Challenging conventional wisdom in U.S. anti-money laundering practices

The 1970 Bank Secrecy Act (BSA), as amended by the U.S.A. Patriot Act, forms the legal framework for governmental bodies to implement the country's anti-money laundering (AML) policies. Initially, U.S. AML's focus was combating organized crime groups (OCGs), in particular, albeit not exclusively, the so-called "War on Drugs."

After 9/11, U.S. AML declaratory objective shifted to terrorist financing. This change in emphasis had several motivations, some well-intentioned (in part, motivated by a heightened sense of fear) and others more cynical — simply seizing on anxiety over national security to strengthen U.S. AML that many specialists had been seeking for years. Congress appropriated more funds for AML tasks, regulations were adopted, and the private sector was assigned roles in the effort.

Unfortunately, it appears that the resulting situation is not entirely satisfactory on many levels. Terrorist organizations (TO) and traditional OCGs modified the manner by which they operated. For example, they increasingly moved "value" outside the financial system (e.g., through commodities. Furthermore, TOs and OCGs were able to identify weak links in the AML systems often since the manner in which they operated was publicly disseminated.

TOs and OCGs frequently were not intimidated by such changes since the private sector lacked willpower and personnel to effectively implement changes. Enhanced AML programs created new costs for businesses, the primary goal of which is the profit motive (for the entity or its employees).

At present, regulated U.S. entities are required to generate Currency Transaction Reports (CTRs) for all transactions in excess of $10,000 as well as the "discretionary" Suspicious Activity Reports to FinCEN, the U.S. financial intelligence unit. This threshold seems to be so low that despite computerization FinCEN would seem to be drowning in paper.[1]

Pursuant to Section 326 of the Patriot Act, the U.S. Department of Commerce was required to develop "Know Your Customer" rules to be followed by regulated entities. The degree to which a private organization is systematic when applying its version of procedures adopted pursuant to this requirement is not uniform. Any system of this nature will vary by the particular business and its employee's conduct.

It remains an open question whether such activities generate intelligence "leads" as opposed to being a source of valuable information to further investigations once targets are identified. The information might be critical in foiling plans or in prosecuting individuals. That is to say, the efforts are of limited value.

The existence of laws, implementing regulations, and guidelines are of little concrete value if they are not followed. In July 2004, the Minority Staff of the Permanent Sub-Committee on Investigation issued a troubling report called "Money Laundering and Foreign Corruption Enforcement and the Effectiveness of the Patriot Act: Case Study Involving Riggs Bank."[2] At one time, Riggs Bank touted itself as the oldest and most important bank in Washington.

The Subcommittee Staff conducted an in depth investigation that involved reviewing thousands of documents, as well as interviewing "representatives of financial institutions, the Office of the Comptroller of the Currency (OCC), the Federal Reserve, various experts and other persons."[3]

The Report described that Riggs' Bank:

(i) Operated a dysfunctional AML program and in fact did not merely allow, but in fact facilitated suspicious financial activity, despite frequent warnings from OCC personnel;

(ii) Embassy Banking business constituted approximately 20 percent of the Bank's revenues, 7 percent of its banking relations involved countries

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[1] According to FINCEN, it processed "over eighteen million reports under the BSA's record keeping and reporting requirements in fiscal year 2008." FINCEN Annual Report for 2008, at 10, more specific data is provided in this report, which is available at http://www.fincen.gov/news_room/rp/files/annual_report_fy2008.pdf. Of course, U.S. financial institutions also may file Suspicious Activity Reports (SARs) when there are circumstances suggesting the possibility of money laundering, but the filing of a SAR is a discretionary act. In 2008, so-called "covered industries filed 1,318,984 SARs; this represents an increase of approximately 150,000 SARs over 2007. *Id.,* at 6.

[2] Available at http://levin.senate.gov/newsroom/supporting/2004/071504psireport.pdf.

[3] *Id.,* at 4.

designated as "non-cooperative" jurisdictions by the Financial Action Task Force (FATF);

(iii) corporate governance system made possible illegal conduct, this failure was due to both organizational shortcomings as well as personnel willing to engage in or tolerate illegal activity; and

(iv) relationship with Equatorial Guinea, Saudi Arabia, and former Chilean President August Pinochet; especially troubling was not only the bank's willingness to assist in the illegal laundering of money, by diplomatic personnel of the aforementioned countries as well as Mr. Pinochet and his family, but also certain major oil companies readily participated in activities that made this possible.

The level and frequency of Riggs Bank's activity cannot be overlooked (and probably does not represent an isolated example). From 1999 to 2004, Equatorial Guinea had more than 60 accounts with Riggs and accepted deposits ranging from $400-700 million at a time. Undoubtedly, there were many red flags for the regulators to notice. Thus, Riggs Bank alone cannot be blamed for what transpired.

