Personal liability: What compliance professionals need to know

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Abstract

The last decade and a half has seen a rise in the number of corporate enforcement actions and prosecutions following financial crimes compliance failures that have resulted in malfeasance. Relatively few of those corporate actions, particularly criminal actions, have included charges against individuals. That is beginning to change as US regulators and law enforcement bring greater focus to the role of individuals in compliance breakdowns. Recent rule making and policy changes aim to identify and hold accountable individuals involved in corporate wrongdoing. While there is an upside to these new approaches, they also raise a legitimate concern that they will stifle innovation and lead to process redundancy.

Keywords: corporate enforcement, individual liability, financial crime compliance

INTRODUCTION

The last several years have seen significant growth in the number of corporate enforcement actions and prosecutions, particularly, as discussed here, where financial crimes compliance failures have permitted, or even led to, malfeasance. While for many years, the conversation focused primarily on corporate accountability, the attention is shifting towards identifying and punishing individual wrongdoers responsible for corporate misdeeds. This focus raises controversial questions regarding fairness, deterrence and proper incentives. It also calls for focused consideration of the difference between civil and criminal liability. Can a corporation form intent to commit a crime? When does a mistake, often evaluated with the benefit of 20/20 hindsight, become a punishable offense, for either a corporation or an individual? When should that punishment be regulatory as opposed to criminal? Finally, as the scrutiny of individual compliance officers becomes more intense, we must ask ourselves how that will affect the way compliance is performed and whether this will promote more effective compliance programmes.

In this paper, we first posit that the recent rise in corporate prosecutions, mostly settled through deferred prosecution agreements ('DPAs'),[1] solidified the concept of corporate prosecutions and helped drive the vast expansion of compliance departments, particularly in regulated financial institutions. We next observe recent actions by various government agencies to hold individuals accountable for compliance failures and related misdeeds, and to create policies to assist in that goal. Finally, through the lens of financial crimes compliance, we examine the potential for

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the unintended consequence that attributing liability to individuals may, over time, limit compliance programme effectiveness and innovation.

THE RISE OF CORPORATE PROSECUTIONS

Corporations and criminal intent: Culture as evidence of intent

Corporate prosecutions are not new. Nevertheless, debate continues over whether such prosecutions are justified or effective. While corporations are defined in some penal and other legal codes (and famously in 2010 with the Supreme Court's decision in *Citizens United*[2]) as a person, that is a legal fiction. Corporations are not persons, but groups of people gathered together with, to some degree, a shared goal of furthering the corporation's business and other interests. For some, that means that the concept of corporate criminal liability is inconsistent with a basic tenet of criminal law, which is that it punishes *intentional* bad acts. Criminal law focuses on the mind of the actor. With limited exceptions, one must wilfully or intentionally commit the acts that make up the crime in order to be guilty. As Judge Jed S. Rakoff put it, writing for the *New York Review of Books*, 'The fierce and fiery weapon called criminal prosecution is directed at intentional misconduct, and nothing less.'[3]

Corporations cannot themselves form such intent, and so corporate guilt has historically been based upon the theory of *respondeat superior* — the idea that an employer is responsible for the acts of an employee committed in the scope of that employment.[4] There is also the notion that the intent and acts of many individuals can be joined together and attributed to the employer.

Broadly speaking then, the law permits employee thoughts and actions to be attributed to the corporation. Similarly, as corporate prosecutions and major enforcement actions have become more regular and established, regulators and prosecutors seek to measure corporate culture and 'tone from the top' as a means of assessing corporate mindset and intent. In this way, the regulatory concept of evaluating 'tone from the top' as part of a compliance review has morphed so that it has become not only a metric for regulators but also a stand-in for prosecutors assessing volition in determining whether there is evidence to support a criminal charge.

