Global Investigations Review

The Guide to Monitorships

Editors
Anthony S Barkow, Neil M Barofsky and Thomas J Perrelli

Second Edition

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Publisher's Note

The Guide to Monitorships is published by Global Investigations Review – the online home for everyone who specialises in investigating and resolving suspected corporate wrongdoing.

It flowed from the observation that there was yet no book available that systematically covered all aspects of the institution known as the 'monitorship' – a situation known to be delicate and challenging for all concerned: the company, the monitor, the appointing government agency and all the professionals helping those players.

This guide aims to fill that gap. It does so by addressing all the most common questions and concerns from all the key perspectives. We have been lucky to attract authors who have lived through the challenges they deconstruct and explain.

The guide is a companion to a larger reference work – GIR's *The Practitioner's Guide to Global Investigations* (now in its fourth edition), which walks readers through the issues raised, and the risks to consider, at every stage in the life cycle of a corporate investigation, from discovery to resolution. You should have both books in your library: *The Practitioner's Guide* for the whole picture and *The Guide to Monitorships* for the close-up.

The Guide to Monitorships is supplied in hard copy to all GIR subscribers as part of their subscription. Non-subscribers can read an e-version at www.globalinvestigationsreview.com.

Finally, I would like to thank the editors of this guide for their energy and vision, and the authors and my colleagues for the elan with which they have brought that vision to life.

We collectively welcome any comments or suggestions on how to improve it. Please write to us at insight@globalinvestigationsreview.com.

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Preface

Corporate monitorships are an increasingly important tool in the arsenal of law enforcement authorities and, given their widespread use, they appear to have staying power. This guide will help both the experienced and the uninitiated to understand this increasingly important area of legal practice. It is organised into five parts, each of which contains chapters on a particular theme, category or issue.

Part I offers an overview of monitorships. First, Neil M Barofsky – former Assistant US Attorney and Special Inspector General for the Troubled Asset Relief Program, who has served as an independent monitor and runs the monitorship practice at Jenner & Block LLP – and his co-authors Matthew D Cipolla and Erin R Schrantz of Jenner & Block LLP explain how a monitor can approach and remedy a broken corporate culture. They consider several critical questions, such as how a monitor can discover a broken culture; how a monitor can apply 'carrot and stick' and other approaches to address a culture of non-compliance; and the sorts of internal partnership and external pressures that can be brought to bear. Next, former Associate Attorney General Tom Perrelli, independent monitor for Citigroup Inc and the Education Management Corporation, walks through the life cycle of a monitorship, including the process of formulating a monitorship agreement and engagement letter, developing a work plan, building a monitorship team, and creating and publishing interim and final reports.

Nicholas Goldin and Mark Stein of Simpson Thacher & Bartlett – both former prosecutors with extensive experience in conducting investigations across the globe – examine the unique challenges of monitorships arising under the US Foreign Corrupt Practices Act (FCPA). FCPA monitorships, by their nature, involve US laws regulating conduct carried out abroad, and so Goldin and Stein examine the difficulties that may arise from this situation, including potential cultural differences that may affect the relationship between the monitor and the company. Additionally, Alex Lipman, a former federal prosecutor and branch chief in the Enforcement Division of the Securities and Exchange Commission (SEC), and Ashley Baynham, fellow partner at Brown Rudnick LLP, explore how monitorships are used in resolutions with the SEC. Further, Bart M Schwartz of Guidepost Solutions LLC – former chief of the Criminal Division in the Southern District of New York, who later served as independent monitor for General Motors – explores how enforcement agencies decide whether to appoint a monitor and how that monitor is selected. Schwartz provides an overview of different types of monitorships, the various agencies that have appointed monitors in the

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past, and the various considerations that go into reaching the decisions to use and select a monitor.

Part II contains three chapters that offer experts' perspectives on monitorships: those of an academic, an in-house attorney and forensic professionals. Professor Mihailis E Diamantis of the University of Iowa provides an academic perspective, describing the unique criminal justice advantages and vulnerabilities of monitorships, and the implications that the appointment of a monitor could have for other types of criminal sanctions. Jeffrey A Taylor, a former US Attorney for the District of Columbia and chief compliance officer of General Motors, who is now executive vice president and chief litigation counsel of Fox Corporation, provides an in-house perspective, examining what issues a company must confront when faced with a monitor, and suggesting strategies that corporations can follow to navigate a monitorship. Finally, Loren Friedman, Thomas Cooper and Nicole Sliger of BDO USA provide insights as forensic professionals by exploring the testing methodologies and metrics used by monitorship teams.

The four chapters in Part III examine the issues that arise in the context of cross-border monitorships and the unique characteristics of monitorships in different areas of the world. Litigator Shaun Wu, who served as a monitor to a large Chinese state-owed enterprise, and his co-authors at Kobre & Kim examine the treatment of monitorships in the East Asia region. Switzerland-based investigators Daniel Bühr and Simone Nadelhofer of LALIVE SA explore the Swiss financial regulatory body's use of monitors. Judith Seddon, an experienced white-collar solicitor in the United Kingdom, and her co-authors at Ropes & Gray International LLP explore how UK monitorships differ from those in the United States. And Gil Soffer, former Associate Deputy Attorney General, former federal prosecutor and a principal drafter of the Morford Memorandum, and his co-authors at Katten Muchin Rosenman LLP consider the myriad issues that arise when a US regulator imposes a cross-border monitorship, examining issues of conflicting privacy and banking laws, the potential for culture clashes, and various other diplomatic and policy issues that corporations and monitors must face in an international context.

