

Introduction

On April 20, 2020, the Industrial Bank of Korea (IBK) and its New York branch (IBKNY) (collectively, the Bank) entered into a Deferred Prosecution Agreement (DPA) with the US Attorney’s Office for the Southern District of New York (SDNY) and a Consent Order with the New York State Department of Financial Services (NYDFS), to resolve violations of the Bank Secrecy Act (BSA),¹ the International Emergency Economic Powers Act (IEEPA),² the Iranian Transactions and Sanctions Regulations (ITSR)³ and various provisions of New York law.⁴ The transactions at issue exceeded US\$1 billion and the Bank agreed to an overall penalty of US\$86 million. SDNY imposed a US\$51 million forfeiture for the Bank’s *willful* failure to establish and maintain an anti-money laundering (AML) compliance program as required by the BSA,⁵ while NYDFS imposed a US\$35 million penalty for the Bank’s failure to maintain appropriate books, accounts and records of all transactions, as well as its failure to maintain an effective and compliant AML program.⁶

Notably, the settlement with NYDFS follows a 2016 written agreement between the Bank, NYDFS and the Federal Reserve Bank of New York (FRBNY) (the Written Agreement), reached after regulatory examinations identified serious deficiencies in IBKNY’s BSA/AML compliance program and its efforts to comply with regulations of the Department of the Treasury’s Office of Foreign Assets Control (OFAC) and New York State and federal laws.⁷ To date, there has been no announcement regarding the Bank resolving the sanctions violations by a separate agreement with OFAC.

Factual Background

The facts giving rise to the Bank’s recent settlements began with the adoption of an inadequate, manual transaction monitoring system. According to the DPA, between 2006 and 2013, the Bank utilized a manual review system for processing IBKNY transactions. That system required the IBKNY compliance officer – the only IBKNY employee with full-time compliance responsibilities – to manually review every transaction processed by the branch.

The result was a review backlog that prevented timely reports on suspicious activity. Importantly, these deficiencies were identified and escalated to IBKNY management by the Bank’s own personnel and by its primary regulator. The compliance officer identified the shortcomings in this process in multiple memoranda in 2010 and 2011 and recommended that the Bank adopt an automated transaction screening program to reduce errors and improve efficiency. Meanwhile, a 2010 examination report by the New York State Banking Department – the predecessor to NYDFS – identified deficiencies in transaction monitoring as a “Matter Requiring Immediate Attention.” A 2011 IBKNY internal audit report arrived at similar conclusions.

Insufficient compliance staffing exacerbated these challenges. According to the DPA, the IBKNY compliance officer made repeated requests for additional full-time staff between 2010 and 2011. The Bank initially responded by attempting to assign interns with no English fluency and no BSA/AML experience to assist. When the compliance officer objected, management instead assigned an IT employee with limited English fluency and no compliance experience to provide part-time assistance.

1 Specifically, the allegations involve 31 U.S.C. §§ 5318(h), 5322(a), and 5322(c) and 31 C.F.R. 1020.210. In particular, Section 5322(a) criminalizes the willful failure to maintain an adequate AML compliance function. See 31 U.S.C. § 5322(a).

2 See 50 U.S.C. § 1701, *et seq.*

3 See 31 C.F.R. §§ 560.203, 560.204, and 560.427(a).

4 IBK has also entered into a Non-Prosecution Agreement (NPA) with the New York Attorney General. However, as of the time of writing, the Attorney General has not filed the NPA in the Courts of New York, and the NPA is not publically available. The press release announcing the NPA is available at <https://ag.ny.gov/press-release/2020/attorney-general-james-announces-agreement-industrial-bank-korea-related-illegal>.

5 See Industrial Bank of Korea – Deferred Prosecution Agreement, April 13, 2020, available at <https://www.justice.gov/usao-sdny/press-release/file/1270016/download>.

6 See Consent Order Under New York Banking Law §§ 39 and 44, In the Matter of Industrial Bank of Korea and Industrial Bank of Korea New York Branch, April 20, 2020, available at https://www.dfs.ny.gov/system/files/documents/2020/04/ea20200419_co_ibk_ibk_ny.pdf.

7 See Written Agreement by and among Industrial Bank of Korea, Industrial Bank of Korea New York Branch, the Federal Reserve Bank of New York, and the New York State Department of Financial Services, Docket No. 16-002-WA/RB-FB, February 24, 2016, at 1. The Written Agreement is available at https://www.dfs.ny.gov/system/files/documents/2020/04/ea160224_industrial_bank_korea.pdf.



The Zong Transactions

According to the DPA, the Bank's failure to implement an adequate BSA/AML compliance function made it possible for more than US\$1 billion in transactions linked to Iran to pass through IBK in 2011.

