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VOLUNTARY DISCLOSURE

In Part 1 of this article, which appeared in the August 28 issue of the White Collar Crime Report, we examined the primary characteristics and potential risks and benefits of those policies of the Department of Justice and the Securities and Exchange Commission that are designed to encourage corporate self-reporting of wrongful conduct.

In Part 2, we take a look at similar policies established by the Environmental Protection Agency, the Department of Health and Human Services, and the Internal Revenue Service, as well as the Bank Secrecy Act's regulations that require financial institutions to self-report fraud or misconduct to the Treasury Department.

When Should a Company Voluntarily Disclose Wrongful Conduct to the Government? Factors to Consider

BY DAVID M. ROSENFIELD

David Rosenfield is of counsel at Herrick, Feinstein LLP in the firm's New York City office. He was assisted in the preparation of this article by Laura Halbreich, an associate at Herrick.

Department of the Treasury

The Treasury Department, which oversees the banking system, includes such agencies as the Federal Reserve Bank, the Federal Deposit Insurance Corp., the Office of the Comptroller of the Currency (''OCC''), and the Office of Thrift Supervision.[1] Pursuant to the Bank Secrecy Act (''BSA''), 31 U.S.C. §§ 5318, et seq., self-reporting of criminal violations by banking

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institutions is not voluntary, it is *mandatory*. Thus, a bank does not have the option of deciding whether to self-report a violation—it *must* do so.

The BSA authorizes the Secretary of the Treasury to impose suspicious activity reporting, currency transaction reporting, and other reporting and recordkeeping requirements on a ''financial institution.'' The BSA defines ''financial institution'' broadly to include various types of banking institutions, including FDIC-insured banks, commercial bank and trust companies, and thrift institutions.[2] Finally, the Treasury Department has issued various regulations to implement the BSA, and the BSA is enforced by the Financial Crimes Enforcement Network (''FinCEN''), a bureau within Treasury.[3]

BSA Amendments. The BSA, which was enacted in 1970, is a powerful tool. Originally focused on money laundering, it has been amended multiple times and regulators and law enforcement officials now use it to target numerous crimes. The most recent BSA amendments came after the Sept. 11, 2001 terrorist attacks when Congress passed the USA PATRIOT Act. The current BSA framework involves the use of Suspicious Activity Reports (''SARs'') to track financial data and thus combat money laundering, terrorism, the illicit drug trade, bribery, loan fraud, embezzlement, and other crimes involving the movement of funds.[4]

The BSA requires financial institutions to self-monitor and report currency transactions and suspicious activities to FinCEN using Currency Transaction Reports (''CTRs'') and SARs, respectively. Financial institutions must file CTRs and SARs using specified forms within specified time limits, and must also create and maintain ''an effective system of internal controls'' to ensure compliance with the reporting obligations.[5] Financial institutions that fail to institute and maintain sufficient internal systems and controls may be found criminally and/or civilly liable for failing to comply with the BSA.[6]

FinCEN Requirements for SARS. FinCEN requires that a SAR be filed by a financial institution under the following circumstances: when the financial institution suspects criminal violations by an employee regardless of the amount of money involved, criminal violations aggregating $5,000 or more where a subject can be identified, criminal law violations aggregating $25,000 or more regardless of whether a potential subject can be identified, and transactions aggregating $5,000 or more that involve either potential money laundering or other BSA violations.[7]

The BSA also requires that a financial institution file a CTR whenever a currency transaction exceeds $10,000.[8] If a currency transaction exceeds $10,000 and is suspicious, the institution must file both a CTR (reporting the currency transaction) and a SAR (reporting the suspicious activity).[9] If a currency transaction equals or is below $10,000 and is suspicious, the institution need only file a SAR.[10]

It should also be recognized that SARs are confidential, and the BSA includes a ''safe harbor'' provision for a financial institution that files a SAR. As noted in the SAR form instructions:

> Federal law (31 U.S.C. 5318(g)(3)) provides complete protection from civil liability for all reports of suspicious transactions made to appropriate authorities, including supporting documentation, regardless of whether such reports are filed pursuant to this report's instructions or are filed on a voluntary basis.[11]

