

# Financial Crimes Compliance Self-Governance: Applying the *Faragher* Defense to Bank Secrecy Act/Anti-Money Laundering Violations

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## I. INTRODUCTION

Financial institutions in the United States have been subject to, and having been working toward compliance with, anti-money laundering (“AML”) regulations since the 1970s.<sup>1</sup> Subsequent additions and clarifications from Congress and regulatory agencies have produced a broad and expansive set of rules pertaining to the responsibility of financial institutions to monitor, prevent, and detect money laundering and terrorist financing. Compliance with these regulatory requirements has become a pervasive issue in the post-9/11 financial system, with regulatory scrutiny of the financial industry and institutionally driven enterprise scrutiny seeming to intensify each year.<sup>2</sup> A record number of enforcement actions have been brought against financial institutions in recent years—banks and non-banks alike—for perceived failures in those institutions’ compliance programs, with fines reaching into the billions of dollars.<sup>3</sup> Although regulatory scrutiny seems to be increasing, some have questioned whether continued enforcement actions are the best tactics for ensuring AML compliance in the financial industry.

This Article does not advocate that financial institutions do not have a responsibility to comply with the laws of the nations in which they operate, or that BSA/AML regulatory requirements are superfluous. The question is whether continued public regulatory actions are appropriate vehicles for furthering the public policy underpinning of the immense framework of BSA/AML regulations. Instead, this Article will introduce the idea that an affirmative defense,

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1. The generally agreed beginning of the anti-money laundering compliance framework is the passage of the Bank Secrecy Act of 1970 (“BSA”). See Richard D. Horn & Shelby J. Kelley, *The Bank Secrecy Act: Are There Still Secrets in Banking?*, 9 PRIVACY & DATA SECURITY L.J. 781, 781–82 (2006) (noting that anti-money laundering regulations began to appear with the passage of the BSA).

2. See John F. White & Steven Lewis, *Regulators Are Increasing Their Scrutiny of Banks’ BSA/AML Compliance*, BANKDIRECTOR.COM (Aug. 5, 2013), <http://www.bankdirector.com/index.php/issues/regulation/regulators-are-increasing-their-scrutiny-of-banks-bsaaml-complia/> (noting the increasing trend of regulatory scrutiny of BSA/AML compliance programs).

3. Olivia A. Radin, *A Rising Tide of AML Reg Actions—and What We Can Learn*, LAW360 (Mar. 31, 2015, 10:43 AM), <https://www.law360.com/articles/637334/a-rising-tide-of-aml-reg-actions-and-what-we-can-learn>.

on which financial institutions can rely when they detect and correct potential failures in their own compliance programs, would further advance the goals of federal and international anti-money laundering and terrorist financing laws. An affirmative defense that rewards a compliance program dedicated to self-governance provides a better impetus for financial institutions to strengthen anti-money laundering/counter-terrorism financing (“AML/CTF”) controls than the current practice of relying on large fines and regulatory enforcement actions. Specifically, allowing banks the latitude to develop, monitor, and validate would more likely result in a self-sustaining compliance feedback loop; increase the likelihood of industry self-enforcement to decrease reputational, legal, and credit risk; and would lead to greater compliance than continued public admonishments of banks with compliance programs already in place.

Part II will introduce and discuss a common safe harbor defense from employment law that lawmakers could deploy in the world of financial regulation in a manner consistent with the public policy underpinning of both disciplines of law. Part III of this Article will briefly explore the history of the AML regulatory framework in the United States, paying particular attention to the public policy underpinning of and common practices within financial institutions’ financial crimes compliance divisions. Part IV will examine whether there is a link between the creation of an affirmative defense in employment law and the proposed creation of an affirmative defense in BSA/AML compliance to determine if such a proposal would enhance the public policy objectives of financial regulations. The Article concludes by encouraging review of the current framework for BSA/AML compliance to determine whether such a safe harbor would better achieve the goals of financial regulation than would reliance on federal and state enforcement actions against financial institutions for perceived failures in compliance programs.

## II. EMPLOYING THE *FARAGHER* DEFENSE

The creation of an affirmative defense to protect financial institutions that make good-faith efforts to comply with BSA/AML regulations would be a more significant assurance of compliance than federal or state enforcement actions. Although the concept of an affirmative defense in BSA/AML compliance would be somewhat

new, employment law has a well-recognized affirmative defense that shares many of the goals of financial compliance. This affirmative defense, called the *Faragher* defense, could easily provide a blueprint for a similar defense in financial compliance.

#### A. Principles of *Faragher*

Employers, whether large or small, have a legal obligation to investigate employees' claims that allege instances of workplace harassment, discrimination, or retaliation.<sup>4</sup> One of the seminal cases in employment law relating to employer liability for workplace harassment, *Faragher v. City of Boca Raton*,<sup>5</sup> established, or at least greatly tipped the scales in favor of, mandatory workplace investigations. In *Faragher*, female lifeguards employed by the City of Boca Raton were continually subjected to sexual harassment by supervisors and, despite filing complaints with a lower-level supervisor, the employer failed to take remedial action.<sup>6</sup> The U.S. Supreme Court found this type of situation particularly troublesome, as it recognized that an imbalance of power possessed by supervisors could prevent employees from reporting sexual harassment.<sup>7</sup> In fact, the Court found that employers are in a distinct position to stop harassment at the outset, as they are in a position to screen, train, and monitor supervisors to prevent sexual harassment.<sup>8</sup> Given this "aided-by agency" for which the Court finds employers liable, it believed that vicarious employer liability was appropriate for instances of sexual harassment.<sup>9</sup> However, the Court, bound by precedent and attempting

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4. *Malik v. Carrier Corp.*, 202 F.3d 97, 105 (2d Cir. 2000) (noting that an employer's duty to investigate sexual harassment complaints is not optional; it is a requirement under federal law that leaves the employer open to liability if not fulfilled); *The Title VII Affirmative Defense to Sexual Harassment Claims*, JACKSON LEWIS P.C. (Nov. 23, 2005), <http://www.jacksonlewis.com/resources-publication/title-vii-affirmative-defense-sexual-harassment-claims>.

5. 524 U.S. 775 (1998).

6. *Id.* at 780–83.

7. *Id.* at 803–04 (discussing agency theory and disparate power relationships as an underpinning for the decision).

8. *Id.*

9. *Id.* at 802. The Court supported its holding by noting that the *Restatement (Second) of Agency* and previous case law finds an employer vicariously liable for the

to balance employer liability with agency theory, did not believe that an employer is automatically liable for every instance of supervisor misconduct.<sup>10</sup> As a result, the Supreme Court developed what has become known as the “*Faragher* defense,” under which an employer can avoid liability for its employees’ harassment if (1) “the employer exercised reasonable care to prevent and correct promptly any sexually harassing behavior,” and (2) the complaining employee unreasonably failed to take advantage of the preventative or corrective measures available under the employer’s policies and procedures.<sup>11</sup> While the *Faragher* defense’s reliance on employer-controlled investigation and corrective actions serves as the lynchpin to escaping liability, subsequent case law has not left the duty as open-ended as one can imagine.

The first important element of this defense is the reasonable care that employers must take in investigating and correcting workplace harassment. Reasonable care includes installing comprehensive policies condemning workplace harassment, making sure that all employees are aware of the policies, and having the employees confirm receipt of these policies.<sup>12</sup> However, it is not just the maintenance of arcane and unknown lists of policies and procedures that protects employers (which would be a matter of strict compliance); rather, the *Faragher* defense also looks at the reasonable care the employer used to actually prevent sexual harassment. For example, the U.S. District Court for the Middle District of Tennessee denied an employer the ability to escape liability via the *Faragher* defense where the employer merely distributed anti-harassment policies to employees without training to help the employees

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acts of supervisors under the “aided-by” agency theory. *Id.* (citing RESTATEMENT (SECOND) OF AGENCY § 219(2)(d) (1958)).

10. *Id.* at 804 (attempting to align *Faragher* with the principles of previous litigation in which courts decided that an employer cannot automatically be held liable for all instances of supervisor harassment).

11. *Id.* at 807.

12. Louis P. Britt III, *Legal Alert: Court Emphasizes That Evidence of Training Is a Must*, FORDHARRISON (Apr. 27, 2010) <http://www.fordharrison.com/legal-alert-court-emphasizes-that-evidence-of-training-is-a-must> (explaining actions an employer must take to guarantee protection under the *Faragher* defense).

understand their rights and responsibilities.<sup>13</sup> Strict compliance was not enough to save that employer; it needed greater measures to show a reasonable attempt at compliance.<sup>14</sup>

Although the reasonableness requirements imposed by courts are important safeguards that ensure self-compliance, it is the investigations piece that is especially notable in the context of this Article. Although not expressly required by the *Faragher* defense, practitioners widely understand that investigations into cases of alleged sexual harassment are vital for employers who wish to assert an affirmative defense.<sup>15</sup> Subsequent case law has evaluated whether or not an investigation was conducted to evaluate whether the employer exercised reasonable care in preventing workplace harassment.<sup>16</sup> This line of reasoning has continued to develop, and now, to show due care in preventing harassment, investigations must be timely, conducted by those that can be trusted to be impartial, and must not be for retaliatory purposes.<sup>17</sup> Equal Employment Opportunity

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13. *Bishop v. Woodbury Clinical Lab., Inc.*, No. 3:08-1032, 2010 WL 1609949, at \*1–2 (M.D. Tenn. 2010); *see also Failure to Train: A Costly Mistake in Sexual Harassment Cases*, HR PROFESSIONALS MAGAZINE, <http://hrprofessionalsmagazine.com/failure-to-train-a-costly-mistake-in-sexual-harassment-cases/> (discussing the holding in *Bishop*).

14. *Bishop*, 2010 WL 1609949, at \*1–2; *see also* *Hurley v. Atlantic City Police Dep't*, 174 F.3d 95, 117–18 (3d Cir. 1999) (holding that an employer was not entitled to protection under *Faragher* simply because it had policies and procedures in place, because the employer should have taken reasonable steps to enforce them).

15. *See* Keisha-Ann G. Gray, *The Ins and Outs of Investigations*, HUM. RESOURCE EXECUTIVE ONLINE (Dec. 28, 2009), <http://www.hreonline.com/HRE/view/story.jhtml?id=312336789> (noting the importance of internal employer investigations to avoiding liability for allegations of sexual harassment committed in the workplace).

16. Theresa M. Beiner, *Sex, Science, and Social Knowledge: The Implications of Social Science Research on Imputing Liability to Employers for Sexual Harassment*, 7 WM. & MARY J. WOMEN & LAW 273, 286 n. 79 (2001) (citing *Cardidad v. Metro-N. Commuter R.R.*, 191 F.3d 283, 295 (2d Cir. 1999) (“[E]ndeavors to investigate and remedy problems reported by its employees’ are sufficient [to demonstrate reasonable care]”).

17. Stewart S. Manela, *Workplace Investigations* 5–8 (2009) (unpublished manuscript) [https://www.americanbar.org/content/dam/aba/administrative/labor\\_law/meetings/2009/ac2009/107.authcheckdam.pdf](https://www.americanbar.org/content/dam/aba/administrative/labor_law/meetings/2009/ac2009/107.authcheckdam.pdf) (detailing various elements that determine the adequacy of an internal investigation into workplace harassment).