Part IV has eight chapters that provide subject-matter and sector-specific analyses of different kinds of monitorships. With their co-authors at Wilmer Cutler Pickering Hale and Dorr LLP, former Deputy Attorney General David Ogden and former US Attorney for the District of Columbia Ron Machen, co-monitors in a healthcare fraud monitorship led by the US Department of Justice (US DOJ), explore the appointment of monitors in cases alleging violations of healthcare law. Günter Degitz and Richard Kando of AlixPartners, both former monitors in the financial services industry, examine the use of monitorships in that field. With his co-authors at Kirkland & Ellis LLP, former US District Court Judge, Deputy Attorney General and Acting Attorney General Mark Filip, who returned to private practice and represented BP in the aftermath of the Deepwater Horizon explosion and the company's subsequent monitorship, explores issues unique to environmental and energy monitorships. Glen McGorty, a former federal prosecutor who now serves as the monitor of the New York City District Council of Carpenters and related Taft-Hartley benefit funds, and Joanne Oleksyk of Crowell & Moring LLP lend their perspectives to an examination of union monitorships. Michael J Bresnick of Venable LLP, who served as independent monitor of the residential mortgage-backed securities consumer relief settlement with Deutsche Bank AG, examines consumer-relief fund monitorships. Ellen S Zimiles, Patrick J McArdle and their

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co-authors at Guidehouse explore the legal and historical context of sanctions monitorships. Jodi Avergun, a former chief of the Narcotic and Dangerous Drug Section of the US DOJ and former Chief of Staff for the US Drug Enforcement Administration, and her co-authors, former federal prosecutor Todd Blanche and Christian Larson of Cadwalader Wickersham & Taft LLP, discuss the complexities of monitorships within the pharmaceutical industry. And Frances McLeod and her co-authors at Forensic Risk Alliance explore the role of forensic firms in monitorships, examining how these firms can use data analytics and transaction testing to identify relevant issues and risk in a monitored financial institution.

Finally, Part V contains two chapters discussing key issues that arise in connection with monitorships. McKool Smith's Daniel W Levy, a former federal prosecutor who has been appointed to monitor an international financial institution, and Doreen Klein, a former New York County District Attorney, consider the complex issues of privilege and confidentiality surrounding monitorships. Among other things, Levy and Klein examine case law that balances the recognised interests in monitorship confidentiality against other considerations, such as the First Amendment. And former US District Court Judge John Gleeson, now of Debevoise & Plimpton LLP, provides incisive commentary on judicial scrutiny of deferred prosecution agreements (DPAs) and monitorships. Gleeson surveys the law surrounding DPAs and monitorships, including the role and authority of judges in those respects, and separation-of-powers issues.

Acknowledgements

The editors gratefully acknowledge Jenner & Block LLP for its support of this publication, and Jessica Ring Amunson, co-chair of Jenner's appellate and Supreme Court practice, and Jenner associates Jessica Martinez, Ravi Ramanathan and Tessa J G Roberts for their important assistance.

Anthony S Barkow, Neil M Barofsky and Thomas J Perrelli
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Contents

Preface v

Introduction 1
Anthony S Barkow and Michael W Ross

Part I: An Overview of Monitorships

1 **Changing Corporate Culture** 11
Neil M Barofsky, Matthew D Cipolla and Erin R Schrantz

2 **The Life Cycle of a Monitorship** 31
Thomas J Perrelli

3 **The Foreign Corrupt Practices Act** 43
Nicholas S Goldin and Joshua A Levine

4 **The Securities and Exchange Commission** 53
Ashley Baynham and Rachel Wolkinson

5 **When to Appoint a Monitor** 69
Bart M Schwartz

Part II: Experts' Perspectives

6 **An Academic Perspective** 79
Mihailis E Diamantis

7 **An In-House Perspective** 89
Jeffrey A Taylor

8 **A Forensic Perspective: Testing and Verification of the Assertions Made Within Settlement Agreements** 99
Loren Friedman, Thomas Cooper and Nicole Sliger

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Part III: International and Cross-Border Monitorships

9 **Monitorships in East Asia** 111
Jason J Kang, Daniel S Lee, Nan Wang, Ryan Middlemas and Hangil Lee

10 **Switzerland-Ordered Monitorships** 118
Simone Nadelhofer and Daniel Lucien Bühr

11 **Monitorships in the United Kingdom** 125
Judith Seddon, Chris Stott and Andris Ivanovs

12 **US-Ordered Cross-Border Monitorships** 142
Gil M Soffer, Nicola Bunick and Johnjerica Hodge

Part IV: Sectors and Industries

13 **The Healthcare Industry** 155
David W Ogden, Ronald C Machen, Stephen A Jonas, Ericka Aiken and James D Barton

14 **The Financial Services Industry** 174
Günter Degitz and Rich Kando

15 **Energy and the Environment** 184
Mark Filip, Brigham Cannon and Nicolas Thompson

16 **Unions** 196
Glen G McGorty and Lisa Umans

17 **Consumer-Relief Funds** 205
Michael J Bresnick

18 **Sanctions Monitorships** 214
Ellen S Zimiles, Patrick J McArdle, Steven McCarthy and Jeremy Robb

