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Compliance Overseers Under Financial Regulatory Fire

Law360, New York (May 07, 2014, 1:20 PM ET) -- In the wake of the financial crisis, federal and state regulators are increasingly taking action against individuals for alleged compliance lapses inside financial services companies, and recent reports indicate that sanctions imposed on individuals are on the rise.

This trend in actions against individuals taken by banking, consumer finance, securities and anti-money laundering regulators elevates the risk of individual liability for both compliance professionals and corporate officers. Most telling, the enforcement actions against individuals are reaching beyond sanctions for personal misconduct to address lapses in oversight and management of controls. Indeed, a recent survey found that more than half of compliance professionals expect their personal liability to increase in 2014.

Securities Enforcement Actions

For many years, securities industry regulators have pursued individual liability in actions alleging misconduct against corporations or financial institutions. More recently, however, these regulators have increased their pursuit of individuals who fail in their responsibility to ensure that companies adopt and apply required internal compliance standards.

In October 2013, U.S. Securities and Exchange Commission Chairwoman Mary Jo White announced that the SEC would “focus[] on deficient gatekeepers — pursuing those who should be serving as the neighborhood watch, but who fail to do their jobs.” Since the end of the financial crisis, the SEC has brought a series of actions against corporate officers, including chief compliance officers, for institutional compliance issues.

For example, in a November 2013 action against an investment adviser for failure to comply with custody rules, not only did the SEC pursue the firm, it also alleged that the CCO failed to take necessary steps to ensure that the firm complied with the required custody rules.

The Financial Industry Regulatory Authority takes the same approach. In January 2014, FINRA disciplined a broker-dealer and the firm's former CCO because of inadequate anti-money laundering systems and procedures. In addition to fines and operational requirements imposed on the firm, FINRA suspended the former CCO for 30 days in a principal capacity, concluding that he was responsible for the firm's AML program, and failed to fully enforce the program.

FINRA also announced in February 2014 that an investment firm had agreed to pay $8 million over "substantial" AML lapses, and FINRA fined the firm's compliance officer $25,000 for failure to establish and implement an adequate AML program, in violation of National Association of Securities Dealers rules.

Bank Regulatory Actions

Bank regulators also have begun pursuing individual liability more aggressively. In December 2013, the New York Department of Financial Services entered into a consent order with a New York branch of a foreign bank alleging that the branch facilitated transactions in violation of Office of Foreign Assets Control sanctions.

NYDFS imposed fines on the branch, and "recognize[d] ... disciplinary action taken by the bank ... against individual wrongdoers." That action reflects statements made by NYDFS Superintendent Benjamin Lawsky, who recently encouraged regulators to "publicly expose — in great detail — the actual, specific misconduct that individual employees engage in …. [And] where appropriate — individuals should face real, serious penalties and sanctions when they break the rules." The Office of the Comptroller of the Currency and the U.S. Treasury also are seeking civil money penalties against individual board members at financial institutions with alleged Bank Secrecy Act/AML compliance issues.

Individual Liability in the Retail Financial Services Sector

The newest regulator on the block, the Consumer Financial Protection Bureau, also has asserted claims against individual defendants for compliance failures. In doing so, the agency has relied on "related person" liability in Title X of the Dodd-Frank Act, a cognate of "institution affiliated party" liability in the Federal Deposit Insurance Act.

For example, in October 2013, the CFPB filed a complaint in federal district court alleging that a debt settlement payment processor and a corporate officer violated the Telemarketing Sales Rule by helping debt settlement companies charge consumers upfront fees.

The CFPB alleged that the corporate officer "should have known that [the processor] provided substantial assistance to its ... partners by processing payments on their behalf and that its ... partners were charging and collecting unlawful advance fees."

The processor and the corporate officer agreed to a consent order under which the processor and the corporate officer are jointly and severally liable for a $1.37 million dollar civil money penalty. CFPB

Director Richard Cordray has signaled the CFPB's intent to pursue individual liability when stating: "I've always felt strongly that you can't only go after companies. Companies run through individuals, and individuals need to know that they're at risk when they do bad things under the umbrella of a company."

The Financial Crimes Enforcement Network also has pursued actions against individuals. For example, in April 2014, FinCEN entered into a consent order against a money services business and the president of the MSB, alleging conduct that violated the Bank Secrecy Act, including failure to register as a money services business, failure to establish and implement an effective anti-AML program, and failure to adhere to reporting and record-keeping requirements under the BSA.

The MSB and its president consented to a $10,000 civil money penalty. U.S. Treasury officials have said that FinCEN will "look for more opportunities" to penalize "partners, directors, officers and employees" of financial institutions "who themselves actively participate in misconduct."

Indeed, FinCEN Director Jennifer Shasky Calvery has broadened this sentiment, stating, "When a culture of compliance is lacking, the result is ineffective AML safeguards. A number of our recent enforcement actions have led us to begin thinking more broadly about how the culture of compliance impacts financial institutions, often with devastating consequences. ... [W]e will employ all of the tools at our disposal and hold accountable those institutions and individuals who recklessly allow our financial institutions to be vulnerable to terrorist financing, money laundering, proliferation finance and other illicit financial activity."

The context of recent actions and these positions suggest that future FinCEN action could include more fines for failure of oversight, and an as-yet unsubstantiated report suggests that significantly higher fines against individuals are in the offing.

Federal prosecutors have initiated a number of lawsuits under the Financial Institutions Reform Recovery Enforcement Act seeking civil penalties from bank employees. The Federal Deposit Insurance Corporation has recently "dusted off" FIRREA, a powerful law enacted in 1989 in the wake of the savings and loan crisis, to seek recovery from officers and directors of failed financial institutions.

In the Southern District of New York, civil prosecutors brought suit against a bank and one of its employees alleging that the bank and the individual engaged in a scheme to defraud the bank's clients when pricing foreign exchange trades. The court denied the defendants' motion to dismiss and concluded that the government may bring a claim for civil monetary penalties under FIRREA when an individual's fraudulent conduct might put federally insured deposits at risk. A possible next step could be federal prosecutors pressing individual liability for lapses in oversight.

Clarity for Compliance Overseers?

Government enforcers have long pursued actions against individuals whose misconduct causes an entity to fail or violate finance-related laws. The stakes increase, however, when federal and state regulators seek to impose significant fines and other sanctions against individual corporate officers, including compliance professionals, for lapses of oversight based on their management and oversight responsibilities.

Acts or omissions committed in good faith by oversight or compliance personnel should receive some legal protection, or it will be difficult for these supervisors to exercise the independent judgment essential to their roles. Continued enforcement without transparency and clarity risks chasing experienced and competent compliance professionals and corporate officers from their posts, raising the question: Who will be left to oversee compliance with laws and regulations?

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