

Anti-Money Laundering Compliance: Only Mega Banks Need Apply

I. INTRODUCTION

Imagine a group of climbers starting a hike on safe terrain led by an instructor. The terrain then gets progressively rockier and steeper until the instructor arrives at a nearly vertical cliff. From there, the only options for each climber are to stop the hike altogether or proceed up a tall, jagged cliff. The instructor's advice to the climbers wishing to continue is to use reasonable judgment as to the risks and to buy expensive safety equipment. The climbers know that others have attempted to tackle the cliff but have fallen without enough equipment, suffering grave injuries. Furthermore, today the cliff face has also become more jagged, and there is a storm approaching.

This analogy represents the present anti-money laundering (AML) situation between banks and federal regulators. Banks are at the base of the cliff facing hard decisions. As AML compliance becomes more difficult, the only guidance given by federal regulators is to make a reasonable attempt given the risks inherent to each account.¹ Despite the increasingly complex financial landscape and minimal guidance, the disciplinary consequences are grave should a bank's monitoring system fail. That being said, for a bank that can throw enough money at the problem to pay for the safety equipment, reaching the top of the cliff is possible despite the approaching regulatory storm.

In the last decade, federal agencies have increased their oversight of bank compliance with AML laws.² While increased federal

1. Due Diligence Programs for Correspondent Accounts for Foreign Financial Institutions, 31 C.F.R. § 1010.176(b)(1) (2012) ("Conduct enhanced scrutiny of such correspondent account to guard against money laundering and to identify and report any suspicious transactions in accordance with applicable law and regulation. This enhanced scrutiny shall reflect the risk assessment of the account . . .").

2. See STAFF OF THE PERMANENT SUBCOMM. ON INVESTIGATIONS, 108TH CONG., REP. ON. MONEY LAUNDERING AND FOREIGN CORRUPTION: ENFORCEMENT AND EFFECTIVENESS OF THE PATRIOT ACT: CASE STUDY INVOLVING RIGGS BANK 9 (2004) [hereinafter RIGGS BANK REPORT], available at

regulation is nothing new in the financial world, the force of AML regulation is increasing at a faster pace than it has in response to banks' AML failures in the past.³ Congress has not only been critical of financial institutions and their compliance efforts, but also of federal regulators and their oversight.⁴ Dealing with tighter scrutiny from avid regulators, banks will be forced to increase costs to adhere to stricter AML guidelines.⁵ "Second tier"⁶ banks will likely struggle with the costs and red tape of this stricter compliance regime.⁷ In contrast, the world's largest banks, with vast financial resources, will have an opportunity to capitalize on a competitive advantage in providing financial services which require enhanced due diligence.⁸

Following this introduction, Part II of this note will outline the

<http://www.levin.senate.gov/imo/media/doc/supporting/2004/0924psireport.pdf> (released in conjunction with the Permanent Subcommittee on Investigations' Hearing on July 15, 2004, this report details the AML deficiencies at Riggs Bank).

3. See Press Release, Opening Statement of Sen. Carl Levin: U.S. Vulnerabilities to Money Laundering, Drugs and Terrorist Financing: HSBC Case History 5 (July 17, 2012) [hereinafter Levin Statement] (follow Member Statements, Chairman, Permanent Subcommittee on Investigations CARL LEVIN D (MI) "Download Statement (93.9 KB)" hyperlink) (recommending harsher penalties for non-compliance, including charter revocation) (the U.S. Senate Permanent Subcommittee on Investigations immediately released Sen. Levin's opening statement from the hearing as a press release); Greg Farrell, *Deutsche Bank Among Four Said to Be in U.S. Iran Probe*, BLOOMBERG (Aug. 18, 2012), <http://www.bloomberg.com/news/2012-08-18/deutsche-bank-among-four-said-to-be-in-u-s-laundersing-probe.html> (predicting from insider information that Deutsche Bank and three other unnamed banks would be the next to join the series of banks already subjected to investigations).

4. STAFF OF THE PERMANENT SUBCOMM. ON INVESTIGATIONS, 112TH CONG., REP. ON U.S. VULNERABILITIES TO MONEY LAUNDERING, DRUGS, AND TERRORIST FINANCING: HSBC CASE HISTORY (2012) [hereinafter HSBC REPORT], available at <http://www.hsgac.senate.gov/subcommittees/investigations/hearings/us-vulnerabilities-to-money-laundering-drugs-and-terrorist-financing-hsbc-case-history> (released in conjunction with the Permanent Subcomm. on Investigations' July 17, 2012 hearing, this report describes oversight from the Office of the Comptroller of the Currency as ineffective).

5. See Neil Katkov, *Trends in Anti-Money Laundering 2011* (2011), <http://amlcft.com/files/2011/09/Celent-AML-Trends-2011-2013-Report.pdf> (last visited Feb. 5, 2013) (reporting the results of a survey of more than 75 financial institutions globally as to the current and projected costs of AML compliance).

6. This note focuses on the cost and impact of compliance with AML laws by comparing those of the world's largest global banks with those of smaller global or multinational banks. To distinguish the two, this note will use the terms "first tier" and "second tier."

7. See *HSBC's Grilling, What Comes Out in the Wash*, ECONOMIST (Jul. 18, 2012, 9:45 PM) [hereinafter, *HSBC's Grilling*], <http://www.economist.com/blogs/schumpeter/2012/07/hsbc's-grilling> (last visited Feb. 3, 2013).

8. *Id.*

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development of AML statutes from their inception to the Patriot Act.⁹ Part III will detail the inadequate implementation of these laws by financial institutions and the minimal oversight from regulators in the past.¹⁰ Next, Part IV will explore what is now expected of U.S. chartered banks in today's heightened regulatory regime and the economies of scale needed for compliance.¹¹ Finally, Part V concludes by identifying some of the prospective issues surrounding AML compliance and by suggesting that without change, the regulatory regime will have more losers than winners as second tier banks struggle to remain competitive with industry giants.¹²

II. THE DEVELOPMENT OF AML LAWS

A. *Money Laundering Defined*

Federal law defines money laundering as “the movement of illicit cash or cash equivalent proceeds into, out of, or through the United States [or] . . . United States financial institutions.”¹³ The impetus behind AML laws was a rise in reports of people carrying “bags full of currency of doubtful origin into banks for deposit” in the 1950s and 1960s.¹⁴ Since then, the banking industry has expanded and globalized, and AML laws have continually evolved to confront contemporary problems.¹⁵

B. *Early AML Legislation*

Passed in 1970, the first federal law designed to limit money laundering was the Financial Recordkeeping and Reporting of Currency

9. *See infra* Part II.

10. *See infra* Part III.

11. *See infra* part IV.

12. *See infra* part V.

13. 31 U.S.C. § 5340(2) (2006).

14. Internal Revenue Service, *Internal Revenue Manual*, HISTORY OF THE BANK SECRECY ACT (2012), http://www.irs.gov/irm/part4/irm_04-026-005.html#d0e23. As opposed to deposits of bags of cash, money laundering has taken a myriad of forms using complex transactions and various financial instruments.

15. *See, e.g.*, FDIC, *See Bank Secrecy Act, Anti-Money Laundering, and Office of Foreign Assets Control*, DSC RISK MANAGEMENT MANUAL OF EXAMINATION POLICIES, 1 (2004) [hereinafter *FDIC Manual*], http://www.ffiec.gov/bsa_aml_infobase/documents/FDIC_DOCS/BSA_Manual.pdf.

and Foreign Transaction Report Act,¹⁶ more commonly known as the Bank Secrecy Act (BSA). The law required banks to keep certain records and reports in order to aid in “criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.”¹⁷ These records and reports were intended to facilitate audits or form a paper trail for law enforcement and regulatory agencies such that transactions could be reconstructed or retraced when necessary.¹⁸ As the first AML law of its kind, Title I of the BSA authorized the Secretary of the Department of the Treasury (Treasury) to issue regulations requiring recordkeeping from financial institutions.¹⁹ Title II empowered the Treasury to prescribe the exact requirements concerning reports of transactions over \$10,000.²⁰

The next important piece of AML legislation, following minor amendments to the BSA, was the Money Laundering Control Act of 1986.²¹ It imposed criminal liability for violation of money-laundering regulations,²² but also expanded the reach of AML laws by defining “transaction”²³ and “financial transaction”²⁴ as broadly as possible to cover a wider range of activities. These two provisions put very few, if any, economic activities outside the purview of AML law.²⁵ The

16. 31 U.S.C. § 5311 (2006).