19 **The Pharmaceutical Industry and the Controlled Substances Act – A Distinct Breed of Monitorship** 225
Jodi Avergun, Todd Blanche and Christian Larson

20 **Leveraging Forensic Accountants** 238
Frances McLeod, Emma Hodges, Neil Goradia, Jenna Voss and Samantha Hsu

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Part V: Key Issues

21 **Privilege and Confidentiality** 249
Daniel W Levy and Doreen Klein

22 **Judicial Scrutiny of DPAs and NPAs** 264
John Gleeson

Conclusion 271
Anthony S Barkow, Neil M Barofsky and Thomas J Perrelli

About the Authors 273

Contributors' Contact Details 295

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Part IV

Sectors and Industries

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18

Sanctions Monitorships

Ellen S Zimiles, Patrick J McArdle, Steven McCarthy and Jeremy Robb[1]

Although the structure of sanctions monitorships can be similar to other types of monitorships, owing to the specifics of sanctions law and regulation, the technology systems required to be compliant, inconsistencies across geographies and the binary context of sanctions compliance, these factors require specific attention. This chapter sets forth the legal and historical context of sanctions monitorships, and specific challenges for institutions under a monitorship.

Legal context of a sanctions monitorship

Sanctions law and regulation are implemented by numerous countries and governing bodies throughout the world. Sanctions can be considered an extension or application of a country's foreign policy, which can be unique to a single country (unilateral sanctions) or jointly applied by multiple countries (multilateral sanctions). Generally, the majority of sanctions are implemented by the United States, the United Nations and the European Union. US sanctions law, dictated by presidential executive orders and through acts of Congress, requires compliance by the following groups and entities:

- US citizens and permanent residents regardless of present location;
- companies and other entities established under US law;
- people and organisations located within the United States, regardless of origin; and
- branches of US companies and other entities outside the United States.

1 Ellen S Zimiles and Patrick J McArdle are partners, Steven McCarthy is a director and Jeremy Robb is an associate director at Guidehouse.

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Sanctions compliance within the United States is applied through the concept of strict liability.[2] All individuals and entities subject to US sanctions law are required to comply regardless of an explicit awareness of non-compliance or a provable intent to evade the law.

In the event of a violation or non-compliance with sanctions law, the competent regulatory body or law enforcement agency may choose to pursue civil and criminal action. The extent of penalties often depends on the severity of the infraction and other extenuating circumstances, such as whether the conduct is considered wilful or reckless. In the case of criminal prosecution, penalties against an individual may include jail time, although fines are the most common penalty.[3] In addition to monetary penalties, companies and organisations may be required to commit to remediation efforts or enforcement actions by a regulator or law enforcement, which can include the implementation of business restrictions or the appointment of an independent monitor.

In the United States, the Department of Justice (DOJ) or other regulatory bodies may issue various enforcement actions as a result of non-compliance with US sanctions law. These enforcement actions may result from external investigations or proactive disclosures. The Office of Foreign Assets Control (OFAC) and the DOJ encourage companies to voluntarily self-disclose all potentially wilful violations of the statutes implementing the US government's primary export control and sanctions regimes.[4] If a company (1) voluntarily self-discloses export control or sanctions violations, (2) fully cooperates and (3) remediates the violations appropriately and in a timely manner, there is a presumption that the company will receive a non-prosecution agreement and pay a limited or potentially no fine. The DOJ may enforce criminal resolutions, such as a deferred prosecution agreement (DPA) or guilty plea if the violations exhibit aggravating factors, such as the export of particularly sensitive items, repeated violations, the involvement of senior management and significant profit. In these instances, the DOJ will issue, or recommend to a sentencing court, a monetary fine, but will not require the appointment of a monitor if the company provides evidence of an established and effective compliance programme being in place at the time of resolution.

Historical context and trends

Recent sanctions enforcement actions and monitorships

Between 2018 and 2019, OFAC issued 33 enforcement actions, including penalties and settlements.[5] Historically, regulators and law enforcement agencies have focused most enforcement actions and monitorships resulting from sanctions violations towards financial institutions. In recent years, however, corporations have been the subject of increases in scrutiny and penalties following the discovery of sanctions violations.

2 Electronic Code of Federal Regulations, 'Appendix A to Part 501 – Economic Sanctions Enforcement Guidelines', 18 February 2020, at https://www.ecfr.gov/cgi-bin/text-idx?SID=ccac94aaa0387efe2a9c3fca2dc5a4ab&mc=true&node=ap31.3.501_1901.a&rgn=div9.

3 18 U.S. Code § 981; 18 U.S. Code § 982; 18 U.S.C. § 3571(d); 18 U.S.C. § 3572(a).

4 US Department of Justice, 'Export Control and Sanctions Enforcement Policy for Business Organizations', 13 December 2019.

5 US Department of Treasury, 'Civil Penalties and Enforcement Information', 21 January 2020, at https://www.treasury.gov/resource-center/sanctions/CivPen/Pages/2019.aspx.

