Anti-Money Laundering Enforcement and Compliance

2018 Year in Review and Observations for 2019

Bates Research

January 2019

Bates Research takes a look at a year's worth of AML enforcement and compliance actions as well as outreach efforts by regulators. As Bates Group has been reporting throughout 2018, these efforts incorporate a simple carrot and stick message: cooperate and comply or face significant penalties and serious consequences. This article takes a closer look at that message in the context of the major regulatory enforcement actions taken against AML violations in 2018 and offers observations to consider for 2019.

Introduction

At this time last year, the Financial Industry Regulatory Authority ("FINRA") had just issued new anti-money laundering / Bank Secrecy Act ("AML/BSA") guidance to inform member firms on how best to comply with the Financial Crimes Enforcement Network's ("FinCEN") final rule on Customer Due Diligence Requirements for Financial Institutions ("CDD Rule"). The May 2018 mandatory implementation deadline for compliance with the CDD Rule placed heavy burdens on financial market participants to get their overall AML/BSA processes and procedures in order. Though the requirements of the CDD Rule had been public for some time, 2018 was a year in which financial firms were either scrambling to put in place structures or fine-tuning existing systems to cope with the evolving compliance regime. Even after the mandatory implementation date, regulators, elected representatives and various associations continued to debate both broad legislative enhancements as well as narrow compliance exceptions (and in certain cases adjustments) to the AML framework. These steps only served to solidify the new requirements as indispensable to the regulators' enforcement arsenal.

In 2018, regulators backed up some innovative outreach efforts with tough enforcement actions. While regulators testified to the importance of creating a culture of compliance, collaborating with law enforcement, and embracing RegTech tools to improve processes, FINRA, FinCEN, the Board of Governors of the Federal Reserve Board ("FRB"), the SEC, the U.S. Treasury's Office of the Comptroller of the Currency ("OCC") and state regulators such as the New York Department of Financial Services ("NYDFS") aggressively pursued AML/BSA compliance violations.

As Bates Group has been reporting throughout 2018, these efforts incorporate a simple carrot and stick message: cooperate and comply or face significant penalties and serious (intrusive) consequences. This article takes a closer look at that message in the context of the major regulatory enforcement actions taken against AML violations in 2018.

Exam Findings and Guidance: Collaboration or Enforcement Warning?

The regulatory agencies issued a considerable amount of guidance on AML requirements this year. The FINRA guidance focused on core requirements: customer identification and verification, beneficial ownership identification and verification, the nature and purpose of the customer relationship, the development of a risk profile, the monitoring of suspicious transactions and the maintenance of customer information. FinCEN also continued to provide guidance in the form

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of specific answers to Frequently Asked Questions, albeit with the caveat: "a covered financial institution with notice of, or a reasonable suspicion that a customer is evading or attempting to evade beneficial ownership or other customer due diligence requirements should consider whether it should not open an account, close an account, or file a suspicious activity report ("SAR"), regardless of any [of these] interpretations."

FINRA guidance was informed by a 2017 Examination Findings Report which highlighted the following concerns: (i) failures to establish and implement an AML program reasonably designed to detect, and cause the reporting of, suspicious activity; (ii) failures concerning what monitored activities required escalation; (iii) monitoring system deficiencies; and (iv) failures regarding independent testing, (v) failures of program implementation, and (vi) deficiencies caused by a firm's failure to provide adequate resources to AML departments. FinCEN's guidance and FINRA's Report read like a precursor to the kinds of violations regulatory enforcers were looking to find in 2018.

2018 Enforcement Themes

A broad review of actions brought against financial entities for BSA/AML violations in 2018 reflects several enforcement priorities of federal banking regulators and relevant state agencies. In light of the mandatory implementation of the CDD rule to the BSA/AML framework, these actions send an unmistakable message that the regulatory agencies will aggressively pursue firms that fail to comply with core elements of the new regime.

