



What Went Wrong at Riggs

A View from the Inside

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SUMMARY

The story of Riggs Bank defines the AML compliance environment in the post PATRIOT Act environment. A small bank with a large presence, Riggs was known as the “most important bank in the most important city in the world.” It sought out the high risk business of diplomats, international leaders and the wealthy from other countries. It did not grasp the momentous shift in regulatory focus brought on by the attacks of 9/11. This paper tells the first hand story of the executive team who was called on to resolve the various challenges at Riggs and the how the lessons learned can help other avoid similar fates.

ABOUT THE AUTHOR

David Caruso, CEO of the Dominion Advisory Group, has more than 15 years of experience creating and implementing comprehensive Anti-Money Laundering (AML) programs. As CEO, David is responsible for providing strategic leadership and industry expertise to ensure clients receive the best possible solution for regulatory compliance issues. Prior to forming Dominion, Caruso was the Executive Vice President of Compliance for Riggs Bank.

While negative media stories, regulatory penalties, government investigations, and ultimately, the sale of the bank to PNC pushed Riggs into the headlines, it was a combination of less sensation problems which truly caused turmoil. In this article, I will share my opinions on the fundamental reasons why Riggs Bank went from being an independent, historic Washington DC bank to regulatory newsmaker to being sold. This path of notoriety includes the causes for the first Consent Order issued in July, 2003 as well as the basis for the \$25 million fine levied ten months later. These views are strictly my own and may differ from opinions of fellow Riggs employees, regulators, and other government agencies.

From my firsthand experience, I believe the following core issues, when not recognized, understood, or addressed appropriately, led to Riggs' situation:

- Corporate culture overshadowed compliance
- Embassy Banking became more than “banking embassies”
- Lack of awareness of changing political and regulatory environments
- Inadequate compliance programs
- Inadequate BSA internal audit
- Front office thought compliance was a back office job
- The Equatorial Guinea investigation
- External events spun out of the bank's control

Corporate Culture

Every institution has a corporate culture. Popular business magazines write lengthy articles on the ones that work (GE) and the one's that do not (Enron). Like most companies, Riggs developed its own culture over the last several decades. Riggs believed it was (as its tag line in the 1980s and 1990s claimed) "the bankers to the most important money in the most important city in the world." Being the bank of governments and government figures was the image Riggs projected and the mission on which its employees focused. Not only was this unofficial mission statement advertised through media outlets, but it was reinforced by visible actions. Airplanes were purchased to travel to foreign capitals, new Embassy Banking offices were built in Washington, an office was opened in Berlin, and existing offices in London were expanded.

Whether intentional or not, a corporate culture of centering operations around the banking of foreign governments and foreign high net worth individuals was created. Thus, employees working in the Embassy and International Banking Divisions believed they were tasked with fulfilling the lofty expectations of housing accounts with as many foreign embassies and as many affluent foreign families as possible. While this goal itself was not problematic, especially in a pre-Patriot Act environment, the internal stature and prestige of the Embassy group led a few bankers to believe they could make their own rules.

Over the past decade, this culture fostered an environment of elitism which led some bankers to exceed the limits of acceptable behavior. This phenomenon is not exclusive to Riggs. Many stories of internal breakdowns or regulatory transgressions feature characters who believed they were better or more important than others. Often these people are those who manage large clients or win significant business. Often these same people are insufferable. They treat other employees rudely, disdain any attempt by others to learn more about their client relationships, bully co-workers, and carry an air of superiority.

While people like this exist in many organizations, their attitudes can develop into serious institutional problems when employees observe that this behavior goes unpunished or unchallenged by senior management. Over time, the belligerent banker is seen as someone who must be accepted because "that's the way he is." To further reinforce the acceptability of their behavior, incorrigible bankers are rewarded by management. Those rewards are financial, a promotion, a bigger office, a puff piece in the corporate newsletter, or just pats on the back from executives. Front line staff sees the rewards heaped on these "star" bankers and become less likely to raise concerns of inappropriate activity involving the banker or one of his customers. Corporate culture has just overrun the first line of defense.