Finally, the financial institution may not notify the subjects of a SAR that a SAR has been filed.[12]

Risk, Benefit Analysis. Pursuant to the BSA, it is imperative that financial institutions (a) implement an effective compliance program; (b) proactively ensure the proper maintenance of that compliance program; and (c) remedy any defects that may exist in their present reporting programs.[13] A failure to institute or maintain an effective BSA compliance program to ensure the proper and timely submission of SARs and CTRs could lead to a criminal prosecution, civil penalties, and shareholder derivative lawsuits.

Regulators and law enforcement agencies have and will continue to prosecute financial institutions that fail to timely and accurately report suspicious banking activity. For example, the Justice Department investigated AmSouth Bancorporation and AmSouth Bank (collectively ''AmSouth'') after two businessmen running a Ponzi scheme opened custody accounts at AmSouth.[14] Although AmSouth did file a SAR concerning these accounts, it delayed submitting the report until two years after it should have first discovered and reported the suspicious activity.[15] In addition, DOJ found that AmSouth had mischaracterized the suspicious activity as reported in the SAR and had inaccurately reported the amount involved.[16]

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[1] The Obama administration is seeking to subsume the Office of Thrift Supervision into the OCC.

[2] *See* 31 U.S.C. § 5312(a)(2).

[3] *See* 31 C.F.R. §§ 103.11-103.187.

[4] Under specified circumstances, companies in other industries, such as broker-dealers, commodities and futures brokers, casinos, and money services businesses, must also file SARs. The SAR forms are available at http://www.fincen.gov/forms/bsa_forms/index.html.

[5] *Bank Secrecy Act/Anti-Money Laundering Comptroller's Handbook*, at 7-8 (December 2000), available at http://www.occ.treas.gov/handbook/bsa.pdf.

[6] *Id.* at 5.

[7] *Id.*

[8] *Id.* at 7; *see also* 31 C.F.R. § 103.22.

[9] *Bank Secrecy Act/Anti-Money Laundering Comptroller's Handbook, supra* at 7.

[10] *Id.*

[11] *See* Form SAR-DI.

[12] *See* 31 U.S.C. § 5318(g)(2).

[13] *See Bank Secrecy Act/Anti-Money Laundering Comptroller's Handbook, supra.*

[14] Betty Santangelo and Margaret Jacobs, *Ask Not for Whom the Bell Tolls, It May Toll for You Next: Intensified Anti-Money-Laundering Enforcement Transforms the Regulatory Landscape,* Journal of Investment Compliance, Vol. 6, No. 1, at 2 (2005), available at http://www.emeraldinsight.com/Insight/viewPDF.jsp?contentType=Article&Filename=html/Output/Published/EmeraldFullTextArticle/Pdf/3130060101.pdf; *see United States v. AmSouth Bancorporation and AmSouth Bank*, No. 3:04-cr-00167 (S.D. Miss. Oct. 28, 2004).

[15] Santangelo and Jacobs, *Ask Not for Whom the Bell Tolls*, *supra* at 2.

[16] *Id.*

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Once a company has made the decision to self-report, there are some important factors it should take into consideration as to *how* to self-report.

As a result of the Justice Department investigation, AmSouth entered into a deferred prosecution agreement with DOJ in 2004 that included a $40 million criminal fine and a required review of all transactions and account activity dating back several years.[17] AmSouth also had to pay a $10 million civil penalty and faced cease-and-desist orders issued by the Federal Reserve Bank.[18] In addition to the criminal and civil penalties, AmSouth's directors were faced with a shareholder derivative lawsuit.[19]

As a second example, in 2004 victims of terrorism brought a civil action against Arab Bank, triggering an OCC investigation that established that Arab Bank's New York branch had transferred more than $20 million to 45 different terrorists or terrorist groups.[20] In February 2005, Arab Bank reached a consent agreement with the OCC barring the bank from making any further transfers from its U.S. branch.[21] Later that year, OCC and FinCEN fined Arab Bank $24 million for '' 'unsafe and unsound' practices constituting breaches of the BSA.''[22]

Thus, it is imperative that financial institutions fully comply with the BSA by implementing robust compliance programs that will enable them to file accurate and timely SARs and CTRs.

