign bank was fined for AML or OFAC violations, but rather that the regulator was the New York State Department of Financial Services ("NYDFS"),[19] not FinCEN, the DOJ, or a federal banking agency.[20]

A comprehensive state regulator like NYDFS could exercise AML examination authority (FinCEN recently approved such authority for state insurance regulators)[21] and apply its AML focus to these other industries. Institutions in those less scrutinized industries may thus have less developed AML programs, or boards and senior management less focused on AML compliance, and thus they may be more vulnerable to AML enforcement. With this intensified and expanded AML scrutiny, boards of directors of both bank and nonbank financial institutions would do well to intensify their knowledge of and focus on AML policies and strategies because they will be vulnerable if they do not.

This article is intended to serve as a roadmap for how boards of directors may intensify their knowledge and focus. We begin with a brief overview of AML statutory and regulatory developments written with a board director in mind. We then lay out steps and actions the board should take to ensure that its knowledge stays current, responsibilities and lines of authority are clear, and monitoring and accountability become part of the institution's culture.

BRIEF OVERVIEW OF AML RULES

Statutory History

Anti-money laundering rules do not prohibit money laundering. That is the purview of federal and state criminal and civil laws, which prohibit knowingly engaging in or facilitating certain money laundering activities.[22] In fact, the AML rules are not directed at would-be money launderers at all. Instead, the rules target financial institutions on the theory that any money laundering (or terrorist financing) likely at some point involves a financial

institution, so it is easier to combat money laundering by controlling the actions of the law-abiding (and controllable) financial institution rather than the criminal actor.[23] The AML regime aims to make laundering money difficult, or detect it when it does occur, by forcing financial institutions to conduct diligence on their customers and to report certain movements of funds that could indicate a money laundering or other illicit purpose.

The AML rules can be traced to the inaptly named Bank Secrecy Act, passed in 1970.[24] Rather than prohibiting banks from sharing information about their customers, as many foreign "bank secrecy" laws do, the BSA required banks and certain other financial institutions to share information about their customers' activities with the U.S. government. The BSA required these financial institutions to file currency reports of certain transactions with the U.S. Treasury, to identify customers on whose behalf the transactions were made, and to maintain certain transaction records. Later laws passed in the late 1980s and 1990s, such as the Money Laundering Control Act of 1986,[25] increased sanctions for violating the BSA. The federal banking agencies first required banks to implement policies and procedures designed to ensure BSA compliance beginning in 1987,[26] and later required banks to report certain suspicious activity to the agencies in the early 1990s.[27]

The AML rules were substantially expanded to cover additional types of financial institutions by the Title III of the 2001 USA PATRIOT Act, which established most of the AML program requirements in place today.[28] Most notably, the act required certain financial institutions to formalize procedures for identifying and investigating customers through a "Customer Identification Program" and through standard and, in certain cases, enhanced due diligence of customers. The act also criminalized terrorist financing and increased the information institutions must share with the government through reporting requirements.

Types of AML Rules

The cornerstone of the AML compliance regime is the AML program. An AML program is a set of policies, procedures, and controls, along with training and independent review, developed by a financial institution to detect, prevent, and report potential money laundering, terrorist financing, or

other unlawful activities.[29] These policies and procedures must address the AML legal requirements applicable to the institution. These requirements generally fall into two categories: (1) customer identification and (2) reporting and recordkeeping.

Customer Identification

Financial institutions are merely conduits for money laundering performed by customers. Thus the BSA instructs FinCEN to prescribe regulations requiring financial institutions to implement "reasonable procedures" for verifying the identity of persons opening an account and maintaining records used to conduct this verification.[30] AML regulations require financial institutions, to different extents, to identify their customers and conduct varying degrees of diligence on the customers to determine whether they represent an AML risk. Customer identification rules rarely require financial institutions to reject a high-risk customer, though of course they may choose not to accept a customer as a matter of policy. Rather, they are welcome to open high risk accounts if they perform appropriate due diligence and monitoring of such accounts for possible money laundering or other criminal activity.[31]

Reporting and Recordkeeping

The AML rules typically do not bar financial institutions from conducting customer transactions that may involve money laundering. Instead, they require the financial institutions to report these suspicious transactions to the government. The "cornerstone of the BSA reporting system"[32] is the Suspicious Activity Report ("SAR"), which must be filed when a financial institution detects criminal activity or transactions with no lawful purpose above specified monetary thresholds (typically $5,000).[33] The government may use SARs collected from across the financial system to detect, prevent, or prosecute money laundering activity. SARs are strictly confidential and may be shared outside the institution or parent company in extremely limited circumstances, not even in response to a court subpoena or discovery request.[34]

AML RULES AS DEFINED BY THE REGULATORS

From Congress to FinCEN

FinCEN Regulations Define Who Must Follow Which Rules

Since Congress passed the USA PATRIOT Act, responsibility for evaluating and changing the AML rules has fallen on regulators, particularly FinCEN, which is charged with implementing the BSA (as amended by the USA PATRIOT Act and other statutes). Since 2001, FinCEN has issued a multitude of regulations and guidance defining institutions' customer identification and reporting obligations for different financial institutions.