Not surprising, after Riggs signed the July, 2003 Consent Order and began to seek accountability and confront its corporate culture is when the problems created by a handful of bankers surfaced. As seen with other high profile corporate scandals, when a troubled culture is revealed, it does not take a long time for a department or even an institution to wither under the avalanche of negative findings.

As a result of Riggs' corporate culture, bank employees were hesitant to ask the most fundamental of all business questions: "Should we be doing this?" It's arguable that a culture less focused on banking governments would have asked, "Do we want to bank Equatorial Guinea?" or "Do we really want to bank Augusto Pinochet?" When a culture imposes limits on

the questions that can be raised, sometimes, the key questions do not get asked.

Institutions that declare themselves to be a “sales culture”, a “revenue culture”, or a “cost savings culture” must realize the implications of their attitudes. Understanding the BSA risks posed by these often unstated cultures is an essential component of the BSA risk mitigation program.

Embassy Banking Became More than Banking Embassies

As Riggs exited the Embassy Banking business in 2004, there was a mini-crisis for the State Department and the Treasury Department: after seeing the crushing blows leveled on Riggs, who would want to bank foreign embassies? A legitimate question, especially since the regulatory authorities consider banking embassies high risk and explicitly state any bank deciding to bank embassies should expect heightened scrutiny.

Banking embassies is risky and regulators have not overstated the risks involved when banking foreign embassies, but a closer look at Riggs and the major events leading to the bank’s crisis show few direct connections with banking a foreign embassy. Instead, the three highest publicized transgressions were a result of an Embassy Banking group performing services better suited for other departments.

The first event involved Saudi Arabia. When news stories broke an allegation of a connection between the Saudi’s and associates of two of the 9/11 hijackers, it marked the beginning of the end for Riggs. Although no charges have ever been brought in this matter, (CNN and the Financial Times have reported the FBI found no evidence substantiating the news story) the allegations did shine a bright light on the poor internal control environment at Riggs. The allegations claimed the Saudi Royal family, specifically the accounts of Princess Haifa; (wife of the Saudi Arabian ambassador to the U.S.) paid funds to the wife of a man who may have known someone who may have helped two of the hijackers find an apartment in San Diego. The key point here is that these allegations had nothing to do with the official embassy accounts of Saudi Arabia. However, since the line between the institutional embassy banking and the banking of personal accounts of embassy employees and PEPs had been so blurred, it was impossible to distinguish the two supposedly separate relationships.

The second major event featured Equatorial Guinea (EG). Since EG is an underdeveloped nation with little or no central banking system, Riggs became the de facto national treasury. These official EG government accounts were placed under the Embassy Banking department as opposed to a sovereign treasury management group. The personal embassy accounts of Equatorial Guinea leaders and their families were also placed in Embassy Banking. Problems festered because there was little separation between personal and institutional accounts.

Finally, Augusto Pinochet proved to be another example of poor separation between departments. Instead of his accounts being managed in the International Private Banking Department, they were managed by Embassy Banking along with Chile’s official embassy accounts.

These three circumstances show that Riggs’ Embassy Banking division diverted energies from its business model and became private bankers for high risk politically exposed persons without having the internal control infrastructure in place for support. Riggs did have an International Private Banking group (although not completely independent of Embassy

Banking) which would appear to have been better suited to manage personal financial affairs. Banking the funds of another nation's entire government was a risky business Riggs was unprepared to manage. A larger institution with the infrastructure and more experience might have been better suited to handle the EG relationship.

Failure to See Changes Brought on by September 11, 2001

Riggs did not fully understand the implications of the USA Patriot Act or how dramatically the regulatory environment on BSA and terror financing issues changed after September 11, 2001.