A significant number of prominent enforcement actions in 2018 concerned such compliance failures and their consequences. The common denominator in these cases was a failure to file suspicious activity reports ("SARs"). As these cases show, failure to file SARs is the ultimate result of many types of AML program or supervisory deficiencies warned of in the guidance. It is clear by both the number of these cases, and the size and severity of the penalties and sanctions, that enforcement regulators mean to leave an impression about the importance they place on filing SARs. Still, there is no way to read the cases without recognizing the almost infinite variety of ways in which a company can intentionally or negligently fail to file their SARs.

A second theme that emerges from a review of these cases is the desire to hold financial institutions and corporate officers accountable for the functioning of the AML Compliance program. These cases were notable in that they send a message about very significant personal and professional consequences for failing to appropriately oversee a BSA/AML Compliance program.

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SARs Reporting Violations

The filing of suspicious activity reports to FinCEN is a cornerstone of any BSA/AML Compliance program. Failure to file SARs represents an almost existential threat to the overall BSA/AML framework. Filings of SARs (and Currency Transactions Reports) provide critical intelligence data in volume to law enforcement agencies to assist them with their investigations. The beneficial ownership information now required by the CDD Rule, for example, provides critical information for investigations and exposing illegal networks. The potential for RegTech to increase the efficiency and reduce the burdens of government oversight depends on these filings.

FinCEN's regulations require that financial institutions file SARs to report a transaction (or a pattern of transactions) involving at least $5,000 that the institution knows or suspects: (i) involves funds derived from illegal activity; (ii) is designed to evade any requirement of the BSA; (iii) has no business or apparent lawful purpose; or (iv) involves the use of the institution to facilitate criminal activity.

Given the importance of SARs to the overall BSA/AML framework, it is not surprising that most of the most prominent enforcement cases this year concern failures to file these forms.

Here are highlights from some of the prominent BSA/AML cases in 2018.

Suspicious Transactions Related to Independent Advisors

In September, a registered broker-dealer and investment adviser settled[1] SEC charges for failing to submit suspicious activity reports to FinCEN related to the activities of a number of previously terminated independent advisors. The SEC stated that between 2013 and 2015, the firm, acting in its capacity as a registered broker-dealer and investment adviser, ended business relationships with 111 independent investment advisers. The advisors were terminated on the recommendation of the firm's Institutional Risk and Oversight Control department, a division of the company that manages risks arising from the brokerage and custodial services provided to advisers. The internal department determined that the advisers "presented an unacceptable business, credit, operational, reputational, or regulatory risk" to the firm or its customers.

The SEC charged that the company failed to file SARs on the suspicious transactions of a number of these advisers. Some of the suspect transactions included: suspicious securities trading; questionable transfers and fees to an adviser who was acting as trustee over a client's account; making potentially material false and misleading statements to a client. (The Commission pointed out that after termination, it was possible for the advisers to move to another bro-

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ker-dealer to operate their businesses.) As a result of the company's failure to "consistently and appropriately refer terminated advisers and their possibly suspicious transactions to the firm's Anti-Money Laundering Department," the Commission concluded that the firm was in violation of its obligations under the BSA. Though not admitting or denying the allegations, the company accepted censure and a penalty of $500,000.

In July, a registered broker-dealer settled charges[2] for failing to file SARs related to suspicious transactions conducted by numerous independent investment advisers through the broker-dealer's custodial platform. The SEC alleged that between 2012 and 2013, the company terminated its business relationships with 83 independent advisers because they violated its internal policies and procedures that put customer funds at risk.

The SEC found that the company failed to file SARs related to many of these investment advisers "where it suspected or had reason to suspect … a range of suspicious transactions … including: (1) transactions involving possible undisclosed self-dealing or conflicts of interest; (2) charging client accounts excessive advisory fees; (3) potentially fraudulent transactions in client accounts; (4) posing as a client to effect or confirm transactions in the client account; and (5) executing client trades and/or collecting advisory fees without being properly registered as an adviser." Though not admitting or denying the allegations, the broker-dealer accepted the entry of a permanent injunction and the payment of a $2.8 million civil penalty.