The EPA's Auditing Policy

Policy Description. The EPA has an auditing policy (the ''Policy'') that provides immunity to corporations that self-report their environmental violations[23] Although amnesty under the Policy does not prevent the EPA from collecting any monies received by a company as a result of the company's noncompliance, it does immunize the corporation from either criminal prosecution or any fines or penalties.[24]

To take advantage of the Policy, a corporation must have discovered its violation as a result of a systematic, objective, and periodic procedure or environmental audit, and must have promptly disclosed its discovery to the EPA in writing within 21 days of discovery.[25] Furthermore, the corporation must have taken steps to correct the violation, to prevent future occurrences, and to remedy any harm caused by the violation.[26] The corporation must also have fully cooperated with the EPA.[27]

Voluntary disclosure is a tool that, when used appropriately, can help a corporation manage its legal exposure; however, it can also cause problems and increase liability if undertaken without careful consideration.

A corporation may not take advantage of the Policy, however, if it has committed the same or a related violation within the previous three years, or if the violation is part of a pattern of violations over the previous five years.[28] Moreover, certain violations are excluded from the Policy, including those that (a) result in serious actual harm; (b) present an imminent danger to the public heath; or (c) contravene specific orders, consent decrees, or plea agreements.[29]

The EPA has both civil and criminal enforcement programs. Civil penalties include two elements: an ''economic benefit'' component and a ''gravity-based'' component.[30] The economic benefit component penalizes gains derived by a company from any competitive advantage that resulted from the company's environmental noncompliance.[31] The gravity-based component is the punitive portion of the Policy, reflecting the egregiousness of the corporation's misbehavior.[32] By complying with the Policy and disclosing discovered violations, a corporation can avoid the gravity-based component of the civil penalty.[33] Even if the corporation does not have an audit or due diligence program in place, the company may still be eligible for a 75 percent reduction

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[17] *Id.*

[18] *Id.* at 3.

[19] *See Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362 (Del. 2006).

[20] Santangelo and Jacobs, *Ask Not for Whom the Bell Tolls*, *supra* at 7.

[21] *Id.; see In Re The Federal Branch of Arab Bank PLC*, AA-EC-05-12, Consent Order, Office of the Comptroller of the Currency (Feb. 24, 2005).

[22] Santangelo and Jacobs, *Ask Not for Whom the Bell Tolls*, *supra* at 7; *see In Re The Federal Branch of Arab Bank PLC*, AA-EC-05-37, Consent Order, Office of the Comptroller of the Currency (Aug. 17, 2005).

[23] To address the needs of small businesses, the EPA also has issued a Small Business Compliance Policy. Under this policy, the ''EPA will waive or reduce the gravity component of civil penalties whenever a small business makes a good faith effort to comply with environmental requirements by: (1) voluntarily discovering a violation, (2) promptly disclosing the violation within the required time period, and (3) expeditiously correcting the violation within the required timeframe.'' The business will also need to satisfy other criteria relating to criminal conduct, violation history, and lack of harm. The Small Business Compliance Policy is available at http://epa.gov/Compliance/resources/policies/incentives/smallbusiness/sbcomppolicy.pdf.

[24] EPA Audit Policy, available at http://www.epa.gov/compliance/incentives/auditing/auditpolicy.html.

[25] *Id.*

[26] *Id.* at 2.

[27] *Id.*

[28] *Id.*

[29] *Id.*

[30] *Id.* at 1.

[31] *Id.*

[32] *Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations; Notice*, EPA, 65 Fed. Reg. 19620 (April 11, 2000), available at http://www.epa.gov/compliance/resources/policies/incentives/auditing/auditpolicy51100.pdf.