In the regulatory context, the emphasis on corporate culture is explicit. In fact, the first substantive item in the Financial Industry Regulatory Authority's (FINRA) 2016 Regulatory and Examinations Priorities Letter is entitled. 'Culture, conflicts of interest and ethics' and includes the novel assertion that firm culture will become a focus of regulatory exams.[5] While not yet including culture as an explicit, singular exam focus, other regulators have repeatedly emphasised publicly the importance of firm culture. For example, in a 2014 speech entitled 'Enhancing financial stability by improving culture in the financial services industry', William C. Dudley, former president and chief executive of the Federal Reserve Bank of New York, noted an 'existing culture problem', which he blamed, in part, for 'ongoing occurrences of serious professional misbehavior, ethical lapses and compliance failures at financial institutions.' He asserted, 'The problems originate from the culture of the firms, and this culture is largely shaped by the firms' leadership. This means that the solution needs to originate from within the firms, from their leaders.'[6]

Emphasis on corporate culture is equally explicit for prosecutors and has been for some time. In 1999, then deputy attorney general Eric Holder issued guidelines for federal prosecutors to use in the investigation of corporate criminal conduct in what is colloquially known as the 'Holder Memo'.[7] This memo has been updated several times, but the primary considerations remained substantially the same in each iteration. In sum, the considerations are as follows:

> The nature and seriousness of the offense, including the risk of harm to the public[,]… the pervasiveness of wrongdoing within the corporation[,]…the corporation's history of similar conduct[,]…the corporation's timely and voluntary disclosure of wrong-doing and its willingness to cooperate[,]… the existence and adequacy of the corporation's compliance program[,]… the corporation's remedial actions[,]…. collateral consequences[,]…the adequacy of the prosecution of individuals responsible[,]…the adequacy of remedies such as civil or regulatory enforcement actions.

Thus, in determining whether a corporation should be criminally charged for committing bad acts, the US Department of Justice (DOJ) explicitly considers 'the existence and effectiveness of the corporation's pre-existing compliance program'[8] and the corporation's efforts to improve its programme upon discovering weaknesses.[9]

Moreover, in November 2015, the DOJ announced that it had hired, for the first time, a full-time compliance expert, whose mandate is to evaluate the adequacy of corporate compliance and remediation in order to advise the DOJ fraud section in its determination of appropriate charges.

RECENT ACTIONS BY GOVERNMENT AGENCIES

Determining when to prosecute and driving corrective action

In the face of rising corporate prosecutions and the focus on corporate culture, there are many who are critical of corporate prosecutions, not only because of doubts as to whether they are consistent with the notion of intentional behaviour but also because of questions regarding their utility: What do corporate prosecutions aim to accomplish, and do they succeed? For an individual, the ultimate price of crime is prison. For a corporation, the ultimate price is dissolution. Nevertheless, especially since the 2002 collapse of Arthur Andersen in connection with the Enron accounting scandal, prosecutors have gone to great lengths to avoid dissolution and other collateral consequences. As one observer put it, 'The conventional wisdom states that prosecuting corporations can subject them to terrible collateral consequences that risk putting them out of business and causing massive social and economic harm.'[10] In what appears to be an attempt to balance the need for criminal enforcement with concerns about the negative impact of such actions, prosecutors increasingly turned to DPAs to resolve criminal investigations as a means of avoiding adverse collateral consequences of a corporate criminal conviction, while still seeking accountability.

When a financial institution enters a DPA, there is nearly always a forward-looking compliance component. DPAs usually include a condition that requires reforms be undertaken and maintained, sometimes under the oversight of a monitor over a period of some years. In this way, the DPAs entered into by financial institutions exist on a plane somewhere in between criminal and regulatory. While difficult to quantify, these prosecutions have been an important factor leading to the tremendous expansion of compliance departments. DPAs require such expansion, and corporations want to protect their reputations and avoid the huge fines that attend these settlements.

Financial institutions are in many ways at the forefront of economic crime fighting. That is accepted now as a given, but it was not always so. Financial institutions have enhanced their anti-money laundering (AML) and economic sanctions compliance programmes by engaging in extensive hiring and technology updates throughout the enterprise. They have created specialised financial crime investigation units within the banks that focus on, and take advantage of, the massive amounts of data that run through these institutions to try to surveil, identify and prevent crime. Financial institutions have filled many of these positions with former prosecutors, investigators and policymakers who have experience investigating and thinking about how financial crime should be tracked and prevented.

The public is largely unaware of the money, talent and time that financial institutions spend fighting crime. Rather, what the public perceives is that when banks and other financial institutions are implicated in schemes to launder money or avoid economic sanctions, prosecutors give those banks deals for which shareholders must pay. This is one reason for the loud and harsh public outcry over a lack of individual prosecutions.