This shift from congressional to regulatory leadership was contemplated by the USA PATRIOT Act, which gave FinCEN vast authority to regulate all financial institutions regarding money laundering activity, then let FinCEN decide how much, or how little, of that power to exercise. The USA PATRIOT Act granted FinCEN jurisdiction to require AML measures over, or to take enforcement action against, any "financial institution," a term that Congress expansively defined.[35] That jurisdiction covers not just the traditional financial institutions such as banks and securities firms, but also other "financial institutions" in more than 25 categories, including but not limited to certain investment companies, pawnbrokers, travel agencies, insurance companies, "loan or finance" companies, currency exchanges, casinos, and telegraph companies.[36]

Critically, the current AML rules reflect only a fraction of the authority the USA PATRIOT Act grants FinCEN to regulate "financial institution" activity. FinCEN has placed its most expansive AML obligations on core financial institutions such as banks and broker-dealers. These institutions must, for example, process new customers through a Customer Identification Program, which requires them to collect and verify names, addresses, and identification numbers (such as a social security number or tax ID) of their individual and entity customers. In some cases (such as with international customers or high-risk entities), they may have to perform additional due diligence.

A second group of financial institutions are subject to only a subset of these bank and broker-dealer regulations: They may be required to file reports of suspicious activity or high currency transactions, but are not required to implement a Customer Identification Program. Institutions in this second

group include life insurances, casinos, and money transmitters.

A third group includes financial institutions that FinCEN has exempted completely from AML program requirements. FinCEN has granted a temporary exemption to such "financial institutions" including certain investment companies (notably hedge funds), travel agencies, and auto and other vehicle dealers.[37]

Other Sources of AML Rules

FinCEN and other U.S. regulators rely on more than regulations to define the scope of institutions' AML obligations. *First*, agencies have released lengthy examination manuals for banks and money services businesses, and these are used as guidance by other types of financial institutions. While nominally directed at FinCEN or bank examiners, these manuals summarize for other financial institutions both the applicable AML rules and guidance and FinCEN's interpretation of them. For example, the *BSA/AML Bank Examination Manual*, issued by the Federal Financial Institutions Examination Council ("FFIEC"), not only describes the SAR rules but goes beyond written regulations by discussing how banks should conduct manual and automatic transaction monitoring, manage alerts of suspicious activity, and decide whether to file a SAR. *Second*, FinCEN typically releases Frequently Asked Questions or other guidance documents shortly after issuing regulations that expand AML responsibilities or extend AML rules to new classes of financial institutions.[38] *Third*, FinCEN periodically issues guidance to explain or highlight focus areas for existing obligations.

Focus on Financial Institutions

The underlying assumption of AML regulation is that financial institutions are in a better position than the U.S. government to detect and prevent money laundering and terrorist financing. Thus the BSA and FinCEN's implementing regulations place a significant degree of responsibility and trust in financial institutions. In some cases FinCEN guidance even *encourages* institutions to carry out criminal transactions that will result in the laundering of money. For example, law enforcement may ask a financial institution to keep an account open notwithstanding suspicious or potential criminal activ-

ity in connection with that account.[39]

This trust in financial institutions is reflected in FinCEN's implementation of the AML program requirement. Rather than specifying exactly what AML procedures an institution must adopt, the AML rules state that institutions are required to have an AML program that is "risk-based." In other words, an institution's customer identification and reporting procedures and controls should be based on its own assessment of its AML risk rather than follow prescribed requirements.[40]

These risk-based AML rules accept that some illegal transactions may evade a financial institution's AML processes, so long as there are reasonable procedures to identify and report such transactions. FinCEN recognizes that "as a practical matter, it is not possible for a bank to detect and report all potentially illicit transactions that flow through the bank."[41] FinCEN's risk-based approach allows two institutions of similar type and size to have markedly different AML programs, if their customers and transactions pose differing AML risk. FinCEN encourages financial institutions to perform risk assessments that "provide a comprehensive analysis of the BSA/AML risks in a concise and organized presentation" before implementing an AML program.[42] Examiners will review the risk assessment for adequacy but, if adequate, will not rewrite it.

By letting institutions create their own risk assessment and implement procedures based on that assessment, the AML rules in effect let financial institutions decide the scope of their AML obligations. But for the AML rules to function properly, institutions and their boards must understand their AML risk such that their AML procedures are appropriate for that institution.

Sanctions for Failures

The trust placed by AML regulators in financial institutions comes with a large penalty for violating that trust, and all indications are that penalties will increase in the future. The banking regulators have reserved their largest civil money penalties for AML failures. Last year the OCC issued its largest ever AML civil money penalty, $500 million, but even penalties against smaller banks routinely reach into the many millions of dollars.[43] The bulk of AML sanctions, however, are in the form of forfeiture of assets linked to money laundering activities, which often reach the hundreds of millions of

dollars.[44] Consequences for AML failures can also hit senior management directly. While regulators have not yet required institutions to claw back bonuses for AML issues, recently the Department of Justice has favorably cited two institutions' voluntary decisions to do so in conjunction with deferred prosecution agreements.[45] This increasing attention from law enforcement signals that such actions may become required components of AML enforcement settlements in the near future.