[33] *Id.*

in gravity-based penalties if all other Policy requirements are met.[34]

Finally, the EPA will not recommend criminal prosecution to the Justice Department unless corporate officials were consciously involved in, willfully blind to, or concealed or condoned the improper activities.[35]

Risk, Benefit Analysis. A corporation deciding whether to disclose environmental violations and take part in the EPA's Policy must consider the severity of the sanctions facing the corporation if it does not self-disclose, compared with the likelihood that the government may never become aware of the violations. Fortunately, and appropriately, the Policy includes bright-line rules to ensure that a corporation can predict whether it will likely qualify for immunity under the Policy should it choose to self-report.

Significantly, if corporate officials learn about environmental violations but nevertheless choose *not* to self-report—and if the conduct rises to the level of an environmental crime—both the company itself and the principals and primary wrongdoers at the company may face criminal prosecution and significant fines.[36]

Department of Health and Human Services' Provider Self-Disclosure Protocol

Policy Description. The Department of Health and Human Services (''HHS'') Office of Inspector General (''OIG'') has enacted a ''Provider Self-Disclosure Protocol'' (the ''Protocol'') as a means by which corporate healthcare providers may self-disclose fraud and abuse. Any grant of amnesty by the OIG under the Protocol, however, is purely discretionary.[37] To report a violation under the Protocol a company must send a written disclosure to the OIG that contains extensive information about the provider and the violation.[38]

On April 15, 2008, HHS Inspector General Daniel R. Levinson issued ''An Open Letter to Health Care Providers,'' which stated that the initial submission must contain the following information:

> (1) a complete description of the conduct being disclosed; (2) a description of the provider's internal investigation or a commitment regarding when it will be completed; (3) an estimate of the damages to the Federal health care programs and the methodology used to calculate that figure or a commitment regarding when the provider will complete such estimate; and (4) a statement of the laws potentially violated by the conduct.[39]

If the investigation and/or the damages calculations have not been completed by the provider at the time of the initial submission, the provider must complete them within three months of acceptance into the Protocol.[40] Even after all of these steps are completed, however, the Protocol does not guarantee a grant of immunity to the provider.[41] Instead, the OIG has confirmed only that self-reporting can be a mitigating factor in its recommendations to prosecuting agencies.[42]

Risk, Benefit Analysis. There are significant potential benefits to a provider that self-discloses to the OIG. The submission of a disclosure, an accurate audit, and prompt responses to any requests for additional information from the OIG are indications that a provider has implemented effective compliance measures.[43] Therefore, under such circumstances the OIG generally will not require the provider to enter into a Corporate Integrity Agreement (''CIA'') or a Certification of Compliance Agreement (''CCA'').[44]

An adequate self-disclosure means more than simply reporting past violations, however. The taxpayer must also cooperate with the IRS in determining its correct tax liability and make good-faith arrangements to pay in full.

Previously, the OIG generally imposed either a CIA or a CCA on the offending provider regardless of whether the violations were discovered by the OIG or self-reported. The terms of a CIA are often harsh and include significant penalties for any breaches. A CIA also usually requires the development of written standards and policies, the implementation of employee training programs, the establishment of confidential disclosure programs, and the submission of a variety of reports to the OIG.[45] Thus, in the past, as an incentive to self-report, the OIG would often either reduce the obligations under a CIA or agree to the imposition of a CCA instead.[46] A CCA merely requires a provider to certify that it will continue to operate its existing compliance programs for a fixed term.[47]

Today, it appears that, although self-disclosure under the Protocol does not guarantee that the OIG will not require either a CIA or a CCA, self-disclosure is an important consideration in the OIG's determination. Indeed, as stated above, the very fact that the provider detected