Commission (“EEOC”) guidelines note four principles that constitute a sound investigation: (1) it is prompt, thorough, and impartial; (2) the employer should launch it in a time appropriate to its necessity; (3) the employer is ready to undertake corrective actions to stop discovered harassment; and (4) the investigator is well-trained.<sup>18</sup> Without these internal investigations, there is little evidence to show that an employer’s attempts at discovering and remedying abuses were reasonable.

Courts have also recognized the importance of the *Faragher* defense’s second element, that employees avail themselves of the employer’s preventative or corrective measures.<sup>19</sup> The second element is vitally important, for if the employee was able to hold the employer liable without attempting to report workplace harassment, it would undermine the entire defense.<sup>20</sup> Just as the affirmative defense relies on the active participation of the employer in developing safeguards, the employees themselves must make an effort to assert those rights. Otherwise, *Faragher* amounts to a regulatory compliance framework without the participation of those it intended to help.

### B. The Public Policy of *Faragher*

The public policy that underpins the judicial resolutions of *Faragher* and its progeny<sup>21</sup> demonstrates a continued trend of

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18. DIANE M. PFADENHAUER, WORKPLACE INVESTIGATIONS: DISCRIMINATION AND HARASSMENT 68–69 (2009) (discussing the EEOC’s guidelines for investigating allegations of sexual harassment in the workplace).

19. EQUAL EMP. OPPORTUNITY COMM’N, SELECTED DEVELOPMENTS IN RETALIATION CASE LAW 2–3 (2015) (citing *Hatmaker v. Mem’l Med. Ctr.*, 619 F.3d 741, 746 (7th Cir. 2010), in which the Court of Appeals did not sustain an employee’s claims of sexual harassment because her emails about the alleged conduct did not rise to the level of complaint; they were only discussions about an “awkward boss”); see also 1 ALBA CONTE, SEXUAL HARASSMENT IN THE WORKPLACE: LAW AND PRACTICE 3-22.3 (4th ed. Supp. 2017) (noting that, to overcome the *Faragher* defense, an employee must make use of complaint processes unless there is a prevailing reason for an exception).

20. Ann M. Henry, *Employer and Employee Reasonableness Regarding Retaliation Under the Ellerth/Faragher Affirmative Defense*, 1999 U. CHI. LEGAL F. 553, 563 (1999) (citing *Sconce v. Tandy Corp.*, F. Supp. 2d 773 (W.D. Ky. 1998)) (analyzing a similar situation with the *Faragher* defense).

21. See, e.g., *Burlington Indus., Inc. v. Ellerth*, 524 U.S. 742 (1998). Decided in the same term as *Faragher*, the Supreme Court in *Ellerth* held that an employee

protecting employers from liability where an employer takes prompt investigative and remedial measures in instances of employee harassment.<sup>22</sup> As a result, the existence of affirmative defenses insulating employers from liability necessitates, not as a matter of law, but as a matter of prudence, “(A) effective policies prohibiting harassment and directing and encouraging employees to report harassment or other improper conduct to supervisors or managers; (B) effective procedures to promptly and effectively investigate complaints; and (C) managers well trained to identify, implement and document appropriate corrective action.”<sup>23</sup> Put simply, the public policy behind the development of the *Faragher* defense is to “encourag[e] employers to adopt and promulgate adequate sexual-harassment policies and complaint procedures.”<sup>24</sup> As a result, the *Faragher* defense incentivizes employers to develop robust compliance programs.<sup>25</sup> As part of these programs, employers must not only dedicate resources to knowing and understanding state and federal employment regulations; they must also create a culture of compliance within their businesses.<sup>26</sup> Employee training and effective policies and procedures are necessary and intended byproducts of the adoption of this defense. By creating this affirmative defense, courts have created employers who, even if solely out of self-interest, have adopted robust employment-law compliance programs and cultures. Implementing anti-harassment policies and conducting training in an effort to create a holistic culture of compliance enables employers to

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did not need to suffer negative employment repercussions to sustain a harassment suit against an employer. *Id.* at 766.

22. See DENNIS P. DUFFY, NAT’L EMP’T LAW INST., CONDUCTING LAWFUL AND EFFECTIVE WORKPLACE INVESTIGATIONS AND RESPONDING TO AGENCY INVESTIGATIONS 1 (2007).

23. *Id.* at 2.

24. Lauren P. Gearty, Comment, *Scope of Faragher-Ellerth Affirmative Defense to Vicarious Liability Not Defined by Employer’s Own Sexual Harassment Policy*, 42 SUFFOLK U. L. REV. 399, 403 (2009) (citing *Ellerth*, 524 U.S. at 764).

25. See Bob Kilgore, *You Are Going to Face a Retaliation Claim—Deal With It*, LAW360 (Mar. 31, 2016), <https://www.law360.com/articles/778167/you-are-going-to-face-a-retaliation-claim-deal-with-it>.

26. *Id.* (noting that a culture of compliance is a best practice to ensure that a company is entitled to use a *Faragher* defense).

reduce workplace harassment.<sup>27</sup> However, there are limitations to the efficacy of affirmative defenses in reducing illegal activity. In the case of workplace harassment, studies show that, where training and policies were merely designed to avoid legal liability and not dedicated to creating a culture of compliance, there was no corresponding decrease in harassment claims.<sup>28</sup>

### III. BANK SECRECY ACT/ANTI-MONEY LAUNDERING REGULATIONS AND PUBLIC POLICY

Money laundering has captured headlines recently, with an increasing number of regulators taking action against financial institutions across the world for alleged failures to stop it.<sup>29</sup> Although the predicate crimes that lead to money laundering have existed since the inception of civilization, the formal designation of money laundering as a crime is a fairly recent legal designation.<sup>30</sup> But what exactly are the financial crimes these banks are supposed to stop? There are three general categories of financial crimes that fall under the umbrella “anti-money laundering” designation that casually describe a number of offenses: money laundering, terrorist financing, and sanctions requirements.

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27. See CHAI R. FELDBLUM & VICTORIA A. LIPNIC, U.S. EQUAL EMPLOYMENT OPPORTUNITY COMMISSION, SELECT TASK FORCE ON HARASSMENT IN THE WORKPLACE (2016), [https://www.eeoc.gov/eeoc/task\\_force/harassment/report.cfm](https://www.eeoc.gov/eeoc/task_force/harassment/report.cfm) (noting that only a holistic compliance effort involving training, objectives, and policies can decrease workplace sexual harassment).

28. See Eric Raphan & Lindsay Colvin, *Steps for Effective Workplace Harassment Prevention*, LAW360 (Nov. 4, 2016), <https://www.law360.com/articles/855900/steps-for-effective-workplace-harassment-prevention> (noting that harassment policies and training that focus mainly on avoiding employer liability have proven ineffective).

29. See Brad S. Karp, *The Regulatory and Enforcement Outlook for Financial Institutions in 2017*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Mar. 8, 2017), <https://corpgov.law.harvard.edu/2017/03/08/the-regulatory-and-enforcement-outlook-for-financial-institutions-in-2017> (discussing recent trends in AML enforcement actions).

30. See RODOLFO URIBE, ORG. AM. STATES, INTER-AM. DRUG ABUSE CONTROL COMMISSION, CHANGING PARADIGMS ON MONEY LAUNDERING (2003), [http://www.cicad.oas.org/oid/NEW/Information/Observer/Observer2\\_2003/MLParadigms.pdf](http://www.cicad.oas.org/oid/NEW/Information/Observer/Observer2_2003/MLParadigms.pdf) (explaining the historical development of money laundering).

Money laundering is “the process of changing money gained from illegal operations into a manageable form while concealing its illicit origins.”<sup>31</sup> Terrorist financing, however, is often considered to be “reverse money laundering.”<sup>32</sup> Whereas money laundering sends illegally received proceeds from criminal activities through the financial system to convert the funds into legal tender, terrorist financing generally sees legally procured funds placed into the financial system in a manner to disguise their ultimate illegal use.<sup>33</sup> Financial crimes also generally encompass sanctions requirements, which require financial institutions to ensure that they are not doing business with persons or business organizations, or in places, that have been sanctioned by the U.S. government.<sup>34</sup>

These definitions, however, are deceptively simple because money laundering and terrorist financing are constantly evolving threats to the national and international financial system.<sup>35</sup> Recognizing that these simplistic definitions actually encapsulate an extremely complex and convoluted form of criminal activity is imperative in attempting to marry the current enforcement mechanisms of compliance with the public policy underpinnings of AML regulations.

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31. Matthew R. Auten, *Money Spending or Money Laundering: The Fine Line Between Legal and Illegal Financial Transactions*, 33 PACE L. REV. 1231, 1231 (2013) (quoting STAFF OF S. CAUCUS ON INT’L NARCOTICS CONTROL, 100TH CONG., LEGIS. AIMED AT COMBATING INT’L DRUG TRAFFICKING AND MONEY LAUNDERING 13 (Comm. Print 1987)).

32. C. Mallada Fernández, *Money Laundering and Financing of Terrorism*, 8 INT’L J. HUMAN. & SOC. SCI. 1337, 1339 (2014), <http://waset.org/publications/9998196/money-laundering-and-financing-of-terrorism>.

33. See PAUL ALLAN SCHOTT, REFERENCE GUIDE TO ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM I-1–I-6 (2003) (defining and explaining the differences between money laundering and terrorist financing).

34. See Vanessa Ortblad, Comment, *Criminal Prosecution in Sheep’s Clothing: The Punitive Effects of OFAC Freezing Sanctions*, 98 J. CRIM. L. & CRIMINOLOGY 1439, 1442–43 (2008).

35. See PATRYCJA SZARECK-MASON, THE EUROPEAN UNION’S FIGHT AGAINST CORRUPTION: THE EVOLVING POLICY TOWARDS MEMBER STATES AND CANDIDATE COUNTRIES 31–32 (Laurence Gormley & Jo Shaw eds., 2010) (noting that recommendations on combating money laundering are updated frequently to control the evolving threat that this illicit financial activity poses).

A. *A History of BSA/AML Regulations and Safe Harbor Protections*

The BSA/AML regulatory regime originated with the seminal 1970 legislation passed by Congress, the Currency and Foreign Transactions Reporting Act.<sup>36</sup> Commonly known as the Bank Secrecy Act (“BSA”), this legislation “established requirements for record keeping and reporting by private individuals, banks, and other financial institutions.”<sup>37</sup> The purpose of the BSA was to “identify the source, volume, and movement of currency and other monetary instruments transported or transmitted into or out of the United States or deposited in financial institutions.”<sup>38</sup>

There are two principal parts of the BSA. Title I authorizes the Treasury Department to pass regulations on financial institutions, and Title II allows the Treasury Department to prescribe regulations governing the reporting and recordkeeping of currency transactions.<sup>39</sup> Of additional importance are the recordkeeping requirements that the BSA established, as they required financial institutions to record and retain the identities of the parties to each transaction.<sup>40</sup> In addition to the Currency Transaction Report reporting requirement,<sup>41</sup> the BSA also required financial institutions to record and report the moving of funds into and out of the United States,<sup>42</sup> and that individuals with foreign bank accounts report those accounts to the Treasury

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36. See 31 U.S.C. § 5331 (2012).

