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BALANCE SORELY LACKING IN BANK SECRECY ACT ENFORCEMENT

by

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On November 10, 2004, the Office of the Comptroller of the Currency (OCC) issued a bulletin (OCC 2004-50) entitled “Enforcement Guidance for BSA/AML Program Deficiencies.” Simultaneously, a classified advertisement appeared in the *American Banker* in which the OCC sought qualified applicants for a newly created position of “Director-Bank Secrecy Act [BSA] and Anti-Money Laundering [AML] Compliance.” In different times, such regulatory actions would barely be noticed; but, in these times of regulatory and politically induced overreaction about money laundering and terrorist financing, these events are but two additional indications of the lost balance in the current approach to BSA/AML compliance. Bankers are caught in a maelstrom ignited by politicians, regulators, prosecutors, and the media. Businesses, and also individuals, who deal in even minimal amounts of cash or wire transfer services are being subjected to unrelenting secretive scrutiny and are finding jumpy bankers increasingly reluctant to provide routine banking services. The question that must be addressed is: how and when can balance be restored to compliance with anti-money laundering laws and regulations?

Before that question can be answered, an examination of how the current environment has evolved is in order. For many years banks have lived with and, for the most part, complied in good faith with the Bank Secrecy Act. The BSA’s primary objective was to thwart dirty money, usually involving cash sales of illicit drugs, from entering the legitimate banking system. This proved to be an illusive goal, but one which spawned numerous rules for filing Currency Transaction Reports (CTRs) and Suspicious Activity Reports (SARs). This routine continued unabated for many years, with bankers and regulators growing comfortable in their respective responsibilities. Then September 11, 2001 altered this comfortable pattern. Those horrifying events led to the rapid passage of the Title III of the USA PATRIOT Act, which featured a renewed emphasis on banks as the first line of defense, this time against terrorist financing. Only now the rules had changed because, instead of seeking to prevent dirty money from entering the banking system, banks were charged with identifying “suspicious” money that was already in the system and preventing that

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money from being used to fund terrorist activities (or, indeed, any other illegal activities). Congress issued this challenge with virtually no meaningful guidance and banks were left to sort out the details (explicitly including a USA PATRIOT Act requirement that BSA compliance be evaluated prior to regulatory approval of any “expansionary” application), at their own peril.

Much like the “Enron crisis” in the corporate world, subsequent BSA/AML events created the perfect storm. Initially a couple of foreign-based banks (ABN Amro and UBS) were found to be deficient in their AML compliance and they entered into regulatory enforcement agreements. UBS also paid a fine. Politicians followed the developments with increasing interest. Shortly after these seemingly innocuous matters, a highly embarrassing AML event erupted in the form of Riggs Bank’s foreign embassy private banking business. The OCC had previously entered an order against the manner in which Riggs had conducted its BSA compliance of accounts provided to foreign diplomats, but the bank apparently ignored the order and continued to offer services for which AML compliance was deficient. This became a highly publicized and politically charged situation, with congressional hearings into the culpability of the OCC and consideration of whether bank regulators should be stripped of their BSA examination authority and a new AML agency installed. Nothing motivates regulators like the combination of embarrassment and potential loss of authority. The challenge was issued and the bank regulators did the natural thing — they became enveloped by BSA.

The Federal Financial Institutions Examining Counsel organized an interagency AML training taskforce. With ferocious determination, regulatory examinations soon found fault with long existing compliance programs, and instead of gentle warnings, rigorous enforcement actions became routine. As enforcement actions rain down, otherwise healthy banks are being prevented from expansionary activities (such as mergers or branch acquisitions or formation). Multi-million dollar fines have been assessed in circumstances that, in the past, would have been resolved in civil litigation. Criminal prosecutors intent on extracting large fines are targeting banks that provide standard financial services to customers that subsequently are found to be engaged in illegal activities. Banks caught in routine check kites or Ponzi schemes are now confronted with potential criminal prosecution and fines that, under the prior regulatory scheme, would have been unthinkable. And all of this is adding enormous regulatory burdens to all banks, large and small, and in turn impacting customers both in terms of cost and banking services.

Of particular concern has been the criminalization of actions that, in the past, had been dealt with solely as civil regulatory matters. The initial example of this development is the widely-reported AmSouth Corp case in which AmSouth, as the bank for a customer that engaged in an alleged Ponzi scheme, was targeted by the U.S. Department of Justice for its failure to file a SAR when the Ponzi scheme was discovered. The most startling aspect of this case is that AmSouth’s failure to file one single SAR resulted in a fine of \$40 million by the DOJ and an additional \$10 million paid to the Federal Reserve. Lest this be viewed as an aberration, *The Wall Street Journal* recently reported that Bank of New York is currently negotiating with federal prosecutors to pay a fine of “perhaps \$24 million” to avoid a potential criminal indictment on charges that it failed to file SARs from one of its branches. And to reinforce the pervasiveness of these developments, on December 30, 2004, *The Wall Street Journal* also reported that a local prosecutor, District Attorney Robert Morgenthau of Manhattan, has threatened to indict Bank of America Corp. in connection

with “allegations that [Bank of America] transferred hundreds of millions of dollars for a Uruguayan money-transmitting business linked to drug trafficking, tax fraud, and other financial crimes.” Even if we cast aside the presumption of innocence of these banks and assume that their respective compliance officers failed to correct obvious and significant failings, the fact that they are or may be confronted with criminal sanctions which could destroy these institutions seems both unjustified and unbalanced.