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Financial institutions

HSBC Bank USA

HSBC entered into a DPA with the DOJ, which acknowledges the bank's wilful violation of the International Emergency Economic Powers Act (IEEPA) and the Trading With the Enemy Act (TWEA), both sanctions laws imposed by the US Congress. The DPA required HSBC to retain an independent compliance monitor to evaluate the effectiveness of the bank's internal controls, policies and procedures as related to continuing compliance with the IEEPA, the TWEA and applicable anti-money laundering laws.[6]

Standard Chartered Bank

The Amended DPA between the DOJ and Standard Chartered Bank (SCB) describes the bank's historical violations, including 'knowingly and willfully conspiring, in violation of Title 18, United States Code, Section 371, to engage in transactions with entities associated with sanctioned countries, including Iran, Sudan, Libya, and Burma and further states that 'the 2014 DPA Amendment required SCB to retain an independent compliance monitor'.[7]

Deutsche Bank AG

In November 2015, Deutsche Bank and the New York State Department of Financial Services (NY DFS) agreed to a Consent Order as a result of the bank's historical dollar clearing transactions processed on behalf of Iranian, Libyan, Syrian, Burmese and Sudanese financial institutions and other entities. As part of the Consent Order, the NY DFS required Deutsche Bank to engage an independent monitor to perform a comprehensive review of the bank's Bank Secrecy Act (BSA) and Anti-Money Laundering (AML) and OFAC sanctions compliance programmes, policies and procedures.[8]

BNP Paribas

BNP Paribas entered into a plea agreement with the DOJ on 27 June 2014 for conspiring to violate the IEEPA and TWEA through the illegal processing of transactions for countries subject to US economic sanctions. The plea agreement discusses the total forfeiture amount, or fine, levied against BNP Paribas, which takes into account the bank's related settlements imposed by the New York County District Attorney's Office, the Board of Governors of the Federal Reserve System and the NY DFS. In addition, a stipulation of the plea agreement required BNP Paribas to engage a compliance consultant or monitor.[9]

6 *United States of America v. HSBC USA*, Deferred Prosecution Agreement, Attachment B Corporate Compliance Monitor, 10 December 2012, at https://www.justice.gov/sites/default/files/opa/legacy/2012/12/11/dpa-executed.pdf.

7 *United States of America v. Standard Chartered Bank*, Notice on Consent of Amended Deferred Prosecution Agreement, 9 April 2019, at https://www.justice.gov/opa/press-release/file/1152801/download.

8 New York State Department of Financial Services, *In the Matter of Deutsche Bank AG*, Consent Order, 30 January 2017, at https://www.dfs.ny.gov/docs/about/ea/ea170130.pdf.

9 US Department of Justice, *United States v. BNP Paribas S.A.*, Plea Agreement, 27 June 2014, at https://www.justice.gov/sites/default/files/opa/legacy/2014/06/30/plea-agreement.pdf.

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Corporations

ZTE Corporation

In the case of large corporations, ZTE Corporation (ZTEC), the China-based telecommunications company, entered into a plea agreement with the DOJ in 2017 for conspiring to evade US sanctions law through the illegal shipping of US goods and technology to Iran. The plea agreement states: 'ZTEC agrees to retain an independent, third-party compliance monitor (the Monitor) to review and assess in a professionally independent and objective fashion ZTEC's processes, policies, and procedures related to compliance with US Export Control Laws, as well as ZTEC's compliance with the terms of this Plea Agreement.'[10]

Huawei Technologies Co Ltd

Huawei, a Chinese multinational technology company, was indicted on charges of knowingly and wilfully conducting business in countries subject to US, UN and EU sanctions, and of efforts to conceal the scope of business activity with sanctioned countries or entities.[11] The US government's investigation of Huawei and the allegations included in the indictment are ongoing. Effective 16 May 2019, the Bureau of Industry and Security (BIS) added Huawei to its restricted entity list as a result of Huawei's involvement in activities considered contrary to US national security or foreign policy including violations of the IEEPA through the export, re-export, sale and supply of goods, technology and services (banking and other financial services) from the US to Iran and the government of Iran.[12] Although Huawei is not currently the subject of a monitorship, the actions taken against the organisation highlight regulators' increased efforts to seek enforcement actions against corporations, not solely financial institutions. As a result, corporations could also face the prospect of settlements that include provisions for oversight by a monitor for a substantial period.

The enforcers

Legislative bodies, governments and intergovernmental organisations all implement various forms of sanctions law, resolutions or restrictive measures. Separately, in most cases, related government branches, regulatory bodies and law enforcers are responsible for the enforcement and monitoring of sanctions compliance. The primary enforcers of sanctions measures include the United States, the United Nations, the European Union, as well as other countries and influential organisations.

United States

OFAC, BIS, other financial regulators such as the Office of the Comptroller of the Currency, the Federal Reserve Bank and state-level regulators, such as the NY DFS, each have a role in the monitoring of sanctions compliance. OFAC, as part of the Department of the Treasury,

10 *United States of America v. ZTE Corporation*, Plea Agreement, 2 March 2017, at https://www.justice.gov/opa/press-release/file/946276/download.

11 *United States of America v. Huawei Technologies Co., Ltd.* Superseding Indictment, 13 February 2020, at https://www.justice.gov/opa/press-release/file/1248961/download.

12 Federal Register. 'Addition of Entities to the Entity List – A Rule by the Industry and Security Bureau', 21 May 2019, at https://www.federalregister.gov/documents/2019/05/21/2019-10616/addition-of-entities-to-the-entity-list.

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maintains the Specially Designated Nationals and Blocked Persons lists, which identify individuals, companies and other entities deemed restricted, requiring activity to be blocked or frozen. Within the Department of Commerce, the BIS is responsible for the Denied Persons List, a catalogue of individuals who are denied export privileges, and for the Export Administration Regulations, which apply export controls to specific commodities, technology, software and other items.