37. FED. FIN. INST. EXAMINATION COUNCIL, BANK-SECRECY ACT/ANTI-MONEY LAUNDERING EXAMINATION MANUAL 3 (2014).

38. *Id.*

39. FED. DEPOSIT INS. CORP., RISK MGMT. MANUAL OF EXAMINATION POLICIES § 8.1-1 (2005), <https://www.fdic.gov/regulations/safety/manual/section8-1.pdf>.

40. Douglas King, *Banking Bitcoin-Related Businesses: A Primer for Managing BSA/AML Risks* 6 (Retail Payments Risk Forum Working Paper, 2016), [https://www.frbatlanta.org/-/media/documents/rprf/rprf\\_pubs/2016/banking-bitcoin-related-businesses.pdf](https://www.frbatlanta.org/-/media/documents/rprf/rprf_pubs/2016/banking-bitcoin-related-businesses.pdf) (discussing the history of the BSA and its important regulatory provisions).

41. 31 C.F.R. § 1010.311 (2011) (requiring that financial institutions report transactions involving more than \$10,000 in cash).

42. 31 C.F.R. § 1010.340 (2011) (mandating individuals who transport more than \$10,000 in currency into or out of the United States to report such transactions).

Department.<sup>43</sup> While the BSA established reporting requirements, it did not make money laundering illegal, which meant that regulators could not penalize illicit financial activity; they could only punish the failure to report the suspicious activity.<sup>44</sup>

It was not until the 1986 passage of the Money Laundering Control Act (“MLCA”) that Congress criminalized money laundering itself.<sup>45</sup> The MLCA makes it a crime to knowingly engage in a financial transaction with the proceeds of some form of unlawful activity, either with the intent to promote the carrying on of specified unlawful activity or with the design of concealing the nature, location, source, ownership, or control of the illicit proceeds.<sup>46</sup> Distilled even further, the MLCA makes it a federal crime to launder proceeds from specified unlawful activity.<sup>47</sup> One especially noteworthy feature of the MLCA was the broad imposition of anti-money laundering regulations; while previously only money laundering was criminalized, the MLCA broadened the application of the money laundering regime to more predicate offenses.<sup>48</sup>

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43. 31 C.F.R. § 1010.350(a) (2011) (directing individuals with overseas accounts or interests in overseas accounts to file a Report of Foreign Bank and Financial Accounts).

44. ROBERT E. GROSSE, DRUGS AND MONEY: LAUNDERING LATIN AMERICA’S COCAINE DOLLARS 54 (2001) (noting that the BSA did not make money laundering illegal, it just created reporting requirements and penalized the failure to report certain transactions).

45. Emily J. Lawrence, *Let the Seller Beware: Money Laundering, Merchants and 18 U.S.C. §§ 1956, 1957*, 33 B.C. L. REV. 841, 841 (1992); see also Jon Matonis, *Money Laundering Is Financial Thoughtcrime*, AM. BANKER (May 7, 2013), <https://www.americanbanker.com/opinion/money-laundering-is-financial-thoughtcrime>.

46. 18 U.S.C. § 1956(a)(1) (2012). Although § 1956(a)(1) generally prohibits money laundering, subsequent sections of the law target specific predicate crimes.

47. See Jimmy Gurule, *The Money Laundering Control Act of 1986: Creating a New Federal Offense or Merely Affording Federal Prosecutors an Alternative Means of Punishing Specified Unlawful Activity?*, 32 AM. CRIM. L. REV. 823, 824 (1995). Money laundering involves “cleaning” the proceeds from illegal activities. These illegal activities are called predicate crimes and include drug trafficking, gambling, and bribery. See CHARLES DOYLE, CONG. RESEARCH SERV., RL33315, MONEY LAUNDERING: AN OVERVIEW OF 18 U.S.C. 1956 AND RELATED FEDERAL CRIMINAL LAW 1 (2012).

48. Auten, *supra* note 31, at 1232 (noting the changes to AML laws made by the MLCA). See Money Laundering Control Act of 1986, Pub. L. No. 99-570, §§

Congress again strengthened anti-money laundering laws in the 1990s. In 1992, for example, Congress passed the Annunzio-Wylie Anti-Money Laundering Act,<sup>49</sup> which added several provisions to the BSA.<sup>50</sup> One of the more recognized regulatory requirements imposed by the Annunzio-Wylie Act was the mandate that financial institutions and their employees report any suspicious activity; but the act also created a safe-harbor for this reporting.<sup>51</sup> Additionally, the Annunzio-Wylie Act required regulators to implement procedures and make determinations as to whether or not financial institutions that participated in money laundering could keep their bank charter.<sup>52</sup>

Congress also followed the Annunzio-Wylie Act by passing the Money Laundering Suppression Act of 1994 (“MLSA”).<sup>53</sup> This act provided a set of AML laws that govern regulators.<sup>54</sup> The MLSA’s requirements empowered financial regulators to stop money laundering by improving examiner training and creating more robust examination schedules and procedures.<sup>55</sup>

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1351–1367, 100 Stat. 3207 (1986) (enacted as Title I.H. of the Anti-Drug Abuse Act of 1986).

49. Pub. L. No. 102-550, 106 Stat. 3672 (1992).

50. See OFFICE OF THE COMPTROLLER OF THE CURRENCY, MONEY LAUNDERING: A BANKER’S GUIDE TO AVOIDING PROBLEMS 4–5 (2002) (describing the additional AML provisions added by the Annunzio-Wylie Act).

51. Trifin J. Roule, *Money Laundering*, in 2 THE AMERICAN ECONOMY: A HISTORICAL ENCYCLOPEDIA 754, 757–58 (Cynthia L. Clark ed., 2011) (noting the Suspicious Activity Reporting requirements implemented by the Annunzio-Wylie Act).

52. See generally Annunzio-Wylie Act §§ 1502–1503, 106 Stat. at 4045–51; Duncan Alford, *Anti-Money Laundering Regulations: A Burden on Financial Institutions*, 19 N.C. J. INT’L L. & COM. REG. 437, 460 n. 244 (1994) (noting the legislative authority for revoking bank charters for participating in money laundering schemes); see also *Taking the Profit out of Drug Trafficking: The Battle Against Money Laundering: Hearing Before the Subcomm. on Crime of the Comm. on the Judiciary*, 105th Cong. 96 (1997) (Statement of Michael F. Zeldin, Principal, Price Waterhouse LLP).

53. 18 U.S.C. § 1956 (2012 & Supp. 2016).

54. See James Bossert, “G” and “H” Control Charts and Risk Analysis in the Banking Industry 18 (2008) (unpublished Ph.D. dissertation, Indiana State University) (on file with the author) (noting that the MLSA requirements were aimed at regulatory oversight changes).

55. U.S. GOV’T ACCOUNTABILITY OFF., GAO-06-386, BANK SECRECY ACT: OPPORTUNITIES EXIST FOR FINCEN AND THE BANKING REGULATORS TO FURTHER

Post-9/11, Congress and federal regulators again increased their scrutiny of AML regulations, this time to target terrorist financing, as part of the 2002 Patriot Act.<sup>56</sup> These new regulations prompted U.S. financial institutions to take a critical look at the types and customer bases of the products they offer.<sup>57</sup> The most notable changes that the Patriot Act made to the BSA were that it increased the requirements surrounding the reporting of suspicious behavior.<sup>58</sup> Additionally, the Patriot Act expanded regulators' definition of "financial institutions," and thus, the number of businesses that were responsible for compliance with BSA/AML regulations, including identifying and reporting of suspicious activity.<sup>59</sup> An especially relevant portion of the Patriot Act, Section 314, authorizes financial institutions to share information—after notification to the Treasury—"regarding individuals, entities, organizations, and countries suspected of possible terrorist or money laundering activities."<sup>60</sup>

Beyond the regulations passed by Congress, the Financial Crimes Enforcement Network ("FinCEN")<sup>61</sup> and other financial

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STRENGTHEN THE FRAMEWORK FOR CONSISTENT BSA OVERSIGHT 24 (2006) (describing the new regulations codified by the MLSA).

56. S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 112TH CONG., U.S. VULNERABILITIES TO MONEY LAUNDERING, DRUGS, AND TERRORIST FINANCING: HSBC CASE HISTORY 1 (Comm. Print 2012) (discussing the strengthened AML regulations in the post-9/11 financial systems).

57. WORLD BANK, BARRIERS TO ACCESS TO PAYMENT SYSTEMS IN SENDING COUNTRIES AND PROPOSED SOLUTIONS 8–9 (2013), [http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/282044-1359488786791/barriers\\_web.pdf](http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/282044-1359488786791/barriers_web.pdf) (describing general banking trends in light of post-9/11 financial regulations).

58. CARY STACY SMITH & LI-CHING HUNG, THE PATRIOT ACT: ISSUES AND CONTROVERSIES 116 (2010) (noting that the Patriot Act broadened the BSA's reporting and recordkeeping requirements for financial institutions).

59. Douglas N. Greenburg & Jonathan C. Su, *Financial Institutions in the Cross-Hairs: Lessons from Recent Major Anti-Money Laundering Enforcement Cases*, 22 REV. BANKING & FIN. SERVICES 17, 18 (2006) (discussing the changes to the BSA codified by the passage of the Patriot Act).

60. Robert S. Pasley, *Privacy Rights v. Anti-Money Laundering Enforcement*, 6 N.C. BANKING L. INST. 147, 207 (2002) (citing Patriot Act, Pub. L. No. 107-56, § 314 (2001)) (discussing the Patriot Act's codification of information sharing in Section 314).

61. FinCEN is an office of the United States Department of the Treasury that fights illicit financial activity "through the collection, analysis, and dissemination of

regulators issued a new set of regulations that required financial institutions to create and maintain a Customer Identification Program (“CIP”) and to collect information about and verify customer identities.<sup>62</sup> In the continuing trend of the post-9/11 financial system to “Know Your Customer,”<sup>63</sup> CIP and “Customer Due Diligence” became important weapons in the BSA/AML compliance arsenals of financial institutions.<sup>64</sup> Whereas pre-9/11 regulations, including the BSA and MLCA, focused on a transaction-based approach to stopping the flow of illicit funds, post-9/11 regulations have taken a customer-centric approach to prevent and detect money laundering and terrorist financing.<sup>65</sup>

It is also important to note that there are a number of safe-harbor provisions that have been formally codified under various BSA/AML statutes. Section 314(b) of the Patriot Act provides an important tool in combating illicit financial transactions by establishing the ability of financial institutions to work together and share information on suspected customers who may be engaging in money laundering or terrorist financing.<sup>66</sup> The same section also establishes a safe-harbor provision for financial institutions that shields those institutions that share information about persons, entities, or organizations with other

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financial intelligence and strategic use of financial authorities.” *Mission*, FIN. CRIMES ENF’T NETWORK, U.S. DEP’T. OF THE TREASURY, <https://www.fincen.gov/about/mission> (last visited Oct. 24, 2017).

62. Maria A. de Dio, Note, *The Sixth Pillar of Anti-Money Laundering Compliance: Balancing Effective Enforcement with Financial Privacy*, 10 BROOK. J. CORP. FIN. & COM. L. 495, 502 (2016) (discussing the promulgation of CIP requirements).