Before the USA Patriot Act, banking foreign governments was not considered high risk. Riggs did not place extra emphasis on BSA compliance in the Embassy Banking Division nor were there many signals from the bank's examiners that they did either.

However, since September, 2001, the stated policy of the U.S. government had changed. On September 20, 2001 President Bush declared: "You're either with us or you're with the terrorists." A fundamental shift in U.S. foreign policy had just occurred and no one at Riggs thought to realize what the impact would be if it continued to bank certain foreign governments. (It is likely no bank thought this entirely through. However, the problem for Riggs was it banked 95% of the foreign governments and militaries with representatives in Washington, DC).

The focus on state sponsorship of terrorism heightened as well as the focus on the tacit roles states play in allowing organizations that provide support to terrorists to organize and operate without fear of consequences. Riggs banked many of the countries the regulatory authorities believed fit this latter description. That the regulators believed this came as a shock to Riggs in the spring of 2003. By that time, no matter how quickly the bank moved to mitigate its country risk, irreparable damage had been done.

Prior to joining Riggs in June 2003 I was a consultant with two Big Four accounting firms where I led the BSA/AML practices. The fact that Riggs was slow to react to the implications of the USA Patriot Act was not unusual. My experience between September 2001 and spring 2003 was few, if any banks, made substantial changes to their BSA programs. Banks should not be faulted for this. The entire industry as well as government regulatory and law enforcement authorities were unsure of the Patriot Act's implications. Many of the regulations had yet to be written, implemented, or tested. None of that however, mattered to Riggs and the situation it found itself - the bank was beginning to realize it was caught in a perfect storm.

Inadequate Compliance Programs

Compliance work can be tedious, boring at times, and not usually a place of glamour and renown. Even the best compliance programs have to fight the natural inertia of front office business that are constantly pushing outwards for new clients, introducing new products, and seeking to fulfill ambitious business goals. As the businesses push outwards the compliance group should be trying to pull the businesses back towards them. This is natural and frankly, a formula for business success because it promotes innovative business ideas with proper controls around them. It's when one side is able to operate without the competing pressure from the other when problems arise.

This was the case at Riggs. Compliance policy and procedures were generally adequate in that

they addressed the requirements of regulations and law, provided guidance, and were updated periodically. What did not exist was that dynamic tension between the business groups and the compliance department.

This was in part because of the bank's corporate culture but also because the compliance group did not appear to be properly staffed. Determining the proper staffing levels for a compliance group is sometimes a guessing game. Compliance risk assessments are one way to assist to determine the number of staff a compliance group needs. Riggs did not conduct such assessments.

Completing BSA risk assessments require expertise on regulatory requirements, regulatory expectations, products and services offered by a bank, an understanding of the experience of bank staff, and the depth of BSA training of the bank staff. The results of a proper risk assessment provide guidance as to how a compliance director needs to allocate resources, identify high risk areas, augment policy and procedures and focus testing.

Riggs also did not implement a compliance testing program. Compliance testing is an often overlooked necessity for a BSA program. It's likely that many institutions are now finishing assessing their BSA programs, re-writing policy, buying transaction monitoring systems, figuring out what to do with all those exceptions generated from the new monitoring system, and developing updated training - all these things are taking most of the time and resources of a compliance department. It's also likely that in the midst of all of this, compliance testing is being shelved for later.

Vigorous compliance testing – really getting into account opening documentation, looking at EDD for high risk customers, testing transactions, reviewing SARs for completeness – is vital, especially today in an environment where BSA examinations become more and more onerous.

Compliance departments and compliance executives need to have the proper stature in a corporate structure. If a compliance department is buried deep down in the support structure or is regarded as a "cost center" its executives and staff will lack the profile they need to raise important issues to senior management. The compliance department should have a straight line to a bank's executive or management committee so that it may raise issues to the appropriate level of management. At Riggs, after the post 2003, Consent Order management re-organization, no compliance officer reported to a business head, instead all line of business compliance officers reported to the Director of Compliance. When setting up the department, the bank felt it necessary to provide compliance officers with the tools they needed to remain independent and tough minded. Having one's compensation, position, and other rewards controlled by the person you are in charge of policing is a conflict.