Finally, AML failures also can and have led to criminal sanctions. Failure to maintain an effective AML program, or file required SARs, can be a criminal offense, and multiple banks have pled guilty to criminal AML charges since 2000. Several more banks have entered into deferred prosecution agreements with the DOJ.

There is now political pressure to increase criminal enforcement. Members of Congress from both parties have indicated that they are not satisfied with the lack of criminal prosecutions against large banks and the DOJ's preference for deferred prosecution agreements rather than criminal indictments. An April 2013 Senate report called on the DOJ to "fully enforce existing criminal sanctions against both the financial institutions and the individuals knowingly and intentionally responsible for the criminal activity."[46] The report continued, "Without serious consequences for those who break the law, financial institutions will continue to avoid compliance with U.S. anti-money laundering rules and regulations."[47] As the government faces more political pressure to take forceful action, it may turn more and more to criminal law remedies.[48]

RECENT DEVELOPMENTS

Expanding Scope of AML Obligations

At present, only a subset of financial institutions covered by the BSA are subject to AML rules, and most of those are exempted from the full slate of rules applicable to banks or broker-dealers. But recent actions by FinCEN and the Treasury Department indicate that this may soon change.

In November 2012, FinCEN and the Treasury Department announced a comprehensive review of the AML rules, citing dissatisfaction with the existing AML regime. Under Secretary for Terrorism and Financial Intelligence David Cohen said that the Treasury Department review will address

a "disconnect" between the actions necessary to fight money laundering and the regulatory responsibilities placed on financial institutions, by identifying "gaps, redundancies or inefficiencies" in the AML framework.[49] This review will be conducted by the "Delta Team," so named because of what FinCEN director Jennifer Shasky Calvery calls a "delta" between AML compliance officers' duties and the results of their compliance efforts.

The "Delta Team" review reflects agency discontent with current AML regulations and signals change once the review is complete. While the review may also address the "redundancies" or "inefficiencies" mentioned by Under Secretary Cohen, recommendations will most likely look to close the regulatory "gap" by expanding AML rules to new classes of financial institutions or by strengthening the obligations on existing covered institutions. As one former Treasury official stated after the Treasury review announcement, "Under the Patriot Act, the United States is supposed to cover a lot more industries than it does now."[50] Indeed, FinCEN has already begun narrowing the "delta" between "financial institutions" as defined by the BSA and those subject to AML rules. Rules effective in the last two years impose AML program requirements on a greater number of financial institutions (and non-financial institutions like retailers) that manage or sell prepaid cards,[51] and to nonbank residential mortgage lenders and originators.[52] And rules to cover investment advisors to hedge funds are widely expected within the next two years.

Lower Thresholds for Enforcement Actions

Among the fallout from the 2011-2012 Senate PSI investigation has been increased political pressure for AML regulators to take a more aggressive approach toward enforcement. Testifying before the committee, OCC Comptroller Thomas Curry agreed with much of the PSI's criticism, acknowledging that his agency "was much too slow in responding and addressing what are significant weaknesses or violations."[53]

The OCC's prior approach was influenced by a banking law provision that required it to issue a public enforcement action whenever it found a BSA compliance program violation.[54] To retain its discretion, the OCC would issue informal, nonpublic examination findings rather than publicly identify compliance program violations, and the PSI criticized the OCC for this approach.[55] Comptroller Curry acknowledged that there could be "disincen-

tives to making the tough calls when there are BSA compliance program violations mandating the issuance of a cease and desist order."[56] The result of this internal policy was that AML deficiencies were characterized as less serious than they actually were. The OCC announced that it will revise this policy going forward.[57]

Focus on Both Small and Large Financial Institutions

Bank and nonbank financial institutions and their boards would be mistaken to think that the political pressure for increased enforcement will be limited to large banks regulated by the OCC. The FDIC and Federal Reserve, the federal prudential regulators of (mostly smaller state) banks, are subject to the same automatic enforcement rules for pillar violations, so they should feel pressure to adopt any OCC decision to cite these violations more frequently.[58] FinCEN, the SEC and the securities self-regulatory organization FINRA certainly have taken note of the political climate and can also be expected to respond accordingly.

Boards of financial institutions can expect a similar process as the government takes a fresh look at the AML rules and responds to political pressures to take a tougher position on AML deficiencies. First, we anticipate that the banking agencies, FinCEN, and state attorneys general will expand and toughen their AML enforcement efforts, and that the DOJ will be more aggressive in enforcing criminal AML law through deferred prosecution agreements. We also expect that trend to extend to non-bank financial institutions such as money services businesses in a leveling of the playing field between banks and nonbanks. What follows is our view on how a board might best respond to avoid being caught in the government dragnet.

HEIGHTENED EXPECTATIONS FOR BOARDS

The Business Judgment Rule Is Not Enough

Under state law, directors, including directors of financial institutions, owe two principal fiduciary duties to stockholders: the duty of care and the duty of loyalty.[59] If the directors are found to have breached their duty of

care or their duty of loyalty in taking a corporate action, such conduct may be actionable. If action by directors is challenged in court, however, the directors are generally entitled to the very protective benefits of the "business judgment rule," which establishes a presumption that directors, in making a business decision, acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company unless a plaintiff proves otherwise.