63. *Id.* at 501–05.

64. See Josetta S. McLaughlin & Deborah Pavelka, *The Use of Customer Due Diligence to Combat Money Laundering*, 12 ACCT. BUS. & PUB. INT. 57, 61 (2013) (enunciating the importance of establishing CDD and CIP procedures in combating money laundering at financial institutions).

65. See *The Bank Secrecy Act and the USA Patriot Act Before H. Comm. on Int’l Rel.*, 108th Cong. (2004) (testimony of Herbert A. Biern, Senior Associate Director, Division of Banking Supervision and Regulation), <https://www.federalreserve.gov/boarddocs/testimony/2004/20041117> (noting that the Patriot Act created and strengthened customer identification and due diligence information collection responsibilities for financial institutions).

66. See 31 C.F.R. § 1010.540(b) (2011); Jane Abramczyk, *Information Sharing Pursuant to Section 314(b) of the Patriot Act*, REG. COMPLIANCE, July 2010, [http://www.regulatorycompliance.com/newsletter/2010/july/info\\_sharing.html](http://www.regulatorycompliance.com/newsletter/2010/july/info_sharing.html).

financial institutions and law enforcement.<sup>67</sup> This safe harbor, however, also requires a financial institution sharing information pursuant to Section 314(b) to notify FinCEN of its intention to share information, *and* it must take steps to insure the security and confidentiality of the information that it plans to share.<sup>68</sup> Not all BSA/AML regulations come with safe-harbor cutouts, though, and even diligent investigations that comply with AML rules may fail to mitigate liability for the financial institution.<sup>69</sup>

Additionally, international guidance from the Financial Action Task Force (“FATF”) and domestic regulatory and judicial actions have created a safe-harbor for the filing of Suspicious Activity Reports (“SARs”).<sup>70</sup> Pursuant to federal regulatory requirements, financial institutions have developed policies, procedures, and processes to

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67. 31 C.F.R. § 1010.540(b)(5) (2011). This section reads:

Safe harbor from certain liability—

(i) In general. A financial institution or association of financial institutions that shares information pursuant to paragraph (b) of this section shall be protected from liability for such sharing, or for any failure to provide notice of such sharing, to an individual, entity, or organization that is identified in such sharing, to the full extent provided in subsection 314(b) of Public Law 107-56.

(ii) Limitation. Paragraph (b)(5)(i) of this Section shall not apply to a financial institution or association of financial institutions to the extent such institution or association fails to comply with paragraphs (b)(2), (b)(3), or (b)(4) of this section.

*Id.*

68. 31 C.F.R. § 1010.540(b)(2)–(4) (2011).

69. See Joseph Lynyak III, Lawrence Ward & Michelle Ng, *The New AML Regulations and Their Impact on Banks—Increased Compliance for Lending Transactions with Legal Entities*, DORSEY & WHITNEY LLP (June 7, 2016), <https://www.dorsey.com/newsresources/publications/client-alerts/2016/06/new-aml-regulations-and-their-impact-on-banks> (noting that there is no safe harbor for financial institutions that rely on one-pagers sent to customers to determine beneficial ownership).

70. FIN. ACTION TASK FORCE, INTERNATIONAL STANDARDS ON COMBATING MONEY LAUNDERING AND THE FINANCING OF TERRORISM & PROLIFERATION: THE FATF RECOMMENDATIONS 19 (2016), [http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF\\_Recommendations.pdf](http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf) (“Financial institutions, their directors, officers, and employees should be: (a) protected by law from criminal and civil liability for breach of any restriction on disclosure of information . . . if they report their suspicions in good faith to the [Financial Intelligence Unit] . . .”).

detect and report suspicious activity.<sup>71</sup> When financial institutions and their employees believe, or have a reasonable basis to believe, that illicit financial activity is occurring at their financial institution, the financial institution or employee must file a SAR with FinCEN.<sup>72</sup> In an effort to ensure that suspicious activity is reported, FinCEN has created a safe-harbor provision, protecting financial institutions and their employees from civil liability that they may incur while reporting suspicious financial activity.<sup>73</sup> While this safe-harbor provision is fairly broad, it does require financial institutions to make a good-faith effort to appropriately identify and report potentially suspicious activity.<sup>74</sup>

Despite the extensive anti-money laundering and terrorist financing regulations that the U.S. government has enacted, there are still gaps in the nation's AML/CTF controls. The FATF, an international body that develops model regulations to combat money laundering and terrorist financing worldwide,<sup>75</sup> notes that there are several major deficiencies, such as the failure to extend AML regulations beyond traditional financial institutions<sup>76</sup> and the failure by U.S. financial institutions to collect beneficial ownership of legal entity clients.<sup>77</sup> Nevertheless, the U.S. and its stringent anti-money

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71. See 12 C.F.R. § 21.11 (2017).

72. 12 C.F.R. § 163.180(d) (2017) (requiring financial institutions to file suspicious activity reports (SARs) when they detect suspicious activity).

73. 31 U.S.C. § 5318(g)(3) (2012) (providing for the immunity from civil actions for reporting potentially suspicious activity by a financial institution).

74. See Pete Brush, "Good Faith" Bank Immunity Row Won't Make It to High Court, LAW360 (Nov. 26, 2012), <https://www.law360.com/articles/396216>. There is a current circuit split between the Eleventh Circuit and the First and Second Circuits as to the good-faith requirement. *Id.* As a result of the circuit split, some jurisdictions require good-faith effort in detecting and reporting suspicious activity, while other jurisdictions recognize a much broader safe harbor provision for SAR reporting. *Id.*

75. See JAMES K. JACKSON, CONG. RESEARCH SERV., RS21904, THE FINANCIAL ACTION TASKFORCE: AN OVERVIEW (2012) (describing and defining the FATF).

76. See Ken Tysiac, *U.S. Anti-Money Laundering Regulations Well-Developed, Analysis Finds*, J. ACCT. (Dec. 1, 2016), <http://www.journalofaccountancy.com/news/2016/dec/us-anti-money-laundering-regulations-201615620.html> (detailing the limitations in U.S. AML laws as noted by the FATF).

77. See Mary Beth Goodman, *Beneficial Ownership Rules Would Drag Criminals into Daylight*, AM. BANKER (Feb. 18, 2015),

laundering regulations play an important role worldwide. The international financial community is dominated by U.S. regulations,<sup>78</sup> and financial institutions worldwide seek to maintain formal ties with the U.S. banking system.<sup>79</sup>

*B. Public Policy Underpinning of BSA/AML Regulations*

One of the greatest lubricants for money laundering and terrorist financing is the indifference of those who, as gatekeepers to the financial system, do not bear the burden of enforcement. Congressman Shaw, a sponsor of the MLCA, remarked, “I am sick and tired of watching people sit back and say, ‘I am not part of the problem, I am not committing the crime, and, therefore, my hands are clean even though I know the money is dirty I am handling.’”<sup>80</sup> While financial institutions may have initially opposed increased regulatory burdens, AML compliance is now a multi-billion dollar industry that employs tens of thousands of people.<sup>81</sup>

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<https://www.americanbanker.com/opinion/beneficial-ownership-rules-would-drag-criminals-into-daylight> (noting that, in the United States, there is no requirement to collect the personal information of beneficial owners of accounts).

78. See generally WILLIAM H. BYRNES & ROBERT J. MUNRO, MONEY LAUNDERING, ASSET FORFEITURE AND RECOVERY AND COMPLIANCE—A GLOBAL GUIDE (2017) (providing the importance of U.S. regulatory requirements to international financial institutions and the stringent AML laws that currently exist in the U.S.).

79. See, e.g., Yeganeh Torbati, *Caribbean Countries Caught in Crossfire of U.S. Crackdown on Illicit Money Flow*, REUTERS (July 12, 2016), <http://www.reuters.com/investigates/special-report/usa-banking-caribbean/> (noting that Belize, in particular, took actions to strengthen AML enforcement within its borders, in a broader effort to reconnect its financial institutions with the U.S. financial system).

80. H.R. REP. NO. 99-855, at 13 (1986).

81. See, e.g., Lanier Saperstein, Geoffrey Sant & Michelle Ng, *The Failure of Anti-Money Laundering Regulation: Where Is the Cost-Benefit Analysis?*, 91 NOTRE DAME L. REV. ONLINE 1, 4 (2015) (“International banks spend enormous amounts on anti-money laundering compliance.”); Joel Schectman, Karen Freifeld & Brett Wolf, *Big U.S. Banks to Push for Easing of Money Laundering Rules*, REUTERS (Feb. 16, 2017), <http://www.reuters.com/article/us-usa-banks-moneylaundrying-exclusive-idUSKBN15V1E9> (describing estimation of yearly AML-related compliance costs at \$8 billion for U.S. financial institutions).

Although U.S. financial institutions initially opposed BSA/AML regulations on grounds of increased compliance costs, they quickly mobilized their massive resources to ensure compliance.<sup>82</sup> The dramatic increase in threats to reputational risk led many financial institutions to willingly bear the compliance burdens to ensure the integrity of the financial system and avoid becoming the lynchpin of a terrorist financing scheme.<sup>83</sup>

Developing and nurturing the culture of compliance and self-regulation of private sector financial institutions has long been a central underpinning of financial crimes regulation. The United States Treasury, the federal agency that develops and implements many BSA/AML regulations,<sup>84</sup> has long recognized that, for national and international BSA/AML/OFAC tools to be truly effective, private financial institutions must make a concentrated effort to assume the mantle of gatekeepers of the financial system.<sup>85</sup> Essential to this culture of compliance is not only the widespread adoption of AML/BSA regulations, but also the ability of the private sector to police itself.<sup>86</sup>

Although it is clear to regulators and financial institutions that wish to avoid bank-closure levels of reputational risk<sup>87</sup> that financial

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82. See Brett Wolf, *U.S. Banks' Anti-Laundering Revamp Sees Treasury-Run Exams, Support for "Utilities"*, REUTERS (Feb. 17, 2017), <http://www.reuters.com/article/bc-finreg-aml-revamp-idUSKBN15W2AF> (noting that U.S. banks currently spend billions of dollars a year in AML compliance).

83. JUAN C. ZARATE, *TREASURY'S WAR: THE UNLEASHING OF A NEW ERA OF FINANCIAL WARFARE* 89 (2013) (discussing the shift in financial institutions views on BSA/AML compliance requirements post-9/11).

84. The Department of the Treasury has delegated FinCEN with the authority to enforce AML/BSA regulations. *Mission*, FINCEN, <https://www.fincen.gov/about/mission> (last visited Oct. 24, 2017) ("FinCEN's mission is to safeguard the financial system from illicit use and combat money laundering and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities.").

85. ZARATE, *supra* note 83, at 159, 165 (discussing the important of private sector initiatives in creating a culture of compliance that ensures the efficacy of AML/BSA regulations).

86. *Id.* at 152–53 (noting that part of the Treasury's Section 311 strategy was bank's willingness to police their own).