Insufficient Internal Controls, Training and Monitoring

In April, a bank agreed to a detailed Consent Order[3] based on an OCC examination and findings of significant deficiencies in the AML operations of the New York Branch ("Branch") Office. The Branch has been operating in New York since 2009. According to the Order, the OCC found that the Branch failed to timely file SARS concerning suspicious customer activity and failed to adopt and implement a compliance program that adequately covered required BSA/AML program elements. (The findings also included deficiencies in the Branch's compliance with Office of Foreign Asset Control ("OFAC") requirements).

The OCC found that the failure to file SARs was in part due to the Branch's inadequate system of internal controls, ineffective independent testing, weak supervision and insufficient training, as well as "systemic deficiencies in its transaction monitoring systems." Though not admitting or denying the findings, the Bank agreed to a $12.5 million civil penalty, and to very specific remedial measures including the development and implementation of a BSA/AML and OFAC risk assessment program; an independent audit of the bank's BSA/AML compliance program; and to hiring an experienced BSA officer.

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Market Manipulation and Suspicious Trading of Low-Priced Securities

In March, a dually-registered investment adviser and broker-dealer settled[4] SEC charges for failing to file SARs on hundreds of suspicious transactions between 2012 and 2014 that raised red flags of potential market manipulation. The suspect transactions included "high trading volume in companies with little or no business activity during a time of simultaneous promotional activity."

The SEC determined that the company failed to file SARs even though the suspect activity was highlighted in the firm's written supervisory procedures. The Commission concluded that the company's internal trade review mechanisms listed in its written supervisory procedures were ineffective. Further, the Commission found that the company did not analyze, investigate or compile any records regarding the suspect transactions, nor did it assess why its own surveillance systems failed to detect the suspicious activity. the company agreed to pay a $750,000 penalty and retain a compliance expert and take further remedial steps.

In a parallel proceeding, the company settled[5] FINRA charges for failing to have adequate supervisory and AML programs tailored to detect suspicious activity connected to its sale of low-priced securities. Specifically, FINRA determined that the company's supervisory system for trading in "delivery versus payment" accounts was inadequate and that it failed to adequately monitor or investigate the trading in seven such customer accounts that liquidated billions of shares of low-priced securities, generating millions of dollars in proceeds for its customers. In settling with FINRA, the company agreed to an additional $550,000 penalty.

Suspicious Trading Patterns and Lack of Business Purpose

In May, a Chinese-owned registered broker-dealer agreed to settle[6] charges for failing to file SARs related to a business line that cleared a large volume of low-priced securities transactions between late 2013 and late 2016. One of the company's correspondents, a registered broker-dealer headquartered in New York, also agreed to settle[7] charges for failing to file SARs between 2013 and 2014 on transactions that used the company's clearing system.

Though the company stated that it relied on employee reporting, review of trade blotters, reviews of securities deposits, and internal reports to monitor suspicious activity, no SARs were filed with respect to its clearing platform from the inception of the business line in 2013 to 2016. The SEC determined that the company did not update its AML policies and procedures to reflect the risks of clearing these low-priced equity securities. the company agreed to a censure and a civil penalty of $860,000. In a corresponding AML investigation and

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settlement[8], FINRA found the company to have committed financial, recordkeeping, and operational violations. As a result, the company agreed to pay an additional $5.3 million penalty, to retain an independent compliance consultant and to take other remedial measures.

The correspondent, which sold billions of shares of penny stocks through the company, failed to file SARs despite red flags raised by the company as to suspicious trading patterns and issuers "who lacked revenues and products." The SEC determined that the correspodent "…knew, suspected, or had reason to suspect that its customers were using their … accounts to facilitate unlawful activity," and that its customers' deposits and subsequent liquidations of penny stocks were suspicious because they lacked any apparent business or lawful purpose. The correspondent agreed to accept censure and to pay civil penalties of $1 million.

