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## **Regulatory & Enforcement Outlook for Financial Institutions**

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In the wake of the 2008 financial crisis, financial institutions have seen their business practices and compliance programs subjected to more exacting scrutiny from regulators and sharper criticism from politicians, commentators, and consumers. In recent months, there has been a spate of headlines regarding high-profile enforcement actions and record-setting penalties levied against some of the world's leading banks. Nonetheless, leading members of Congress continue to chide federal regulators and prosecutors for a perceived "light touch" with respect to allegations of wrongdoing by financial institutions. Going forward, we will likely see more expansive and aggressive enforcement actions, and perhaps criminal prosecutions, against such institutions as well as the individuals who engage in or are responsible for the conduct at issue.

### **BSA/AML Focus**

The Bank Secrecy Act ("BSA") requires financial institutions to assist the U.S. government in its efforts to detect and prevent money laundering. To that end, the BSA requires financial institutions to keep records of cash purchases of negotiable instruments, file reports of cash transactions exceeding \$10,000 (daily aggregate amount), and to report suspicious activity that might signify money laundering, tax evasion, or other illicit activity. While enforcement of the BSA and anti-money laundering ("AML") laws was historically often lax, that is no longer the case. They are now viewed as a critical tool in the fight against money laundering, terrorist financing, drug trafficking, and organized crime, and recent actions demonstrate the U.S. government's renewed focus on BSA/AML compliance.

In 2010, the Department of Justice created a specialized unit (Money Laundering & Bank Integrity Unit) to investigate and prosecute financial institutions and others for BSA/AML violations. Leaders of the Federal Reserve, the Office of the Comptroller of the Currency ("OCC"), and the Financial Crimes Enforcement Network ("FinCEN") have all publicly reiterated their commitment to rigorous BSA/AML enforcement. Enforcement actions taken against financial institutions over the last several years demonstrate that this is not merely empty rhetoric.

In 2010, Wachovia Bank agreed to pay \$160 million to settle charges that it failed to maintain an adequate BSA/AML program. In December 2012, HSBC agreed to pay \$1.9 billion in fines to settle allegations that its failure to maintain adequate anti-money laundering controls allowed terrorists and drug cartels access to the U.S. financial system. Even more recently, regulators have targeted Citigroup and J.P. Morgan Chase concerning lapses in their

BSA/AML compliance. In light of the global footprint of the banks involved and/or the size of the penalties imposed, these events garnered substantial media coverage. Less publicized, however, have been a number of enforcement actions against smaller to mid-size financial institutions.

- In February 2011, Zions First National Bank in Utah, a \$16.9 billion bank, agreed to pay \$8 million to settle allegations by FinCEN that it failed to implement an adequate AML program and failed to report suspicious activity
- In March 2011, Miami-based Pacific National Bank, a \$350 million bank, agreed to pay \$7 million to settle similar allegations
- In August 2011, Miami-based Ocean Bank, a \$3.9 billion bank, agreed to pay \$10.9 million as part of a deferred prosecution agreement stemming from charges that it willfully failed to establish an effective AML program
- In November 2012, regulators imposed on First Bank of Delaware, a \$200 million bank, a \$15 million penalty and also invoked the “death penalty” by revoking its state charter as a result of significant BSA/AML violations
- That same month, MoneyGram International forfeited \$100 million and entered into a deferred prosecution agreement for, among other things, failing to maintain an effective AML program

It is imperative that all financial institutions, whether globally or locally focused, ensure that their compliance programs are adequate in light of the heightened regulatory scrutiny. Indeed, regulators have expressed concern that as larger institutions implement better BSA/AML procedures and jettison higher risk lines of business, the riskier products and customers will migrate to smaller financial institutions, including mid-size and community banks.

Effective Compliance Programs for Financial Institutions

At a minimum, financial institutions need a BSA/AML program that: (1) establishes internal controls to ensure ongoing compliance; (2) designates an individual or individuals responsible for compliance issues; (3) provides training for appropriate personnel; and (4) provides for independent testing of the program in order to monitor its effectiveness. A successful BSA/AML compliance program, however, also requires that the senior leadership establish a strong culture of compliance throughout the financial institution. Consider the following best practices:

- Build BSA/AML compliance measures into the performance criteria for all senior officers and business unit managers, not just those directly tasked with compliance. All senior officers, directors, and managers should receive periodic training on BSA/AML issues and reports on the institution’s compliance program.
- Establish clearly defined channels by which compliance personnel or lower-level employees may inform board directors or senior management of potential BSA/AML violations or other compliance deficiencies.