17. *See id.*

18. *See FDIC Manual, supra* note 15, at 1.

19. *See id.*

20. *See id.*

21. 18 U.S.C. § 1956 (2006).

22. *See* 18 U.S.C. § 1956(a)(1)(B)(ii) (2006); 18 U.S.C. § 1956(a)(2)(B)(ii) (2006); 18 U.S.C. § 1956(a)(3)(C) (2006).

23. 18 U.S.C. § 1956(c)(3) (2006) (defining “transaction” to include “a purchase, sale, loan, pledge, gift, transfer, delivery, or other disposition, and with respect to a financial institution includes a deposit, withdrawal transfer between accounts . . . or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected.”). Clearly, transactions subject to AML laws include those that do not involve financial institutions.

24. 18 U.S.C. § 1956 (c)(4) (2006) (“The term ‘financial transaction’ means (A) a transaction which in any way or degree affects interstate or foreign commerce (i) involving the movement of funds by wire or other means, (ii) involving one or more monetary instruments, or (iii) involving the transfer of title to any real property, vehicle, vessel, or aircraft, or (B) a transaction involving the use of a financial institution which is engaged in, or the activities of which affect, interstate or foreign commerce in any way or degree.”). In *United States v. Skinner* (946 F.2d 176) (1991), the court upheld convictions for laundering money even though they resulted from a series of uncomplicated cocaine sales, rather than traditional bank activity.

25. Congress is almost always purposeful with use of the phrase “affecting commerce”

Annunzio-Wylie Anti-Money Laundering Act of 1992 formally increased the authority of the Secretary of the Treasury to include summons powers²⁶ and the explicit ability to subject “nonfinancial trades or businesses” to AML laws.²⁷ Taken together, these pieces of legislation empowered the Treasury to impose criminal liability on a wider variety of institutions (and individuals) for a broader range of “transactions.”

Between 1986 and 2001, additional legislation increased the body of AML law,²⁸ but none had the substantial impact of the Uniting and Strengthening America by Providing Appropriate Tools Required to Interpret and Obstruct Terrorism Act of 2001 (Patriot Act).²⁹ The 9/11 attacks revealed the vulnerability of American financial institutions to money laundering as investigations later made clear that the terrorists responsible utilized the U.S. financial system.³⁰ In the aftermath of the attacks, Congress included stronger AML laws in the Patriot Act of 2002,³¹ and federal agencies in turn promulgated stronger regulations for financial institutions.³² The twelve portions of the Patriot Act remain the most important additions to AML law since the enactment of the BSA in 1970.³³

Of the sections affecting financial institutions, Section 312 imposed the most substantial regulatory burden on banks and the biggest oversight burden on federal agencies.³⁴ It was an amendment to the BSA that “impos[ed] due diligence and enhanced due diligence

to imply that legislation applies as broadly as the Commerce Clause. *See* *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52, 56 (interpreting the term “involving commerce” in the FAA as the functional equivalent of “affecting commerce,” describing the latter as words of art that signal the broadest permissible exercise of Congress’ Commerce Clause power).

26. 31 U.S.C. § 5318 (a)(4) (2006).

27. 31 U.S.C. § 5318 (a)(2) (2006).

28. *See* Money Laundering Suppression Act of 1994, Pub. L. No. 103-325, 108 Stat. 2243; Money Laundering Crimes Strategy Act of 1998, Pub. L. No. 105-310, 112 Stat. 2941.

29. *See* FDIC, *Bank Secrecy Act, Anti-Money Laundering, and Office of Foreign Asset Control*, DSC RISK MANAGEMENT MANUAL OF EXAMINATION POLICIES 8 (2004), http://www.ffiec.gov/bsa_aml_infobase/documents/FDIC_DOCs/BSA_Manual.pdf.

30. HSBC REPORT, *supra* note 4, at 6 (2012).

31. *Id.* at 1, n.4 (2012).

32. *See, e.g.*, Due Diligence Programs for Correspondent Accounts for Foreign Financial Institutions, 31 C.F.R. §§ 1010.605; 1010.610; 1010.630; 1010.670 (2012).

33. *See generally* *Bank Secrecy Act (BSA)/Anti-Money Laundering (AML) Examination Manual*, *supra* note 29, at 8.

34. *See* 31 C.F.R. § 1010.610 (2012).

requirements on U.S. financial institutions that maintain correspondent accounts for foreign financial institutions or private banking accounts for non-U.S. persons.”³⁵ As discussed below in the context of the HSBC example,³⁶ the correspondent accounts³⁷ of greatest concern and subject to enhanced due diligence are those maintained for banks operating: (1) under an offshore banking license;³⁸ (2) under a license issued by a country that has been designated as being non-cooperative with international anti-money laundering principles or procedures;³⁹ or (3) under a license issued by a country designated by the Secretary of the Treasury as warranting special measures due to money laundering concerns.⁴⁰ In effect, banks are now required to show that they are reasonably capable of detecting suspicious activities given the high risk of money laundering inherent to designated correspondent accounts.⁴¹

III. AML ASSESSMENTS: BANKS AND REGULATORS

Federal agencies are empowered to promulgate procedures for banks and to oversee the implementation of these procedures.⁴² Reports from the Senate Permanent Subcommittee on Investigations (PSI) have revealed a culture of non-compliance by banks and deficient oversight by agencies.⁴³ Absent sufficient compliance and meaningful oversight, a substantial volume of laundered money has been moved through the

35. USA Patriot Act, FinCEN, http://www.fincen.gov/statutes_regs/patriot/index.html?r=1&id=312#312 (last visited Jan. 23, 2013).

36. See *infra* Part III.

37. The final rule implementing Section 312 and the Patriot Act itself define correspondent banking broadly as any account established for a foreign financial institution “to receive deposits from, or to make payments or other disbursements on behalf of, the financial institution, or to handle other financial transactions related to such foreign financial institution.” *FACT SHEET, Section 312 of the USA Patriot Act, Final Regulation and Notice of Proposed Rulemaking*, FINANCIAL CRIMES ENFORCEMENT NETWORK DEPARTMENT OF THE TREASURY 1-2 (Dec. 2005).

38. 31 C.F.R. § 1010.610(c)(1) (2012).

39. 31 C.F.R. § 1010.610(c)(2) (2012).

40. 31 C.F.R. § 1010.610(c)(3) (2012).

41. 31 C.F.R. § 1010.610(b) (2012). Part IV of this Note details the implementation of the enhanced due diligence procedures.

42. See *Bank Secrecy Act, Anti-Money Laundering, and Office of Foreign Asset Control*, DSC RISK MANAGEMENT MANUAL OF EXAMINATION POLICIES, FEDERAL DEPOSIT INSURANCE CORPORATION 8.1-8 (2004), http://www.ffiec.gov/bsa_aml_infobase/documents/FDIC_DOCS/BSA_Manual.pdf.

43. See HSBC REPORT, *supra* note 4 (2012).

U.S. financial system.

A. *Bank Compliance History*

1. Riggs Bank

The first high-profile Congressional investigation into AML compliance following the passage of the Patriot Act began in 2003.⁴⁴ Upon the request of Senator Carl Levin, Ranking Minority Member, the Subcommittee investigated “the enforcement and effectiveness of key anti-money laundering provisions in the Patriot Act, using Riggs Bank as a case study.”⁴⁵ The evidence did not cast a positive light on Riggs Bank; the investigation revealed a dysfunctional AML program and blatant disregard for its AML obligations.⁴⁶ Notably, two sets of troublesome accounts linked Riggs Bank to Augusto Pinochet and Equatorial Guinea.⁴⁷

Pinochet, the former president of Chile, maintained personal accounts at Riggs Banks for at least eight years while under investigation and subject to a worldwide court order freezing his assets.⁴⁸ Riggs Banks not only served as his personal bank, but the

44. RIGGS BANK REPORT, *supra* note 2, at 1 (2004).

45. *Id.*

46. Press Release, FinCEN, U.S. Dep’t of the Treasury, Assessment of Civil Money Penalty 8 (May 13, 2004), *available at* http://www.fincen.gov/news_room/ea/files/riggsassessment3.pdf.

