SAR Privilege: Unveiling the Complexities and Use for Financial Institutions

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Executive Summary

The Financial Crimes Enforcement Network (FinCEN) issued an advisory in November 2010 to “regulatory and law enforcement agencies, self-regulatory organizations (SROs), and financial institutions to reinforce and reiterate the requirement to preserve the confidentiality of Suspicious Activity Reporting (SAR) information.” As the delegated administrator of the Bank Secrecy Act (BSA), FinCEN is responsible for the safekeeping, maintenance, and integrity of all SAR information once obtained. Alongside FinCEN, financial institutions and other SAR-filing groups must also uphold confidentiality and integrity of reports and their existence. Over the years, there has been increased focus specifically on financial institutions to remain vigilant about SAR confidentiality, including BSA provisions, which allow financial institutions to defer requests from civil litigants to FinCEN, citing confidentiality and SAR privilege.

This white paper explores the complexity in: litigants challenging the SAR privilege where regulation is not definitive; the paybacks of SAR confidentiality; and the demand for financial institutions to be intentional in creating internal controls that enable their legal counsel and FinCEN to uphold SAR privilege during trial discovery.
Introduction

Financial institutions are required under the BSA to report any known or potentially suspicious activity to FinCEN. This reporting intelligence aides the government in investigating and prosecuting crimes related to terrorist financing, money laundering, or other criminal activities. Reports generally contain circumstantial evidence of persons attempting to conceal funds, promote the movement of illegal funds, evade tax reporting requirements and/or avoid reporting thresholds wherein financial institutions are obligated to notify FinCEN. The information provided within SARs must remain confidential under 31 U.S.C. § 5318 and implementing regulations. This statute states: “No savings association or Service Corporation, and no director, officer, employee, or agent of a savings association or service corporation, shall disclose a SAR or any information that would reveal the existence of a SAR”. Furthermore, this statute also states that a “financial institution and its officers, directors, employees, and agents are prohibited from notifying any person involved in a suspicious transaction that the transaction was reported.”

While the Secretary of the Treasury may summon books, papers, records, or other data from domestic financial institutions, it is prohibited from disclosing SARs or evidence that supports the existence of a SAR, or specifically named individuals within the report, to be provided to parties outside of FinCEN or other United States regulatory agencies. Under 31 U.S.C. § 5318, the BSA created a safe harbor provision to protect financial institutions from civil liability for reporting suspected or known criminal activity. Combined with 31 CFR § 1020.320, providing such materials when requested from civil litigants is prohibited. Under these regulations, financial institutions can cite SAR privilege and request the court to ban disclosure of covered materials. Common knowledge of SAR privilege may also discourage advances by the plaintiff to acquire SARs or related protected documents.

While the regulation clearly states that SARs and confirmation of their existence must remain confidential, there have been multiple discovery attempts to obtain information that challenges the scope to safeguarding such information. An example of such an attempt includes the request of financial institutions to provide supporting documents used to construct SARs, such as internal reporting, company policies, and/or investigation procedures with intent to divulge vulnerabilities of the financial institution to uphold fiduciary duties. Instances of these requests and subsequent rulings from the courts have exposed a gap on which material exactly would fall under protection of SAR privilege, creating a gray area for the court’s interpretation of the regulation.
**SAR Privilege Within Discovery**

Reporting intelligence provided to FinCEN through SAR filings is generally only considered suspicious activity with no direct proof of an actual crime being committed. This is one reason why details within or relating to the creation of a SAR could be beneficial for civil litigation where a person or entity is bringing forth a legal case against a financial institution, challenging the argument that the bank did or in some cases did not have legally sufficient reason to report the information. Additionally, a financial institution’s reliance on the intervention of human intelligence within the detection, monitoring, and filing of SARs can lead to vulnerabilities in identifying and reporting suspicious activity, while in certain instances further deterring financial crimes or terrorist activities.

**Use Within Litigation**

*Norton et al., v. U.S. Bank National Association*

Within this civil case, a former U.S. Bank employee left the financial institution to start an investment company, which actually became a Ponzi scheme executing through accounts held at U.S. Bank, with the aid of individuals who remained employed at the company. The plaintiffs were investors solicited by the ex-employee who collectively lost a total of $11 million dollars. U.S. Bank was sued for “breaches of fiduciary duty, fraud, and several other causes of action” due to the belief that the financial institution did not perform adequate investigation to detect and stop the illegal activity.