The NY DFS implemented its 504 Rule pertaining to Transaction Monitoring and Filtering Program Requirements and Certifications following prior investigations into institutions regulated by the NY DFS and various identified deficiencies. The 504 Rule aims to clarify the required components of a transaction monitoring and filtering programme. Further, it specifically requires management to certify that a filtering programme is reasonably designed to interdict transactions prohibited by OFAC, similar to requirements of The Sarbanes–Oxley Act of 2002.[13]

United Nations

The UN enacts sanctions regulations through resolutions, and the UN Security Council sets the specific criteria for targeting individuals and entities. The UN Security Council is composed of 15 member countries, with each member participating or voting to enact sanctions resolutions. Member States of the UN are each obliged to adopt and comply with the UN sanctions resolutions but may also create their own laws and regulations, and enforcement bodies.

European Union

The European Union imposes sanctions law through restrictive measures developed by the European External Action Service and agreed by the Council of the European Union. The European Union implements all UN-issued sanctions resolutions, and EU Member States are required to enact individualised legislation for sanctions monitoring and enforcement, including penalties for violations.

Other nations

Various other countries enact sanctions law and compliance requirements, and establish local authorities to oversee enforcement. The following are some examples:

- *United Kingdom*: The Office of Financial Sanctions Implementation (part of HM Treasury) establishes and administers sanctions.
- *Australia*: The Department of Foreign Affairs and Trade enacts general sanctions policy.
- *Singapore*: The Monetary Authority of Singapore administers financial sanctions.

Influential organisations

Several notable organisations have taken steps to further develop principles and guidance to aid in anti-money laundering, terrorist financing and sanctions compliance.

13 Department of Financial Services, Superintendent's Regulations, 'Part 504 Banking Division Transaction Monitoring and Filtering Program Requirements and Certifications', 1 January 2017, at https://www.dfs.ny.gov/docs/legal/regulations/adoptions/dfsp504t.pdf

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Financial Action Task Force

In 1989, seven countries came together to create the Financial Action Task Force (FATF) with the primary goal of developing recommendations on international standards to combat money laundering and terrorist financing. The FATF has grown to 35 Member States, each required to adhere to the FATF recommendations. Additionally, the FATF publishes Mutual Evaluation Reports, which evaluate a country's adherence to the FATF recommendations.

The Wolfsberg Group

The Wolfsberg Group, an international organisation composed of 13 global banks, develops and publishes guidance for global banks on the framework and best practices for managing and combating financial crime risk.

The legal requirements

As discussed above, the United States, the United Nations and the European Union have implemented more numerous and comprehensive sanctions regimes than other countries or intergovernmental bodies. Upon implementation of a law or restriction, various regulatory bodies, such as OFAC, are tasked with enforcement.

In the United States, the President may enact sanctions regulations through Acts of Congress or Executive Orders. The UN Security Council implements sanctions or resolutions, and all Member States are expected to adopt the passed resolutions. Last, the European External Action Service prepares restrictive measures to which Member States are expected to adhere.

Unique challenges of sanctions monitorships and compliance

Financial institutions under a sanctions monitorship

Financial institutions under a sanctions monitorship encounter several challenges to comply with the terms of a monitorship and regulatory requirements. From a general perspective, unique aspects of a sanctions monitorship include (1) the global scope versus the regional scope of the remediation, (2) the level of remediation efforts and regulator involvement, (3) the effect on 'business as usual' of monitorship requirements and (4) system enhancements and technology changes. Specific challenges also include data issues, inconsistent or conflicting regulation of sanctions law against certain countries, and the requirements of a DPA or consent order may be more restrictive than the law.

Global versus regional scope

The scope of the monitorship presents a challenge to financial institutions based on the size of the institution, the geographies within which it operates, the number of customers, the products and services offered, and the delivery channels. For example, sanctions violations may originate from one region or branch of a financial institution, leading to localised remediation efforts of the regional sanctions compliance programme. A financial institution with a more expansive footprint and a global presence may require enhancements to the global sanctions compliance programme, and compliance elements unique to each region. It is imperative that regional sanctions personnel are properly trained on the requirements of the global sanctions compliance programme and on the sanctions laws of the jurisdictions where the

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financial institution conducts business or processes transactions. In addition, changes and enhancements made to a global sanctions compliance programme may require implementation in the applicable regional sanctions compliance programmes.

Remediation efforts and regulator involvement

Monitorships exhibit varying levels of involvement by multiple enforcement bodies and consulting firms. For example, a financial institution may be simultaneously complying with multiple DPAs or consent orders involving more than one enforcement body (such as the NY DFS, the DOJ or the UK's Prudential Regulatory Authority). Depending on the scope of the engagement or applicable conflicts of interest, the enforcement bodies may engage different consulting firms to carry out the work. As such, the financial institution may handle requests for information and meetings from multiple firms, resulting in potential duplication of efforts and increased burden on sanctions personnel. Additionally, the enforcement body's level of direct involvement may vary. For example, an enforcement body may be satisfied with receiving updates from the monitor on the status of the engagement, while another may prefer to have regular meetings itself with the financial institution or submit special requests in addition to those made by the monitor.