The OCC’s recently issued “enforcement guidance” is a chilling example of the lack of specific direction regulators are offering and the dire consequences of their 20/20 hindsight. The OCC cites a “statutory mandate” to “issue a cease and desist order (C&D) whenever a bank fails to establish and maintain a BSA compliance program...” The guidance cites circumstances where a C&D is appropriate. These include the OCC’s determination that a compliance program lacks sufficient internal controls, independent testing, responsible personnel, or training. If a regulatory examination concludes that “highly suspicious” activity is present with the “potential” for money laundering or terrorist financing and the bank has not filed SARs or CTRs, an enforcement action is required. Even a “one-time, non-technical violation” will result in a C&D where the regulators conclude that the violation “demonstrates willful or reckless disregard for the requirements of the BSA or that creates a substantial risk of money laundering or the financing of terrorism.” Moreover, “program deficiencies that are not severe enough to cite a violation” will require corrective action that “may be in the form of a formal or informal enforcement action.” What is clear from the OCC’s “guidance” and from other regulatory pronouncements on BSA is that banks have been left to their own devices to determine what is “suspicious” about their customers’ account activities and that they will be held accountable in hindsight if they misjudge those activities. And, the consequences in such circumstances have been and will be draconian.

One predictable, if ironic, result of the current regulatory trend in BSA enforcement is that bankers now are flooding the U.S. Treasury Department’s Financial Crimes Enforcement Network (FinCEN) with SARs, thus rendering the investigative and probative value of SARs virtually meaningless. FinCEN is awash in SARs and has publicly requested bankers to be more discrete in their SAR filings. But, as one BSA compliance officer for a major institution recently stated only semi-facetiously, “I won’t be satisfied until every account transaction in our institution results in a SAR.”

The impact on banks and their customers of the current madcap adventure and the ultimate costs to the U.S. economy are incalculable. Without any compelling evidence that this enhanced BSA enforcement regime is proving effective in fighting terrorism, the enforcement of the BSA and USA PATRIOT Act is dramatically altering the financial landscape of the U.S. First, and most obviously, the costs of regulatory compliance are soaring for banks and these costs are being passed on to their customers. These costs are also forcing community banks, which are experiencing dramatically disproportionate AML compliance expenses, to make the decision to sell their institution to larger competitors. But, these regulatory burden-based merger decisions are being made at the very time that many potential acquirers are unable to proceed either because of their own pending BSA enforcement actions or out of fear that the target’s possible compliance shortcomings could expose the acquirer to successor liability.

Increasingly, banks are rejecting certain classes of customers, thus creating significant and lasting impacts for individuals, businesses and, ultimately, the U.S. economy. These potentially “high risk” customers that are being excluded from the U.S. banking system include small grocery stores (because grocery stores tend to deal in cash and check cashing), check cashers (to whom many un-banked individuals turn for financial services), money transmitters (which send funds abroad for immigrant workers), foreign businesses, and foreign correspondent banks. The vast majority of these businesses are legitimate and serve important sectors of our economy. Yet, rather than taking the risk of regulatory criticism or criminal prosecution, bankers are concluding that the best approach is to withdraw services, in some cases leaving these bank customers (and their customers) with no legitimate financial system alternatives. The harm to individuals and businesses legitimately trying to conduct their financial affairs has not yet been factored into the regulatory excesses.

Of grave concern should also be the assault on financial privacy of bank customers, which is unprecedented. In packaging the enhanced BSA enforcement in anti-terrorism rhetoric, the American public has yet to be truthfully informed that every check they cash, every deposit they make, every transfer of funds they direct to friends or relatives, is being scrutinized by their bank for “suspicious” aspects and reported to government agencies.

Finally, the basic appropriateness of using the Bank Secrecy Act to threaten criminal sanctions against banks needs to be evaluated. Prosecutors neither understand the monumental task faced by banks in attempting to ferret out criminal or terrorist intentions, nor are they nuanced in their approach to such matters. They proceed with the benefit of hindsight and threaten banks that have no realistic alternative but to pay stratospheric fines. Such an atmosphere is not conducive to balanced justice.

Like all Americans, bankers are determined that terrorism must be rooted out. But the current BSA enforcement scheme is out of balance. The consequences of this lack of balance must be anticipated and remedied before the impacts have lasting effects on the U.S. economy and the citizens whom the BSA theoretically is intended to protect.