47. James Rowley, *Riggs Bank Fined \$16 Mln for Helping Chile’s Pinochet (Update 5)*, BLOOMBERG, (March 29, 2005), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aDX6Lhj3.j3I> (last visited Jan. 15, 2013). Augusto Pinochet Ugarte seized power on September 11, 1973. While his time in office led to economic growth in Chile, thousands of citizens were executed or disappeared, and countless others were detained, tortured or exiled. Jonathan Kandell, *Augusto Pinochet, Dictator Who Ruled by Terror in Chile, Dies at 91*, N.Y. TIMES, (December 11, 2006), <http://www.nytimes.com/2006/12/11/world/americas/11pinochet.html?pagewanted=all> (last visited Jan. 15, 2013). Equatorial Guinea is a small, oil-rich country in central Africa. The ruling elite has amassed a litany of human rights violations spanning fifty years under Francisco Macias Ngeuma and his nephew Teodoro Obiang Nguema. The totalitarian reality of life for the 700,000 citizens was “stolen elections, strict censorship, routine torture, and murdered dissidents.” Thor Halvorssen and Tutu Alicante, *How Dictators Triumph: With a Little Help From Their Friends*, THE HUFFINGTON POST (August 6, 2012), http://www.huffingtonpost.com/thor-halvorssen/how-dictators-triumph-wit_b_1789668.html (last visited Jan. 17, 2013).

48. Terence O’Hara & Kathleen Day, *Riggs Bank Hid Assets of Pinochet, Report Says*, WASHINGTON POST (July 15, 2004), <http://www.washingtonpost.com/wp->

relationship began because senior officials at Riggs actively pursued Pinochet's business.⁴⁹ The report alleges that the bank conducted transactions in violation of AML laws for many years, including deposits of money from unknown origins, the creation of offshore shell corporations, efforts to hide Pinochet's involvement in cash transactions, and personal deliveries of cashier checks to Chile.⁵⁰

Riggs carried on a similar relationship with Equatorial Guinea, its officials, and their family members for whom the bank managed more than 60 accounts and certificates of deposits.⁵¹ While Pinochet's total deposits varied between \$4 and \$8 million at a time, Equatorial Guinean officials and their families maintained balances and outstanding loans approaching \$700 million, representing the bank's largest single relationship.⁵² The bank turned a blind eye to the unknown origins of millions of dollars in deposits, and set up shell corporations as a means of covering up beneficial ownership, among other things.⁵³ The Congressional report concluded that "the evidence demonstrates that the Pinochet and Equatorial Guinea accounts were not treated in an unusual manner but were the product of a dysfunctional AML program with long-standing, major deficiencies."⁵⁴

2. HSBC Bank USA, N.A. (HSBC-US)

In comparison, HSBC-US exhibited longstanding AML deficiencies through various, more clandestine financial vehicles, ranging from the transfer in bulk of travelers checks and cash to bearer share accounts and high-risk affiliate accounts.⁵⁵ More specifically,

[dyn/articles/A50222-2004Jul14.html](http://www.nytimes.com/dyn/articles/A50222-2004Jul14.html) (last visited Jan. 17, 2013).

49. Rowley, *supra* note 47.

50. RIGGS BANK REPORT, *supra* note 2, at 19. The bank changed the name on the accounts from "Augusto Pinochet Ugarte & Lucia Hiriart de Pinochet" to "L. Hiriart &/or A. Ugarte" to make sure the name Pinochet would not be found if searched. Timothy L. O'Brien, *At Riggs Bank, A Tangled Path Led To Scandal*, N.Y. TIMES, (July 19, 2004), <http://www.nytimes.com/2004/07/19/us/at-riggs-bank-a-tangled-path-led-to-scandal.html?pagewanted=all&src=pm> (last visited Jan. 3, 2013).

51. O'Brien, *supra* note 50.

52. *Id.*

53. Terence O'Hara, *Riggs Bank Agrees to Guilty Plea and Fine*, WASHINGTON POST (January 28, 2005), <http://www.washingtonpost.com/wp-dyn/articles/A41584-2005Jan27.html> (last visited Jan. 3, 2013).

54. RIGGS BANK REPORT, *supra* note 2, at 4.

55. See HSBC REPORT, *supra* note 4. HSBC-US provided millions of dollars per year

HSBC's group-wide policy regarding its global affiliates was systematically at odds with AML laws in that it failed to follow enhanced due diligence requirements pursuant to the BSA and Section 312.⁵⁶ These procedures include: (1) verification of the identity of the nominal and beneficial owners of an account; (2) documentation showing the sources of funds; and (3) enhanced scrutiny of accounts and transactions of senior foreign political figures.⁵⁷

HSBC-US, as the U.S. affiliate to HSBC, operated correspondent accounts for approximately eighty HSBC affiliates around the world.⁵⁸ These, like other correspondent accounts, provided access to the U.S. financial system to respondent banks located in high-risk jurisdictions and/or to those that provided services to high-risk clients.⁵⁹ The obvious defect in HSBC group policy was its assumption that any affiliate owned fifty percent or more by the group met federal AML standards. Thus, to HSBC-US this relieved the burden to conduct any due diligence as to the affiliate's AML compliance program.⁶⁰ HSBC-US treated its own affiliates in high-risk jurisdictions as it would treat the bank next door instead of using stricter scrutiny as it should when dealing with unaffiliated high-risk banks.⁶¹ This HSBC group policy disregarded even ordinary due diligence standards that must be met when opening a correspondent account with *any* financial

to a Japanese bank by cashing travelers' checks. Bulk cash transfers were a part of the HBMX money-laundering scheme and ultimately allowed HBMX to smuggle the more physical U.S. dollars to HSBC-US than any of its 80 affiliates. Over the course of a decade, HSBC-US allowed more than 2,000 customers to open bearer share accounts; these are high risk accounts in that ownership is assigned to whomever has physical possession of the shares, allowing secrecy as to the true beneficial owner. The HSBC-US office in Miami had over 1,600 bearer share accounts at its peak, while there were over 850 at HSBC-US New York. *Id.* at 277. This note uses HSBC-US instead of HBUS in hopes of avoiding confusion.

56. See News Release, OCC, OCC Assesses \$500 Million Civil Money Penalty Against HSBC Bank USA, N.A. (Dec. 11, 2012), <http://occ.gov/news-issuances/news-releases/2012/nr-occ-2012-173.html> (last visited Jan. 9, 2013).

57. See FDIC, *Bank Secrecy Act, Anti-Money Laundering, and Office of Foreign Asset Control*, DSC RISK MANAGEMENT MANUAL OF EXAMINATION POLICIES 30 (2004), http://www.ffiec.gov/bsa_aml_infobase/documents/FDIC_DOCs/BSA_Manual.pdf.

58. HSBC REPORT, *supra* note 4, at 21.

59. Levin Statement, *supra* note 3, at 1.

60. HSBC REPORT, *supra* note 4, at 35; see also *HSBC's Grilling*, *supra* note 7. Ownership of the affiliate was no guarantee of AML compliance.