87. One of the most well-known cases of AML/BSA violations concerns the \$25 million fine imposed by the OCC on Riggs Bank, a Washington, D.C. bank with an exclusive clientele list, including a number of foreign embassies. See J.C.

institutions bear the burden of BSA/AML compliance, two distinct schools of thought that have developed within the industry that frame the culture of compliance. While both compliance methodologies recognize the important front-line role that financial institutions play to ensure that the financial system remains free from illicit activity, they independently frame how financial institutions arrive at their compliance decisions.<sup>88</sup> This is because financial industry regulators have traditionally given financial institutions wide latitude in crafting BSA/AML programs.<sup>89</sup>

The first and more widespread school of thought regarding the responsibility of banks to ensure AML/BSA/OFAC regulatory compliance can be called the “Extension Philosophy.” Under this philosophy of compliance, stakeholders view financial institutions as an extension of the government, with a deep-seated responsibility for ensuring BSA/AML compliance because the financial institution is the government’s most effective first-line actor for eliminating money-laundering and terrorist financing from the financial system.<sup>90</sup> This

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SHARMAN, *THE MONEY LAUNDRY: REGULATING CRIMINAL FINANCE IN THE GLOBAL ECONOMY* 48–49 (2011) (noting the reputational damage Riggs Bank suffered for AML/BSA failures); Timothy L. O’Brien, *Regulators Fine Riggs \$25 Million*, N.Y. TIMES (May 14, 2004), [http://www.nytimes.com/2004/05/14/business/regulators-fine-riggs-25-million.html?\\_r=0](http://www.nytimes.com/2004/05/14/business/regulators-fine-riggs-25-million.html?_r=0). Riggs Bank was fined for BSA/AML violations concerning those embassy accounts and the reputational damage it suffered was cited as the predominate reason for its closure. *See id.*

88. KARIMA TOUIL, *ASS’N CERTIFIED ANTI-MONEY LAUNDERING SPECIALISTS, RISK-BASED APPROACH UNDERSTANDING AND IMPLEMENTATION: CHALLENGES BETWEEN RISK APPETITE AND COMPLIANCE* 4 (2016), [http://files.acams.org/pdfs/2016/Risk-Based\\_Approach\\_Understanding\\_and\\_Implementation\\_K\\_Touil.pdf](http://files.acams.org/pdfs/2016/Risk-Based_Approach_Understanding_and_Implementation_K_Touil.pdf) (noting that AML compliance is a risk-based approach, and that, although financial institutions have similar legal requirements, the compliance programs they create are different).

89. Michael Dawson, *Expect Regulators to Demand More from Boards on AML Compliance*, AM. BANKER (Feb. 27, 2013), <http://www.americanbanker.com/bankthink/expect-regulators-to-demand-more-from-boards-on-aml-compliance-1057081-1.html>.

90. *See Efforts to Ensure Compliance and Enforcement of the Bank Secrecy Act: Hearing on Bank Secrecy Act Enforcement Before the S. Comm. on Banking, Hous., and Urban Affairs*, 108th Cong. 5 (2004) (statement of Susan S. Bies, Member, Board of Governors of the Federal Reserve System) (“The Federal Reserve has long shared Congress’ view that financial institutions and their employees are on the front lines of the efforts to combat illicit financial activity.”).

kind of operating philosophy has been the target of regulators for years, and a number of state and federal regulatory bodies have pushed, both formally and informally, the widespread adoption of a culture of compliance, starting with the Board of Directors.<sup>91</sup> It is the inherent belief of this philosophy that banks have an obligation to the financial system, its constituents, and to the government to prevent bad actors from using the financial system to process illicit funds.<sup>92</sup>

The second school of thought regarding the responsibility of financial institutions of ensuring BSA/AML compliance can be called the “Regulatory Requirement Philosophy.” While the executives and associates of a firm that has adopted the Extension Philosophy views BSA/AML compliance work as a necessary task to protect the financial system, those that have adopted the Regulatory Requirement Philosophy comply with BSA/AML regulations in an effort to avoid the fines of examiners.<sup>93</sup> Most financial institutions have BSA/AML programs, but these institutions frequently do the bare minimum needed to comply with the law, which presents a systemic threat to not just the survival of the institution but to the industry as a whole.<sup>94</sup> This

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91. See Lawrence Kaplan, Michael Hertzberg & Laura Bain, *A Client Alert from Paul Hastings: Promoting a Culture of BSA/AML Compliance—FinCEN Ups the Ante*, PAUL HASTINGS LLP (Aug. 19, 2014), <https://www.paulhastings.com/docs/default-source/default-document-library/stay-current-fincen-bsa-aml-compliance-guidance.pdf> (discussing new steps promulgated by FinCEN to increase BSA/AML compliance leadership by the boards and executives of financial institutions).

92. See Stavros Gadinis & Colby Mangels, *Collaborative Gatekeepers*, 73 WASH. & LEE L. REV. 797, 801–03 (2016) (explaining the role of financial institutions as gatekeepers of the financial system obligated to cooperate with each other and government offices to reduce financial crimes); Deborah Shaw, *Banking on the Financial Institutions as Gatekeepers*, FED. RES. BANK ATLANTA: TAKE ON PAYMENTS (June 16, 2014), <http://takeonpayments.frbatlanta.org/2014/06/banking-on-financial-institutions-as-gatekeepers.html> (echoing the school of thought that financial institutions should act as a gatekeeper in abating money laundering).

93. See Daniel P. Stipano, Acting Chief Counsel, Office of the Comptroller of the Currency, Remarks Before the Florida International Bankers Association 6 (Feb. 10, 2005), <https://www.occ.gov/news-issuances/speeches/2005/pub-speech-2005-13.pdf> (noting that there are financial institutions where compliance with BSA/AML regulations is mere lip service and not a case of committed action).

94. See John C. Dugan, Comptroller of the Currency, Remarks Before the American Bankers Association/American Bar Association Money Laundering Enforcement Conference 3 (Nov. 1, 2005), <https://www.occ.gov/news->

type of mentality is most evident in the responses of some financial institutions that, when presented with regulatory criticism of certain accounts, simply terminate those accounts.<sup>95</sup> Instead of adopting a risk-based approach to identify and monitor potentially troublesome clients, termination provides a quick fix: institutions merely ensure regulatory compliance de facto without embodying the spirit of the law.

#### IV. THE LINK BETWEEN *FARAGER* AND ANTI-MONEY LAUNDERING

The Court's decision in *Faragher*, as noted in Part II, follows the recent judicial trend of attempting to end regulatory rule-breaking by placing the burden of enforcement of the law on the industries it governs. This system has long been recognized as a model of industry enforcement, as self-regulation in lieu of public enforcement has been employed by other industries in the past.<sup>96</sup> Undergirding the liability exception that *Faragher* and its progeny carved out is the belief that, if the law provides safe harbors, those who benefit from them will take corrective actions to remediate problems. The question then becomes: what would a similar and broad-reaching affirmative defense for BSA/AML compliance look like?

##### A. Proposed BSA/AML Affirmative Defense

So far, this Article has examined a commonly employed affirmative defense in the sphere of employment law, the *Faragher* defense, which may shield employers from liability in cases of

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issuances/speeches/2005/pub-speech-2005-108.pdf (noting that banks adopting minimal BSA/AML compliance measures are most likely to be in violation of the law).

95. See Jonathan Lloyd, *The OCC's Increasing Focus on BSA-AML Compliance*, PAYMENT L. ADVISOR (Mar. 13, 2015), <http://www.paymentlawadvisor.com/2015/03/13/the-occs-increasing-focus-on-bsa-aml-compliance/> (noting that former Comptroller Curry warned institutions that simply terminating customers based on BSA/AML risk was insufficient to constitute a compliance program).

96. See Cynthia Estlund, *Corporate Self-Regulation and the Future of Workplace Governance*, 84 CHI.-KENT L. REV. 617, 623–24 (2009) (noting that while this system of regulatory enforcement existed, it did contain several challenges).

workplace sexual harassment.<sup>97</sup> This Article has also examined the fundamental underpinnings of anti-money laundering laws in the United States, beginning with the enactment of the BSA in 1970.<sup>98</sup> While these two areas of the law may appear to be completely unconnected, BSA/AML law can draw upon the *Faragher* defense to create a broad affirmative defense that would shield financial institutions from regulatory enforcement actions in certain situations.

An effective affirmative defense for financial institutions would be very similar to the two-pronged defense recognized by the *Faragher* court. This rule would read:

BSA/AML Affirmative Defense: No financial institution subject to BSA/AML regulations and regulatory review shall be deemed liable for or subject to any enforcement actions, fines, penalties, civil suits, or negative regulatory actions for failure to comply with applicable BSA/AML regulations if:

(a) The financial institution used reasonable care to prevent and correct BSA/AML/OFAC failures, provided that such failures were reported to the appropriate regulatory body, after

(i) Such financial institution undertakes, with appropriate frequency, a reasonably detailed review and/or audit of its BSA/AML compliance program, which evaluates the institution's current program, the risk of its operations, the existence and strength of current controls, and the resulting residual risk of its business activities; and

(b) The financial institution did not unreasonably fail to take any preventive or corrective actions after discovering the alleged defects in its compliance program or fail to report such defects to the appropriate regulatory body within a reasonable time of discovery.

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97. See *supra* Part II.

98. See *supra* Part III.

This proposed affirmative defense tracks very closely with the requirements of the *Faragher* defense, but there are several key differences between the two. The proposed AML defense requires the reporting of alleged failures or deficiencies in the financial institution's compliance program to the appropriate regulatory body—not, as the *Faragher* defense requires, from the employee to the employer.<sup>99</sup> This differentiation is imperative to the AML defense, as it fosters a spirit of transparency and self-governance in the financial institutions. Allowing financial institutions to merely detect and fix proposed problems without first reporting them to the regulatory body would instead create a compliance environment marked by secrecy and sweeping potential problems under the rug. The first element of the AML defense would instead create cooperation, not only between the financial institution and regulatory authority, but also between financial institutions that would be incentivized to share potential shortcomings and solutions to their current gaps in compliance controls.

The more important element of the BSA/AML affirmative defense is the requirement that the financial institution conduct routine maintenance on its BSA/AML compliance program, either through an audit or continuous second-line monitoring.<sup>100</sup> This comprehensive approach to the development of a compliance program is in line with what federal regulators generally recommend.<sup>101</sup> Having a strong revisionary element of a compliance program is part of the four pillars

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99. See, e.g., *Daniel v. Autozone, Inc.*, No. 1:13-cv-118, 2015 WL 2114158, at \*7 (N.D.N.Y. May 6, 2015) (restating that if the employee reports the harassment, the employer is eligible to assert the *Faragher* defense if appropriate protective action was taken).

100. See SUSAN CANNON, ASS'N CERTIFIED ANTI-MONEY LAUNDERING SPECIALISTS, BANK SECRECY ACT AUDITING FOR COMMUNITY BANKS: A RISK-BASED APPROACH 4–5 (2015), <http://www.acams.org/wp-content/uploads/2015/08/Bank-Secrecy-Act-Auditing-for-Community-Banks-A-Risk-Based-Approach-S-Cannon.pdf> (recommending that a BSA/AML compliance program should be strengthened by three lines of defense: (1) first-line monitoring, which happens at the business unit level; (2) second-line compliance monitoring; and (3) third-line audit).