Yet despite the extent of its transgressions, the OCC and FinCEN fined Riggs a grand total of $25 million for its BSA violations. It is noteworthy that at various times the OCC and the Federal Reserve issued Riggs Bank cease and desist orders and required it to correct the shortcomings in its AML program.[4] Needless to say, this did not occur.

Particularly disturbing was that Riggs, to give the impression that it was taking the necessary steps to prevent future violations, hired various former government officials, *including an OCC official who had worked on Riggs Bank matters.*[5] While there may have not been any federal conflict of interest rules violated, query whether some regulators may be tempted

[4] *Id.,* at 8, 14, 15, 17, 20, 76, *et al.*
[5] *Id.,* at 7, 56 58, 62, 74, 83 and 89.

to use their positions as means of obtaining future employment, which might lead to less (or greater) BSA enforcement in pursuant of this aim in the future.

The Report made the following recommendations:

(1) *Strengthen Enforcement.* To strengthen anti-money laundering (AML) enforcement federal bank regulators should require prompt correction of AML deficiencies identified by their examiners, making greater use of enforcement tools, including more timely use of civil fines, and consider developing a policy requiring mandatory enforcement actions within a specified period of time against any financial institution with repeat AML deficiencies.

(2) *Take Regulatory Action.* By the end of 2004, federal regulators should issue final regulations and revised examination guidelines implementing the due diligence requirements, including for private banking accounts opened for senior foreign political officials and their families.[6]

(3) *Issue Annual AML Assessments.* Federal Regulators should include on a routine basis AML assessments in the Report on Examination given to banks each year, and should make those AML assessments available to the public, both to increase bank compliance with requirements to combat money laundering and foreign corruption, and to alert to other financial institutions to banks with inadequate AML controls.

(4) *Strengthen Post-Employment Restrictions.* Using 41 U.S.C. §423(d) as a model, Congress should enact legislation to impose a one-year cooling-off period for Federal Examiners-in-Charge of a financial institution before they can accept a position with the financial institution they oversaw.

(5) *Authorize Intrabank Disclosure.* The United States should work with the European Union and other international bodies to enable financial institutions with U.S. and foreign affiliates to exchange client information across international lines to safeguard against money laundering and terrorist financing.

(6) *Increase Transparency.* Oil companies operating in Equatorial Guinea should publicly disclose all payments made to or business ventures entered into with individual E.G. officials, their family members or entities controlled by them, and should prohibit future business ventures in which senior government officials or their family members have a direct or beneficial interest. Congress should amend the Foreign Corrupt Practices Act to require U.S. companies to disclose substantial payments made to or business ventures entered into with a country's officials, their family members, or entities controlled by them.

Following the money can be important, but having effective intelligence systems and creating mechanisms that establish financial incentives (and disincentives) to induce desirable behavior should not be overlooked

Now that the Democrats possess a majority in both the Senate (albeit still needing for some Republican votes to close debate), and House of Representatives, there is less of a likelihood of Congress challenging any Obama administration's proposals to alter U.S. AML/CFT efforts. This suggests that the aforementioned Report's Recommendations will be assessed to evaluate the effectiveness of our policies, particularly because the methods used by both terrorist and organized crime to move "value" across international borders has changed in recent years. This article examines some of the issues that should be evaluated in any such evaluation.

If money laundering and terrorist financing problems remain such a concern, one needs to ask why FATF's recommendations set out in The Third Mutual Activity Report on Anti-Money Laundering and Combating the Financing of Terrorism, dated 23 June 2006[7] have not been acted upon nor more demanding requirements proposed, much less enacted.

In any event, I would like to propose certain additional ideas that I believe may be worthy of consideration as a means to enhance effectiveness of existing U.S. AML and Anti-Terrorist Financing Programs. Granted, some of these may not be politically feasible given the strength of certain special interests, but they are worthy of discussion by specialists in the field. The most important of which and perhaps the easiest to implement are:

1) Raise the threshold for CTRs from $10,000 to a larger amount, perhaps $100,000 or even $1,000,000. This would reduce the effort processing paper simply because the system established requires it. If intelligence or law enforcement personnel wanted to gather financial activity of particular individuals, they should first get a subpoena and then obtain the information sought — it need not be generated by bureaucracies on "auto-pilot."

2) Presently legislation rewards whistleblowers financially for alerting government officials of instances where the government has been overcharged by contracts; the very same mechanism might be adapted to the money laundering area. Giving individuals a financial incentive to combat money laundering and terrorism financing could produce valuable results. The

[6] Query whether this definition is adequate given the complexity of human and business relationships. Through the use of shills, trusts and other structures that hide who are the true beneficiaries, it is difficult to arrive at a fully satisfactory definition. This suggests that analyses in this area must be performed on a case-by-case basis.