61. See *HSBC's Grilling*, *supra* note 7 ("The senator noted that the bank continued to operate in jurisdictions with secrecy laws; he asked whether it could ignore those limitations to meet America's transparency demands.").

institution (much less one in a high-risk country) by creating an exception for foreign affiliates not recognized by law.⁶²

Correspondent accounts have been identified for over a decade as a banking mechanism susceptible to manipulation by foreign banks in order to launder money.⁶³ The relationship between HSBC-US and HSBC Mexico S.A. Banco (HBMX) “illustrates how providing a correspondent account and U.S. dollar services to a high-risk affiliate increase[s] AML risks.”⁶⁴ HSBC group purchased a Mexican bank called Bital in 2002, creating HBMX; Bital had no functional AML compliance program at the time despite widespread drug trafficking and money laundering in Mexico.⁶⁵ Consistent with HSBC policy, HSBC-US treated HBMX as a low-risk affiliate, despite its operations in a high-risk jurisdiction without an AML compliance program.⁶⁶ Unsurprisingly, the PSI investigation revealed that HBMX opened accounts for high-risk clients, including criminal currency exchange businesses and suspect corporations.⁶⁷

3. Other Prosecutions and Legal Actions

AML compliance was not a problem limited to Riggs Bank and HSBC, as evidenced by the number of investigations⁶⁸ into large banks operating in the U.S. In 2010, the government filed a deferred prosecution agreement against Wachovia Bank, N.A. after discovering that Mexican casa de cambios had moved at least \$110 million in drug proceeds through the bank.⁶⁹ Wachovia paid \$160 million in civil and

62. HSBC REPORT, *supra* note 4, at 35.

63. See USA Patriot Act, Pub. L. No. 107-156, 15 Stat. 272, 296 (2001).

64. HSBC REPORT, *supra* note 4, at 35.

65. *Id.*

66. *HSBC Money Laundering Report: Key Findings*, BBC NEWS (December 11, 2012), <http://www.bbc.co.uk/news/business-18880269>.

67. HSBC REPORT, *supra* note 4, at 35. The currency exchange businesses in Mexico are referred to as casa de cambios, used by criminals to launder funds by exchanging U.S. dollars or Mexican pesos prior to their being transmitted to an international account. *Illegal Casa De Cambio Launderers More Than \$5 Million*, THE SAR ACTIVITY REVIEW 3 (2001), http://www.fincen.gov/law_enforcement/ss/pdf/032.pdf. The corporations of concern were later proven to be shell corporations used to launder funds from illegal drug sales in the United States. HSBC REPORT, *supra* note 4, at 35.

68. Farrell, *supra* note 3.

69. Curt Anderson, *Wachovia To Settle Money Laundering Case for \$160 Million*, HUFFINGTON POST (March 17, 2010, 6:23 PM), http://www.huffingtonpost.com/2010/03/17/wachovia-to-settle-money-_n_502959.html.

criminal fines and promised to undertake significant AML reforms to avoid prosecution.⁷⁰ In December of 2012, Standard Chartered, PLC, pledged to pay over \$650 million in penalties.⁷¹ Insiders involved in the Standard Chartered case have suggested that regulators will likely soon turn their attention to a new set of banks thought to be in violation of AML laws.⁷² Taken together, these and numerous other examples⁷³ highlight failed compliance from large banks in the last decade despite the AML provisions in the Patriot Act.

Smaller banks have run afoul of AML laws, sometimes leading to lost charters or their exit from the correspondent banking market.⁷⁴ Zions First National Bank, headquartered in Salt Lake City, UT, wound down its foreign correspondent business as the cost of compliance technology increased beyond its budget.⁷⁵ In November of 2012, First Bank of Delaware lost its charter (the so-called “Death Penalty”)⁷⁶ for its AML failures.⁷⁷ On top of the charter revocation, the bank paid a \$15 million civil penalty; the deficiencies included failure “to adequately oversee third-party payment processor relationships and related products and services in a manner commensurate with associated risks.”⁷⁸ The examples of Zions First National Bank and the First Bank

70. Press Release, U.S. Att’y’s Off. for the S. Dist. of Fla., Wachovia Enters into Deferred Prosecution Agreement (Mar. 17, 2010) (*available at* <http://www.justice.gov/usao/fls/PressReleases/100317-02.html>); Anderson, *supra* note 69.

71. *Too Big to Jail*, ECONOMIST, December 15, 2012, [hereinafter *Too Big to Jail*] <http://www.economist.com/news/finance-and-economics/21568403-two-big-british-banks-reach-controversial-settlements-too-big-jail?fsrc=scn/tw/te/pe/toobigtoojail>.

72. See Farrell, *supra* note 3.

73. See *Too Big to Jail*, *supra* note 71.

74. *BSA/AML Penalty List, CitiBank, N.A.*, BANKERSONLINE.COM, <http://www.bankersonline.com/security/bsapenaltylist.html#citibankna> (last visited Jan. 21, 2013).

75. Samuel Rubinfeld, *FinCEN, OCC Fine Zions First Bank \$8 Million for Inadequate AML Compliance*, CORRUPTION CURRENTS, WALL ST. J. BLOGS (Feb. 11, 2011, 3:56 PM), <http://blogs.wsj.com/corruption-currents/2011/02/11/fincen-occ-fine-utah-bank-8-million-for-inadequate-aml-compliance/> (“Zions exited the business in 2008 and reported the suspicious activity connected to it, the OCC said in its statement”). Zions attempted to market a deposit service to high-risk foreign customers, but failed to implement an effective AML safeguard or file timely suspicious activity reports therefrom. *BSA/AML Penalty List, Citibank, N.A.*, *supra* note 74.

76. *BSA/AML Penalty List, CitiBank, N.A.*, *supra* note 74. The Delaware Office of State Bank Commissioner terminated the bank’s charter and the FDIC terminated its deposit insurance.

77. Samuel Rubinfeld, *First Bank of Delaware Loses Charter Over AML Problems*, WALL ST. J. BLOGS: CORRUPTION CURRENTS, WALL ST. J. (November 19, 2012 3:23 PM).

78. *BSA/AML Penalty List, CitiBank, N.A.*, *supra* note 74.

of Delaware represent the departure of regional and small national banks from the foreign correspondent banking market, a fate that may soon face smaller multinational banks.

B. *Oversight from the Office of the Comptroller of the Currency*

1. Organization and Strategies

Banks' widespread failure in AML compliance would not have been possible without ineffective oversight from regulators.⁷⁹ The Office of the Comptroller of the Currency (OCC) is the federal agency responsible for oversight of banks and savings associations with national charters, and certain U.S. affiliates of foreign-owned banks.⁸⁰ State chartered non-member banks and state chartered member banks are regulated by the Federal Deposit Insurance Corporation and the Federal Reserve Bank respectively.⁸¹

When large banks are under investigation, the relevant OCC office assigns an Examiner-in-Charge (EIC) and a team of examiners to work full-time on site at a particular bank.⁸² The EIC is assigned to a specific bank for a five-year term, while the other examiners are assigned to a specific bank for any period of time.⁸³ Large banks are placed on an annual examination cycle,⁸⁴ and the EIC and his team use a variety of examination procedures set forth in the Federal Financial

79. HSBC REPORT, *supra* note 4, at 283. The PSI report claims that the OCC examination system has tolerated "severe AML deficiencies."

80. *Id.* at 287. The Office of Thrift Supervision (OTS) previously supervised federal savings associations and institutions, but it was abolished by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The OCC assumed all of the OTS's duties on July 21, 2011. *Id.* at 287, n.1727. With a budget of \$875 million in 2011, the OCC oversees about 2,000 nationally chartered banks and about 50 U.S. affiliates of foreign owned banks. Headquartered in Washington, D.C., the OCC employs 3,700 workers in 66 offices nationwide and divides its offices into four districts known as the Northeastern, Central, Southern, and Western districts. Each of the districts is assigned with oversight of banks in its respective region. OCC, *2011 Annual Fiscal Report* (2011) [hereinafter *OCC Annual Report*] <http://www.occ.gov/publications/publications-by-type/annual-reports/2011AnnualReport.pdf> (located under chart entitled "OCC at-a-Glance") (last visited Feb. 1, 2013); HSBC Report, *supra* note 4, at 293-294.

81. *Banking Regulators*, U.S. SEC. AND EXCH. COMM'N, <http://www.sec.gov/answers/bankreg.htm> (last updated Jan. 13, 2012). The member/non-member distinction refers to membership in the Federal Reserve System.

82. HSBC REPORT, *supra* note 4, at 294.

83. *Id.*

84. *Id.* at 5.