Regulatory and jurisdictional conflicts

Financial institutions may also encounter potential conflicts between the requirements of a DPA and the application of sanctions laws across various countries. Specifically, the requirements of the applicable DPA or consent order may be more restrictive than the governing laws of the jurisdiction where the financial institution resides or conducts business. As such, the financial institution may be required to implement additional programme enhancements or compliance measures beyond those necessary to comply with regional sanctions laws, which may necessitate an increase in compliance budget or personnel. Further, the application of sanctions laws against a particular country may vary depending on the jurisdiction. Specifically, sanctions implemented against a country such as Cuba by the United States may not be honoured by other countries and could cause a conflict for financial institutions with customers transacting with both Cuba and the United States.

Balancing 'business as usual' with monitorship requirements

Financial institutions working with an appointed monitor to oversee compliance with the terms of a DPA or consent order face the unique challenge of balancing 'business as usual' responsibilities with the additional work required to comply with monitor, regulator or law enforcement requests. Specifically, in addition to day-to-day responsibilities and requests from the monitor, the sanctions or compliance teams are often responding to requests from internal audit or compliance assurance. Further, the monitor may submit a substantial number of document requests, and schedule meetings and interviews with sanctions personnel to gain a better understanding of the levels of knowledge and expertise of the staff, and of the sanctions compliance process in place at the financial institution. These simultaneous requests can place a significant strain on resources, specifically the sanctions personnel responding to requests for documentation and attending meetings with the monitor, and responsible for the applicable internal compliance functions.

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The monitor may also identify findings and related recommendations to improve the financial institution's sanctions compliance programme, including enhancements to policies and procedures, improvements to processes or programme documents, and the addition or re-assignment of Sanctions personnel. The increased workload to comply with the terms of the monitorship, remediate any findings and implement enhancements to the programme may require the financial institution to hire additional full-time resources or contract work out to external firms.

It is imperative that the business or corporate functions of the financial institution remain aware of the challenges being faced and the amount of work and financial commitment needed to comply with the terms of the monitorship. The sanctions compliance team should provide regular updates to the governance oversight committee, senior leadership and the board of directors on the progress of the monitorship and any significant changes required to remediate the monitor's findings. Without full commitment from the financial institution to approve additional funding or increase staff, the sanctions compliance team may struggle to balance 'business as usual' with the requirements of the monitorship, posing additional compliance risk to the institution.

Data, sanctions technology and personnel

Data challenges

Data presents a challenge to financial institutions in complying with sanctions laws as the volume and format of available data varies across institutions and jurisdictions. Frequently, data sources can be truncated, incomplete and disjointed across multiple systems or platforms within the institution, making it difficult to maintain real-time watch list screening practices. In addition, the data must be screened against state, federal and international watch lists, depending on regulatory requirements. Further, institutions with a global presence face the challenge of differing data privacy laws and translation or transliteration processes. Finally, the volume of data in an organisation can further complicate sanctions screening. The difficulty in monitoring the flow of payments increases as an institution expands its customer base and the products and services offered. Specific challenges include customer onboarding and identity verification, transaction screening and watch list updates.[14]

System technology

Additional challenges for financial institutions facing sanctions monitorships include the implementation of the enhancements recommended by the monitor. These often involve enhancements to sanctions screening technology, changes to, or the implementation of, case management systems, and improvements to list management processes. Implementing system changes or new technologies presents additional risk as system down time can lead to a backlog of required regulatory filings, such as potential circumvention attempts and voluntary self-disclosures. Further, changes to sanctions screening technology and system settings may increase the number of sanctions alerts and cases requiring review and possible escalation.

14 Computer Services, Inc, 'The 4 Major Challenges of Real-Time Sanctions Screening', 21 September 2017, at https://www.csiweb.com/resources/blog/post/2017/09/21/the-4-major-challenges-of-real-time-sanctions-screening.

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Sanctions personnel and training

System enhancements and the implementation of new technology requires financial institutions to conduct supplementary training for all sanctions personnel as well as the required formal compliance training programme. The training ensures that all members of staff are deploying the sanctions screening technology in the proper manner and serves as an important control in the mitigation of sanctions compliance risks to which the financial institution may be exposed. In addition, a monitor may make recommendations to augment or reduce the number of sanctions compliance personnel, based on the appropriateness of roles and responsibilities, sanctions experience and industry knowledge. The proposed changes in role or responsibilities might result in staff attrition or a heavier workload for the sanctions team.

Maintaining sanctions compliance

Financial institutions face continuous challenges in maintaining compliance with local and international sanctions laws. Specifically, the following can affect a financial institution's sanctions compliance programme.

Evolving sanctions regulation and regimes

Sanctions regulation and regimes are continually evolving, creating a moving target for financial institutions striving to achieve compliance with regulatory standards. Effectively monitoring these changes and staying informed about the global political climate mitigates the risk inherent to financial institutions posed by these changes. Methods of staying current include requiring vendors to provide updated lists, monitoring government websites through subscriptions, and creating tailored news alerts. In addition, consulting external sanctions experts or counsel can ensure that an institution stays aware of sanctions developments. Sanctions counsel can actively track pending sanctions legislation and provide real-time advice on developments.[15] Financial institutions must also remain diligent in updating sanctions-related policies, procedures and process documents to reflect these changes, train applicable personnel on any developments affecting their day-to-day responsibilities and rescreen any customers who may be affected by the regulatory changes.