The business judgment rule protects directors from shareholder liability, but regulators play by a different set of rules and those rules do not recognize the business judgment rule as a defense. As has been evidenced in both recent regulatory guidance and enforcement actions, although the business judgment rule allows directors to rely heavily on company senior management or consultants in whom they have trust, AML regulators do not accept that limitation on responsibility, or the protections the business judgment rule provides.

Regulators also will not allow a board to wait passively to hear about AML compliance issues through the standard reporting processes sufficient for other purposes. If a financial institution has a particularly self-confident chief compliance officer, or a particularly strong compliance management system, its board of directors may hear about AML compliance issues before the examiners raise issues. The practical likelihood is, however, that the board will first become aware of AML compliance issues when the institution's regulatory examiners raise questions in the draft examination findings or in an examination exit meeting, or worse, when the Department of Justice or other law enforcement begins investigating. It goes without saying, the regulators will consider that too late for the board to order prophylactic measures. Instead, the financial institution is likely to find itself subject to criticism in the examination findings, at best, if this is the first time deficiencies were found, or more significantly, to sizable administrative, civil, or criminal actions in egregious or repeat offenses.

A Primer on Board Best Practices

So, what is a board to do in this environment? The remainder of this article discusses what directors should do to ensure adequate AML compliance in their institution.

Own the Issue

It is critical that directors recognize that they have heightened responsibilities with respect to AML compliance. In exchange for placing trust in financial institutions to determine their AML risk and develop risk-based AML programs, the AML rules put significant responsibility on the institution, and its directors, to ensure that the institution identifies and manages this risk. FinCEN and the FFIEC, through their examination manuals, policy guidance, and enforcement actions hold the board of directors ultimately responsible for the institutions' AML decisions.[60] As stated in the FFIEC bank examination manual:

> *Boards of directors.* The board of directors is responsible for approving the BSA/AML compliance program and for overseeing the structure and management of the bank's BSA/AML compliance function. The board is responsible for setting an appropriate culture of BSA/AML compliance, establishing clear policies regarding the management of key BSA/AML risks, and ensuring that these policies are adhered to in practice.
>
> The board should ensure that senior management is fully capable, qualified, and properly motivated to manage the BSA/AML compliance risks arising from the organization's business activities in a manner that is consistent with the board's expectations. The board should ensure that the BSA/AML compliance function has an appropriately prominent status within the organization. Senior management within the BSA/AML compliance function and senior compliance personnel within the individual business lines should have the appropriate authority, independence, and access to personnel and information within the organization, and appropriate resources to conduct their activities effectively. The board should ensure that its views about the importance of BSA/AML compliance are understood and communicated across all levels of the banking organization. The board also should ensure that senior management has established appropriate incentives to integrate BSA/AML compliance objectives into management goals and compensation structure across the organization, and that corrective actions, including disciplinary measures, if appropriate, are taken when serious BSA/AML compliance failures are identified.[61]

Set the Tone at the Top

The term "tone at the top" entered the common lexicon with the corporate scandals of the early 2000s and has become almost a cliché at this point. The phrase originated in the field of accounting and is most often used to describe an organization's general ethical climate, as established by its board of directors, audit committee, and senior management. Unfortunately, the term is mostly used in a negative connotation when the SEC, bank regulators, or internal investigators want to describe how a board, its audit or compliance committee, or senior management failed to set the tone for those responsible for ensuring the institution's compliance with applicable requirements.

In dealing with AML issues and compliance, regulators have made clear that a board must establish an incontrovertible tone at the top that encourages compliance, fosters discussion and questions from those involved in the process, protects those who raise questions and issues, and constantly seeks information from those involved in the process that can be used to improve the institution's performance. The tone must be one that seeks to know existing or possible problems and deals with those problems surely and quickly.

The "tone at the top" also makes a board responsible for ensuring that senior management and other financial institution employees understand the importance of AML compliance.[62] While senior management is responsible for implementing the institution's AML program, the board is responsible for ensuring that senior management has the necessary qualifications to carry out its responsibilities, and that the AML compliance function has an "appropriately prominent status within the organization."[63] If business lines do not heed the warnings or instructions of AML compliance, the government may hold the board of directors responsible for the business line's actions on the theory that the board did not establish the appropriate culture of compliance or fulfill its own AML compliance responsibilities. The board must ensure that the business lines respect AML risk and take action if there is evidence to the contrary.

In setting the tone, the board should also regularly schedule presentations and discuss AML risk and compliance, both in front of institution's management, outside advisors, or consultants, and in executive session. The regularity of this discussion, if done with discipline and rigor, will instill diligence in the institution's officers, employees, and consultants. The board should also

conduct follow-up on topics brought to its attention, receiving reports on mitigation and other improvements to the process. Enforcement orders and regulator examination reports regularly reflect that senior management and the board heard about an issue of concern and failed to follow-up to ensure remediation. The regulators deem it insufficient for a board to say "fix it" and then not follow through to ensure the fix is made.[64] This is grounds for likely administrative action by the regulators and, thus, must be avoided. Finally, the board should inquire of senior management and insist that no employee raising concerns, even if these concerns are determined to be in error, is subject to any retribution or other adverse employment action.