Institutions Examination Council's Interagency BSA/AML Examination Manual⁸⁵ and/or the Comptroller Handbook for Large Bank Supervision.⁸⁶

The supervisory and enforcement process begins with a Supervisory Letter to the bank's senior management and board of directors documenting the OCC's findings and conclusions as to the AML problems identified in the bank.⁸⁷ The Supervisory letter includes a section called "Matters Requiring Attention" (MRA); "MRAs are a serious consequence of the examination," and once "identified and communicated to the banks, the bank's senior management and board of directors are required to promptly correct them within the agreed upon time frame."⁸⁸ MRAs for large banks are continually updated and tracked in an OCC data system used only for large banks, and examiners issue reports on a quarterly basis.⁸⁹ In addition, the EIC is required to draft an annual supervisory strategy based on perceived risks and subject to the approval of the deputy comptroller for Large Bank Supervision at OCC headquarters.⁹⁰ When deficiencies amount to a violation of minimum AML compliance procedures,⁹¹ the agency can issue a cease and desist order (C&D order) and begin legal proceedings when necessary.⁹²

85. In an effort to improve supervision, federal banking agencies finalized an interagency manual that provides consistent examination procedures for BSA/AML and Office of Foreign Assets Control (OFAC) regulations. *See* Press Release, Testimony of the Office of the Comptroller of the Currency Before the Permanent Subcomm. on Investigations of the Comm. On Homeland Sec. And Governmental Affairs of the U.S. Senate" 3-5 (July 17, 2012) [hereinafter OCC Testimony] (including graphic aids and dividing the OCC testimony into well organized sections and subsections) (*available at* <http://www.hsgac.senate.gov/subcommittees/investigations/hearings/us-vulnerabilities-to-money-laundering-drugs-and-terrorist-financing-hsbc-case-history>) (follow Witnesses, Panel 4, The Honorable Thomas J. Curry, "Download Tesimony (117 KB)" hyperlink).

86. *See generally* COMPTROLLER OF THE CURRENCY, U.S. DEP'T OF THE TREASURY, LARGE BANK SUPERVISION (2010) [hereinafter LARGE BANK SUPERVISION], *available at* <http://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/lbs.pdf> (outlining the procedure for large bank supervision).

87. OCC Testimony, *supra* note 85, at 7.

88. *Id.*

89. COMPTROLLER OF THE CURRENCY, LARGE BANK SUPERVISION, *supra* note 86, at 15-17.

90. *Id.*

91. 12 C.F.R. § 21.21 (2012).

92. 12 U.S.C. § 1818(s) (2006).

2. The OCC's Poor Performance

Despite the seemingly well-tailored procedures in place for AML oversight, the OCC has consistently failed to institute adequate enforcement actions.⁹³ In his opening statement for the HSBC hearing, Senator Levin expressed disapproval by saying that any risks to the U.S. financial system is troubling but even more so when “there is a failure of AML oversight by the OCC which is supposed to oversee our biggest banks.”⁹⁴ The record indicates that the OCC is often effective in identifying AML problems, but lax in enforcement of its recommendations and in imposing penalties.⁹⁵ Senators Levin and Tom Coburn went so far as to call the OCC “an ineffectual industry lapdog,” serving only mild sanctions in exchange for empty promises to do better.⁹⁶

Based on prior poor performance, the Committee on Homeland Security and Governmental Affairs (the Committee) issued enforcement recommendations for the OCC.⁹⁷ The Committee was critical of the OCC for “not citing violations of the individual AML program components, instead treating any such deficiency as a Matter Requiring Attention (MRA) by the bank,”⁹⁸ reserving harsh citations only for violations of the pillars⁹⁹ and not lesser components. The Committee

93. Levin Statement, *supra* note 3, at 6.

94. *Id.*

95. See Brett Wolf, *U.S. Bank Regulator Promises Better Enforcement Following Scathing Congressional Report into HSBC AML Failures*, REUTERS FINANCIAL REGULATORY FORUM (July 18, 2012), <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/> (“[Senator] Levin said: ‘This is not a case where OCC examiners failed to do their jobs. The higher-ups were overly passive, waiting until the problem grew into a very huge one before taking any action.’”).

96. *HSBC's Grilling*, *supra* note 7.

97. Levin Statement, *supra* note 3, at 6.

98. HSBC REPORT, *supra* note 4, at 322.

99. The Bank Secrecy Act lists four minimum requirements sometimes referred to as the “pillars” of an effective AML program. They are (1) internal controls to ensure ongoing compliance, (2) a designated individual responsible for managing AML compliance, (3) AML training for appropriate personnel, and (4) independent testing of AML compliance. Internal controls at a large bank “would include Know-Your-Customer (KYC) policies and procedures, including developing a customer identification program, conducting due diligence reviews, and assessing customer risk; a monitoring system to analyze account and wire transfer activity to detect suspicious activity, and a system for reporting suspicious activity to law enforcement.” The designated individual is a bank’s AML compliance officer who must be knowledgeable about the law and have the expertise and authority to ensure compliance. The third requirement is training for all personnel with AML

argued that while MRAs do require corrective action from the bank, they don't carry the same weight as violations of law because MRAs are not enforceable in court and may "mislead[] a bank about the seriousness of an AML deficiency, delay remedial action, and allow an AML problem to fester."¹⁰⁰ Therefore, if examiners only assign MRAs to narrow issues, banks can get away with addressing just these narrow problems instead of the broader deficiency underlying the entire pillar.¹⁰¹

3. OCC's Policy Changes

While there is no guarantee that the OCC will follow the Committee's suggestion to issue more violations of law and C&D orders (and fewer MRAs),¹⁰² the OCC has outlined some of its newly enacted and proposed policies.¹⁰³ Underlying this entire conversation is the OCC's commitment to increasing its presence and oversight¹⁰⁴ given its shortcomings in the past. Between 2005 and 2011, the OCC issued more BSA focused C&D orders and civil money penalties (CMP) against banks than the FDIC and the Federal Reserve combined as a ratio of banks supervised.¹⁰⁵ The OCC has also imposed the largest dollar amount in penalties in CMPs related to AML- \$124 million compared to penalties of \$25 million and \$50 million by the FDIC and Federal Reserve respectively.¹⁰⁶

The OCC has identified certain activities or areas as warranting additional attention in the near future.¹⁰⁷ To address these issues, the OCC plans to implement changes to the Large Bank Review Team to improve the "ability to bring different perspectives to bear and react on

responsibilities, including the need to be up-to-date with the law. Finally, the last pillar is independent testing, which is normally performed by a bank's internal audit group or by an outside auditor with AML expertise. *HSBC Report, supra* note 4, at 286-87.

100. *Id.*

101. *Id.*

102. Levin Statement, *supra* note 3, at 6 (Curry said the OCC would also seek to provide more flexibility in citing BSA violations) (emphasis added); Wolf, *supra* note 95.

103. *OCC Annual Report, supra* note 80, at 13.

104. See Wolf, *supra* note 95 ("The agency was much too slow in responding and addressing what are significant weaknesses or violations at this institution.")

105. OCC Testimony, *supra* note 85, at 10.

106. *Id.*

107. *Id.* at 13.

a more timely basis” to MRAs or apparent AML failures.¹⁰⁸ The OCC’s new policies are purportedly more risk-based, rather than rule-based, and focused on accountability for senior managers and board members.¹⁰⁹ Finally, the OCC stressed the need for constant evolution of compliance programs to deal with new methods used by money launderers and terrorist financiers.¹¹⁰

IV. THE REALITIES OF THE NEW AML COMPLIANCE REGIME FOR BANKS

A. *Implementation of Enhanced Due Diligence*

While Congress passes AML laws, it is up to the agencies to set standards and concrete rules for banks to implement.¹¹¹ The implementing statute for Section 312 of the Patriot Act¹¹² outlines due diligence procedures for all foreign correspondent accounts and enhanced due diligence procedures for correspondent accounts fitting the criteria mentioned above.¹¹³ Compliance with enhanced due diligence requires a covered financial institution¹¹⁴ to establish procedures that, at a minimum, include taking “reasonable” steps in three important areas.¹¹⁵

108. Wolf, *supra* note 95. Curry also pledged “changes to our LB Review Team process to make it more effective in supporting and ensuring consistency of the supervisory processes for the larger banks we supervise.” OCC Testimony, *supra* note 85, at 13.

