OBSTRUCTING BANK EXAMINATIONS IS A COSTLY CRIME

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Recently, an American bank entered into a deferred prosecution agreement requiring it to pay over US$610 million in penalties. The plea agreement was based on "impos[ing] hard caps on the number of transactions subject to AML review in order to create the appearance that the program was operating properly" when it was not—and then "conceal[ing] its wrongful approach from the Office of the Comptroller of the Currency. ("OCC")" [1]

Less than a month later, the U. S. bank subsidiary of a large Dutch bank organization pled guilty to defrauding the United States and to corruptly obstructing the examination of a financial institution. [2] According to the plea agreement, the bank hired a consultant to evaluate its BSA/AML programs. The consultant's report noted several deficiencies. Instead of acknowledging the deficiencies, bank executives told the OCC that the consultant's report did not exist and that the BSA/AML program was functioning well and appropriately designed to manage risks. Further, the bank demoted the one manager who accurately reported her concerns with respect to the bank's BSA/AML program. As a result of these actions and the ensuing guilty plea, the bank forfeited over US$360 million.

Taken together, these two cases demonstrate that the government is sending a billion-dollar message to banks: prosecutors are watching closely for both BSA/AML compliance and efforts to conceal compliance failures from bank examiners. Federal law requires candor with bank regulators and prescribes several punishments, both civil and criminal, for the intuitions and individuals who violate those laws. This article will discuss those statutes and regulations. It will also discuss the potential penalties, both criminal and civil, for violating those laws. Finally, this article will develop a series of best practices for participants in the financial services sector.

CANDOR IS REQUIRED WITH FINANCIAL-INSTITUTION REGULATORS

The government strictly enforces laws requiring candor and transparency with bank examiners and other regulators. Regulators are prepared to undertake enforcement actions—and refer cases for criminal prosecution—against banks and their executives if the banks deceive regulators, obstruct examinations, or otherwise run afoul of federal law. Last year, when announcing a US$2.5 million settlement with a large American bank for obstructing an investigation, the Assistant U.S. Attorney stated: "[t]he financial system depends on the integrity of everyone involved in it." [3] Regulators have several tools to insure the integrity of the institutions and individuals involved in the financial systems ranging from criminal prosecutions to civil enforcement actions to regulatory sanctions.

Criminal Law

Under federal law, it is a crime punishable by a fine and possibly five years in prison to obstruct—or attempt to obstruct—the examination of any financial institution. [4] Bank employees that work together to dupe regulators or conceal information, such as the bank's own illegal activity or—in the case of failing or troubled banks—the true nature of the bank's financial condition, may be charged with conspiracy, which carries its own potentially consecutive penalties of an additional fine and five more years in prison. [5]

Federal law also authorizes criminal penalties for a willful failure to make required currency transaction reports and suspicious activity reports. [6] Further, if the violations are part of a pattern of illegal activity involving more than US$100,000 in a 12-month period, the violator faces a fine of up to US$500,000 and 10 years in jail. [7]

Civil Enforcement

In addition to the fines provided by the criminal statutes, there are also civil fines for obstructing a bank examination. The OCC has the power to assess a civil monetary penalty against any insured depository institution that violates the laws or regulations requiring candor. [8] For example, the U.S. subsidiary of the large Dutch bank previously mentioned paid an additional US$50 million fine to the OCC, based in part on the bank's efforts to preclude the OCC from obtaining requested documents and information. [9]

Additionally, the money involved in obstruction or the underlying activity is subject to civil asset forfeiture. The vast majority of the US$360 million paid by the U.S. subsidiary of the large Dutch bank was based on the acknowledgment that the United States could institute a civil asset forfeiture action against it.

There are also civil penalties for willful failure to make required currency transaction reports and suspicious activity reports. [10] The potential fine ranges from US$25,000 to US$100,000.

The Federal Deposit Insurance Act Has Its Own Requirements

Finally, the Federal Deposit Insurance Act ("the Act") imposes its own requirements on banks and their officers. Banks are required to make reports regarding the bank's financial condition. A bank that knowingly or with reckless disregard submits a false or misleading report faces a penalty of the lesser of not more than (a) US$1,000,000 or (b) 1 percent of the bank's total assets for each day that the false or misleading information goes without correction. [11]

The Act also requires that insured institutions maintain certain records related to domestic and international funds transfers. Institutions are also required to submit these documents to the Federal Deposit Insurance Corporation ("FDIC") upon request. [12] An institution that violates these provisions is subject to a civil fine of up to US$10,000 a day for violations of the Act's record keeping requirements. [13]

The penalties outlined above for obstruction, conspiracy, false or misleading statements, and failure to file required reports, are often imposed in addition to penalties for underlying acts, such as money laundering or fraud facilitated by the bank—and then concealed. Even in a less-severe case, such as one where the bank's only failure relates to inadequate BSA/AML procedures, the concealment of that failure can dramatically increase the criminal exposure, monetary penalty, and likelihood of government enforcement beyond the regulatory consent-order context.

Executives May Face Criminal and Civil Liability

In addition to the financial penalties assessed against the financial institution, executives may face personal liability for their own actions taken in furtherance of alleged obstruction or deception by a financial institution. The consequences have included both fines and prison sentences. Last year, a former executive at a now-defunct Tennessee bank was negotiating a resolution of criminal charges for deceiving federal regulators. The executive allegedly lied to federal and state regulators regarding the true nature of the bank's financial condition by overstating the bank's income and understating its losses. As a result of his deception, the executive faced up to 30 years in prison and a criminal fine of up to US$1,000,000. The executive died before the criminal charges against him were resolved. It is important to emphasize here, that the executive was not concealing any money laundering or other criminal activity, only the bank's failing condition.