Maintain Regular AML Education

The board must also continue to update its knowledge of AML requirements and track the institution's responses to changes in rules and legal developments. AML strategy and requirements have never been static and, we can say with confidence, never will be. The board's obligation is to stay educated on AML rules and the institution's compliance efforts. The board cannot rely on management reports stating that the institution is complying with the legal requirements; the board needs a "general understanding" of the underlying rules and regulations, including the importance of BSA/AML regulatory requirements, the risks posed to the institution, and the consequences of noncompliance.[65] Thus, the board should regularly (*at least annually*) review the institution's risk-based AML program and policies and ask for management's recommendations for changes. The board should also ensure that orientation for a new board member covers AML compliance, and should have regular updates (again, at least annually) to its own training. Finally, the board should schedule regular (again, at least annual) reports on the training undertaken for bank officers and employees.

Practice Smart Delegation

The board should also insist on full and active cooperation among those senior management officers responsible in some way for AML compliance. It is too easy (and common) for busy executives such as the chief compliance officer, the internal auditor, the chief risk officer, and those with business opera-

tional responsibilities to focus only on their part of the whole, or frankly, for personality differences to thwart cooperation among these stake holders. The board should be alert to both forces and insist that nothing interferes with a coordinated effort. Anything less exposes the bank to compliance failure and resulting sanctions, and exposes the board to regulatory scrutiny. Another useful tool in evaluating management effectiveness may be the external auditor, who generally has a better chance to observe and evaluate management's cooperation and effectiveness as part of the auditor's internal control review.

In fulfilling these duties, the board may decide to designate a new or existing committee to provide initial coverage of AML compliance issues. Here, the provisions in regulators' enforcement actions after findings of lack of compliance are instructive. Almost without exception, the bank regulators require a financial institution sanctioned for lax AML compliance to establish a compliance committee of not fewer than three directors, a majority of whom are independent. Boards should consider designating such a committee *before* being instructed to do so. If the institution has a standing compliance committee, that committee would be a good candidate. The institution's audit committee might also be a good candidate for this designation, given its independence.

Although designation of a board committee helps in focusing the board's efforts and creates certain efficiencies, designation is not a substitute for the direct full board involvement in AML programs. Even if a committee is designated, the full board remains responsible for the AML program and the risk assessment guiding the program.[66] As stated in one recent enforcement Order, "The appointment of a Compliance Committee by the Bank's holding company shall not in any way affect or relieve the Board's responsibility in that regard."[67]

Cultivate Good Regulatory Relations

Finally, the board would do well to meet with regulators regularly, and although this would seem axiomatic, to listen carefully. Regulators can and will be blunt when they have concluded the institution has engaged in inappropriate behavior or have determined that an institution is not giving sufficient focus to AML compliance, but they often can be subtle in earlier

conversations. When a regulator seems to be conveying less than satisfaction with the institution's performance, the board must ask blunt questions and act decisively to alleviate the regulators' concerns. The consequences for not doing so can be harsh.

CONCLUSION

Compliance with anti-money laundering rules requires diligence. Traditionally, this has meant diligence on the part of a financial institution's compliance and legal functions to keep aware of rules, understand the institution's AML risk, and monitor the institution's customers and transactions for AML risk. Effective compliance departments also trained line of business personnel to be diligent in watching for flags of suspicious activities and reporting them to the compliance committee.

Now, however, the regulators have made clear that the diligence obligation extends to the institution's board of directors as well. Boards cannot rely on the business judgment rule to shield themselves from liability, nor will regulators allow boards to wait for AML compliance issues to arise through the same reporting processes used for other business and compliance matters. Instead, boards must understand the institution's AML risks and responsibilities and must set a tone of AML diligence throughout the institution. In the current climate, boards that do not take responsibility for AML compliance seriously may find regulators placing responsibility for compliance failures on them.

NOTES

[1] James Petras, *US Bank Money Laundering - Enormous By Any Measure* (May 19, 2001), at http://rense.com/general28/money.htm ("There is a consensus among U.S. Congressional Investigators, former bankers and international banking experts that U.S. and European banks launder between $500 billion and $1 trillion of dirty money each year, half of which is laundered by U.S. banks alone."). Accurately estimating the amount of money that is laundered is extremely difficult due to the nature of the activity. *See* Financial Action Task Force, *What is Money Laundering?* (2012), at http://www.fatf-gafi.org/pages/faq/moneylaundering ("By its very nature, money laundering is an illegal activity carried out by criminals which occurs outside of the normal range of economic and financial statistics.").

[2] Hearing: Patterns of Abuse: Assessing Bank Secrecy Act Compliance and Enforcement, Senate Comm. on Banking…, 113th Cong. (Mar. 7 2013) (oral testimony of Thomas J. Curry, Comptroller of the Currency).

[3] Brian Monroe and Colby Adams, *Financial Institutions Paid Sharply More for AML Infractions in 2012*, *Data Shows*, MoneyLaundering.com (May 21, 2013).