Individual liability and the Yates Memorandum

Although corporations undeniably act through their individual employees, there are many reasons that a corporation may be prosecuted without an accompanying prosecution of an individual.[11] For example, as alluded to previously, different people working throughout an organisation can commit acts. As former attorney general Holder described it, 'Responsibility remains so diffuse, and top executives so insulated, that any misconduct could again be considered more a symptom of the institution's culture than a result of the willful actions of any single individual.'[12] This language is consistent with the notion that 'tone from the top' functions as a corporate stand-in for individual intent. It also suggests an unwillingness to pursue low-level employees, while high-level decision-makers remain unaffected. This is just one of many reasons that prosecutors put forth to explain why individuals are not more frequently charged. Other reasons include, for example, the statute of limitations (often waived for cooperating corporations but not for individuals) and the difficulty in obtaining admissible evidence that sometimes resides overseas. In any event, having heard the public outcry, and perhaps addressing its own frustration, the government has instituted policies that it will use to push corporations to look for and provide evidence, and take on responsibility that not only supports a finding of corporate liability but also individual liability.

In September 2015, the DOJ issued the Yates Memorandum (known as the 'Yates Memo').[13] At its most basic, the Yates Memo states that corporations will not get credit for cooperation with the government unless they identify, hold accountable and provide evidence against culpable individuals in a timely fashion. It further requires that when a corporation is charged without accompanying charges against individuals, DOJ staff cannot close the case without a written, although not necessarily public, explanation as to why. While, generally speaking, prosecutors would not conduct a corporate investigation without also examining whether there are chargeable individuals, the Yates Memo imposes significant new requirements that will demand a different type of prosecutorial focus. Just as crucial, although less commented upon, the Yates Memo demands more and earlier communication and cooperation between the DOJ's civil and criminal divisions. This premise may enable stepped-up civil actions against individuals, as the criminal division is encouraged, indeed, instructed, to share information with the civil division. It is important to note that civil cases have a lower burden of proof and generally require a lesser *mens rea*, or intent, than criminal charges, and it is possible that civil cases can be brought when there is insufficient evidence to support a criminal charge.

The Foreign Corrupt Practices Act Pilot Program

Approximately one year after announcing the Yates Memo, the DOJ rolled out the Foreign Corrupt Practices Act (FCPA) Pilot

Program (the 'Pilot Program'), which is meant to encourage corporations to self-report issues and corrective action plans in connection with FCPA compliance.[14] The Pilot Program confirms, specifically in the FCPA context, that corporations will receive treatment that is more lenient if they cooperate with government investigations. Consistent with the Yates Memo's modification of corporate charging policy, however, corporations will not be eligible for this lenient treatment if they do not provide relevant evidence (where it exists) against individuals. The Pilot Program also builds on the concept of corporate responsibility by emphasising that to receive full credit, companies must exhibit good corporate citizenship. Further, they must demonstrate that compliance with the law is, and was, of primary importance and that they have remediated and continue to remediate areas of weakness. The Pilot Program puts forth several specific measures that a company must take in order to receive cooperation credit, such as timely disclosure of all relevant facts, including those related to the involvement of the corporation's officers, employees or agents, as well as third parties; preservation, collection and disclosure of relevant documents and witnesses; availability of company officers and employees for interview by the government; disclosure of overseas documents, except where foreign law prohibits such disclosure; and facilitation and translation of the third-party production of documents (including translation where required). These are factors that will be relevant in any instance when the government is assessing cooperation, and the list possibly provides a hint as to where the government has felt stymied in past investigations.

Cooperating with an investigation is not enough, however. Remediation efforts are vital, as is the state of play before and during the misbehaviour. The government will evaluate a company's compliance and ethics programme to assess its culture of compliance. Employees must know that a company will not tolerate criminal conduct. In assessing culture, the Pilot Program mentions several areas to examine, including resources devoted to compliance and corporate culture, employee's ability to 'understand and identify the transactions identified as posing a potential risk',[15] independence and reporting structure, compensation and promotion and effectiveness of the company risk assessment and audit programme. Important for purposes of this discussion, to receive credit for remediation, the company must demonstrate appropriate discipline of any employees responsible for misconduct and those overseeing such employees.

