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Regulatory Update on Recent FinCEN Anti-Money Laundering Developments

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Introductions and Overview

- Setting the Stage
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  - How is money laundered?
- Current Regulatory Focus and Trends
  - Compliance Priorities
  - FinCEN Rulemaking on Beneficial Owners
- Who regulates?
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  - OFAC (Economic Sanctions and Terrorist Finance)
  - State AGs & Financial Service Regulators
- Recent Cases & Developments
- Best Practices, Preparedness, and Red Flags
- Looking Ahead

Setting the Stage

How did we get here?

- What is Money Laundering?
  - Introduction of dirty money into the legitimate financial system, “layering” the money through a series of transactions to separate the money from its illicit origins, and “integrating” the dirty money into legitimate commerce.
- Not to be confused with Terrorist Finance
  - May be dirty money, but frequently is clean money used for terrorist purposes.

Setting the Stage

How did we get here?

- Drug and Corrupt Money.
  - UN Estimate: $800 Billion to $2 Trillion/year
- Terrorist money:
  - 9/11: AA Fl 11 (BOS-LAX)(North Tower)
    - $184,098.24 (from 1/2000 to 9/11/2001, five people, cash, lodging, auto, flight lessons, airline tickets, food, *etc.)*
  - *USS Cole:* Less than $10,000 (2000)
  - Madrid subway: ~$10,000 (2004)

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Setting the Stage

How did we get here?

- Drugs & Cash – money laundering "typologies"
  - Cocaine, marijuana, heroin and amphetamines
  - Bulk Cash
    - Smurfing
    - Cross-border bulk cash
    - Corruption
- Trade-based money laundering
  - FinCEN Geographic Targeting Order (GTO) for certain trades and businesses located within the Los Angeles Fashion District.
- Informal value transfer systems (Hawala)

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Setting the Stage

AML/CFT Landscape

- Who are the BSA/AML Enforcers?
  - Department of the Treasury, Financial Crimes Enforcement Network (FinCEN)
  - Federal functional regulators (SEC, OCC, FDIC, FRB, NCUA, *etc*.)
  - Self-regulatory bodies (FINRA)
  - Department of the Treasury, Office of Foreign Assets Control (economic sanctions and terrorist finance)
  - State AGs and financial regulators
  - Private citizens

Setting the Stage

AML/CFT Landscape

- What are the AML Laws?
  - Bank Secrecy Act (BSA) (as amended by the USA PATRIOT Act)
  - Federal regulations (FinCEN, FFIEC, SEC)
  - FINRA rules
- Who is Subject to the AML Laws?
  - Depository Institutions
  - Casinos
  - Money Services Businesses
  - Insurance Industry
  - Securities and Futures
  - Precious Metals/Jewelry Industry
  - Mortgage Co/Broker

Current Regulatory Focus and Trends

AML as Compliance Priority

- Renewed Focus on BSA/AML
  - Compliance Culture
  - Tailored Risk Management Systems
  - Information Technology ("IT") Strength
  - Resources
- New (and old) Challenges
  - Know your customer (beneficiaries and owners too)
  - Growth and diversity of payment system
    - Digital and virtual currencies
    - Mobile payments
  - Regulator expectation for entities to "police" business partners and service providers

Current Regulatory Focus and Trends

FinCEN Beneficial Owner Rulemaking

- Long time coming
- Proposed rules designed to “clarify and strengthen” customer due diligence (CDD) requirements for certain financial institutions – “CIP Entities” – banks, broker/dealers, mutual funds, and futures commission merchants and introducing brokers in commodities.

Current Regulatory Focus and Trends

FinCEN Beneficial Owner Rulemaking

- Proposed rules focus on four CDD "pillars:"
  - 1. Identify and verify the identity of customers;
  - 2. Identify and verify the beneficial owners of legal entity customers (*i.e.*, the natural persons who own or control legal entities);
  - 3. Understand the nature and purpose of customer relationships; and,
  - 4.Conduct ongoing monitoring to maintain and update customer information identify and report suspicious transactions.
- The proposed rules integrate the CDD "pillars" into the AML program rules by focusing on (1) "beneficial ownership" of legal entities and (2) explicit requirements to (a) understand the nature and purpose of customer relationships and (b) conduct ongoing monitoring of customer accounts.