109. Michael A. Dawson, *Anti-Money-Laundering Enforcement Gets Tougher and Smarter*, AM. BANKER BANKTHINK (July 26, 2012, 4:00 PM), <http://www.americanbanker.com/bankthink/anti-money-laundering-enforcement-gets-tougher-smarter-1051310-1.html>.

110. OCC Testimony, *supra* note 85, at 12-13.

111. 12 U.S.C. § 1818(s) (2006).

112. FinCEN; Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 72 Fed. Reg. 44,768 (Aug. 9, 2007) (to be codified at 31 C.F.R. pt. 103) (approving final rules after notice and comment and since codified as planned and included into the most recent C.F.R. pursuant 75 Fed. Reg. 65,806 (Oct. 26, 2010)).

113. *See supra* at Part II.

114. “Covered” financial institutions are those that are affected by the correspondent banking portion of Section 312. The following U.S. financial institutions are covered by the correspondent banking provisions of the final rule: (1) banking institutions; (2) securities broker-dealers, (3) futures commission merchants and introducing brokers in commodities; and (4) mutual funds. *See* Anti-Money Laundering Programs for Financial Institutions, 67 Fed. Reg. 21,110 (Apr. 29, 2002) (to be codified 31 C.F.R. pt. 103); Anti-Money Laundering Program for Mutual Funds, 67 Fed. Reg. 21,117 (Apr. 29, 2002) (to be codified 31 C.F.R. pt. 103).

115. Due Diligence Programs for Correspondent Accounts for Foreign Financial Institutions, 31 C.F.R. § 1010.610 (2012).

First, enhanced due diligence requires banks to treat correspondent accounts, established or maintained for respondent banks, with elevated scrutiny based upon the risk presented by the account.¹¹⁶ In practice, this elevated scrutiny means obtaining information about the respondent banks' AML program,¹¹⁷ monitoring individual transactions,¹¹⁸ and obtaining the identity of any person with authority to direct transactions or the source and owner of funds placed in the account.¹¹⁹

Second, a covered bank must determine whether the respondent bank provides access to its covered U.S. accounts for other foreign banks through its own correspondent accounts.¹²⁰ If so, the covered bank must take steps, as appropriate, to assess and mitigate the risks of money laundering presented by the third party financial institution.¹²¹ The implementing statute simply suggests finding out the name of the third party bank; but given the first requirement, it follows that once the third party bank is identified, it becomes necessary to assess that bank's AML program as well.

Third, banks are required to determine the identity of each owner of a respondent bank whose shares are not publicly traded and ascertain the nature and extent of each owner's interest.¹²² Owners are defined as those who directly or indirectly own, control, or have the power to vote 10 percent or more of any class of securities for a foreign bank.¹²³

116. 31 C.F.R. § 1010.610(b)(1) (2012) (“Conduct enhanced scrutiny of such correspondent account to guard against money laundering and to identify and report any suspicious transactions in accordance with applicable law and regulation. This enhanced scrutiny shall reflect the risk assessment of the account False”).

117. 31 C.F.R. § 1010.610(b)(1)(i) (2012). The final rule demands that banks obtain and consider “information” relating to a respondent bank’s AML program in order to assess the risk of money laundering. This language replaced the requirement in the Second Proposed Rule that obliged banks to obtain and review “documentation” relating to a respondent’s AML program and to “consider whether such program appears to be reasonably designed to detect and prevent money laundering.” FinCEN; Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 72 Fed. Reg. at 44769.

118. 31 C.F.R. § 1010.610(b)(1)(ii) (2012).

119. 31 C.F.R. § 1010.610(b)(1)(iii) (2012).

120. 31 C.F.R. § 1010.610(b)(2) (2012).

121. *Id.*

122. 31 C.F.R. § 1010.610(b)(3) (2012). “Publicly traded” means shares that are traded on an exchange or an organized over-the-counter market that is regulated by a foreign securities authority as defined in the Securities Exchange Act of 1934.

123. *Id.*

The Treasury believes that because these requirements are risk-based rather than a default or mandatory requirement, banks won't be forced to inspect every respondent bank with a covered correspondent account.¹²⁴ Rather, the extent to which a reasonable inquiry into the AML program of a respondent bank is needed will depend upon the nature of the correspondent account.¹²⁵ Thus, the Treasury claims there is some flexibility and discretion afforded banks in the exercise of this risk-based analysis sufficient to reduce the financial burden.¹²⁶ However, it seems that the attempt to afford discretion by way of a reasonableness standard has had and will continue to have the opposite effect.

The logic of increased flexibility and a lesser burden is at odds with the cautionary tale of HSBC and the numerous banks subjected to penalties in the last eight years. The evidence is not the rise in AML prosecutions and violations, but the increase in costs due to uncertainty as to how to avoid being the next bank to fall under investigation.¹²⁷ Without any clear benchmarks or concrete guidance upon which to make a discretionary decision, banks are stuck in limbo.¹²⁸ In short, these standards "do not describe with any precision at which point on the risk continuum financial institutions should identify suspicious transactions."¹²⁹ It seems that the only reasonable course of action so far is to increase the AML budget and "hunt mice with cannons" to

124. FinCEN; Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts, 72 Fed. Reg. 44,768, 44769 (Aug. 9, 2007) (to be codified at 31 C.F.R. pt. 103).

125. *Id.*

126. *Id.* ("While covered financial institutions have discretion with respect to implementing this provision, as with other risk-based provisions of the BSA and its implementing regulations, a covered financial institution is responsible for reasonably demonstrating that it is effectively exercising that discretion on a risk-assessed basis.")

127. Katkov, *supra* note 5, at 4.

128. Richard K. Gordon, *U.S. Government Efforts to Suppress Terrorism Financing: Trysts or Terrorists? Financial Institutions and the Search for Bad Guys*, 43 WAKE FOREST L. REV. 699, 724 (2008).

129. *Id.* The wording of the recommendations themselves includes a number of terms that are not easily defined in practice and therefore add significantly to the problem. For example, what are "reasonable measures" when it comes to identifying a beneficial owner/controller? How detailed must a "risk profile" be, and when will it be "necessary" to identify the source of funds? With respect to politically exposed persons, what are "reasonable measures" to establish the source of wealth and source of funds, and what constitutes "enhanced" monitoring? What does it mean to examine "as far as possible" the "background" and "purpose" of unusual transactions? Again, there is little help in the FFIEC Manual. *Id.* at 725.

appear thorough.¹³⁰

The counterargument is that previous transgressors have had grossly deficient AML programs and the OCC has been ineffectual, so the new standard should not be a burden for reasonably diligent banks.¹³¹ While there is some truth to that argument, it fails after consideration of compliance trends, technology, and competitive advantage in the banking industry as described below.¹³²

B. *The Financial Industry's Response*

Before issuing the final rules regarding implementation of Section 312 of the Patriot Act, the Financial Crimes Enforcement Network (FinCEN)¹³³ and the Treasury issued a notice of proposed rulemaking and welcomed comments.¹³⁴ Despite their initial support of a risk-based system, commenters were generally alarmed about the breadth and likely costs of Section 312's new requirements.¹³⁵ For example, commenters questioned how a covered institution might adequately assess the risks associated with a foreign respondent bank without costly research or a broad audit into its AML program.¹³⁶

130. Andrew Kahr, *Let's Invite HSBC to Leave U.S.*, AM. BANKER BANKTHINK (July 30, 2012, 9:44 AM), <http://www.americanbanker.com/bankthink/say-good-riddance-to-hsbc-1051398-1.html#comments>.

131. See Michael A. Dawson, *Anti-Money-Laundering Enforcement Gets Tougher and Smarter*, AM. BANKER BANKTHINK (July 26, 2012, 4:00 PM), <http://www.americanbanker.com/bankthink/anti-money-laundering-enforcement-gets-tougher-smarter-1051310-1.html>; FinCEN, *Anti-Money Laundering Programs, Special Due Diligence Programs for Certain Foreign Accounts*, 72 Fed. Reg. 44,768, 44773 (Aug. 9, 2007) (to be codified at 31 C.F.R. pt. 103).