The New York State Department of Financial Services approach to individual liability

In June 2016, the New York State Department of Financial Services (DFS) issued Rule 504, which lays out specific expectations regarding transaction monitoring and filtering requirements that DFS-regulated financial institutions must employ in support of their AML and Office of Foreign Assets Control (OFAC) sanctions compliance programmes.[16] The original proposed rule, made public on 1st December, 2015, was met with great trepidation by the compliance community because of a novel requirement that a chief compliance officer or functional equivalent certify yearly that the institution has an effective compliance programme.[17] Unlike other somewhat comparable certification provisions, such as those contained in Sarbanes–Oxley,[18] the proposed rule did not use modifying language such as 'reasonable'. Moreover, the proposed rule explicitly stated that inaccurate certifications could form the basis of criminal charges.

In the final iteration of Rule 504, the language has been modified to extend the field of permissible certifiers to include boards of directors or senior officers and, critically, drops the reference to criminal charges. Instead, Rule 504 states that it is not intended to 'limit…the Superintendent's authority under any applicable law.'[19] Notably, the DFS does not have criminal jurisdiction, so, while it can make a referral to a district attorney's office that would determine whether to seek criminal charges, the agency itself does not have authority to bring criminal charges.

While these modifications should make adherence to Rule 504 less challenging for compliance officers, DFS has demonstrated that it is willing to hold individual compliance officers accountable. For example, DFS's settlement of its enforcement action against one bank was striking in that it required in the agreement the termination of employees when those employees were not the subject of an individual action. Since then, DFS has enforced similar requirements in, for example, OFAC sanctions settlements with institutions. In its concurrent settlements, the Federal Reserve Bank of New York refrained from naming or otherwise identifying individuals, but included terms forbidding the employment of people disciplined because of the investigation.

As previously noted, these policies exist in a space between regulatory and criminal. They build on the concept articulated in various government policies and in some ways co-opted by DPAs (and a smaller number of corporate criminal pleas) that examine corporate culture as an indicator of corporate intent. The policies cited herein describe some of the expectations regarding corporate policy and tone in terms of compliance; however, the policies also acknowledge that individuals commit acts, and the policies are designed to push corporations to provide evidence against individuals the government has thus far had difficulty obtaining in a timely manner. DFS's Rule 504 does not necessarily aim to unearth usable evidence, but appears to be motivated, at least in part, by a desire to make senior executives explicitly responsible and accountable for the programmes they oversee. This can be seen in the preamble to Rule 504, which states that during its investigations of institutions, DFS has identified 'shortcomings in the transactions monitoring and filtering programmes' and asserts that those shortcomings are 'attributable to a lack of robust governance, oversight, and accountability at senior levels.'[20] Rule 504 also requires creation of a document that, if false, could potentially serve as the basis for a New York State criminal charge for filing a false document under Article 175 of the New York State Penal Law. While it is possible under Rule 504 that a single compliance officer will sign the certification, it is likely that, particularly in a large institution, that certification will have to be based upon similar certifications from people responsible down the reporting line, thereby creating several potentially false documents.[21]

Viewed in the most positive light, then, these policies share the common goals of enhancing corporate compliance culture and asserting that the responsibility for creating that culture lies with senior members of the organisation; laying out certain of those culture expectations more explicitly than previously done; and requiring, at least in the DFS rule, that senior people take responsibility through a certification, or compliance, 'finding'. That is the positive view of these policies and the focus that they reflect. There is, of course, another side to this analysis. It would be an understatement to say that compliance officers, while they may understand and even sympathise with the goals of these types of policies, also view them with concern. It is not only concern that they will be blamed, fired or prosecuted, however, but also concern that these policies may have the unintended consequence of undermining compliance programme effectiveness.