101. OFFICE OF THRIFT SUPERVISION, U.S. DEP'T OF THE TREASURY, USA PATRIOT ACT PREPAREDNESS CHECK-UP 1 (2003) (noting that program analysis and continuous testing of program controls are essential to any BSA/AML compliance program).

of anti-money laundering compliance,<sup>102</sup> and independent testing is one of the integral parts to detecting program weaknesses in an effort to promote regulatory compliance.<sup>103</sup> Not only is the monitoring portion of the affirmative defense an important element that strengthens monitoring standards, it also places ownership of monitoring and reporting directly on the financial institution. Only by imbuing the financial institution with a sense of ownership over compliance monitoring and testing, and by stripping or minimizing these functions from the regulators, can corporate self-governance become a sustainable bedrock of BSA/AML compliance.<sup>104</sup>

While one can criticize the monitoring and reporting requirements under Subsection (1)(a) of the proposed affirmative defense as overly burdensome,<sup>105</sup> the introduction of several core concepts into the defense saves it from being unwieldy. The concept of a risk-based approach to BSA/AML compliance programs is neither new nor prohibited by regulators.<sup>106</sup> Again, this rule subsection would

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102. See OFFICE OF AUDITS AND EVALUATIONS, OFFICE OF INSPECTOR GENERAL, FED. DEPOSIT INS. CORP., AUD-14-009, THE FDIC'S RESPONSE TO BANK SECRECY ACT AND ANTI-MONEY LAUNDERING CONCERNS IDENTIFIED AT FDIC-SUPERVISED INSTITUTIONS 2-3 (2014) (identifying and discussing the importance of the four "pillars" of a successful BSA/AML compliance program).

103. LINDSAY M. DASTRUP, ASS'N CERTIFIED ANTI-MONEY LAUNDERING SPECIALISTS, DATA ANALYTICS AUDIT CONSIDERATIONS WHEN DESIGNING BSA/AML AUDIT TESTING 3 (2015), <http://www.acams.org/wp-content/uploads/2015/08/Data-Analytics-Audit-Considerations-When-Designing-BSA-AML-Audit-Testing-L-Dastrup.pdf> (explaining the importance of independent monitoring and testing in an effective BSA/AML compliance program).

104. See John Palmiero, *Deregulation and the New Era of Self-Governance*, ETHICAL BOARDROOM, <https://ethicalboardroom.com/deregulation-and-the-new-era-of-self-governance> (noting that effective self-governance in the face of deregulation is only sustainable if there is a culture of compliance). Only by allowing financial institutions to take ownership of compliance and develop a self-sustaining feedback loop with management input can financial institutions build a functioning compliance program and establish a culture of compliance.

105. See Michael Ray Harris, *Promoting Corporate Self-Compliance: An Examination of the Debate over Legal Protection for Environmental Audits*, 22 ECOLOGY L.Q. 663, 666 (1996) (reasoning that, at least in the realm of environmental compliance, an overly-burdensome regulatory agenda may hamper corporate efforts at self-compliance).

106. See, e.g., COMMUNITY BANKING CONNECTIONS, FED. RES. SYS., FEDLINKS: BANK SECRECY ACT/ANTI-MONEY LAUNDERING COMPLIANCE (Dec.

place the onus on the financial institution to develop a comprehensive risk assessment program to (1) understand its current lines of business and assess what risks they pose, (2) determine what controls and governance are in place to mitigate BSA/AML risks, and (3) determine whether and to what extent there are residual BSA/AML risks. This type of compliance framework provides a constant feedback loop and embodies the vision of international standards used to tackle money laundering and terrorist financing.<sup>107</sup> By imposing this element, the rule practically guarantees implementation of full-scale compliance programs with effective risk assessments, monitoring, and validation testing.<sup>108</sup> Without proper investment and implementation of systems and personnel, the use of the affirmative defense would not be available to a hypothetical institution.<sup>109</sup>

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2015), <https://www.communitybankingconnections.org/assets/fedlinks/2015/bank-secrecy-act-anti-money-laundering-compliance.pdf?la=en> (explaining the role of risk assessments and risk profiles in creating a risk-based approach to anti-money laundering compliance).

107. See THE WOLFSBERG GROUP, FREQUENTLY ASKED QUESTIONS ON RISK ASSESSMENTS FOR MONEY LAUNDERING, SANCTIONS AND BRIBERY & CORRUPTION 2–3 (2015), <http://www.wolfsberg-principles.com/pdf/home/Wolfsberg-Risk-Assessment-FAQs-2015.pdf> (explaining the role of risk assessments, which are bank-generated analyses that incorporate quantitative and qualitative evaluations of the various risks financial institutions face and the ability of internal controls to mitigate BSA/AML risks).

108. See, e.g., Kerri Lynn Stone, *License to Harass: Holding Defendants Accountable for Retaining Recidivist Harassers*, 41 AKRON L. REV. 1059, 1072 (2009) (noting that *Faragher* incentivizes employers, through the use of a legal shield, to stave off or remediate harm instead of ignoring it); Lorene D. Park, *Employers That Ignore or Fail to Investigate Sexual Harassment Will Pay for It*, WOLTERS KLUWER (Sept. 5, 2013), <http://www.employmentlawdaily.com/index.php/2013/09/05/employers-that-ignore-or-fail-to-investigate-sexual-harassment-will-pay-for-it> (noting that in a post-*Faragher* landscape, employers are strongly motivated to take training, investigations, and corporate policies surrounding sexual harassment much more seriously, as *Faragher* creates legal incentive for employers to investigate and mitigate sexual harassment when it is discovered instead of sweeping it under the rug).

109. See, e.g., Dianne Avery, *Overview of the Law of Sexual Harassment and Related Claims*, in LITIGATING THE SEXUAL HARASSMENT CLAIM 1, 19 (Matthew B. Schiff & Linda C. Kramer 2d. eds., 2000) (noting that recent court cases have prohibited employers from employing the *Faragher* defense where the employer conducted a “sham investigation” and did not properly train employees).

Subsection 1(b) of the proposed defense would additionally prevent financial institutions from regulatory free-riding. “Free-riding,” in the regulatory sense, occurs when some financial institutions create lax—or completely fail to create—compliance programs, while others in the industry create and invest in more stringent programs.<sup>110</sup> Under the proposed legal framework, the only way that a financial institution would be able to assert the defense would be to ensure that institution itself develops a robust, risk-based compliance program, *availing itself of the protections such a program offers through continuous monitoring, and correcting any program deficiencies, weaknesses, or control gaps that were discovered during routine validation*. As a result, subsection 1(b) would fully tie all the requirements of a comprehensive BSA/AML compliance program into the affirmative defense, strongly encouraging financial institutions to not only comply with the letter of the law, but also encouraging new and innovative methodologies of monitoring and detecting. This will provide financial institutions with the comfort of knowing that they could correct a failure, whether at the program level or a control gap, and report it without fear of a subsequent regulatory enforcement action.<sup>111</sup>

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110. NORMAN MUGARURA, THE GLOBAL ANTI-MONEY LAUNDERING REGULATORY LANDSCAPE IN LESS DEVELOPED COUNTRIES 148 (2012) (defining and explaining the problem of regulatory free-riding in the context of disparate enforcement between countries of AML laws).

111. *See, e.g.*, DANIEL CASTRO, BENEFITS AND LIMITATIONS OF INDUSTRY SELF-REGULATION FOR ONLINE BEHAVIORAL ADVERTISING 4 (2011), <http://www.itif.org/files/2011-self-regulation-online-behavioral-advertising.pdf> (noting that the Federal Aviation Administration successfully encourages self-reporting of potential violations by not using the report for enforcement investigations and forgiving unintentional infractions); Jodi L. Short & Michael W. Toffel, *Coming Clean and Cleaning Up: Does Voluntary Self-Reporting Indicative Effective Self-Policing?*, 54 GEO. J. L. & ECON. 609, 614–15 (2011). The Environmental Protection Agency ran a successful Audit Program, in which entities had 75%–100% of punitive damages for regulatory violations waived and the EPA promised not to refer self-reported cases to the DOJ for prosecution. Jodi L. Short & Michael W. Toffel, *Coerced Confessions: Self-Policing in the Shadow of the Regulator*, 24 J.L. ECON. & ORG. 45, 49 (2008). This program was considered to be a success with approximately 3,500 facilities participating and many reporting more than one violation per location. *Id.* at 50.

*B. Does an Affirmative Defense Further the Public Policy Objectives of BSA/AML Regulations?*

Judging from regulatory actions over the years, it is evident that the intent of the regulators is to create a system of self-enforcement among financial institutions.<sup>112</sup> Although the private sector takes the stance that there should be a decrease in the reliance on BSA/AML enforcement actions as effective tools of change to convince financial institutions to implement specific BSA/AML policies or procedures, regulators appear to adopt another view.<sup>113</sup> Regulators still see enforcement actions as the predominant tool of change, but these actions create a number of problems for financial institutions trying to build robust and sustainable BSA programs.<sup>114</sup>

Enforcement actions do not always arise out of statutory violations; rather, regulators look to other financial institutions to develop best practices and industry standards.<sup>115</sup> Indeed, regulators appear to be heightening the regulatory standards to which financial institutions must adhere.<sup>116</sup> In order to stay on the forefront of BSA/AML regulations, financial institutions frequently turn to industry groups to make sure the institution is effectively employing the most recent practices and technologies.<sup>117</sup> Given the efficiencies

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112. Dan Ryan, *AML Monitoring: New York Regulator Gets Prescriptive*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 23, 2016), <https://corpgov.law.harvard.edu/2016/07/23/aml-monitoring-new-york-regulator-gets-prescriptive/> (noting that the NYDFS requires that financial institutions implement enterprise-wide risk assessments and model risk management frameworks to monitor, identify, and eliminate potentially suspicious activity/illicit activity).

113. Nicole M. Healy et al., *U.S. and International Anti-Money Laundering Developments*, 43 INT'L LAW. 795, 801 (2009) (noting that one of the recommendations of the 2008 American Bankers Association proposed reforms to BSA regulations was decreased reliance on criminal actions to effect change in the financial industry).

114. See, e.g., John Engen, *What's Behind the Uptick in BSA Enforcement?*, AM. BANKER 20 (July 28, 2014) (quoting Teresa Pesce of KMPG's American AML practice, "We are now in an era of 'regulation by enforcement action.'").

115. *Id.* (noting the current trend in BSA compliance is not necessarily based on statutory violations).

116. Kaplan, et al., *supra* note 91.

117. See *Anti-Money Laundering Issues for Financial Institutions*, FINANCIER WORLDWIDE, Dec. 2013, <https://www.financierworldwide.com/anti-money-laundering-issues-for-financial-institutions/#.WHamYU3rsdU> (noting that the

and important role collaboration within the industry plays, a regulatory system that prioritizes industry-wide information-sharing would provide the most natural model for self-sufficiency.

The trend for self-regulation within the financial sector has been evident since the inception of anti-money laundering laws.<sup>118</sup> Currently, the standard framework for BSA/AML compliance at large financial institutions is the monitoring-and-validation model, in which gap analysis, control identification, and self-sustaining monitoring are reinforced by a consistent validation strategy to ensure that the financial institutions' monitoring (whether manual or automatic) identifies problematic transactions.<sup>119</sup> This is exactly the type of compliance framework the Wolfsberg Group identified in its 2001 white paper, in which the committee created guidance for the self-screening and monitoring process.<sup>120</sup> Practically, most financial institutions in the developed world have a keen understanding of the money laundering/terrorist financing (ML/TF) risks that are present, and they actively take steps to mitigate those risks.<sup>121</sup> Instituting an affirmative defense in BSA/AML law recognizes that financial institutions are aware of their regulatory requirements while giving them the latitude to develop, via experimentation, self-governing compliance structures.