[4] *See*, *e.g.*, A Report of the United States Senate Caucus on Int'l Narcotics Control, The Buck Stops Here: Improving U.S. Anti-Money Laundering Practices 37 (April 2013) ("[M]uch more needs to be done to improve the U.S. anti-money laundering framework. Existing laws also must be better enforced.").

[5] *See* Brian Monroe and Colby Adams, *Financial Institutions Paid Sharply More for AML Infractions in 2012*, *Data Shows*, MoneyLaundering.com (May 21, 2013). *See also In re Citigroup Inc.*, Docket No. 13-004-B-HC (Mar. 21, 2013); *In re JPMorgan Chase & Co.*, Docket No. 13-002-B-HC (Jan. 14, 2003).

[6] Thomas J. Curry, Testimony before the Senate Banking Committee (Mar. 7, 2013) ("[Expectations…for board and management accountability…have served as important part of our enforcement orders that we have issued in the last several months.").

[7] For example, banking agency enforcement actions regularly require boards of directors to appoint compliance committees with a majority of independent directors. *See*, *e.g.*, *In re JPMorgan Chase and Co.*, Docket No. 13-001-B-HC (Jan. 14, 2013); *In re PNC Bank, N.A.*, Docket No. 11-0047i (Apr. 13, 2011).

[8] *In re Citibank, N.A.*, Docket No. 2012-052 (Apr. 4, 2012).

[9] *In re Citigroup Inc.*, Docket No. 13-004-B-HC (Mar. 21, 2013); *In re JPMorgan Chase & Co.*, Docket No. 13-002-B-HC (Jan. 14, 2013).

[10] Thomas J. Curry, Testimony before the Senate Banking Committee, *supra* n.2.

[11] A prior FDIC order in 2007 found that the bank had been "operating without effective [Board] oversight and executive management supervision" to prevent BSA/AML violations. *In re Ocean Bank*, Docket No. FDIC-07-017b (Mar. 16, 2007), at 2.

[12] Remarks by Daniel P. Stipano, Deputy Chief Counsel, OCC, at Institute of International Bankers 2011 Anti-Money Laundering Seminar (May 23, 2011).

[13] Senate Permanent Subcommittee on Investigations, U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History (Jul. 16, 2012) ("PSI Report").

[14] *E.g.*, United Bank for Africa, plc, New York Branch (U.S. branch of foreign bank lacked internal controls to identify high-risk customers and manage associated risks and had inadequate testing and SAR procedures), FinCEN No. 2008-3 (Apr. 22, 2008).

[15] *E.g.,* El Noa Noa Corp., FinCEN No. 2008-2 (Apr. 14, 2008) (money transmitter

did not establish an AML program or file currency transaction reports).

[16] While FinCEN was not named in the settlement, it was involved in the underlying investigation, as MoneyGram disclosed in March 2011. Chris Serres, *MoneyGram under investigation again*, Star Trib., Mar. 16, 2011.

[17] *See* Ariz. State Attorney General, *Brown and Arizona AG Goddard Announce $94 Million Agreement with Western Union to Fight Money Laundering by Mexican Cartels*, Press Release (Feb. 11, 2010).

[18] *In re Standard Chartered Bank, New York Branch*, Order Pursuant to Banking Law § 39 (Aug. 6, 2012).

[19] The Federal Reserve and DOJ subsequently entered into a $327 million settlement with Standard Chartered in December 2012, *available at* http://www.justice.gov/opa/pr/2012/December/12-crm-1467.html; http://www.federalreserve.gov/newsevents/press/enforcement/20121210a.htm.

[20] As state banking regulators take a more active role in AML enforcement, the implications also extend beyond banks. Many state regulators have authority over both bank and non-bank financial institutions. NYDFS, for example, also regulates New York insurance companies, mortgage lenders, and money transmitters. State-regulated industries subject to AML rules, such as life insurance companies, were historically examined for AML issues, if at all, by the Internal Revenue Service. IRS examiners are far less familiar with or focused on AML rules than banking examiners, so examinations have been less sophisticated and enforcement has been rare.

[21] Statement of James Freis, Director, on FinCEN's Partnership with State Insurance Commissioners to Combat Fraud, Aug. 15, 2012, http://www.fincen.gov/whatsnew/html/20120815.html.

[22] *See, e.g.*, 18 U.S.C. §§ 1956-1957 (punishing whoever "knowingly engages or attempts to engage" in forms of money laundering); N.Y. Penal Code Art. 470 (state law criminalizing similar conduct).

[23] The soundness of this theory is being tested with the rise of virtual currency exchanges, which are not as obviously "financial institutions" and thus have become a preferred vehicle for laundering money. FinCEN and law enforcement have begun targeting these exchanges are arguing that they are essentially money transmitters, a type of financial institution covered by AML rules. *See* FinCEN, Guidance, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, No. FIN-2013-G001 (Mar. 18, 2013) (attempting to clarify AML regulations as they apply to virtual currency transactions).

[24] Pub. L. No. 91-508 (Oct. 26, 1970), codified as amended at 31 U.S.C. §§ 5311 *et seq*., 12 U.S.C. §§ 1829b and 1951-1959.

[25] 12 U.S.C. 1818(s), 1829(b), and 1786(q).

[26] *See* Federal Financial Institutions Examination Council (FFIEC) *BSA/AML*

Examination Manual ("FFIEC Bank Examination Manual") at 7.