POTENTIAL UNINTENDED CONSEQUENCES

The enforcement priority to seek individual liability outlined earlier is ostensibly predicated on the belief that individual liability will drive better individual behaviour and better compliance programme effectiveness. Nevertheless, with that belief is the perception that enforcement authorities are focused on holding senior compliance officers accountable for an ineffective programme in the absence of allegations of purposeful misconduct or individual enrichment. That perception will inevitably drive resources and attention to process and process redundancies because evidence of successful process execution is often one of the few objective results that can be demonstrated. But will the focus on process come at the expense of innovation? Novel approaches to surveillance and detection of criminal activity or specialised projects targeting specific crimes or risks will be of little use in the context of arguing against individual liability following a high-profile programme 'miss'. This is also true in the context of the supervisory process where the focus has been on evidence of the comprehensive and validated application of common rules and programmes across the institution.

Thus the question becomes whether the quest for individual accountability will, in time, begin to undermine the overall effectiveness and proactive enhancement of financial crimes programmes. Appropriate process and evidence of execution is an essential part of an effective financial crimes compliance programme. The risk, however, is in process becoming a goal as opposed to a means to reach the goals of stopping financial crimes and ensuring compliance with applicable regulations. Therefore, it is important to distinguish instances of purposeful misconduct by a compliance officer from situations in which individual liability is sought on the basis that the programme in place was deficient or ineffective. A compliance officer, as would be the case with any other employee, should expect severe consequences for unethical or self-dealing behaviour. The more interesting questions are posed when individual conduct is ethical, but unsuccessful.

The drivers of excessive process and redundancy

Financial crimes compliance appears to be uniquely susceptible to the issue of an overemphasis on process execution and redundancy. This is driven by several factors considered next.

First, the lack of clarity and prioritisation of the results sought by the various stakeholders of the financial crimes regulatory system has an impact. While combating financial crimes rightfully remains a top global policy priority, there still appears to be a lack of consensus on priorities among law enforcement and the intelligence community, as the beneficiaries of these programmes, and those charged with supervising the implementation of the regulations. For example, is it the goal to keep illicit funds out of the financial system entirely, or is it better to identify illicit funds and work with law enforcement to track the flow through the institutions? Do the needs of the unbanked take precedence over concerns with introducing illicit activity from certain types of customers? In the absence of a consistent vision for the results we seek among stakeholders, the demand for results will be situational. When faced with this uncertainty, it is logical, then, to expect that financial institutions will prioritise process, potentially resulting in redundancy, to build a record of programme output as a defence.

Risk-based approach

Moreover, the very nature of the financial crimes regulatory framework contributes to the drive to process. The risk-based approach is an elegant theory that underlies financial crimes regulations. Given the complexity and ever-changing nature of financial crimes, controls should be dynamic and focused (and continually refocused) on those customers, products and services posing the highest risks of abuse by criminals and terrorists. Criminals are successful because they adapt and find new ways to carry out their crimes; controls should be similarly adaptable.

In practice, however, as the regulatory requirements continue to grow in response to new threats or perceived weaknesses, programmes have become increasingly complex and process focused. The risk-based approach, in reality, also suffers from important challenges that increase regulatory risks for financial institutions: Financial crime and terrorism risks are difficult to quantify, highly subjective and particularly subject to the hindsight bias. Thus if a control framework is supposed to be focused on the greatest risks of financial crimes, and a significant financial crime is committed through the institution, it is increasingly difficult for that institution to successfully make the case several years later that it had appropriately tailored its programme to the highest risks identified at the time.

The types of directives found in applicable laws and regulations compound the challenges of the risk-based approach. For example, a foundational component of the Bank Secrecy Act compliance programme is the requirement that institutions develop controls reasonably designed to ensure compliance with applicable reporting and record-keeping requirements, and guard against illicit activity conducted through the institution. The contours of a reasonable programme are informed by a variety of formal and informal guidance from the US Treasury, prudential supervisors and securities regulators, as well as industry best practices and the guidance provided during the supervisory process. Yet what may be reasonable for an institution will depend on a multitude of factors for which there is no set formula, and once a programme is evaluated following a significant issue, reasonableness is an elusive standard against which a programme and individuals will be judged.

Finally, success in the fight against financial crime is itself difficult to identify and measure. Financial crimes range from the simple placement of the proceeds of street drug sales to highly complex and layered global transactions used to disguise the ongoing financing of transnational crime. For financial institutions, it is often not possible to know whether information provided to law enforcement or regulators results in arrests or the seizure of criminal proceeds. As such, financial institutions are often left with only evidence of successful process execution, number of reports timely filed, quality assurance, etc.