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Transaction Monitoring Program Weaknesses

In February, FinCEN determined that a bank "willfully violated[9] BSA's program and reporting requirements" between 2011 and 2015 by failing to report suspicious activities, filing inadequate currency transaction reports and by otherwise failing to establish and implement an adequate AML program. In its Assessment, FinCEN described the deficiencies. First, the agency found that the Bank had an automated transaction monitoring system which "capped" the number of alerts generated for investigation. FinCEN determined that "these caps caused the Bank to fail to investigate and report large numbers of suspicious transactions." Second, FinCEN found that the Bank allowed non-customers to conduct currency transfers at its branches through a large money transmitter without monitoring those transfers for suspicious activity. Third, FinCEN determined that the procedures the Bank used to identify high-risk customers was inadequate and caused a failure "to effectively analyze and report the transactions of such customers." Finally, FinCEN found that the Bank filed thousands of currency transaction reports "that provided materially inaccurate information" as to the ultimate beneficiaries of money services transactions.

As a result, FinCEN assessed a $185 million civil money penalty against the Bank. Its investigation was coordinated with the OCC and the Department of Justice.

Structuring Schemes

In January, a global money service business agreed to a Consent Order[10] by the NYDFS for violations of New York Bank Secrecy Act and anti-money laundering laws that reach back to 2004. The New York State Order comes one year after the company resolved similar issues[11] with FinCEN, the Department of Justice and the Federal Trade Commission and agreeing to forfeit $586 million for victims who were allegedly defrauded. the company agreed to pay FinCEN $184 million in penalties and to take further remedial actions for willfully violating the BSA by failing to implement and maintain an effective, risk-based AML program and by failing to file timely SARs.

The NYDFS Order stated that the company "willfully failed to implement and maintain an effective anti-money laundering program that was designed to deter, detect, and report on criminals' use of [the company] to facilitate fraud, money laundering, and structuring schemes." The NYDFS explained that structuring schemes are financial transactions executed in a pattern to avoid "triggering the obligation of a money transmitter … to file reports … required by the BSA." The NYDFS found that company executives and managers failed to report suspicious transactions by several high-volume agents throughout New York in violation of, among other statutes, NYDFS licenses and money transmitting regulations.

The Consent Order penalized the company $60 million and gave explicit instructions on elements to be included in a remediation plan designed to ensure the adequacy of its AML program. NYDFS also required the company to submit written progress reports describing actions taken to comply with the Order.

Branch Program Deficiencies and Overall Supervisory Failures

In January, a Taiwanese bank with branches in New York, Chicago and San Jose, agreed to a Consent Order[12] from the Board of Governors of the Federal Reserve System ("FRB") for AML/BSA deficiencies.

The deficiencies at the Bank branches were first uncovered during a NYDFS investigation in 2016. Among its findings, NYDFS determined[13] that (i) the Bank's BSA/AML and chief compliance officer lacked familiarity with U.S. regulatory requirements and had conflicted interests because she had key business and operational responsibilities along with her compliance role; (ii) compliance staff at both the head office and branch failed to periodically review surveillance monitoring filter criteria designed to detect suspicious transactions; (iii) New York branch procedures provided virtually no guidance concerning the reporting of continuing suspicious activities; and (iv) that the Bank failed to determine whether foreign affiliates had adequate AML controls in place. As a result of these deficiencies, the Bank agreed to pay a $180 million penalty and install an independent monitor for to ensure compliance with New York's anti-money laundering laws. The New York investigation prompted the FRB to conduct a broader examination of the other branches.

By the FRB Consent Order, the Bank agreed to pay a $29 million civil penalty for additional findings of bank and branch deficiencies, and agreed to institute a series of policy and program remediations for

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each of its branches. Some of the specifics include the submission of a company plan to strengthen oversight of BSA/AML compliance across U.S. operations; branch plans that "clearly define roles, responsibilities, and accountability" regarding AML compliance; enhanced BSA/AML written compliance programs that include a system of internal controls; enhanced independent testing; a comprehensive risk assessment that identifies and considers all products and services; effective training for branch personnel; programs for compliance with the Office of Foreign Assets Control regulations and a program "reasonably designed to ensure the identification and timely, accurate, and complete reporting" by the branch of all known or suspected violations of law or suspicious transactions.