With the aggressive application of BSA regulations and the internal control requirements of the Sarbanes Oxley Act, it's a bad idea for a compliance director to be forced to report through several layers of management and in-house counsel prior to having issues raised to the highest levels of the company. In such a bureaucracy it's very likely important compliance issues will not receive the attention they are due until regulatory or enforcement pressure becomes so great executive management is forced to get involved.

Inadequate Internal Audit

Like the compliance department, Riggs' internal audit department did not have adequate staff to

address the bank's BSA risk nor were adequate audit risk assessments completed that would have identified Embassy and International Private Banking as the highest BSA risk faced by the bank.

Internal BSA audit programs must devote the hours necessary to complete comprehensive testing of transactions, account opening documentation, and EDD information maintained in high risk client files. Many internal audits fail to include this level of testing and are instead more like "process reviews" coupled with a reading and criticism of BSA policy.

I mentioned at the beginning of this paper that I would address the reasons why Riggs was fined \$25 million ten months after it entered into its first Consent Order. There were three reasons – two of which will be discussed later. The first reason was that the bank failed to comply with the article of the July 2003 Consent Order mandating a robust BSA internal audit.

In July, 2003 when Riggs entered into its Consent Order, management decided to outsource the internal audit function to a global accounting firm. Having done so, management relied upon the experience of this firm to conduct a thorough BSA audit in accordance with the requirements of the Consent Order. The firm failed to do so and the bank was found to be in non-compliance with a key provision of the Consent Order. The accounting firm to which the bank outsourced the BSA audit did not complete robust transaction or account testing, nor did it properly fulfill the scope of its proposed audit. As the examiners informed management, a strong internal audit is what executives, the board of directors, and the regulators rely upon to ensure an institution is fully and effectively complying with the BSA.

Front Office vs. Back Office

Leadership from line of business executives is essential to any BSA compliance program. No matter how Herculean the efforts of a compliance officer, when those in charge of retail, wholesale and other departments of banks do not ensure their teams are adequately fulfilling their BSA responsibilities, a program is doomed to fail.

One of the risks bank's face when they put tremendous emphasis on BSA compliance and invest in their BSA compliance officers substantial authority, is that front office staff can be led to believe compliance is the, "the Compliance Department's job." A good compliance program must define very specifically the roles and responsibilities of a line of business and those of a compliance group.

Compliance groups should draft corporate BSA policies and procedures that are very descriptive and provide exact guidance to businesses. One of the shortcomings of procedures is that they are often vague and lack specific requirements as to the documentation a banker must obtain when opening an account and monitoring an accounts ongoing activity.

In addition to policy drafting and executing upon those policies, the front office and compliance groups must understand whose job it is to know the client's expected and actual transaction history. Furthermore, procedures should address the requirements for regular file remediation or file updates of high risk customers. Lastly, procedures need to address the expectations for file documentation. Documentation across an institution should be consistent and capture enough information so a bank can understand the expected activity of its high risk customers and if the actual activity is consistent with the bank's expectations. File documentation on high risk customers must also fully describe a customer's source of wealth and source of funds

as well as the expected use of those funds and the means by which they will be used (i.e. cash, wire, or check). Without this level of documentation a bank exposes itself to regulatory criticism.

A second reason why Riggs was fined \$25 million after it received its initial Consent Order is because the Embassy Banking group did not fully remediate its client files in a manner as described above. The result was that the bank could not demonstrate it knew its high risk customers sufficiently enough to decrease BSA risk.

The Equatorial Guinea Investigation

In September, 2003 after the Riggs Investigations Group was staffed with experienced former government investigators, the bank began a full review of the Equatorial Guinea ("EG") relationship. For a number of reasons, the regulators considered this relationship to be among bank's highest risk.