How, then, do institutions and individuals seek to protect themselves? Largely through the deployment of processes, evidence of such processes and proof of successful execution from testing, auditing and examinations. It is the closest thing to objective evidence of programme operation available, and while such a result is not inherently bad — financial crimes compliance programmes certainly need effective processes — when process takes precedence over achieving more substantive results and innovation, this can limit programme effectiveness.

As the consequences of noncompliance escalate and become more personal through increased civil actions against individual compliance officers, it appears that an unintended consequence will be that financial institutions generally, and compliance teams specifically, will focus on the execution of programme basics and processes (with more redundancies) at the expense of innovation.

CONCLUSION

For anyone who works as a financial crimes compliance officer, regulator or prosecutor, there is one shared purpose: to prevent financial institutions from being used as a means to commit crime. The ultimate goals are to keep our country and institutions safe and secure, and to promote financial well-being. While all corporate and financial services businesses are increasingly expected to support this effort, and demonstrate good citizenship by instituting policies and procedures to prevent crime, regulated institutions and the people who work on their behalf bear a special burden. They have an affirmative duty to identify, track, report and share information with the government and other institutions. Over the past decade or so, institutions that have failed to perform these duties adequately have paid a significant price.

For those who work in compliance, the result of stepped up enforcement is apparent: increased staff, increased expectation and increased pressure. The emerging focus on individual liability is a rational response to the concern and confusion regarding how it can be that a crime is committed or a regulatory failure occurs, but no one is identified as responsible. In implementing the new policies and rules aimed at individual accountability, however, it is worth considering the risks to the overall effectiveness of compliance programmes occasioned by the perceived punishment of unintentional errors or an overall aggressive enforcement posture towards individuals.

Notes and References

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(8) US Department of Justice, 'United States Attorney's Manual, 9-28.000 — Principles of federal prosecution of business organizations', available at: https://www.justice.gov/usam/usam-9-28000-principles-federal-prosecution-business-organizations (accessed 21st April, 2017).

(9) Ibid.

(10) Markoff, G. (2013) 'Arthur Andersen and the myth of the corporate death penalty: Corporate criminal convictions in the twenty-first century', *University of Pennsylvania Journal of Business Law*, available at: http://scholarship.law.upenn.edu/jbl/vol15/iss3/4 (accessed 21st April, 2017).

(11) For compilation and analysis of statistics related to individual prosecutions that accompany corporate prosecutions, see, generally, Garrett, B. L. (2015) 'The corporate criminal as scapegoat', *University of Virginia School of Law Public Law & Legal Theory Research Paper Series 2015*–7, 21st January, available at: https://securitiesdiary.files.wordpress.com/2014/11/the-corporate-criminal-as-scapegoat.pdf (accessed 21st April, 2017).

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(16) Banking Division Transaction Monitoring and Filtering Program Requirements and Certifications, NY State Department of Financial Services, Superintendent's Regulations Part 504 (30th June, 2016) (to be codified as Part 504 of the DFS Superintendent's Regulations) ('Final Rule').
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(18) The Sarbanes–Oxley Act of 2002 (Pub.L. 107–204, 116 Stat. 745, enacted 30th July, 2002) imposed new financial disclosure rules aimed at protecting investors from accounting. Included are requirements of senior management certification of the accuracy of reported financial statements.
(19) Banking Division Transaction Monitoring and Filtering Program Requirements and Certifications, ref. 16.
(20) Ibid.
(21) While this paper has focused on federal prosecutorial policies and actions, it is notable that various states have relevant criminal and regulatory laws. Notably, the New York County District Attorney's office has co-prosecuted each of the major cases against international banks for OFAC sanctions violations. Using New York State's false filing statute, these cases have resulted in more than US$16 billion in forfeiture. Also notable is that office's institution in 2010 of a corporate charging policy similar to the federal government's entitled: '*Considerations in Charging Organizations*', available at: http://manhattanda.org/sites/default/files/Considerations%20in%20Charging%20Organizations.pdf (accessed 21st April, 2017).