Current Regulatory Focus and Trends

FinCEN Beneficial Owner Rulemaking

- Ownership Prong
  - Customer must certify (on a FinCEN form) information concerning any natural person owning – directly or indirectly – 25% or more of a legal entity.
  - Financial institution should "be able to rely generally" on the customers' representations and FinCEN does not intend the 25% threshold to deter FIs currently identifying beneficial owners of 10% or more.
  - FinCEN proposes to exempt a number of entities (broadly defined to include corporations, LLCs, partnerships, and unincorporated nonprofit associations).
- Control Prong
  - Defined as "an individual with significant responsibility to control, manage, or direct a legal entity customer, and gives as examples an "executive officer or senior manager;" or, "Any other individual who regulatory performs similar functions."

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Current Regulatory Focus and Trends

FinCEN Beneficial Owner Rulemaking

- Best Practices Become Regulatory Requirements
  - Understanding the nature and purpose of customer relationships.
    - Rule is intended "to clarify existing expectation for [FIs] to understand the relationship for purposes of identifying transactions in which the customer would not normally be expected to engage."
  - Conduct ongoing monitoring of customer accounts.
    - This rule ensures that FIs maintain and update customer information and identify and report suspicious activity.
- Comments have been submitted – what to expect next?

Current Regulatory Focus and Trends

Other Areas of Focus

- Transparency: Promoting a Culture of Compliance
- Trade based laundering
- Human Trafficking
- Cash Couriers
- Funnel Accounts
- Geographic Targeting Orders
- Marijuana Banking

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Recent Enforcement Actions

- Recent High-Profile Enforcement Activity
  - Enforcement and examination regulators focused on BSA/AML compliance
    - Large and small financial institutions
    - Individual officers and directors
  - Expect continued escalation of fines and other sanctions (e.g., growth limits, activity restrictions, individual sanctions and, for banks, in egregious cases, charter revocation)

Recent Enforcement Actions

Federal Regulators

- January 2014 – Settlement with **JPMorgan Chase Bank, N.A.** for failure to report suspicious transactions arising out of Bernard L. Madoff's decades-long, multi-billion dollar fraudulent investment scheme. Fine of $461 million. [FinCEN, OCC, FRB, U.S. Attorney's Office (SDNY)]
- January and June 2014 – Consent orders with **Old National Bank** and **Associated Bank** based on prior conduct. In both cases, OCC had previously entered into consent orders with the Banks in 2012. The cases highlight regulatory priorities:
  - Failure to implement appropriate BSA/AML policies and procedures;
  - AML function lacked resources and expertise;
  - Inadequate training;
  - Lookback for both companies involved the filing of a combined 897 in new and supplemental SARs.

Recent Enforcement Actions

Federal Regulators

- January 2013 – Cease and desist orders and CMPs on five individuals associated with **Security Bank**, Miami. Two of those individuals were sanctioned for seeking out high-risk lines of business. [OCC]
- April 2012 – Consent order with **Citibank** regarding allegations that the Bank had deficient compliance program for internal controls, customer due diligence, AML audit, transaction monitoring, and SAR reporting. [OCC]
- November 2012 – Settlement with **First Bank of Delaware**, including a $15 million CMP. The Bank allegedly failed to monitor third-party payment processor relationships and related products and services in line with associated risks, such as the use of Remotely Created Checks in consumer/merchant transactions. The CMP was based, in part, on the Bank's prior history of AML non-compliance. [FinCEN, FDIC, DOJ]

Recent Enforcement Actions
FINRA

- Account Monitoring
  - Brown Brothers Harriman & Co. (Feb. 4, 2014)
    - Executed transactions or delivered securities involving six billion shares of penny stocks, many on behalf of undisclosed customers of foreign banks in known bank secrecy havens. In many instances, the Firm lacked the identity of the stock's beneficial owner, how the stock was obtained, and the seller's relationship to the issuer.
  - Capital Path Securities (May 8, 2014)
    - Allowed multiple customers to liquidate blocks of stocks without properly monitoring these accounts for suspicious trading and wire activity.