Observations

This year's enforcement actions highlight the broad spectrum of causes behind the breakdown in the SARs filing process. From enforcement concerns over whether terminated "bad actor" brokers may escape notice when they resurface at another firm, to an all-out failure to have any valid supervised program in place, to outright intentional fraud, the failures to file SARs seems like a call to open an investigatory door. As in previous years, regulators pay close attention to filing SARs in a timely manner and where appropriate. Financial institutions can no longer ignore their responsibility to file SARs, or file minimal quantities of SARs, which ultimately provide the required information to law enforcement to assist with the investigations and prosecutions process. Transaction monitoring systems need to be tuned annually so that suspicious activity is not missed, resulting in the failure to file SARs, which might lead to an enforcement action.

Personal and Professional Liability

A second theme that comes out of the prominent BSA/AML enforcement cases this year is how regulators are holding AML compliance officers personally and professionally responsible for deficiencies found in the programs they oversee. The cases show that holding these officers accountable is yet another powerful enforcement tool.

In a related SEC proceeding to the Chinese-owned BD/Correspondent BD SARs cases discussed above (*see bottom of p.6*), the correspondent's Chief Compliance Officer and designated AML Officer agreed to settle[14] SEC charges that he "willfully aided and abetted and caused" BSA violations. The penalties were not insubstantial. The officer agreed to pay a civil penalty of $15,000 and accept a bar from the industry and penny stocks for three years.

In the above-reference matter concerning the dually-registered BD/IA (*see top of p. 6*), the SEC pursued senior compliance personnel for

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failing in their duty to file SARs after they became aware of transactions that exhibited numerous AML red flags. In a separate settlement[15] the former AML compliance officer agreed to pay a penalty of $20,000 and to refrain from serving in a compliance or AML capacity in the securities industry with a right to reapply. Another former AML compliance officer, alleged to have aided and abetted and caused the company's violations, continues to litigate similar charges as of this writing.

The OCC has issued a number of Consent Orders[16] fining executives and directors of a California Bank for failing to take necessary actions to ensure that the Bank corrected deficiencies contained in prior OCC Consent Orders. The previous Orders related to findings[17] by FinCEN and the OCC that the Bank "failed to (a) establish and implement an adequate anti-money laundering (AML) program, (b) conduct required due diligence on its foreign correspondent accounts, and (c) detect and report suspicious activity."

The underlying case concerned failures that "allowed billions of dollars to flow through the U.S. financial system without effective monitoring to adequately detect and report suspicious activity." The leadership of a bank-owned money services business allegedly forced staff to execute their transactions "without question or face potential dismissal or retaliation." FinCEN found that "bank insiders directly interfered with the BSA staff's attempts to investigate suspicious activity related to these insider-owned accounts."

In the latest Consent Orders, the Comptroller fined the former Chairman of the Board, President and CEO, $175,000; the former Executive Vice president, $70,000, and the Chairman of the Board, $20,000 for failing to take necessary actions to ensure that the Bank corrected the deficiencies that resulted in the violations of the prior Consent Orders.

Observations

By Edward Longridge, Managing Director, Financial Crimes

For a number of years U.S. regulators have identified and brought actions against individual AML/FC officers. Generally, regulators will bring personal actions against individuals in the most egregious of cases where there is clear evidence of an overall failure to address the issues faced by an AML/FC program or where there is willful blindness for example. However, all AML/FC officers are faced with the tangible possibility of being held personally liable for an overall failure of their AML/FC program. Generally, this concept of personal liability will spur AML/FC officers forward to implement well-functioning and robust AML programs. The financial crimes compliance world has changed significantly over the last few years. These cases suggest that personal liability will be a significant factor in the industry in the future.