First, it was the bank's largest relationship consisting of nearly \$350 million in deposits and another \$350 million in assets under management. Second, the human rights reputation of the country and its leaders was atrocious. Third, the bank did not have adequate BSA compliance and internal audit functions to insure proper testing and controls around the relationship. Finally, the regulators were concerned about the quality of management over the account relationship. All of the regulator's concerns were well founded.

While I cannot reveal the facts of the bank's internal investigation in detail because there are still matters related to that investigation that are now before law enforcement, I can say that soon after the bank began its investigation we discovered activity that confirmed the regulator's concerns. The bank's investigation alleges that the account manager engaged in a scheme to defraud the customer and the bank of funds. In addition, the bank's investigation alleges that funds transferred from the official government accounts of EG may have been diverted for personal use by EG government officials.

The revelation of these findings and the fact that they confirmed the concerns of the regulators relating to the lack of internal controls in Embassy Banking was the third reason Riggs was fined \$25 million after the issuance of the first Consent Order.

Events Spun Out of the Bank's Control

When the depth of regulatory transgressions at Riggs became more fully known to the regulators in the winter of 2004 as the bank's findings on the EG investigation were revealed, the Riggs story became much bigger than just a BSA violation by a \$6 billion bank in Washington, DC.

The Riggs story resonated on Capitol Hill and not just with the Permanent Subcommittee on Investigations, but with at least three other committees from the Senate and House. In addition, the international nature of the events at Riggs became a global news story. It was shortly after the bank concluded its investigation of EG and it became public that the bank closed the EG accounts that a group of mercenaries led by the son of Margaret Thatcher failed in an attempt to overthrow the government of EG. The Riggs story continued to take on new angles every day.

At the same time there were a few key Congressmen who were beginning to question the capability of the OCC, the Federal Reserve, and the FDIC to adequately oversee BSA compliance at the nation's financial institutions. Adding to the whirlwind of stories came a statement from the OCC that it had not adequately examined Riggs for the last several years. Stirring the pot more was a story that the former Examiner in Charge of Riggs' OCC supervision was now the bank's chief risk officer and Senators and others questioned the appropriateness of this.¹

These are just a few of the many events that awaited Riggs each morning in the headlines of the Wall Street Journal, Washington Post, and American Banker. Riggs had extremely capable public relations executives and outside media firms. However, institutions must also be realistic as to what it can and cannot say to the media. Misleading statements from an institution can lead to further scrutiny by the SEC. Any media plan must take into account the facts of the BSA matter at hand. If the facts are not on your side that can limit any aggressive media strategy some may recommend. In the end, the most important step to consider when dealing with events like those that Riggs had to deal with is to ensure the integration of those who are investigating and finding facts and those who are responsible for media and public relations.

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Author's Note

My interest in documenting the past problems of Riggs is not to point fingers or blame any one department, but instead, to share the combination of regulatory, cultural, and institutional events which created a whirlwind of negative publicity and financial woes. Banks without a heavy concentration of international accounts can still learn from the scrutiny Riggs faced. An organizational structure which facilitates and prioritizes BSA compliance on a systematic basis, promotes appropriate corporate values, and responds to regulatory changes, will allow a financial institution to avoid many of the hardships Riggs Bank faced.

ABOUT THE DOMINION ADVISORY GROUP

Dominion Advisory Group is the leading provider of comprehensive and sustainable anti-money laundering programs and critical investigations services for top domestic and international financial institutions, law firms, and other organizations. Dominion Advisory Group has 15 years of extensive experience in banking, compliance, law enforcement, regulatory oversight, technology, and consulting to help financial institutions and corporations navigate the complex regulatory environment and address the needs of regulators, customers, and the institution.

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¹ A subsequent investigation by the Treasury Department Office of Inspector General concluded there was no wrongdoing on the part of either Riggs or the former OCC Examiner in Charge who joined Riggs.