132. See *infra* Part IV(C)

133. Created in 1990, FinCEN has the power to exercise regulatory power to fulfill its responsibilities toward the detection and deterrence of financial crime. FinCEN is a bureau of the Treasury whose mission it is to facilitate the detection and deterrence of financial crime. Notably, Congress has delegated to FinCEN the power to issue and interpret regulations authorized by statute. As the main network used to combat financial crime, FinCEN connects and works with federal, state, and local authorities. In its own words, the "basic concept underlying FinCEN's core activities is 'follow the money,'" referring to the financial trails left by criminals as they try to launder the proceeds of crimes or spend their illegally earned profits. *What We Do*, FINCEN, http://www.fincen.gov/about_fincen/wwd/ (last visited Jan. 21, 2012).

134. *Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts*, 67 Fed. Reg. 37,736 (May 30, 2002) (First Proposed Rule).

135. *Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts*, 72 Fed. Reg. 44,770.

136. *Id.*

Further, even if this information were attainable at whatever costs, it is likely that the bank's own records and reports from foreign agencies would be written in the respondent bank's native language.¹³⁷ Additionally, there was uncertainty as to how banks may obtain ownership information for securities that are not publicly traded or are not located in countries whose domestic laws do not require full disclosure of stockholder identity.¹³⁸

Financial giant VISA and national banks of all sizes, represented by the American Bankers Association (ABA), have spoken out against other proposed AML laws.¹³⁹ The ABA released a statement in opposition to a proposal for a cross-border electronic funds transfer reporting system, citing concerns about the cost of compliance.¹⁴⁰ It contends that the prospective mandates will cause substantial cost barriers "for changing systems[,] including the virtually prohibitive expenses in adding information elements to existing transaction information flows."¹⁴¹ In response to the same proposal, Visa encouraged FinCEN to develop reasonable standards necessary to support law enforcement agencies while considering the possibility that the rules as stated would unduly burden the legitimate operations of financial institutions."¹⁴²

137. *Id.*

138. *Id.*

139. FinCEN Industry Survey and Responses, 10, 28 (March 21, 2006), http://www.fincen.gov/news_room/tp/files/Appendix_G.pdf ("[M]andating a new reporting regime for CBET would impose substantial new compliance costs on financial institutions subject to the new rule far out of proportion with the law enforcement utility achieved.") (discussing the feasibility of a mandatory cross-border electric transfer (CBET) reporting system, not enhanced due diligence).

140. *Id.* at 10. ("[M]andating a new reporting regime for CBET would impose substantial new compliance costs on financial institutions subject to the new rule far out of proportion with the law enforcement utility achieved.") *Id.* at 5.

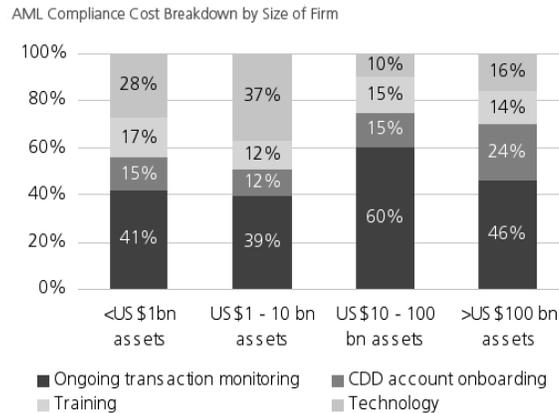
141. *Id.* at 10.

142. *Id.* at 28. VISA's biggest concern was maintaining an exemption for certain kinds of transactions, including debit, point of sale, and ATM transactions. VISA conducts as many as 5,000 such transactions *per second*, so the inclusion of such in the CBET requirements would tremendously increase VISA's monitoring requirements.

C. *Compliance Trends and the Creation of a Dominate Position in Foreign Correspondent Banking*

1. The Costly Process of Compliance

Global AML spending has risen substantially in response to tougher requirements from regulators.¹⁴³ A report published in 2011 estimated that the overall compliance burden would increase costs by 7.8% annually (reaching a total of \$5.8 billion by 2013),¹⁴⁴ and that the software market alone will reach \$690 million in 2015.¹⁴⁵ The threat of increased regulation fully materialized in 2012, causing HSBC (and likely other larger banks facing penalties or investigations) to increase their AML budgets by far more than 7.8 percent.¹⁴⁶ The size and budget of AML compliance departments varies by bank depending upon its finances and business judgment, but there are fairly discernible patterns in terms of spending depending upon the size of the financial institution as shown in the following graph.¹⁴⁷



143. Cornelius Hurley & John A. Beccia, III, *The Compliance Function in Diversified Financial Institutions: Harmonizing the Regulatory Environment for Financial Services Firms* 24 (2007), available at <http://www.fsround.org/publications/pdfs/ComplianceFunctioninDiversifiedFinancialInstitutions.pdf> (recommending strategies to improve the effectiveness of compliance function within diversified financial service institutions).”

144. Katkov, *supra* note 5, at 4.

145. Julie Conroy McNelley, *Global Anti-Money Laundering Vendor Evaluation: A Reinigorated Market* 4 (2011), https://www.sas.com/news/analysts/69575_Aite_Global_AML.pdf.

146. See *HSBC's Grilling*, *supra* note 7.

147. Katkov, *supra* note 5, at 6.

Clearly, ongoing monitoring requires the greatest proportion of spending for banks of all sizes, but it is particularly high in second tier banks.¹⁴⁸ This spending trend reflects the high transaction volume of banks this size, especially compared to the biggest banks which handle high-value accounts.¹⁴⁹ These high-value accounts warrant increased customer due diligence (CDD), a set of procedures with a greater need for technology than ongoing transaction monitoring which “has traditionally been a process of investigating past activity for suspicious behavior.”¹⁵⁰ Smaller institutions should look for solutions that are cost effective;¹⁵¹ thus, given the greater need for ongoing monitoring (less technology) than customer due diligence,¹⁵² and the potential for high fees with the software,¹⁵³ there is an opportunity cost for technology spending. Banks at the very top end of the spectrum do not spend a considerable percentage more on technology,¹⁵⁴ but what they do spend, they can recoup by increased efficiency in customer due diligence.

In order to satisfy regulators banks have pursued centralization and standardization of AML operations¹⁵⁵ and the integration of AML and anti-fraud programs.¹⁵⁶ Should a single bank achieve this standardized, centralized, and integrated AML program, it would be the model of the industry.¹⁵⁷ The question becomes whether the costs of replacing the legacy anti-fraud system and adding anti-fraud functionality, if needed, would produce sufficient incremental gains to

148. *Id.* at 11

149. *Id.*

150. *Id.* at 11, 23.

151. McNelley, *supra* note 145, at 19.

152. Katkov, *supra* note 5, at 11.

153. McNelley, *supra* note 145, at 8. Pricing for AML software solutions typically consists of an annual license fee and an annual maintenance fee. “Annual license fees are usually based on an institution’s asset size, transaction volume, number of customer accounts, number of business lines using the solution, or a combination of these factors.” The cost of a license fee can range from \$40,000 to \$1.5 million. Economies of scale can be realized. The annual maintenance fee can be anywhere between 15 percent and 30 percent of the annual licensing fee.

154. *See* Katkov, *supra* note 5, at 12

155. Chris Belthoff, *Effective AML Demands Centralization*, AM. BANKER (June 1, 2008), http://www.americanbanker.com/btn/21_6/-354042-1.html.