In late 2010, the government of South Korea, in consultation with the US government, authorized IBK to establish a Korean Won-denominated account in the name of the Central Bank of Iran (CBI). The account was intended to allow limited trade in certain permissible exports between entities in Korea and Iran, without violating various US sanctions. Transactions that involved US dollars were prohibited. In January 2011, a US citizen, Kenneth Zong,⁸ conspired with Iranian nationals to evade IEEPA and other US sanctions on Iran, by using the CBI Won account at IBK to convert Iranian payments into US dollars. Zong and his co-conspirators allegedly set up shell companies and fabricated transactions, backed by falsified documents, to facilitate the transfer of Iranian funds from the CBI Won account to accounts under their control. Between February and July of 2011, Zong initiated 88 transactions through IBK accounts, causing more than US\$1 billion in Iranian funds to be transferred from the CBI Won account. The compliance officer at IBKNY did not detect any of the Zong transactions until July of 2011 – some five months after IBKNY processed its first Zong transaction. This was a direct consequence of the manual transaction review system and its resulting backlog. The officer ultimately detected 20 transactions with a total value of approximately US\$10 million linked to Zong and identified all 20 as unlawful. IBK subsequently filed a Suspicious Activity Report with FinCEN regarding the Zong activity and disclosed the 20 transactions to OFAC. However, the Bank only disclosed the portion of Zong transactions that IBKNY processed; it did not disclose the remaining 68 transactions worth an additional US\$990 million that IBK processed through other US correspondent accounts.

The 2014 and 2015 Examinations

IBKNY did eventually adopt an automated transaction screening and monitoring system, but it did not become operational until 2014, and IBKNY waited until October of 2014 – more than three years after its OFAC disclosure – to hire additional compliance staff. Even then, NYDFS found during the Bank's 2014 examination that it still lacked transaction monitoring rules appropriately calibrated for the Bank's risk profile, services, customer base and geographies and, therefore, suffered significant delays in identifying suspicious activity. Those challenges persisted through the 2015 examination, despite SDNY and the New York Attorney General notifying IBKNY in 2014 that it was the subject of criminal investigations related to the Zong transactions.

The Written Agreement

In February 2016, NYDFS, FRBNY and IBKNY entered into the Written Agreement that documented deficiencies in the Bank's AML compliance infrastructure, suspicious activity reporting and OFAC compliance program. The Written Agreement also memorialized the Bank's commitment to a series of compliance reforms.

⁸ Zong was indicted for various federal offenses in the District Court for the District of Alaska on December 15, 2016. See Department of Justice, Office of Public Affairs, "Alaska Man Charged With Conspiring to Provide Unlawful Services to Iran and International Money Laundering Conspiracy," December 15, 2016, available at https://www.justice.gov/opa/pr/alaska-man-charged-conspiring-provide-unlawful-services-iran-and-international-money?mod=article_inline. As of December 7, 2018, Kenneth Zong was in custody in the Republic of South Korea for violations of Korean tax law. His son, Mitchell Zong, was convicted in federal court in 2015 for fraud-related crimes. See Department of Justice, U.S. Attorney's Office District of Alaska, "Former Anchorage Resident Sentenced to Federal Prison for International Money Laundering Conspiracy," December 7, 2018, available at <https://www.justice.gov/usao-ak/pr/former-anchorage-resident-sentenced-federal-prison-international-money-laundering>.

Subsequent Examinations

Despite the Bank's commitments in the Written Agreement, NYDFS and FRBNY continued to identify material deficiencies in the Bank's compliance program. In 2017, NYDFS found that, despite efforts by the Bank to improve its BSA/AML and OFAC compliance, IBKNY still had failed to address all the deficiencies identified in prior examinations. Moreover, when IBKNY's long-time compliance officer retired in July 2016, the Bank appointed a replacement with no direct experience and limited knowledge of transaction surveillance and AML audit testing.

The SDNY DPA

This DPA reflects one of the rare instances in which the Justice Department determined that a "programmatic failure" in a bank's BSA/AML program was so extreme, so pervasive and so persistent that the bank fairly can be found to have acted *willfully*, i.e. to have *specifically intended* to violate its BSA obligations. Such criminal liability typically is imposed only where the bank made absolutely *no* good faith efforts to have a compliant program or to remediate known deficiencies. In finding that the Bank willfully failed to establish and maintain a BSA/AML program here, SDNY criticized the Bank's complete failure over the course of many examination cycles to adopt an adequate transaction screening and monitoring system, implement effective systems to identify suspicious transactions and allocate sufficient staffing and resources to compliance. Indeed, SDNY found that the Bank willfully failed to remediate extreme deficiencies – a backlogged manual screening system and a single compliance officer – even after the compliance officer warned that the program violated regulatory requirements. Despite these findings, the Bank was only required to forfeit US\$51 million, which represents approximately 5% of the US\$1 billion transferred by Zong for the benefit of Iranian entities. This narrowing was likely due to a combination of the Bank's substantial cooperation and remediation efforts. SDNY emphasized the Bank's cooperation in its investigation and its acceptance of responsibility. In particular, SDNY lauded the Bank's efforts to conduct a thorough internal investigation and transactional analysis, collect and produce evidence located in other countries, make employees located in other countries available for interviews in the US and sign statute of limitations tolling agreements and extensions to those tolling agreements. SDNY also characterized the Bank's remediation efforts as "*significant*." These included enhancements to its global governance and the creation of two senior management committees at IBKNY: one to oversee the remediation efforts and another to oversee the Bank's compliance function. Because the fulsome cooperation was somewhat belated, SDNY also noted the Bank "failed to take steps to properly preserve relevant emails and documents..."