During discovery, the defense was requested to provide internal policies and procedures related to monitoring and investigation efforts to identify suspicious and illegal activity. However, U.S. Bank claimed SAR privilege in its request to bar discovery of these materials on the basis that internal processes around investigations were protected under 31 U.S.C. § 5318, as they could reveal the existence of suspicious activity being filed. The plaintiff argued that the details pertaining to SAR-filing could simply be omitted, allowing the requested information to be released. The trial court denied the motion to bar such information and ordered that the bank fully comply with documents requested.

U.S. Bank introduced the discovery request to the state appellate court to intervene with the trial court’s decision. The appellate court concluded that SAR privilege prevents disclosures of policies and procedures for internal investigations, as the entire evaluation of the materials could lead to the determination of whether or not a SAR would have been filed.
Cotton v. Private Bank Trust and Company

This civil litigation case arose from a personal injury suit that resulted in a settlement agreement granting the injured to receive scheduled payments from a designated trust containing U.S. Treasury stripped bonds. The designated trust was held at Private Bank Trust and Company, the paying agent and designated trustee, to execute the payments at the frequency directed by the settlement. During the course of remittance, the injured received notification that Private Bank and Trust Company resigned as trustee and paying agent. Following the resignation, the funds were liquidated from the settlement trust by the controlling officer and diverted into an unrelated side account to then be used for personal benefit of the controlling officer.

Within this case, Private Bank Trust and Company filed a third-party complaint against the designated trust alleging that the controlling officer permitted the liquidation of bonds knowing that the funds were a part of a settlement agreement. During trial discovery, the plaintiff requested materials resulting from internal Private Bank investigations, all SARs filed by the financial institution, and any documents of due diligence and/or inquiries conducted concerning accounts of the parties involved.

The trial court approached Private Bank’s request for SAR privilege by categorizing materials requested in discovery into two categories: factual documents, which may be supplemental to SAR filings, and documents that support the preparation of SAR-filing or its actual existence. Those materials within the factual documents category included transactional and/or account statements, which were deemed permissible in discovery, because they are produced during the normal course of business. Materials aligned under the second category were prohibited in discovery due to the fact that they included items such as communications that relate to SARs and/or drafts of SARs themselves.

Wiand v. Wells Fargo Bank, N.A.

The plaintiff, Burton W. Wiand, was appointed for six hedge funds that invested and lost $168 million dollars by putting funds into accounts that concealed a true Ponzi scheme spanning 1999–2009. The accounts were held within Wells Fargo, to which the plaintiff constructed a case that the financial institution failed to comply with its own internal procedures to detect and report the criminal activity. Within discovery, Wiand challenged SAR privilege claimed by Wells Fargo when the bank provided the court with internal emails and reports, as well as external email communications between other financial institutions and Wells Fargo with information redacted. The claim for challenging the use of SAR privilege was
based on the materials themselves being generated during normal course of business and not during investigation, nor exposing the existence of an actual SAR.

When redacted information was revealed only to the state court, it was determined that the use of SAR privilege remains, because the comments redacted within communications were evaluative in nature and are considered reports created to comply with BSA requirements.

Case Conclusions

Through the curation of these cases, it has become evident that among the United States federal and state court systems, there is an argumentative interpretation as to when immunity is granted to financial institutions that cite SAR privilege. In each case summarized above, the basis argued by civil counsel to acquire the otherwise protected information has been unique. The one commonality these cases share is the attempted challenge to win the materials not clearly defined by the Bank Secrecy Act. It is critical for financial institutions to apply enhanced scrutiny against discovery requests relating to SARs in combination with creating a strong framework within the organization’s AML program.

Unauthorized Disclosures

Unauthorized Disclosure of SAR filings has consequences to the overall success of the SAR-reporting system. Revealing details within SARs or even their existence may impede ongoing law enforcement cases by “tipping off” suspects trying to avoid detection. Additionally, the release of named persons within the report conducting activities or transactions, guilty or innocent, may put these individuals in direct danger of the person trying to evade detection. This also applies to the names of individuals and/or financial institutions who investigated or filed the SAR. Exposure can result in retaliation from the criminal or organization supporting the suspected financial crime, creating safety and security risks.

On the other spectrum, details on how financial institutions suspected unusual activity can act as an educational gateway or playbook for those looking to commit financial crimes or use the financial system to execute illegal activity or acts of terrorism. Details can be studied to successfully navigate methods of transactional monitoring, customer evaluations, and how internal investigations work collectively to provide surveillance for financial institutions. The
integrity of the SAR confidentiality is an intentional design within the reporting system to ensure that financial institutions report liberally without fear of retaliation regarding details provided within. Exposing SAR details can counter the very objective in which confidentiality was created.