Jurisdiction or extraterritoriality issues

It is critical that financial institutions maintain continuous awareness of both domestic and international sanctions requirements. Sanctions measures and requirements for compliance can be complex in nature and the level of cooperation between jurisdictions varies. In certain circumstances, economic sanctions imposed by one jurisdiction may result in measures being imposed against entities located in another country. Examples include the scope and application of the TWEA and IEEPA.[16] In addition, some economic sanctions may conflict with the sanctions laws enacted in another country, creating a challenge for financial institutions conducting business in both countries as to which sanctions laws they are required to follow.

15 Financier Worldwide, 'Global sanctions – compliance and enforcement trends', October 2017, at https://www.financierworldwide.com/global-sanctions-compliance-and-enforcement-trends#.Xk1v9yhKjGi.

16 RT Business, 'EU blocking US sanctions against Iran to protect European companies', 6 August 2018, at https://www.rt.com/business/435198-eu-blocking-us-sanctions-against-iran/.

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Further, some jurisdictions have enacted blocking statutes designed to shield entities in that jurisdiction by disallowing the recognition of certain extraterritorial sanctions imposed by other countries. The European Union established one such blocking statute that nullifies US sanctions against commercial trade with Iran.[17]

Further, many sanctions measures are not absolute in their application and include the possibility of exemptions from sanctioned measures. Entities in the United States, for example, may apply for specific licences for (1) the release of blocked funds, (2) travel under specified conditions to jurisdictions that the sanctions measures would otherwise prohibit or (3) exporting certain commodities that support medical and agricultural needs in sanctioned jurisdictions.[18] The myriad of complexities in the application and enforcement of sanctions efforts across jurisdictions can present challenges in maintaining an effective sanctions compliance programme.

Global trade processes and data privacy laws

In addition to evolving regulations and jurisdictional conflicts, international trade finance continues to operate using outdated technology and antiquated processes that create greater risk of sanctions evasion. Specific examples include (1) trade agreements written before the emergence of digital commerce, (2) transactions accompanied by large amounts of paperwork and (3) trade financing that depends on traditional banking methods.[19] A large portion of the trade industry is still based on paper documents and antiquated processes that slow international commerce and have a significant effect on the economy. Specifically, drawbacks of the global trade process include (1) trucks and containers standing idle at ports, (2) cash flow tied up in goods awaiting the production of trade documents and (3) a lack of visibility and inventory status.[20] Further, missing documentation, inadequate global location tracking and diluted or forfeited data pose daily challenges to sanctions compliance efforts.

In addition, data privacy laws differ across jurisdictions. In certain countries, such as Zimbabwe and South Korea, the data privacy laws limit or restrict the provision of confidential data across jurisdictions. Further, colleagues working within the same institution with a global presence may not be permitted to share information unless they are both physically present in the jurisdiction where the data is stored. Lack of access to certain information poses a challenge to financial institutions in complying with international sanctions laws and opens up the institution to additional risks of a sanctions violation.

Digital assets

Digital assets, such as cryptocurrencies, present challenges to financial institutions in complying with regulatory sanctions requirements owing to the wide array of products and

17 European Commission, 'Updated Blocking Statute in support of Iran nuclear deal enters into force', 6 August 2018, at https://ec.europa.eu/commission/presscorner/detail/en/IP_18_4805.

18 US Department of the Treasury, 'OFAC License Application', 23 July 2018, at https://www.treasury.gov/resource-center/sanctions/Pages/licensing.aspx.

19 World Economic Forum, 'These 5 technologies have the potential to change global trade forever,' 6 June 2018, at https://www.weforum.org/agenda/2018/06/from-blockchain-to-mobile-payments-these-technologies-will-disrupt-global-trade/.

20 IOTA Foundation, 'The challenges facing today's supply chains', 20 December 2018, at https://blog.iota.org/the-challenges-facing-todays-supply-chains-aaa9d3d9fc6d.

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services, and the thousands of cryptocurrencies, currently in circulation. The complexity of cryptocurrency makes it difficult for financial institutions to identify and control inherent risks, making cryptocurrencies attractive to entities in sanctioned countries, such as Iran and Cuba. For example, Cuba is reportedly launching its own cryptocurrency, which may facilitate the circumvention of sanctions currently levied against the country.[21] While many cryptocurrency products are traceable and regulated in certain jurisdictions (Switzerland, the United States) by agencies such as the Financial Crimes Enforcement Network, sanctioned entities can gain access to cryptocurrencies through non-traditional means, such as the dark web, or cryptocurrency mining, which creates anonymity for users. This anonymity increases the difficulty of identifying circumvention attempts by those sanctioned entities.

The future

Artificial intelligence (AI) is the future for sanctions and BSA/AML compliance, but it is also a new area of focus for regulators and law enforcement. Financial institutions investing in AI implementation to improve efficiencies should be fully versed in the solution so that it can be explained easily to regulators and law enforcement. The AI should also be customisable to account for the dynamic nature of economic sanctions, as it appears governments are amenable to an expanded use of economic sanctions. Further, the use of AI will require the introduction of a quality assurance (QA) component by sanctions personnel. In addition to the time spent to review the output of AI, the QA review introduces further risk of potential human error to the process.

Sanctions technology can automate repetitive and menial tasks to make a financial institution's sanctions compliance programme more efficient. If not properly tuned or maintained, however, it could magnify inaccuracies by repeating the same fault on multiple occasions. Financial institutions should conduct periodic model and data validation testing to ensure that the system performs exactly as intended.