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private sector frequently looks to private sector cases and industry events for guidance on best practices in the AML world).

118. Cf. FIN. ACTION TASK FORCE, THIRD MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM 1–2 (2005) (noting that the Swiss system of AML compliance is based on self-regulation, predominately through industry groups, akin to the FINRA system in the U.S.).

119. Kristin Milchanowski, ACAMS TODAY, *AML Model Risk Management and Validation: Introduction to Best Practices* (Aug. 28, 2014), <http://www.acamstoday.org/introduction-to-best-practices> (discussing best practices in automatic monitoring and validation BSA compliance framework).

120. See generally WOLFSBERG GROUP, WOLFSBERG STATEMENT ON AML SCREENING, MONITORING & SEARCHING (2009), [http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg\\_Monitoring\\_Screening\\_Searching\\_Paper\\_\(2009\).pdf](http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg_Monitoring_Screening_Searching_Paper_(2009).pdf).

121. See, e.g., INT'L MONETARY FUND, ITALY: DETAILED ASSESSMENT REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM 12 (2016), <https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Italy-Detailed-Assessment-Report-on-Anti-Money-Laundering-and-Combating-the-Financing-of-43690> (noting that in Italy's financial system, while financial institutions are acutely aware of ML/TF risks, it is the robustness of the controls that is of concern).

The importation of a *Faragher*-type affirmative defense into the BSA/AML sphere would further achieve the policies sought by the Financial Action Task Force Recommendations that AML regulations be implemented via a risk-based approach.<sup>122</sup> This risk-based approach to the development and maintenance of a financial crimes program is a stark contrast to a rules-based approach in which a regulated entity merely conducts a checklist of applicable regulations before taking action.<sup>123</sup> As this Article discusses, some financial institutions, to comply with regulators' demands, simply terminate high-risk customers without developing a risk-based approach first.<sup>124</sup> Regulators, including the Office of the Comptroller of the Currency ("OCC"), have scrutinized this type of drastic risk re-evaluation, likely because it fails to develop a broader risk-based approach to managing client relationships. Immediate risk de-escalation was a response to anticipated regulatory action and was likely not the preferred strategy for managing BSA/AML risk by those financial institutions. The incorporation of the affirmative defense, however, would provide financial institutions the time to adequately develop a comprehensive and realistic risk-based approach to problems before its next audit or regulator exam. Without broad safe-harbor provisions, the immediate-risk de-escalation trend will continue, a course of action that is antithetical to regulators' desired outcome.<sup>125</sup> The preferred outcome for a successful compliance environment is not the immediate

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122. Kelvin L. Shepherd, *Guardians at the Gate: The Gatekeeper Initiative and the Risk-Based Approach for Transactional Lawyers*, 43 REAL PROP. TR. & EST. L.J. 607, 625 (2009) (noting that the FATF Recommendations "encourage[d] countries to develop a risk-based approach to AML/CFT efforts").

123. *Id.* (discussing the difference between a rules-based and a risk-based approach to compliance).

124. Thomas J. Curry, Comptroller of the Currency, Remarks Before the Institute of International Bankers 5–7 (Mar. 7, 2016), <https://www.occ.gov/news-issuances/speeches/2016/pub-speech-2016-25.pdf> (discussing the process of customer risk re-evaluation and how immediate de-risking through termination is not necessarily an appropriate response to BSA/AML regulatory burdens).

125. CLAY LOWERY & VIJAYA RAMACHANDRAN, CTR. FOR GLOB. DEV., UNINTENDED CONSEQUENCES OF ANTI-MONEY LAUNDERING POLICIES FOR POOR COUNTRIES 12 (2015), <https://www.cgdev.org/sites/default/files/CGD-WG-Report-Unintended-Consequences-AML-Policies-2015.pdf> (noting that failure to implement a risk-based approach leads to reactionary de-risking, which is a case of "sweeping [the risk] under the rug").

punishment for BSA/AML failures, but rather the encouragement of a constant monitoring and validation feedback loop that continually redefines process/transaction monitoring, control identification, and gap analysis.<sup>126</sup>

A continued emphasis on self-monitoring is particularly important in the face of the increasingly complex financial schemes that plague the financial system. Only by avoiding de-risking<sup>127</sup> and implementing effective, risk-based controls for customer screening can a financial institution develop the knowledge of its customer base to develop behavioral patterns to detect future unusual activity.<sup>128</sup> Practically, it is impossible to monitor, detect, and neutralize every money laundering or terrorist financing risk that financial institutions face.<sup>129</sup> Instead, the law should focus on creating an evolving compliance framework within banks that can adapt to changing situations. This is because money laundering and terrorist financing

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126. FIN. ACTION TASK FORCE, EFFECTIVE SUPERVISION AND ENFORCEMENT BY AML/CFT SUPERVISORS OF THE FINANCIAL SECTOR AND LAW ENFORCEMENT 13 (2005), <http://www.fatf-gafi.org/media/fatf/documents/reports/RBA-Effective-supervision-and-enforcement.pdf> (noting that minor control failures may not invalidate a BSA/AML compliance framework).

127. De-risking is the process of terminating specific client or type of client accounts because of potential regulatory or compliance concerns. TRACEY DURNER & LIAT SHETRET, UNDERSTANDING BANK DE-RISKING AND ITS EFFECTS ON FINANCIAL INCLUSION 1 (Nov. 2015), <http://www.globalcenter.org/wp-content/uploads/2015/11/tr-bank-de-risking-181115-en.pdf>. This could be due to the client's industry (e.g. money-service business), the type of client (e.g. a Politically Exposed Person), or the client's geography (by terminating international client accounts). *See id.* at 5 (noting that exiting client relationships, or de-risking, occurs when financial institutions "exit relationships assessed as being high risk, unprofitable, or simply 'complex,' such as those with money services businesses (MSBs), foreign embassies, international charities, and correspondent banks").

128. BASEL COMM. ON BANKING SUPERVISION, SOUND MANAGEMENT OF RISKS RELATED TO MONEY LAUNDERING AND FINANCING OF TERRORISM 10 (2017), <http://www.bis.org/bcbs/publ/d405.pdf> (noting that ongoing monitoring by banks of their customers, including customer identification and risk-rating, is important to a robust BSA/AML program).

129. BANKER'S TOOLBOX, MODEL VALIDATION FOR COMMUNITY BANKERS: WHAT A MODEL VALIDATION IS AND HOW TO TAKE A RISK BASED APPROACH 10 (Dec. 2014), <http://www.bankerstoolbox.com/wp-content/uploads/WPaper-Model-Validation.pdf>.

are ever-changing,<sup>130</sup> continually evolving enterprises in which criminals attempt to stay just behind the most recent reaches of those in law enforcement and the private sector. If regulatory enforcement actions continue to primarily drive changes to the compliance programs of financial institutions—the status quo—then they stymie innovation and evolution, with changes coming from already outdated regulatory directives instead of the natural growth of compliance methodologies that banks could otherwise develop through experimentation.<sup>131</sup> Continued evolution of monitoring, backed by extensive validation, is one of the only reliable ways to ensure that the evolving nature of money laundering is checked.<sup>132</sup>

### C. Will Self-Regulation Be Effective?

The question of the efficacy of corporate self-enforcement of regulations is not a new question, as a number of scholars and activists wonder if corporations will bear the responsibility of regulatory requirements without continued prompting by the government.<sup>133</sup> This question has been especially prevalent on the issue of corporate social responsibility, as some have wondered whether the potential risk-and-reward ratio between corporate social responsibility and profit-generating will always skew in favor of business practices that increase

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130. U.S. DEP'T OF THE TREASURY ET AL., U.S. MONEY LAUNDERING THREAT ASSESSMENT ii–iii (2005), <https://www.treasury.gov/resource-center/terrorist-illicit-finance/Documents/mlta.pdf> (noting that money laundering is an evolving challenge that changes in response to legal and strategic advances of federal enforcement bodies).

131. Ivan Garces, *Considering a Bank Acquisition? Don't Forget BSA and AML*, BANKDIRECTOR.COM (June 3, 2011), <https://www.bankdirector.com/magazine/archives/1st-quarter-2010/considering-a-bank-acquisition-dont-forget-bsa-and-aml> (noting the importance of having a BSA/AML compliance program that evolves to meet present risks).

132. See ASS'N CERTIFIED ANTI-MONEY LAUNDERING SPECIALISTS, STUDY GUIDE FOR THE CAMS CERTIFICATION 151 (6th ed. 2012), [http://files.acams.org/pdfs/English\\_Study\\_Guide\\_CAMS6/English\\_Study\\_Guide\\_CAMS6.pdf](http://files.acams.org/pdfs/English_Study_Guide_CAMS6/English_Study_Guide_CAMS6.pdf) (noting that money laundering continually evolves and must be continually monitored by financial institutions).

133. See, e.g., Colleen Walsh, *Can Corporations Police Themselves Effectively?*, HARV. GAZETTE (Mar. 13, 2008), <http://news.harvard.edu/gazette/story/2008/03/can-corporations-police-themselves-effectively>.

revenue.<sup>134</sup> Cheating the system and establishing a culture of “cosmetic compliance,” in which the proverbial foxes guard the henhouses, has long been a recognized threat to the efficacy of the corporate self-governance model.<sup>135</sup> This Article asserts, however, that similar risks of non-compliance would not threaten to derail a system of self-governance as it pertains to compliance with BSA/AML regulations.

The public policy justifications behind many of the current BSA/AML regulatory requirements are an essential part to guaranteeing enforcement. Unlike more vague notions of corporate social responsibility, these anti-money laundering regulations are well-known and codified laws and administrative requirements; the only thing that is at issue is the level of regulatory enforcement over compliance. There is little evidence to suggest financial institutions would abandon anti-money laundering and terrorist financing compliance frameworks wholesale simply to save on compliance costs.<sup>136</sup> While the cost of compliance with these regulations is undoubtedly high,<sup>137</sup> the reputational risk these institutions suffer from the exposure of money laundering or terrorist financing activities—or from wanton disregard of money laundering laws—would be debilitating.<sup>138</sup> Continued access to the national and world-wide

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134. *Id.* (“When viewed in terms of its relative importance, the risks and opportunities from CSR pale in comparison to the risks and opportunities of normal business practices.”).

135. Estlund, *supra* note 96, at 623 (noting and explaining the threats to a system of corporate self-governance).

136. ANTOINETTE VERHAGE, THE ANTI-MONEY LAUNDERING COMPLEX AND COMPLIANCE INDUSTRY 98 (Peter Reuter & Ernesto U. Savona eds. 2001) (noting that one of the pillars underpinning the AML regime is preventing criminal elements from entering the financial system, a preventable action that would likely drive continued compliance absent strict regulatory scrutiny).