Furthermore, any person who breaches SAR confidentiality is violating federal law and may be facing civil and/or criminal penalties. Per 31 U.S.C. § 5321 and § 5322, “violations may be enforced through civil penalties of up to $100,000 for each violation and criminal penalties of up to $250,000 and/or imprisonment not to exceed five years.” Financial institutions are not exempt from civil monetary penalties when deficiencies within the internal program are discovered, with a costly fine of $25,000 per day for each day the violation exists.

Confidentiality and Privilege Paybacks

The BSA safe harbor provision provides financial institutions immunity from civil liability regarding SAR-filing and can also be a point of contention when challenged during a court proceeding. This safeguard is applicable to “any financial institution that makes a voluntary disclosure of any possible violation of law or regulation to a government agency.” Without pulling in specific cases, an expedited conclusion can be asserted that counsel will challenge the sustainability of protection, arguing applicability of these protections when SARs are filed with a “good faith” assumption that a law has been violated. Financial institutions can demonstrate “good faith” by ensuring that their AML programs have effective controls to collect customer due diligence, enhanced due diligence, and transaction details, so that may be used during investigation and create factually supported reporting. By upholding a strong risk and compliance framework within the AML program, financial institutions can combat the challenge of “good faith” and uphold the qualified protection to cite SAR privilege. This protection payback pays forward the security and confidence to maintain SAR filing by financial institutions.

Another payback from SAR privilege is the ability to support the continued dependence that law enforcement and other government agencies have on financial institutions to provide intelligence of suspicious or unusual activity. Agencies working to combat money laundering and fight terrorist financing efforts depend on banks to have a level of comfort in communicating collected information comprehensively, liberally, and frequently. This channel to receive a direct eye account and factual witness observations allows agencies to pursue advanced investigations and corroborate prosecution, where necessary. There is also an
efficiency gained for law enforcement when financial institutions partner to collectively file SARs. Exposure of a SAR by one financial institution may inadvertently result in the exploitation of the other’s internal controls to detect and report suspicious activity and create resentment for future collaborations on joint filing of SARS.

The reporting below is sourced from FinCEN’s website and includes SAR statistics displaying that in 2018, depository institutions alone filed approximately 2.7 million SARs. This number has more than doubled since 2016.

![Department of the Treasury Financial Crimes Enforcement Network](image)

**2018 Filing by Month By Depository Institutions**

*January 1, 2018 through December 31, 2018*

<table>
<thead>
<tr>
<th>Month</th>
<th>2018</th>
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<tr>
<td>January</td>
<td>210,086</td>
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<tr>
<td>February</td>
<td>199,900</td>
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<tr>
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<td>April</td>
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<tr>
<td>May</td>
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<tr>
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<td>September</td>
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<td>October</td>
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<tr>
<td>November</td>
<td>235,457</td>
</tr>
<tr>
<td>December</td>
<td>222,259</td>
</tr>
</tbody>
</table>

*Subtotal 2,720,464*

*Statistics generated for this report were based on the Bank Secrecy Act Identification Number of each record within the Suspicious Activity Report system. The Bank Secrecy Act Identification Number is a unique number assigned to each Suspicious Activity Report submitted. Numeric discrepancies between the total number of filings and the combined number of filings of states and/or territories are a result of multiple locations listed on one or more Suspicious Activity Reports.*
Financial Institution Measures to Maintain SAR Confidentiality and Privilege

There are certain controls that financial institutions should consider when evaluating the effectiveness of maintaining SAR confidentiality and SAR privilege.

Employee Education and Training

Education and training of employees regarding the importance and consequences of SAR confidentiality should be crafted for those specifically performing investigation and actual filing on behalf of the institution. Within this training, it is recommended to mention that violations of SAR confidentiality can impose both civil and criminal penalties, including monetary fines and possible imprisonment. In addition to employees performing key functions leading to and actually filing SARs, it is critical that internal and external legal counsel also understand the consequences in violating this federal law. Attestation of training on these materials and content should be considered to ensure that employees and counsel fully understand their liability of any actions taken to disclose SARs or the existence of a SARs, including details within.

Investigation and Filing of SARs

Policies surrounding SAR filings, including the monitoring, detection, and investigation of financial crimes, should be reviewed on a designated minimum frequency best suited by the financial institution’s risk appetite and/or following regulatory changes. Policies should be mapped to regulatory requirements and include a governance and oversight committee approval prior to publications. Additionally, procedures should be lower-level, step-by-step instructions that employees can repeat, limiting employee variation and visible to those only on a need-to-know basis. Furthermore, procedures supporting the investigation and preparation of SAR-filing should be labeled clearly as such. By clearly labeling relation to SARs, segregation of these documents from those created for normal course of business enables protection during litigation when citing SAR privilege.