Conclusion

Law enforcement and regulatory bodies are becoming more comfortable with the inclusion of an independent body as part of a settlement to ensure their remediation requirements are met. Specifically, regulators and law enforcement agencies appear to be increasing the penalties and frequency of enforcement actions, including the use of monitorships, for economic sanctions violations. Financial institutions and corporations should prepare for the possibility of receiving a monitor as part of a settlement. If an institution does receive a monitor as part of a settlement, it needs to plan and prepare to manage the process as smoothly as possible. The institution and its staff will be challenged to maintain business as usual while also responding to requests from the monitor, regulators and internal or external auditors. Financial institutions and corporations can both benefit from evaluating whether their current programme complies with sanctions law and regulation, keeping in mind the continuing and evolving complexities of sanctions compliance. Further, sanctions technology and AI may be a focus for regulators and law enforcement agencies in future sanctions monitorships, as the use of AI becomes more prevalent in financial institutions and sanctions compliance programmes.

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Appendix 1

About the Authors

Patrick J McArdle
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Patrick J McArdle, a partner in the global investigations and compliance practice, has more than 20 years of experience in regulatory compliance, consulting and law enforcement. He specialises in Bank Secrecy Act (BSA) and anti-money laundering (AML) compliance, fraud prevention and forensic accounting investigations.

Patrick was a regulatory enforcement investigator, which required him to conduct highly sensitive and complex specialised investigations involving violations of bank regulations, illegal activities and suspicious transactions. This work required Patrick to develop and test numerous BSA/AML compliance programmes.

Patrick has led numerous fraud investigations involving financial statement fraud, embezzlements, inventory and receivable manipulations, bid rigging and kickback arrangements across a variety of industries. He has also worked as a financial investigator for a local prosecutor's office, focusing on gathering and compiling various financial records and statements for trial. This unique blend of experience makes Patrick a valuable resource for a wide range of regulatory and fraud investigations.

Steven McCarthy
Guidehouse

Steven McCarthy is a director in the global investigations and compliance practice in Guidehouse's Boston office. He has 12 years of extensive experience in providing regulatory compliance, advisory and investigative services to private and public sector clients. He has expertise in performing services on behalf of financial institutions relative to compliance with the Bank Secrecy Act (BSA), anti-money laundering (AML) regulations, the USA PATRIOT Act and Office of Foreign Assets Control (OFAC) guidelines.

Steven manages a large-scale independent audit engagement resulting from a class action settlement involving a public education school system. He assisted in a number of BSA/AML

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and OFAC compliance reviews and a variety of AML investigation, gap analysis and independent testing engagements for financial institutions, including domestic and foreign banks, broker dealers and investment advisers. Steven also has experience in assessing the BSA/AML and sanctions programmes of global financial institutions to ensure adherence with applicable laws, regulations and industry better practices, to identify deficiencies in the programme and to recommend corrective measures.

Jeremy Robb

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Jeremy Robb is an associate director in the Guidehouse New York office. Within the global investigations and compliance practice, Jeremy has more than six years of experience in performing advisory services for clients, including compliance with the Bank Secrecy Act and anti-money laundering regulations, and OFAC sanctions regulation and industry best practices. Jeremy has extensive experience with financial institution monitorships and independent assessments, of both US and international regulatory standards. Jeremy has provided analytical and investigative work during the monitorship of an international financial institution, which included a global assessment of compliance with US economic sanctions. Jeremy is recognised as a Certified Global Sanctions Specialist by the Association of Certified Anti-Money Laundering Specialists.

Ellen S Zimiles

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Ellen Zimiles is Guidehouse's financial services advisory and compliance segment leader and has more than 30 years of litigation and investigation experience, including 10 years as a federal prosecutor in the US Attorney's Office for the Southern District of New York.

Ellen is a leading authority on anti-money laundering programmes, corporate governance, foreign and domestic public corruption matters, regulatory and corporate compliance, and fraud control. Ellen has worked with a multitude of financial institutions preparing for regulatory exams and also has extensive experience in developing remediation programmes, serving as a regulatory liaison and independent monitor, as well as advising organisations that are the subject of a monitorship.

Ellen was engaged by a multinational financial institution as an independent monitor to conduct a compliance assessment of the financial institution's Bank Secrecy Act, anti-money laundering and sanctions programmes in response to a regulatory consent order and deferred prosecution agreement with the New York Department of Financial Services, the US Department of Justice and the District Attorney of New York County. Additionally, Ellen has led numerous independent consultant engagements for regulators related to sanctions and financial crime.

Since 2008, Ellen has led a team serving as independent auditor to monitor compliance with the terms of a settlement agreement between the NYC Department of Education (DOE) and the parents of children entitled to special education services.

Ellen, with the approval of the Federal Highway Administration, was engaged by a global supplier of commercial highway products to serve as an independent monitor for a three-year

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period. The monitorship was the result of a settlement agreement following a civil judgment pursuant to the False Claims Act.

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Since *WorldCom*, the United States Department of Justice and other agencies have imposed more than 80 monitorships on a variety of companies, including some of the world's best-known names. The terms of these monitorships and the industries in which they have been employed vary widely. Yet many of the legal issues they raise are the same. To date, there has been no in-depth work that examines them.

GIR's *The Guide to Monitorships* fills that gap. Written by contributors with first-hand experience of working with or as monitors, it discusses all the key issues, from every stakeholder's perspective, making it an invaluable resource for anyone interested in understanding or practising in the area.

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