137. See Emily Holbrook, *Anti-Money Laundering Compliance Costs*, RISK MGMT. MAG. (Sept. 1, 2011, 1:27 PM), <http://www.rmmagazine.com/2011/09/01/anti-money-laundering-compliance-costs> (noting that compliance costs were projected to increase 7.8% in 2012 and projected to reach \$5.8 billion a year just AML compliance industry wide in 2015).

138. See, e.g., WOLFSBERG GROUP, FREQUENTLY ASKED QUESTIONS ON RISK ASSESSMENTS FOR MONEY LAUNDERING, SANCTIONS AND BRIBERY & CORRUPTION 15 (2015), <http://www.wolfsberg-principles.com/pdf/faq/Wolfsberg-Risk-Assessment-FAQs-2015.pdf> (noting the potentially severe reputational risks for failure to adequately manage money laundering compliance); Gavin Finch, *World’s*

financial system keeps financial institutions alive overnight; in the long-term, that access would be severely threatened if it were uncovered during a law enforcement investigation that money laundering and terrorist financing were occurring at a bank.<sup>139</sup> Again, it is not the abandonment of the regulatory framework for which this Article argues, but that the use of enforcement actions to change the compliance culture at banks should be modified with an affirmative defense.

Additionally, AML/CTF regulations are unique and distinct from other regulatory frameworks that may have suffered from corporate non-compliance. While BSA/AML compliance departments are expensive programs,<sup>140</sup> there are financial incentives to maintain them.<sup>141</sup> Preventative compliance programs are essential to stopping financial crimes;<sup>142</sup> relying on punitive government actions alone is an insufficient control to insure that the financial system remains free from illicit funds.<sup>143</sup> There are a number of risks that banks may face

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*Biggest Banks Fined \$321 Billion Since Financial Crisis*, BLOOMBERG (Mar. 1, 2017, 11:01 PM), <https://www.bloomberg.com/news/articles/2017-03-02/world-s-biggest-banks-fined-321-billion-since-financial-crisis> (noting that since 2008, large financial institutions have received approximately \$321 billion in fines from regulatory authorities relating to failures in anti-money laundering compliance programs).

139. See generally LOWERY & RAMACHANDRAN, *supra* note 125 (describing that areas of the world in which money laundering is prevalent or in which the nations have weak anti-money laundering laws, known as high-risk jurisdictions, see decreased access to the global financial system).

140. See, e.g., Daniel J. Mitchell, *Do Money Laundering Laws Catch Criminals?*, NEWSWEEK (Oct. 16, 2016, 6:00 AM), <http://www.newsweek.com/do-money-laundering-laws-catch-criminals-509758> (estimating that AML compliance costs an average of between \$4–\$8 billion yearly).

141. See Caitlin M. McGough, Undergraduate Article, *Evaluating the Impact of AML/CTF Regimes: An Economic Approach*, 28 DUKE J. ECON. 1, 23 (2016), <https://sites.duke.edu/djepapers/files/2016/10/caitlinmcgough-dje.pdf> (noting that the current compliance framework, focused on prevention by financial institutions, is justified on a cost-basis analysis given the risks to the financial industry).

142. See, e.g., ALBERTO CHONG & FLORENCIO LÓPEZ-DE-SILANES, INTER-AM. DEV. BANK, MONEY LAUNDERING AND ITS REGULATION 6 (2007), <http://www.iadb.org/res/publications/pubfiles/pubWP-590.pdf> (establishing that deterrence, in the form of AML regulations, is essential to stopping money laundering).

143. See Robert Kim, *Feeding the Beasts: Anti-Money Laundering Enforcement in 2009–2016*, BLOOMBERG BNA (June 30, 2017),

for failing to create adequate compliance structures that would stop money laundering, from the credit risk posed by bad actors who misuse financial products to the reputational risks banks face if the bank is caught knowingly or unknowingly participating in money laundering and especially, terrorist financing.<sup>144</sup> Managing these risks alone, not to mention the legal risks financial institutions would still face under the self-enforcement compliance framework if regulators determined that an institution participated in illicit finance due to regulatory negligence, create a self-reinforcing mechanism for ensuring corporate self-governance.

## V. CONCLUSION

Money laundering and terrorist financing pose a grave threat, not only to the international and domestic financial system and the institutions of which they are composed, but to the public as well. In the era of instant communication and technology that extends to the transfer of money, bad actors are capable of accessing the formal banking networks and causing serious damage to lives and institutions around the world. To combat this threat, central banks and foreign governments have created a multinational response to stop the flow of illicit funds into financial institutions.<sup>145</sup> The United States government has, since the passage of the BSA, continually

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<https://www.bna.com/feeding-beasts-antimoney-n73014461032> (noting that although penalties and enforcement actions against financial institutions for failures in AML/CTF compliance programs have been increasing, there is no evidence of a corresponding increase in the efficacy of compliance programs).

144. *See, e.g.*, Press Release, U.S. Dep't of the Treasury, Deputy Assistant Secretary for Terrorist Financing and Financial Crimes Daniel Glaser Testimony (Apr. 17, 2008), <https://www.treasury.gov/press-center/press-releases/Pages/hp933.aspx> (explaining that banks that take on clients who are subject to condemnation over terrorist financing, money laundering, or sanctions evasion pose substantial risks to banks' reputation).

145. *See, e.g.*, Joseph M. Myer, Assistant Dir., Int'l Programs, Fin. Crimes Enf't Network, U.S. Dep't of the Treasury, Remarks at the International Symposium on the Prevention and Control of Financial Fraud, International Strategies to Combat Money Laundering (Oct. 19, 1998), [https://icclr.law.ubc.ca/wp-content/uploads/2017/06/myer\\_pap.pdf](https://icclr.law.ubc.ca/wp-content/uploads/2017/06/myer_pap.pdf) (noting that concerted international effort to stop money laundering began in the 1980s).

strengthened anti-money laundering regulations.<sup>146</sup> With the increase in regulations has come an increase in the regulatory scrutiny that financial institutions face from enforcement bodies, noticeably the Department of the Treasury and federal and state banking regulators.<sup>147</sup> In the past half-decade, regulators have brought a record number of enforcement actions and levied fines against financial institutions that have knowingly participated in money laundering, terrorist financing, and sanctions evasions, and those whose compliance programs have been deemed ineffective.<sup>148</sup>

Now that BSA/AML/OFAC regulatory requirements have been deeply entrenched in the U.S. financial system, the question becomes whether strict regulatory oversight over the industry is the most beneficial way to ensure compliance and prevent money laundering and terrorist financing. The current system in which financial institutions operate was designed to be self-sustaining, with banks adopting and implementing BSA/AML compliance departments that have created extensive monitoring and validation feedback loops.<sup>149</sup> These programs are designed to implement controls to prevent bad actors from accessing the bank via the financial products it offers, to be constantly monitored for efficacy, and for the controls to be validated both by second-line personnel and independent testing.<sup>150</sup>

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146. See PETER REUTER & EDWIN M. TRUMAN, CHASING DIRTY MONEY: THE FIGHT AGAINST MONEY LAUNDERING 50–52 (2004) (providing a chart that depicts the evolution of AML regimes). Most federal laws and regulations, including the Annunzio-Wylie Money Laundering Act, Money Laundering Control Act, and Money Laundering Suppression Act, were passed after the Bank Secrecy Act. *Id.*

147. See Kevin L. Petrasic, Laura E. Bain & Amanda M. Kowalski, *A Client Alert from Paul Hastings: Key Trends in BSA/AML Compliance: Heightened Regulatory Expectations as Industry Growth Presents New Challenges*, PAUL HASTINGS LLP (Apr. 14, 2015) [https://www.paulhastings.com/docs/default-source/default-document-library/key-trends-in-bsa-aml-compliance\(114584548\\_1\).pdf](https://www.paulhastings.com/docs/default-source/default-document-library/key-trends-in-bsa-aml-compliance(114584548_1).pdf).

148. See Radin, *supra* note 3.

149. See Alan Abel et al., ACAMS Web Seminar Series, Effectively Managing Your AML Quality Assurance Program 11 (Aug. 10, 2011), <http://files.acams.org/webcasts/20110810/Effectively%20Managing%20Your%20AML%20Quality%20Assurance%20Program.pdf> (noting that testing drives a feedback loop that cements action plans for corrective actions).

150. See VA. BUREAU FIN. INSTS., INDEPENDENT TESTING: A CRITICAL PART OF A BSA/AML COMPLIANCE PROGRAM 1–2 (2005), [https://www.scc.virginia.gov/bfi/news/cu/cu\\_fal05.pdf](https://www.scc.virginia.gov/bfi/news/cu/cu_fal05.pdf) (noting that annual

With the threats posed by money laundering and other illicit financial activity constantly evolving, financial institutions need a robust feedback loop that continuously evolves with the threats it faces, which requires experimentation with new controls and re-adjustment of the financial institution's risk-appetite.

The risk-based approach financial regulators have sought and financial institutions have implemented needs room to adapt and to grow in a self-sustaining environment. Strict regulatory enforcement of BSA/AML requirements, however, is antithetical to this idea. The adoption of an affirmative defense that would protect financial institutions from enforcement actions and fines when the financial institutions take ownership for compliance programs is therefore the best way to protect the financial system, its institutions, and the citizens of the world as self-regulating financial institutions would have the most to lose from non-compliance.

#### APPENDIX A. GLOSSARY

**Bank Secrecy Act (“BSA”):** passed in 1970, the first piece of federal legislation that has formed the basic framework for federal anti-money laundering regulations. While the BSA originally established reporting requirements for currency transactions, subsequent legislation dramatically enhanced and expanded the scope of anti-money laundering requirements to which financial institutions are subject.

**Currency Transaction Report:** a report that U.S. financial institutions are required to file with FinCEN for certain transactions, including currency exchange, deposit, and withdrawal, by or through the financial institution, which involves more than \$10,000 in cash.

**Financial Crimes:** a general reference to illicit financial activity which can include money laundering, terrorist financing, fraud, and bribery and corruption. For the purposes of this Article, the term financial crimes refers only to money laundering and terrorist financing.

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independent testing of a compliance program is a pillar of AML compliance and may be performed by internal or external auditors). Many large financial institutions have independent and internal testing staffs to continually and routinely test BSA/AML compliance. *Id.*

**Financial Crimes Enforcement Network (FinCEN):** a bureau of the U.S. Department of the Treasury that serves as the U.S.'s national financial intelligence unit (FIU). In this role, FinCEN is tasked with receiving, analyzing, and disseminating to law enforcement agencies reports of suspicious financial activity provided by financial institutions in Suspicious Activity Reports (SARs). FinCEN also works with counterparts in other nations to combat illicit financial activity.

**Money Laundering:** the taking of criminal proceeds and disguising their illegal causes in order to use the funds to perform legal or illegal activities. There are usually three stages of money laundering: placement, layering, and integration.

**Office of Foreign Asset Control (OFAC):** the department within the United States Treasury responsible for administering and enforcing U.S. trade and economic sanctions. As part of these responsibilities, OFAC maintains specific lists of sanctioned nations, entities, individuals, vessels, and ports with which U.S. citizens are barred from transacting.

**Terrorist Financing:** the use of funds for illegal political reasons. Although money laundering and terrorist financing appear similar, the funds used in terrorist financing can be derived from legitimate sources, in addition to illicit ones.