The Consent Order

In imposing its own US\$36 million fine separate from the SDNY forfeiture, NYDFS found that IBK and IBKNY failed to maintain appropriate books, accounts and records reflecting all transactions, in violation of N.Y.B.L. § 200-c, and failed to maintain an effective and compliant AML program, in violation of 3 N.Y.C.R.R. § 116.2. In reaching this conclusion, NYDFS relied heavily on IBK's long history of non-compliance and its failure to adhere to the prior Written Agreement. Like SDNY, NYDFS praised the Bank for its cooperation and remediation efforts. However, despite the most recent 2019 examination finding that the Bank's BSA/AML compliance program was adequate, the Consent Order cautioned: "While [NYDFS] applauds the Bank for its ultimate efforts after eight examination cycles of noncompliance, one positive examination report does not equate to a sustainable, safe and sound financial institution."

Implications for Financial Institutions and US Branches of Foreign Banks

The Bank's agreements with SDNY and NYDFS are instructive for US financial institutions and branches of foreign financial institutions that operate in New York.

The Bank's Protracted Failure to Remediate Identified Deficiencies Resulted in Greater Regulatory Exposure and, Ultimately, Even Criminal Liability

The DPA and the Consent Order highlight that banks must learn from past mistakes by resolving identified deficiencies in a timely manner. Here, IBKNY had numerous opportunities to address its shortcomings earlier than it did. NYDFS waited nearly five years after the IBKNY Zong transactions were discovered and disclosed to OFAC to impose the Written Agreement and, in the interim, IBKNY received adverse findings regarding its BSA/AML compliance function across multiple examinations. NYDFS then waited another four years before entering the Consent Order. During that time, IBKNY continued to receive criticism from its examiners for the inadequacy of its compliance efforts. Indeed, the deficiencies were so critical and the failure to remediate them was so protracted, SDNY concluded that the Bank *willfully* violated the BSA warranting criminal penalty. Had the Bank made even good faith efforts to remediate, it likely would have negated that specific intent and precluded criminal liability on a programmatic failure theory.

The Lack of an Effective Transaction Screening and Monitoring System Prevented the Bank From Detecting and Reporting Transactions That Violated US Sanctions

Both the DPA and the Consent Order discuss IBKNY's failure to adopt an OFAC screening and BSA/AML transaction monitoring system calibrated to the Bank's risk profile, geographic customer base and transaction volume. A manual screening system was simply inadequate to manage the Bank's risk. The settlements link that weakness directly to the Bank's failure to immediately identify Zong's activities and file timely suspicious activity reports. Even after disclosing IBKNY's Zong transactions to OFAC and facing scrutiny from NYDFS in subsequent examinations, IBKNY failed to implement transaction and suspicious activity monitoring systems that met regulatory expectations. This is an issue of paramount importance to financial regulators, who believe that the failure of regulated institutions to identify suspicious activity and properly resolve transaction monitoring alerts results in inaccurate or untimely reporting of suspicious activity, which in turn adversely affects the ability of law enforcement to investigate financial crime.

Management Should Investigate and Address Warnings From Compliance Officers and Adverse Findings by Internal Audit

SDNY and NYDFS each cited the repeated internal warnings of the IBKNY compliance officer in finding that the Bank violated New York State and federal laws. Those warnings were clear and unequivocal, provided to IBKNY management, and linked the current state of the Bank's BSA/AML compliance program to a future risk of regulatory action. IBKNY internal audit also identified deficiencies in the Bank's transaction monitoring systems. The Bank's conscious disregard of those warnings provided a basis for DOJ and NYDFS to find the Bank culpable for both criminal and regulatory violations of New York State and federal laws. Accordingly, when compliance officers or internal auditors determine that a compliance system or compliance staffing is deficient, management should appropriately investigate the alleged deficiencies and, if confirmed, take prompt remedial action. If management determines that the findings are erroneous, the basis for that determination should be memorialized and vetted by legal counsel.

Cooperation Remains an Important Avenue for Mitigating Criminal and Regulatory Exposure

IBKNY's total financial penalty – forfeiture and fine – was modest relative to the value of underlying violative transactions. IBK and IBKNY paid a total of US\$86 million for nearly eight years of examination failures and for processing more than US\$1 billion in transactions that violated US law. That penalty amounts to less than 10% of the total transactions processed in violation of Iranian sanctions, a substantial reduction in light of the scope of the Bank's conduct, including its failures to disclose all of the OFAC and BSA/AML violations. Both the DPA and the Consent Order praise the Bank for its efforts to cooperate with regulators, and – following the 2018 examination – to remediate past deficiencies. In particular, the DPA credits the Bank for making documents from foreign jurisdictions available to SDNY and for facilitating SDNY interviews with employees working abroad. Such recognition is particularly notable after early cooperation delays evidently prevented the Bank from fully preserving emails and documents that were relevant to the investigation.

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