[7] The Report is available at http://www.fatf-gafi.org/dataoecd/44/9/37101772.pdf, the recommendations are set forth at 304-309.

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paying of informers by law enforcement and intelligence personnel is a common practice, why not formalize it in this area?

3) Persons who have regulatory involvement for financial institutions should be subject to a lifetime prohibition on employment with such institutions, although there may be some legal hurdles, as well as negative practical consequences in making such a prohibition permanent that will need to be further examined. Still, persons with experience and competence in this field will have numerous potential employers. Let's avoid the risks inherent in regulators being tempted to be less rigorous in their duties out of fear of jeopardizing future employment, as well as financial institutions explicitly or implicitly creating incentives for a government official to do so.
4) With respect to the implementation of financial institutions carrying out "Know Your Customer Rules" why not establish a checks and balances system in which individuals would not have potential conflicts of interest. That is, one unit of an organization would be responsible for investigating potential customers whose activities trigger money laundering concerns either through CTRs or suspicious activity reports, another that would deal operationally with customers, and a third with compliance/oversight responsibilities to ensure that governmental requirements are observed. Indeed, it is possible and perhaps desirable that the investigatory function be assigned to an organization that is independent of the financial institution and be assigned to a particular investigation by a governmental body. While this last proposal might be costly, it would be offset in whole or in part by the savings of the first proposal.
5) The fines actually imposed on financial institutions for violating the BSA must be severe enough so that they have a deterrent value.[8] Financial institutions that have repeated violations and show little or no improvement in complying with applicable requirements should be closed down (and must not be allowed to be reconstituted under a different name). Officers, directors, managers and employers who fail to observe the rules should be prohibited from working with financial institutions, and, where appropriate, prosecuted criminally under the appropriate acts.
6) Encourage other countries to take steps similar to those adopted by the United States. Until the 1997 OECD Anti-Bribery Convention was adopted, U.S. corporations complained that the 1977 U.S. Foreign Practices Act created an "uneven" playing field for their business operations abroad.[9] On first impression, if some countries adopt stricter rules for regulating financial institutions, there will be a renewed race to the bottom by jurisdictions seeking to attract illicit funds. If the U.S. is successful in getting a large number of states to enact requirements similar to those found in the U.S., it will enhance the ability of financial intelligence units to focus their efforts. It may be that business and persons that operate in countries that are designated jurisdictions of concern would draw greater attention to their activities. In any event, most criminals ultimately want to place their assets in politically stable environments — that is the money should flow to those locales that offer the secure investment opportunities and possess reliable financial infrastructures.

It is unrealistic to expect that anti-money laundering or anti-terrorist financing regimes are completely effective. This is especially true due to what might be called the decentralization of terrorism combined with the rather small costs involved in preparing for and carrying out terrorist acts. Nonetheless, too much is at stake to resign oneself to passively accept being a target of a terrorist attack. Following the money can be important, but having effective intelligence systems and creating mechanisms that establish financial incentives (and disincentives) to induce desirable behavior should not be overlooked.

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[8] 31 U.S.C. § 5322 – Criminal Penalties sets out the range of sanctions both financial as well as prison terms for various offenses, including those committed in connection with financial reporting requirements. Violations of the BSA in furtherance of a money laundering scheme (aiding and abetting or conspiracy) and under certain circumstances a person could be charged under the Racketeer Influenced and Corrupt Organization Act and other statutes to make more severe penalties in this area. Typically when one is prosecuted for money laundering, it is combined with the predicate offense and other crimes. See 31 U.S.C. § 2 – Principals. *See* Andrew Chung and John Mack, Financial Institutions Fraud, 44 Am. Crim. L. Rev. 555 (2007), Tracy Tucker Mann, Money Laundering, 44 Am. Crim. L. Rev. 769 (2007) (discussing trends in prosecuting financial crimes, including money laundering). Nonetheless, with respect to white-collar criminals (e.g. the Public Company Accounting Reform and Investor Protection Act of 2002 – Commonly referred to as the Sarbanes-Oxley Act, Titles VIII-XI, available at http://www.law.uc.edu/CCL/SOact/toc.html), there seems to be a tendency of judges to impose sentences that are less severe than the harm caused, particularly when compared with violent offenses. See Ethan S. Burger, Author, *Hard-won corporate governance gains must not be lost,* Financial Times, August 24, 2005, at 11; reprinted in Susan Hunnicutt, Corporate Corruption (2007)

[9] *See* Ethan S. Burger and Mary S. Holland, Why the Private Sector is Likely to Lead the Next Stage in the Global Fight Against Corruption, 30 FORDHAM INT'L L. J. 45, 51 (2006).