[27] *See* 58 Fed. Reg. 3237-01 (Jan. 8, 1993) (requiring financial institutions to file "criminal referral reports," a predecessor to SARs).

[28] *Public Law* 107-56 (Oct. 12, 2001).

[29] *See* 31 U.S.C. § 5318(h).

[30] 31 U.S.C. § 5318(l).

[31] A notable exception to FinCEN's policy of permitting high-risk customer accounts is "foreign shell banks," which are foreign banks without a physical presence in any country. 31 U.S.C. § 5318(j)(prohibiting financial institutions from opening correspondent accounts for foreign shell banks). Congress evidently concluded that these shell banks have such a high money laundering risk that they cannot be permitted to operate through the U.S. financial system.

[32] FinCEN Bank Examination Manual at 67.

[33] *See* 31 U.S.C. § 5318(g); 31 C.F.R. 1010.320 (general implementation of SAR rule).

[34] The AML rules require a number of other reports besides SARs. Currency transaction reports ("CTRs") date back to the original BSA passed in 1970 and are required for each transaction in "currency" (i.e., coin and paper money) exceeding $10,000 by or through the financial institution. Also required are reports on certain international funds transfers or foreign accounts. *See*, *e.g.*, 31 C.F.R. §§ 1010.322 (transactions in currency); 1010.340 (physical transportation of currency); 1010.350 (foreign financial account reporting).

[35] FinCEN delegated this authority in part to the various banking and securities regulators, and to the Internal Revenue Service. *See* 31 C.F.R. § 1010.810.

[36] 31 U.S.C. 5312(a)(2).

[37] 31 U.S.C. 5318(h)(2) (granting exemption power); 31 C.F.R. 1010.205(b) (listing institutions granted a "temporary exemption").

[38] *See, e.g.*, Frequently Asked Questions on Prepaid Access (Nov. 2, 2011), at http://www.fincen.gov/news_room/nr/html/20111102.html. FinCEN released these FAQs three months after issuing its final rule greatly expanding AML coverage of prepaid access transactions.

[39] *See* FinCEN Bank Examination Manual at 76.

[40] *See* FinCEN Bank Examination Manual at 33 ("The level of sophistication of the internal controls should be commensurate with the size, structure, risks, and complexity of the bank.").

[41] *See* FinCEN Bank Examination Manual at 67.

[42] FinCEN Bank Examination Manual at 22.

[43] *See*, *e.g.*, In re Pacific National Bank, OCC Docket No. 2011-021 (Mar. 23, 2011) (assessing a $7 million penalty against a bank with approximately $358 million in

assets); *In re Saddle River Valley Bank*, OCC Docket No. 2013-143 (Sept. 24, 2013) (assessing a $4.1 million penalty (combined with an additional $4.1 million forfeiture to the Department of Justice) against a bank with $10.2 million in assets that had ceased operations in 2012).

[44] *See, e.g.,* Press Release, U.S. Department of Justice, 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) (announcing forfeiture of $1.256 billion of AML and OFAC violations); Press Release, U.S. Department of Justice, Wachovia Enters into Deferred Prosecution Agreement (Mar. 17, 2010) (announcing forfeiture of $110 million for AML violations).

[45] *See United States v. HSBC Bank USA, N.A.*, Deferred Prosecution Agreement (Dec. 10, 2012) (stating that HSBC has clawed-back bonuses for senior AML and compliance officers, and requiring HSBC to defer bonus compensation for most senior officers during pendency of the deferred prosecution agreement); Alexandra Berzon, *Casinos Heed U.S. Reporting Warning*, WALL ST. J., Sept. 2, 2013 ("To make employees more likely to report suspicious transactions, for instance, Sands plans to tie bonuses to compliance and to claw back bonuses when a financial-reporting issue arises.").

[46] *See, e.g.*, Report by United States Senate Caucus on Int'l Narcotics Control, THE BUCK STOPS HERE: IMPROVING US. ANTI-MONEY LAUNDERING PRACTICES 3 (April 2013).

[47] *Id.*

[48] Even where the government does not pursue criminal law sanctions, it may strengthen its civil enforcement rhetoric. For example, in September 2013 regulators fined one bank more than $50 million for AML violations. While the enforcement actions did not have detailed remedial provisions, the OCC called the bank's violations "significant and egregious," and FinCEN asserted that the bank "willfully" violated AML reporting requirements. *See* Office of the Comptroller of the Currency, *OCC Assesses $37,500,000 Penalty Against TD Bank, N.A. For Failures to File Suspicious Activity Report*, Press Release (Sept. 23, 2013); United States Treasury, *Financial Crimes Enforcement Network, FinCEN Fines TD Bank for Failing to Report Nearly $1 Billion in Suspicious Transactions Related to Florida Ponzi Scheme*, Press Release (Sept. 23, 2013).

[49] Brett Wolf, *U.S. Treasury to lead review of anti-money laundering rules*, BLOG.THOMPSONREUTERS.COM (Nov 12, 2012), http://blog.thompsonreuters.com.