- Conduct appropriate risk assessments regarding new customers, business partners, services, lines of business, and/or new geographies, in order to determine whether the new business raises particular compliance concerns and whether the existing compliance program is sufficient to address those concerns.

A financial institution must be able to demonstrate to regulators that it has committed the necessary resources, in light of the risks posed by its business model, to its BSA/AML compliance program. Doing so will help avoid the severe sanctions and negative publicity associated with inadequate AML controls, and will further bolster the institution's standing in general. Deficiencies in AML controls are no longer seen as a mere compliance issue, but as a potential threat to an institution's safety and soundness. OCC examiners, in fact, now consider the findings of a BSA/AML examination when assigning the management component of a financial institution's CAMELS rating.

### **Regulatory Outlook Going Forward**

FinCEN Director Jennifer Shasky Calvey recently organized a "Delta Team" of financial industry professionals, regulators, and law enforcement to review current efforts on BSA/AML compliance and how those efforts compare with the risk of illicit financing and money laundering. Though it remains to be seen exactly what recommendations, if any, will come out of this effort, new initiatives are already in the works regarding AML oversight.

Sometime this year, FinCEN expects to formally introduce new AML proposals for investment advisers that will require them to establish AML compliance programs and report suspicious activity. In 2003, FinCEN published a Notice of Proposed Rulemaking that sought to impose this requirement, but no further action was taken and the proposed regulations were withdrawn in 2008. Building on changes to the securities industry's regulatory framework pursuant to the passage of the Dodd-Frank Act, FinCEN is revisiting the idea of imposing AML requirements on investment advisers. The proposed rules should be released for public comment by mid-year.

FinCEN will also issue a Notice of Proposed Rulemaking on Customer Due Diligence Requirement. An advance proposal circulated by FinCEN would have imposed rather stringent due diligence requirements on financial institutions. To assuage industry concern, FinCEN is expected to retool provisions of the proposed rules that would have required institutions to not only identify, but verify, a customer's identity as appropriate on a risk basis at the time of account opening. FinCEN is still likely to require that financial institutions gather beneficial ownership information on new corporate accounts, including the identities of those with a not-insignificant stake in the business and managers who effectively control the business operations. The goal is to prevent financial institutions from opening and servicing accounts for shell companies without obtaining adequate ownership information. The final proposed rules are expected to be released this year.

## Consumer Finance

Aside from AML enforcement, federal regulators are also focusing attention on fair lending issues, a core part of the mission of the Consumer Financial Protection Bureau (“CFPB”) formed under the Dodd-Frank Act. In April 2012, the CFPB released guidance affirming its intention to use the “disparate impact” doctrine in the enforcement of fair lending laws, as well as taking action in situations of overt discrimination or disparate treatment of a protected class. Under the disparate impact doctrine, a lender may be liable for practices that have disproportionately negative effects on a prohibited basis, even though the practices are facially neutral and there is no purposeful intent to discriminate.

In March 2013, the CFPB issued a warning to indirect auto lenders, including banks, regarding discriminatory practices in auto lending. The CFPB does not have authority to regulate auto dealers; it could, however, address auto finance practices by enforcing fair lending laws and regulations against indirect auto lenders. The practice drawing the CFPB’s attention is “dealer markups,” whereby auto dealers are allowed to negotiate the loan rate with the customer and then keep the portion of the rate that exceeds the “buy rate” at which lenders will purchase the customer’s loan. Such practices, according to the CFPB, result in minority borrowers paying more for auto loans.

In the event that the CFPB takes formal action in this area, it will likely provide useful guidance on the agency’s fair lending enforcement priorities and positions. Regardless, the fact that the CFPB has publicly embraced the use of the disparate impact doctrine suggests that agency investigators may begin reviewing consumer lending data for disparities in order to bring enforcement actions.

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