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Conclusion

As the information in SARs forms becomes more and more critical to law enforcement processes—and the additional information mandated by the CDD Rule will ensure that it is—firms should expect that regulators initiating enforcement actions over failure to file SARs will become more aggressive. An indicator of that is the magnitude of the penalties levied in the AML cases this year. The civil monetary penalties and the remedial steps mandated in the consent orders indicate that regulators will continue to take action against financial institutions that fall short of their BSA/AML obligations.

About Bates Financial Crimes Practice

In the face of increasing regulatory investigations and enforcement actions, financial services companies are looking to independent consultants for assistance and to help establish and implement Anti-Money Laundering and Financial Crimes best practices.

Bates Group has been a trusted partner to our financial services clients and their counsel for over 30 years, delivering quality results on a cost-effective basis. Bates Group's Financial Crimes practice offers a valuable combination of industry and technical consulting expertise, providing the highest possible value to our clients in the areas of AML and financial crimes, fraud investigations, forensic accounting, data analysis and expert witness consulting.

Our Financial Crimes team is led by recognized experts in AML, financial crimes, fraud and forensic accounting with extensive experience in the broker-dealer, banks and investment advisor fields. We provide tailored solutions and support for the following areas: AML/OFAC risk assessments, AML/FC program gap assessments and audits, KYC risk model design, AML systems reviews, transaction monitoring look-back and ongoing investigations, fraud investigations, forensic accounting, AML/FC policies and procedures reviews, advisory services for rule implementation, regulatory response support, and white collar crime testimony support. Bates experts and consultants work with you to limit the regulatory, financial and reputational impact of money laundering, financial crimes and fraud that may have occurred and reduce the likelihood of future occurrence.

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Endnotes

1 SEC Admin. Proc No. 3-18829, Release No. 84269 / September 24, 2018.
2 SEC Litigation Release No. 24189 / July 9, 2018.
3 See Department of the Treasury Office of the Comptroller of the Currency, Consent Order, AA-EC-2018-19, April 24, 2018 available at https://www.occ.gov/static/enforcement-actions/ea2018-038.pdf.
4 SEC Admin. Proc . No. 3-18412, Release No. 82956 / March 28, 2018, available at https://www.sec.gov/litigation/admin/2018/34-82956.pdf.
5 FINRA Letter of Acceptance, Waiver and Consent No. 20130387509 (March.28, 2018).
6 SEC Admin Proc. No. 3-18488, Release No. 83253 / May 16, 2018, available at https://www.sec.gov/litigation/admin/2018/34-83253.pdf.
7 SEC Admin Proc. No. 3-18486, Release No. 83251/May 16, 2018, available at https://www.sec.gov/litigation/admin/2018/34-83251.pdf.
8 FINRA Letter of Acceptance, Waiver and Consent No. 2015045550801 (May 16, 2018).
9 FINCEN, Assessment Civil and Monetary Penalty, Number 2018-01 (February 15, 2018).
10 NYSDFS, Consent Order (Jan. 4. 2018).
11 See FINCEN Press Release, "Company Agrees to $184 million Penality and Remedial Actions" (Jan. 19, 2017).
12 Federal Reserve Board of Governors and Illinois Dept. of Financial and Professional Regulation Div. and Banking, Order to Cease and Desist and Order of Assessment of a Civil Money Penalty Issued Upon Consent (Jan. 17, 2018).
13 See NYDFS Press Release: Bank's Violations of AML Laws and Consent Order (Aug. 19. 2016).
14 SEC Admin Proc. No. 3-28487, Release No. 83252 / May 16, 2018.
15 SEC Admin Proc. No. 3-18413, Release No. 82957/ March 28, 2018.
16 See Department of the Treasury Office of the Comptroller of the Currency, Consent Orders: AA-EC-2017-74, #2018-028 (April 4, 2018); AA-EC-2017-75, #2018-029 (March 23, 2018); AA-EC-2017-80, #2018-022 (Feb. 22, 2018).
17 See FINCEN Press Release "FinCEN Penalizes California Bank for Egregious Violations of Anti-Money Laundering Laws" (Feb. 27, 2017).