Recent Enforcement Actions
FINRA

- Compliance Policies and Procedures
  - Gilford Securities Inc. (April 3, 2014)
    - The Firm failed to verify the identity of 12 new customers opening new accounts, and failed to resolve substantive discrepancies discovered when verifying information of 13 new customers opening new accounts.
  - Banorte-IXE Securities International, Ltd. (Jan. 28, 2014)
    - Failure to adopt AML procedures tailored to the Firm's business, relying instead on off-the-shelf procedures which were not customized to address the unique risks with the Firm's customers in Mexico.
    - The Firm did not enforce the AML program as written.
    - Failure to detect suspicious transactions by customers with reported ties to a Mexican drug cartel.

Recent Enforcement Actions

OFAC

- Sept. 2014 – Citigroup agreed to pay $217,841 to settle potential civil liability for eight alleged violations of the Iranian Transactions and Sanctions Regulations, 31 C.F.R. part 560 (ITSR), and other sanction programs
- Dec. 2013 - Royal Bank of Scotland paid $33,122,307 (part of global settlement involving Fed. Reserve, and the New York Department of Financial Services) to settle allegations regarding wire transfers involving Cuba, Burma, Sudan, and Iran.
- Dec. 2012 – HSBC settlement of $1.9 billion for “particularly egregious” conduct
- Dec. 2012 – Standard Chartered paid $132 million to settle allegations of Iran sanctions violations.

Best Practices and Red Flags

Common Problems

- Weak compliance culture
  - No Management/Board accountability for ensuring effectiveness of BSA/AML and OFAC compliance
  - Insufficient financial and staffing resources
- Missing or weak components of AML or OFAC programs
  - Weak enterprise-wide risk management system,
  - Inadequate IT and monitoring processes
  - No business line accountability for BSA/AML compliance
  - Lack of independent audit function
- Compliance risks arising from the use of third-party service providers
- Failure to update BSA/AML programs to account for evolving risk or new products and services

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Best Practices and Red Flags

Preparation and Avoidance

- Develop Strong Compliance Culture
- Designation of a BSA/AML Compliance Officer with sufficient authority and resources (staff and systems)
- Lines of communication between BSA/AML function and Board and senior management
- Adequate financial and staffing resources
- Ongoing, relevant training of employees
- Independent testing and review

Best Practices and Red Flags

Preparation and Avoidance

- Ensure BSA/AML Program Includes Key Elements
  - BSA Compliance Officer with qualifications to address BSA/AML laws and potential risks
  - Documented risk assessment of business activities
  - Develop and implement internal policies and procedures tailored to business and areas of risk
    - Customer Identification Program
    - Customer Due Diligence
    - Transaction Monitoring
  - Training tailored to responsibilities and businesses
  - Independent testing and review on regular basis

Best Practices and Red Flags

Preparation and Avoidance

- Additional considerations to minimize risk
  - Enterprise-Wide Risk Management
    - Early intervention
    - Coordination between different business lines
  - Automated Monitoring Systems and Technologies
    - Ensure systems provide effective and timely feedback to both compliance staff and management
    - Understand vulnerabilities of systems/controls
    - Technology maintenance and upkeep
    - Leverage technology to create “feedback loop” that can be used to further refine compliance policies and procedures

Best Practices and Red Flags

Preparation and Avoidance

- OFAC Compliance Program should include the following minimum requirements:
  - Risk Assessment: tailored to specific product lines, customer base, the nature of transactions and identification of higher-risk areas for OFAC transactions
  - Policies and procedures and internal controls
  - Screening transactions (and updating of OFAC lists)
  - Blocked/Rejected transactions and reporting to OFAC

Best Practices and Red Flags

Looking Ahead

- The pressure stays on
- Increased focus on banks as gate-keepers
- Increased focus on third-party vendors, payment system participants
- Increased emphasis on cybersecurity
- Alternative currencies
- Increased focus on C-Suite involvement and compliance

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