[34] *Id.*
[35] *Id.*
[36] For specific examples of penalties imposed upon environmental crimes defendants, please see *Summaries of Criminal Prosecutions,* available at http://cfpub.epa.gov/compliance/criminal_prosecution.
[37] *The OIG's Provider Self-Disclosure Protocol,* HHS OIG, 63 Fed. Reg. 58,399 and 58,401 (Oct. 30, 1998), available at http://www.oig.hhs.gov/authorities/docs/selfdisclosure.pdf.
[38] *Id.*
[39] Daniel R. Levinson, *An Open Letter to Health Care Providers,* HHS (April 15, 2008), available at http://oig.hhs.gov/fraud/docs/openletters/OpenLetter4-15-08.pdf.
[40] *Id.*
[41] *Summaries of Criminal Prosecutions, supra*, at 58,401.
[42] *OIG Issues Guidance on Voluntary Disclosures of Health Care Fraud,* OIG news release (Oct. 21, 1998), available at http://oig.hhs.gov/fraud/docs/complianceguidance/dispress.pdf.
[43] *An Open Letter to Health Care Providers, supra*.
[44] *Id.*
[45] *Corporate Integrity Agreements,* HHS OIG, available at http://www.oig.hhs.gov/fraud/cias.asp.
[46] *Corporate Integrity Agreements: making them work for you,* Next Generation Pharmaceutical, Issue 12 (March 2008), available at http://www.ngpharma.com/article/Issue-12/Marketing/Corporate-Integrity-Agreements-making-them-work-for-you.
[47] *Id.*

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and disclosed the violation is often evidence of an effective compliance program.[48] Furthermore, even when the OIG requires the imposition of a CIA on a self-disclosing provider, it may significantly reduce the obligations imposed thereunder. The two most common modifications are a reduction in the term of the CIA from the standard five years to three years, and the elimination of any requirement for an independent outside monitor.[49] Such modifications reduce costs significantly.[50]

The IRS's Informal Voluntary Disclosure Policy

Policy Description. Although the IRS does not have a formal amnesty policy, it has a long-standing practice of not recommending criminal prosecution if a delinquent taxpayer self-discloses its own failure to pay.[51] This practice has been followed to ensure that ordinary citizens who simply made mistakes are brought back into the tax system and are not prosecuted.[52] Taxpayers whose undeclared income was acquired through an illegal source, however, cannot take advantage of this practice.[53]

An adequate self-disclosure means more than simply reporting past violations, however. The taxpayer must also cooperate with the IRS in determining its correct tax liability and make good-faith arrangements to pay in full.[54] The IRS does not provide for a set time period within which to self-disclose. Rather, the adequacy of a self-disclosure is determined by whether it occurs before the IRS has initiated an investigation or has received information from another source concerning the taxpayer's liability.[55]

The IRS continues to strengthen its international enforcement efforts, and it recently announced a six-month voluntary disclosure program to encourage taxpayers to report hidden offshore income (the ''Offshore Program''). IRS Commissioner Doug Shulman, in a March 26 public statement, stated, ''[t]hose who truly come in voluntarily will pay back taxes, interest and a significant penalty, but can avoid criminal prosecution.''[56]

The Offshore Program is designed to bring those taxpayers hiding assets offshore back into the U.S. tax system.[57] Under the Offshore Program, those who come in voluntarily will obtain a settlement that requires them to pay back taxes and interest for six years and pay either an accuracy or delinquency penalty on all six years.[58] They will also pay a penalty of 20 percent of the highest asset value of a foreign bank account at any time within the past six years.[59] IRS agents have been instructed to resolve cases in a ''uniform, consistent manner.''[60]

According to Shulman, ''[t]he goal is to have a predictable set of outcomes to encourage people to come forward and take advantage of [the] voluntary disclosure practice while they still can.''[61]

Risk, Benefit Analysis. Although the IRS's practice of prosecutorial restraint is not an absolute guarantee, it has been a consistent practice. Nevertheless, even if a self-disclosure is made, the IRS will likely still assess interest and penalties against the taxpayer.[62] Additionally, when making a decision as to whether to self-disclose to the IRS, a corporation should consider, among other things, the applicable statute of limitations and whether such disclosure would heighten the IRS's scrutiny of other tax issues concerning the corporation.