156. McNelley, *supra* note 145, at 15.

157. Katkov, *supra* note 5, at 27 (describing integrated AML and anti-fraud as the Holy Grail).

make the system profitable.¹⁵⁸ In reality, the vast majority of banks have to take a more affordable siloed or “best-of-breed approach” conducive to their business models, thus “reduc[ing] the opportunity to realize efficiencies through implementation of one (or at least fewer) standardized platform.”¹⁵⁹

One option used to centralize and standardize compliance is the “AML suite,” a potentially end-to-end or all-inclusive AML software program.¹⁶⁰ The software market has become crowded with AML vendors, and their product lines have expanded to include AML suites.¹⁶¹ For large banks, an AML suite affords the opportunity to create a uniform, enterprise-wide platform for all pillars of compliance.¹⁶² Total consolidation remains difficult given the different needs within a large financial services institution and different regulatory demands in various jurisdictions, but “multinational banks such as Citi, HSBC and Standard Chartered have been working to standardize AML technology across the dozens of countries in which they operate.”¹⁶³

Another option being pursued is the integration of AML and anti-fraud measures into a joint technology program.¹⁶⁴ With ever increasing compliance requirements, banks are looking for ways to leverage their investment in AML systems and operations to include anti-fraud protection.¹⁶⁵ The benefits of anti-fraud help offset the cost of AML in that it is a “business activity that generates a direct benefit to

158. *Id.* at 29-30. Even a ten percent improvement in fraud reduction could be effective, but that must be weighed against the “cost of ripping out existing solutions [which] can be prohibitive” and the cost of “additional functionality, such as real-time transaction monitoring and additional data feeds.”

159. *Id.* at 30.

160. Katkov, *supra* note 5, at 14, 19, 23; Rajesh Menon & Sanjaya Kumar, *Understanding the Role of Technology in Anti-Money Laundering Compliance: A Strategic Model for Financial Institutions* 4 (Jan. 2005), <http://www.infosys.com/industries/financial-services/white-papers/Documents/anti-money-laundering-compliance.pdf> (describing the product as a “second general of AML technology,” those including the “four basic risk assessment components that ensure full disclosure and reporting necessary for compliance with the federal statutes.”).

161. McNelley, *supra* note 145, at 4.

162. Menon & Kumar, *supra* note 160, at 4 (describing second generation AML solutions and how they improve on the shortcomings of previous technology).

163. Katkov, *supra* note 5, at 27.

164. *Id.*

165. *Id.* Smaller banks and even credit unions have followed the model and combined anti-fraud and AML.

a firm's bottom line by reducing financial losses due to fraud."¹⁶⁶ This option has another benefit: AML software outperforms existing anti-fraud systems.¹⁶⁷ Further, the underlying twin aims of AML and anti-fraud have revealed suspicious patterns that otherwise would have remained hidden had they not been investigated using a joint technology program.¹⁶⁸

2. Who Is Left Standing

Compliance with enhanced due diligence is predisposed to economies of scale.¹⁶⁹ "Depending on where one sits in the compliance value chain, the cycle of ever more stringent regulatory demands generating a need for ever more efficient AML operations may appear virtuous or vicious."¹⁷⁰ Large compliance departments with large budgets have the manpower and resources needed to generate piles of (potentially unnecessary)¹⁷¹ reports on transactions and high-risk correspondent accounts.¹⁷²

Commentators claim that HSBC has seemingly bought its way out of trouble by paying its fine and taking a slap on the wrist.¹⁷³ This has "amplif[ied] growls about regulations which burden and disadvantage small institutions and businesses, and consumers but from which the giants remain immune."¹⁷⁴ The burden to smaller banks is ultimately passed on to consumers through delays, red tape, and increased costs.¹⁷⁵ The scenarios are fairly predictable. Transaction

166. Katkov, *supra* note 5, at 28 (reporting the results of a survey of more than 75 financial institutions globally as to the current and projected costs of AML compliance).

167. Katkov, *supra* note 5, at 29.

168. John Adams, *Post-HSBC, Banks Rethink Anti-Laundering Tech*, AM. BANKER (July 31, 2012, 5:21 PM), http://www.americanbanker.com/issues/177_147/post-hsbc-banks-rethink-anti-money-laundering-tech-1051470-1.html.

169. Katkov, *supra* note 5, at 6; Hurley & Beccia, *supra* note 143, at 25.

170. Katkov, *supra* note 5, at 15.

171. False positives are transactions over a set limit that are marked as suspicious but that do not represent any existing identified risk to the institution, like securing a mortgage. The problem with false positives is that they distract a financial institution from other transactions that can represent a true money laundering risk. Menon & Kumar, *supra* note 160, at 3.

172. Kahr, *supra* note 130.

173. *See id.*; *Too Big to Jail*, *supra* note 71 (characterizing the penalties of HSBC and Standard Chartered as arbitrary and designed as to not affect their viability in the U.S.).

174. Kahr, *supra* note 130; *Too big to Jail*, *supra* note 71.

175. *See* Devin Leary-Hanebrink, *CFPB Should Stand for 'Choking Financial*

monitoring takes longer with less personnel or technology, and this will lead to delays. Compliance departments will come to resemble an ever-expanding bureaucracy fighting a battle of the forms in both producing reports and responding to questions from regulators.¹⁷⁶ Finally, without liquid assets to pay for compliance, banks will have to generate money for AML budgets through higher costs to consumers.¹⁷⁷

Creating a compliance system that will withstand the rigors of OCC regulation will not be cheap or simple, especially given the size and scope of some of the largest global banks.¹⁷⁸ However, the giant banks that have the scale and resources to operate in this regulatory environment will become the dominant foreign correspondent banking service providers.¹⁷⁹ These banks enjoy the best of both worlds, bankroll a variety of immediately effective strategies while still pursuing long term goals like standardization, consolidation, or integration with anti-fraud.¹⁸⁰ Again, these are ambitious goals given their size and scope; but once achieved, the successful banks will have a streamlined global system combining AML and anti-fraud, the costs of which are potentially offset in part by the financial benefit of fraud prevention.¹⁸¹ This achievement will create a positive reputation among regulators, consumers, and investors¹⁸² sufficient to create a dominant

Professionals and Businesses', AM. BANKER, July 13, 2012, <http://www.americanbanker.com/bankthink/CFPB-Stands-For-Choking-Financial-Professionals-and-Businesses-1050898-1.html> (presenting an analogous argument for the effect of increased regulation in response to Dodd-Frank). The author renames the CFPB "Choking Financial Professionals and Businesses." He highlights the decrease in consumer checking accounts saying, "due to ever-increasing compliance requirements under Dodd-Frank, most banks elected to pass these costs along to the consumer by eliminating free checking." He argues this has led many consumers to abandon checking accounts all together.

176. Kahr, *supra* note 130.

177. Gordon, *supra* note 128.

178. *HSBC's Grilling*, *supra* note 7. Giant banks are large complex corporations and coordination between different offices may be difficult. It could be also be difficult to get different systems in other countries to talk to each other efficiently. However, that problem would amplify and more severely affect second tier banks should they attempt to create a collective AML system. Affiliates operating under the same global bank have at least that commonality, and there are few competing interests to square as they pursue a common goal within the corporation. In contrast, multiple banks are competitors, not teammates working together with a single coach.

179. *Id.*; Katkov, *supra* note 5, at 10.

180. *Id.* at 10.

181. *Id.* at 27.

182. Hurley & Beccia, *supra* note 143, at 48; Katkov, *supra* note 5, at 6. Consumers' confidence is key to any business, as is investor confidence since shareholders essentially

position in foreign correspondent banking.¹⁸³

V. CONCLUSION

While AML compliance and oversight are in the best interest of the American public and financial system, the new compliance regime as it stands will create winners and losers.¹⁸⁴ Additional and stricter regulation from the OCC necessitates that banks improve, but inconsistent enforcement of enhanced due diligence with scant guidance to banks has and will continue to lead to confusion for compliance departments.¹⁸⁵ The winners of this increased regulatory regime are the large banks that can afford to fund expansive AML strategies.¹⁸⁶ These banks are in the unique position to provide short-term AML protection as they implement more effective, long-term solutions.¹⁸⁷ Having lost national and large regional banks to the cost of compliance and fear of large sanctions, the correspondent banking market will next lose second tier multinational banks. Atop the cliff, large global banks will assume a dominant position and become the exclusive actors in foreign correspondent banking.

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pay the penalties. Gordon, *supra* note 128, at 699, 727.

183. *HSBC's Grilling*, *supra* note 7.

184. Kahr, *supra* note 130.

185. Gordon, *supra* note 128, at 727; Hurley & Beccia, *supra* note 143, at 18.

186. *See HSBC's Grilling*, *supra* note 7.

187. Katkov, *supra* note 5, at 23.