Other banking executives have faced similar penalties for deceiving bank examiners. In one case, 10 former officers of a small California bank made numerous false statements to their external auditors and impeded the bank's examination by federal and state regulators. The former officers intentionally made false statements to regulators in face-to-face meetings. They also intentionally omitted negative information from required reports. At the conclusion of the FDIC's investigation, seven of the bank's former executives collectively were fined US$1,640,000. Notably, the three former executives who cooperated with the FDIC were assessed substantially smaller fines—a collective US$87,500. On average, the cooperating former executives paid a fine that was only 12 percent of the fine paid by the non-cooperating executives. While all former executives were fined for their obstruction relative to the oversight efforts of the bank examiners, the former executives who cooperated with the investigation into the obstruction received a much more lenient punishment.

Finally, in addition to the criminal penalties permitted for obstruction or conspiracy, the FDIC may order the removal of a controlling stockholder, director, officer, or employee from a depository institution and prohibit the removed individual from any participation in the affairs of a federally insured institution. [14] In each of the cases discussed here, the FDIC also determined that the executive's breach of a fiduciary duty demonstrated unfitness to serve as a director, officer, or participant in the affairs of any insured depository institution and issued a lifetime ban from banking. This debarment was levied on all 10 former executives of the Californian bank, including the three who cooperated in the investigation.

BEST PRACTICES

As the statutory framework suggests, the federal government takes obstruction of bank examinations and false statements regarding the activities or financial condition of a financial institution very seriously. The classic adage of "the cover-up is worse than the crime" holds true. As one Assistant U.S. Attorney stated: "Worse still, [the bank at issue] took steps to obstruct an examination by its regulator." The Department of Justice ("DOJ"), the Office of the Comptroller of the Currency, and other federal regulators see full compliance with banking regulations and candor with bank examiners as vital to the integrity of the banking system. Given the potential criminal consequences, institutions and their affiliated persons or entities are well-advised that the cover-up is never worth the fine.

If a financial institution becomes aware of suspicious activity, it should make all required reports. Further, financial institutions should ensure that appropriate procedures are in place to detect and report suspicious activity. Employees should be trained on the importance of candor with regulators—even when BSA/AML procedures are functioning less than ideally. It is also advisable to include provisions on cooperation with regulators in a code of ethics or other similar policy that directors, officers, and employees are required to read and sign each year as a condition of their continued association with the financial institution.

When faced with a bank examination or other regulatory inspection, the best practice is always to deal truthfully and honestly with the regulator. Instructing directors, officers, and employees to cooperate fully and speak with candor is significant, as a financial institution may be judged on the "tone at the top" or its "culture of compliance and cooperation." Firing, demoting, or taking other adverse action against an employee because he or she made an honest report of the bank's practices or financial situation to a regulator is prohibited. [15]

If a financial institution learns of illegal activity within its own ranks, proactively investigating, remediating, and reporting that activity and pledging to fully cooperate with regulators typically puts the institution in a much better position during enforcement actions. In contrast to the stiff fines and potential jail time discussed above, regulators often consider cooperation with authorities as a mitigating factor when determining charges, fines, and other sanctions or penalties. As shown in the example of the small California bank above, a cooperating bank or executive may receive substantial cooperation credit, which in turn translates to lower fines, shorter prison sentences, and sometimes, no fine or prison at all. Indeed, the DOJ Principles of Corporate Prosecution heavily emphasize cooperation. [16] Parties can receive cooperation credit for doing the following in a timely manner:

- Disclosing the relevant facts concerning misconduct:
    - Specifically, the government seeks information on when the misconduct occurred; the identity of the person(s) who promoted or approved the misconduct; and the person(s) responsible for committing the misconduct
    - The disclosure of factual information in a timely manner is "the key measure of cooperation. [17]
- Providing non-privileged documents, such as accounting records and e-mails between non-attorneys, in a timely, organized, and accurate fashion.
- Making witnesses available for truthful and complete interviews.
- Assisting in the government's interpretation of complex business records. [18]

However, cooperation cannot totally mitigate obstruction. Even the cooperating executives in the California bank case were fined and banned from participating in the affairs of an FDIC member institution.

The honesty of all participants in the financial system is the fundamental building block of a safe and sound financial system. Enforcement actions such as those outlined in this article highlight this perception—and the risks of running afoul of it.

Notes:

[1] https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-criminal-charges-against-us-bancorp-violations-bank.

[2] https://www.justice.gov/usao-sdca/pr/bank-pleads-guilty-pays-historic-penalty-concealing-anti-money-laundering-failures.
[3] https://www.justice.gov/usao-wdnc/pr/us-attorneys-office-announces-25-million-settlement-bank-america-trading-ahead-and.
[4] 18 U.S.C. § 1517.
[5] 18 U.S.C. § 371.
[6] 31 U.S.C. § 5322.
[7] 31 U.S.C. § 5322.
[8] 31 U.S.C. § 1818(i)(2)
[9] https://www.occ.gov/static/enforcement-actions/ea2018-008.pdf.
[10] 31 U.S.C. § 5321.
[11] 12 U.S.C. § 1829b(i).
[12] 12 U.S.C. § 1829b(b)
[13] 31 U.S.C. § 5322(a)–(b).
[14] Section 8(e) of the FDI Act, 12 U.S.C. § 1818(e)(7)(A).
[15] 12 U.S.C. § 5567 (Consumer Financial Protection Act); 18 U.S.C. § 1514A (Sarbanes-Oxley Act).
[16] Mark Filip, Memo re. *Principals of Federal Prosecution of Business Organizations*, U.S. DEPT. OF JUSTICE, August 28, 2008.
[17] *Id.*
[18] *Id.*

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