Important Considerations for Companies

Once a company has made the decision to self-report, there are some important factors it should take into consideration as to *how* to self-report. First, the company should seek to have the government sign a confidentiality agreement, which may (but will not necessarily) protect the materials being disclosed from further disclosure to third parties, such as plaintiffs in class action lawsuits. The SEC, for example, has recognized the importance of confidentiality agreements.[63]

Additionally, consideration should be given to providing the self-disclosure by means of an oral, as opposed to written, presentation. As noted in an article prepared for a May 2009 ABA corporate investigations seminar:

> Although written reports can be extremely useful in conveying complex information, oral reports have several important advantages. A written report is more likely to be available for discovery in subsequent litigation, and can serve as a road map for civil plaintiffs. The contents of oral reports may be discoverable through depositions, but obtaining their detailed findings through that mechanism will be more difficult for the private litigant.[64]

[48] *An Open Letter to Health Care Providers, supra*.

[49] *Self-Disclosure of Provider Misconduct: Assessment of CIA Modification*, available at http://oig.hhs.gov/fraud/cia/misconduct.asp.

[50] *Id*.

[51] The IRS's practice of factoring whether a voluntary disclosure was made into its determination as to whether to recommend criminal prosecution has been in place since 1952. *See IRS Says Nonfilers Who Come Forward Are Not Prosecuted,* IRS news release, IR92114 (Dec. 7, 1992), available at http://www.unclefed.com/Tax-News/1992/Nr92-114.html.

[52] *Id*.

[53] *Revised IRS Voluntary Disclosure Practice,* IRM 9.5.3.3.1.2.1, available at http://www.irs.gov/newsroom/article/0,,id=104361,00.html.

[54] *Id*.

[55] *Id*.

[56] ''Statement from IRS Commissioner Doug Shulman on Offshore Income,'' March 26, 2009, available at http://www.irs.gov/newsroom/article/0,,id=206014,00.html. The Offshore Program was apparently prompted, in large part, by the problems associated with offshore accounts maintained by tens of thousands of U.S. citizens at Swiss bank UBS AG. *See UBS Enters Into Deferred Prosecution Agreement,* DOJ press release (Feb. 18, 2009), available at http://www.usdoj.gov/tax//txdv09136.htm.

[57] ''Statement from IRS Commissioner Doug Shulman on Offshore Income,'' *supra*.

[58] *Id*.

[59] *Id*.

[60] *Id*.

[61] *Id*.

[62] *Revised IRS Voluntary Disclosure Practice, supra*.

[63] *See* Neil W. Eggleston, *To Disclose or Not Disclose: What the Audit Committee and Boards Should Consider Before Making Their Decision,* ABA National Institute on Internal Corporate Investigations and In-House Counsel, Washington, D.C. (May 6-8, 2009).

[64] *Id*.

Conclusion

As I indicated in a prior article on the Corporate Leniency Policy of DOJ's Antitrust Division,

> When a corporation that suddenly discovers that its employees have engaged in improper or illegal conduct it has a difficult choice to make: (1) turn itself in to take advantage of a government leniency policy, or (2) put an end to the conduct without contacting the government and hope that the government never uncovers and acts upon the conduct.[65]

That statement is equally applicable to this article. In many cases the government offers an attractive bargain, exchanging confession for absolution, or at least a significant reduction in the penalties imposed. No matter how attractive a deal is likely to be, however, the decision as to whether to self-report needs to be considered carefully to ensure that the outcome is more likely to benefit than harm the corporation and its shareholders.

Voluntary disclosure is a tool that, when used appropriately, can help a corporation manage its legal exposure; however, it can also cause problems and increase liability if undertaken without careful consideration. Companies that decide to self-report should thoroughly consider the best path for disclosure in light of the many government leniency programs and their differing features. Each self-disclosure program is structured differently and must be fully understood. Therefore, unless self-reporting is mandatory under a statute such as the BSA, a comprehensive risk assessment of the full range of potential benefits and consequences must be undertaken before corporate management can make a well-informed decision as to whether to voluntarily disclose.

[65] David M. Rosenfield, *The DOJ's Corporate Leniency Policy*, Competition Law 360 (Jan. 23 & 30, 2009), available at http://competition.law360.com/articles/83865 for part I of the article, Jan. 23, 2009, and http://competition.law360.com/articles/83866 for part II of the article, Jan. 30, 2009.

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