[50] Brian Orsak and Brian Monroe, *U.S. Treasury Department Creates AML Taskforce to Evaluate Regulations*, MONEYLAUNDERING.COM (Nov. 12, 2012).

[51] United States Treasury, Financial Crimes Enforcement Network, Bank Secrecy Act Regulations — Definitions and Other Regulations Relating to Prepaid Access, Final

Rule (Jul. 29, 2011) (effective March 2012).

[52] Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Residential Mortgage Lenders and Originators, Final Rule, 77 Fed. Reg. 8148 (Feb. 14, 2012) (effective August 2012).

[53] http://blogs.reuters.com/financial-regulatory-forum/2012/07/18/u-s-bank-regulator-promises-better-enforcement-following-scathing-congressional-report-into-hsbc-aml-failures.

[54] 12 Brett Wolf, *U.S. Bank Regulator Promises Better Enforcement Following Scathing Congressional Report into HSBC AML Failures* (Jul. 18, 2002); U.S.C. § 1818(s) (requiring banking regulators to issue a public enforcement action if they find that an institution fails to establish and maintain or to correct certain AML procedures).

[55] *See* PSI Report, Executive Summary, at 13 ("A second problem is that the OCC has adopted a practice of foregoing the citation of a statutory or regulatory violation in its Supervisory Letters and annual Reports of Examination when a bank fails to comply with one of the four mandatory components of an AML program.").

[56] Testimony of Thomas J. Curry, Comptroller of the Currency, Before the Perm. Subcomm. on Investigations for the S. Comm. for Homeland Security and Governmental Affairs, http://www.occ.gov/news-issuances/congressional-testimony/2012/pub-test-2012-109-oral.pdf (Jul. 17, 2012).

[57] Brian Orsak, *OCC to Draft Internal Guidance on 'Flexibility' of Pillar Violations*, MoneyLaundering.com (Nov. 12, 2012).

[58] The reaction of these agencies towards the new Consumer Financial Protection Bureau ("CFPB") is illustrative. The bureau was created as a centralized overseer of consumer financial products, in part due to a perceived lack of consumer protection enforcement by the existing banking agencies. Rather than yield to the bureau, however, the federal banking agencies have increased their supervision and enforcement of consumer protection matters and joined the bureau's first enforcement actions. Attention then turned to non-bank financial institutions to create a "level playing field" among companies offering consumer financial products. *See* Peggy Twohig and Steve Antonakes, *The CFPB launches its nonbank supervision program*, CFPB Blog, http://www.consumerfinance.gov/blog/the-cfpb-launches-its-nonbank-supervision-program (Jan. 5, 2012) ("[C]onsistent supervisory coverage will help level the playing field for all industry participants to create a fairer marketplace for consumers and the responsible businesses that serve them.").

[59] The duty of care obligates each director, in taking any corporate action, to act on an informed basis, in good faith and in a manner he or she reasonably believes to be in the best interests of the company, and with such care as a reasonable person would use under similar circumstances. This duty can be met in most cases by appropriate reliance on management and experts. The duty of loyalty obligates each director, in

performing his or her duties as a director, to put the interests of the company ahead of his or her personal interests.

[60] FinCEN Bank Examination Manual at 33 ("The board of directors, acting through senior management, is ultimately responsible for ensuring that the bank maintains an effective BSA/AML internal control structure, including suspicious activity monitoring and reporting.").

[61] FinCEN Bank Examination Manual at 163. An internal footnote to this section notes that "Foreign banking organizations should ensure that, with respect to their U.S. operations, the responsibilities of the board described in this section are fulfilled in an appropriate manner through their oversight structure and BSA/AML risk management framework."

[62] FinCEN calls on the board to create a "culture of compliance," a term that conveys the same fundamental meaning as "tone at the top."

[63] FinCEN Bank Examination Manual at 163.

[64] For example, OCC enforcement orders now regularly require a board of directors to "ensure" that the institution takes certain actions. The orders define "ensure" as requiring timely reporting by management, following up on non-compliance, and requiring corrective action for non-compliance. *See*, *e.g.*, In re PNC Bank, N.A., OCC Docket No. 11-0047i (Apr. 13, 2011).

[65] FinCEN Bank Examination Manual at 37 ("Without a general understanding of the BSA, the board of directors cannot adequately provide BSA/AML oversight; approve BSA/AML policies, procedures, and processes; or provide sufficient BSA/AML resources.").

[66] In *In re TCF Nat'l Bank*, OCC Docket No. 2010-164 (Jul. 20, 2010). The board shall remain responsible for the bank's adherence to the provisions of this Consent Order. "The appointment of a Compliance Committee by the Bank's holding company shall not in any way affect or relieve the Board's responsibility in that regard." *Id*. at 2.

[67] *Id*. at 2. As further stated in the TCF Order: "Although the Board is by this Consent Order required to submit certain proposed actions and programs for the review or prior written determination of no supervisory objection of the Assistance Deputy Comptroller, the Board has the ultimate responsibility for proper and sound management of the Bank." *Id*. at 13. And to make the point crystal clear, the Order also states: "References to the 'Bank' in this Consent Order shall mean that the Board, acting on behalf of the Bank, has the ultimate responsibility to ensure that the actions required are taken." *Id*. at 14.