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Like JPMorgan, regulators could have done more to stop Madoff, experts say after $2.6 billion settlement

Jan 08 2014 Brett Wolf, Compliance Complete

The announcement on Tuesday that JPMorgan Chase & Co will pay more than $2 billion in penalties to settle civil and criminal charges it failed to make reports on suspicious transactions tied to Bernard Madoff prompted some anti-money laundering experts to decry the years-long lack of regulatory action that might have halted his Ponzi scheme.

At issue are the Securities and Exchange Commission's failure to detect Madoff's massive fraud despite repeated warnings from a whistleblower and other signs and the Office of the Comptroller of the Currency's failure to address JPMorgan's extensive anti-laundering lapses sooner, they said.

"How much is the SEC going to be fined? They had knowledge of the Ponzi scheme yet failed to report it or stop it even though they have the authority to do so. Where was the OCC? They had been all over JPMorgan for several years," said James Dowling, a former special agent with IRS Criminal Division who now runs an anti-money laundering consulting firm.

As part of its deal with U.S. authorities, JPMorgan admitted to a number of failures to investigate red flags it found during its two-decade relationship with Madoff. It agreed to forfeit $1.7 billion to the Justice Department and pay a $350 million civil penalty to the OCC. A $461 million penalty levied by Treasury's anti-money laundering unit, the Financial Crimes Enforcement Network (FinCEN), will be deemed satisfied by the bank's payment to Justice, the Treasury bureau said.

In private litigation, the bank will pay $218 million to settle a class action suit and $325 million to settle a U.S. bankruptcy trustee's suit. The Department of Justice portion of the payout will go to Madoff's victims.

JPMorgan's compliance failures were outlined in the regulatory enforcement actions and a Deferred Prosecution Agreement (DPA) between the bank and the Justice Department.

The bank committed two Bank Secrecy Act (BSA) violations, failure to maintain an effective anti-money laundering program and failure to file a Suspicious Activity Report (SAR), court documents filed in the case state. The bank made no "meaningful effort" to probe suspect activity in the account Madoff used to warehouse investors' funds, a charging document states.

At the heart of the government's claims was the fact that in October 2008, two months before Madoff was arrested, JPMorgan reported suspicious activity to authorities in the United Kingdom, but the bank did not file a single Madoff-related SAR with U.S. authorities until after the swindler was behind bars.

JPMorgan spokesman Joe Evangelisti said the bank is making "significant efforts" to strengthen its anti-money laundering and customer due diligence practices "across the board to be best-in-class."

"We recognize we could have done a better job pulling together various pieces of information and concerns about Madoff from different parts of the bank over time," Evangelisti said in an email to Compliance Complete.

SAR might have stopped Madoff fraud – official

During a press conference announcing the agreement, FinCEN Director Jennifer Shasky Calvery said JPMorgan speculated internally that Madoff was running a Ponzi scheme, reported suspicious activity to UK authorities, and "reduced its own risk exposure to Madoff-related investments."

"While JPMorgan did all of these things, the one thing it did not do was file a SAR with FinCEN at a time when it may have made a meaningful difference," Shasky Calvery said. "When JPMorgan failed to file a SAR with FinCEN, an opportunity to stop this fraud was missed."

It appears that JPMorgan's right hand didn't know what its left hand was doing, said Peter Djinis, a former regulatory policy official with FinCEN. He said various JPMorgan personnel seem to have had ample opportunities to share internally the red flags they uncovered individually and launch a proper investigation.

"If all of those single voices had just popped up in a phone conversation or an email or something I'm sure they would have taken greater action. They never really conducted any kind of effective anti-money laundering investigation into the account activity," said Djinis, who was not involved in the matter but reviewed the documents made public Tuesday.

With regard to the lesson bankers should take from the government's action, Djinis said communication is vital when suspicions arise.

"Don't suspect something and let it be a tree falling in the forest. Share that concern and then act on it," he said. "People can always differ on whether something meets the threshold to file a SAR, but if you haven't conducted the investigation you can't make the argument convincingly."

While JPMorgan should have done more to detect and report Madoff's scheme, FinCEN's contention that if the bank had filed a SAR, the fraud would have been stopped, rings hollow, Djinis said, noting the whistleblower warnings passed to the SEC and the lack of regulatory action.

"The government doesn't look very good here at all," he said. "Just as you would expect a bank to do more, faced with similar doubts, you would expect the government to take some kind of affirmative action and it failed to do so."

The SEC did not immediately respond to a request for comment.

OCC action

In January 2013 the OCC issued a cease-and-desist order that cited a litany of anti-money laundering weaknesses at JPMorgan and ordered the U.S. banking giant to make improvements. That order, which did not include a fine, said among other things that the bank did not do enough to know its customers and monitor their transactions for suspicious activity.

The consent order that accompanied the OCC's civil penalty said examinations conducted after January 2013 have revealed "additional deficiencies" in JPMorgan's anti-money laundering compliance program.

The regulator said it "continues to monitor progress that JPMorgan Chase has made to correct weaknesses identified by the agency as well as their ongoing work and commitment to remedy the remaining deficiencies."

It added: "We will continue our oversight efforts and take further action as warranted."

JPMorgan has spent an estimated $1 billion during the past year to improve its anti-money laundering program.

The bank has built a team of 7,500 full-time employees devoted to anti-money laundering compliance, a team that is "significantly" larger than in the past, Evangelisti said.

Stronger oversight needed

The JPMorgan deal, like the settlements HSBC and several other banks have faced in recent years for anti-money laundering and sanctions violations, "clearly demonstrate the government cannot count on the banks to do the right thing," said Jimmy Gurule, a former enforcement official at the U.S. Treasury.

Gurule, who is now a University of Notre Dame law-school professor, said an inherent conflict of interest prevents banks from adopting a true culture of compliance. He said they have a financial incentive "to close their eyes to transactions indicative of money laundering" that earn large fees and added that while criminal prosecution of bank executives might have a deterrent effect, large fines are not going to bring big banks to heel.

"I think the government is going to have to assume a more rigorous and a more muscular role with respect to auditing and overseeing banks," he said.

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