In addition to policy and procedures, it can be suggested that financial institutions should have clear direction when handling materials, such as internal and external email communications, memos, cover sheets, and reports related to SAR data. These materials should also label or mention SAR relation to distinguish between protected information and other like material, which could be created during normal course of business.
Risk assessments should also be completed by an independent compliance team to document and opine on the effectiveness of the investigation, preparation, and filing of SARs, including timeliness and frequency. It is recommended that these be concluded annually at minimum or in accordance with the company’s risk appetite. Final reports should also be socialized with the board of directors.

System applications that house investigation data and any supporting documentation needed to prepare a SAR-filing should include controls to limit system access and require access to be reviewed frequently. Financial institutions should consider segregation of duties between those reviewing SARs from those who may be investigating the material leading to the filing. Moreover, establishing restricted areas specifically to isolate those filing SARs may also strengthen control effectiveness to maintain SAR confidentiality. These applications should support the retention of records to adhere to record-keeping requirements set forth by the BSA.

Handling of Discovery Requests

Financial institutions should consider streamlining and documenting a clear process for receiving requests from civil litigation to legal counsel representing the company. This process may include a centralized team or specialist that maintains confidentiality on grounds for legal action, pre-screening requests for discovery and subpoenas for custodians of documents for the legal team. Counsel representing the company should be qualified to handle the financial crime subject matter, preferably experienced with BSA regulation, to uphold the requirement to notify such requests to FinCEN’s Office of Chief Counsel as well as the primary federal regulator.

Escalation of Unauthorized Disclosures

A part of the Bank Secrecy Act’s requirement for instances where SAR confidentiality has been violated includes self-disclosure to FinCEN’s Office of Chief Counsel as well as the primary federal regulator. Financial institutions should consider internal governance controls to notify the board of directors and BSA officer of such occurrence. The BSA officer should either contact FinCEN or the regulator directly and/or have a direct report to evidence that notification occurred.

Banks should give thoughtful consideration to streamline an escalation channel for all employees to refer unauthorized disclosures of potential SAR-filing to the BSA officer and/or compliance team. This process would create a consistent path to report potential violations internally, vetting out instances when a true disclosure was not committed and reporting timely
when it has. This can be achieved through a referral process, which will trigger an investigation and further review of information released to determine whether self-disclosure is warranted. Furthermore, financial institutions’ policies should establish consequences for the unauthorized disclosure of SARs and/or their existence.

**Effective Audit Evaluations**

Whether internal or external, audit teams should consider creating a test plan to specifically evaluate the existing controls’ effectiveness in monitoring, detecting, reporting, investigating, and filing suspicious activity. This test plan should be evaluated annually and/or off-cycle, as industry standards and regulation change. Audit teams should at minimum incorporate the same evaluation as the Federal Financial Institutions Examination Council’s (FFIEC) Bank Secrecy Act/Anti-Money Laundering Examination Manual, specifically the suspicious activity reporting examination procedures.

Audit should identify areas needing improvement with the objective of strengthening controls considered deficient. When an audit plan includes the review of suspicious activity reporting, it should not only include baseline testing for accuracy and timeliness of SAR filing, but also review the controls to maintain SAR confidentiality with the determined escalation paths to notify the BSA officer of potential disclosures. This includes the review of access to case management applications and databases containing SAR data. It would be recommended to also evaluate the subpoena process, specifically the appropriate handling of such requests. In addition, the management of the 314(b) process should be reviewed to ensure confidentially controls are effective, preventing the release of SAR decisions from being discussed. Lastly, any areas of scrutiny in the industry, including new guidance or advisory on SAR-filing must be considered.

Any action plans to remediate deficient areas must be addressed by the specific area within the organization owning the risk and reviewed by audit, as necessary. Final reports and findings from internal audits should be distributed to the BSA officer, the board of directors, and audit committee, if applicable.
Conclusion

The integrity of the reporting system created by FinCEN bears many rewards. Financial institutions remain critical contributors of information to aid law enforcement and other government agencies in countering financial crimes and acts of terrorism. The provision to safeguard the existence of SARs and details are very clear within the BSA. Unfortunately, when it comes to materials surrounding the construction of SARs, not every court is consistent with interpreting regulation and granting SAR privilege. This very realization can make cases complex when facing civil litigation.

Financial institutions must be knowledgeable of precedent cases involving SAR privilege, incorporating the questionable elements of the case within their control frameworks for the avoidance of doubt. For this very reason, it is a call to action to think about what controls are in place surrounding SAR confidentiality. Many financial institutions often get tied into the elementary meaning of the regulation. My recommendations set forth in this whitepaper should be used in consideration when developing appropriate controls to maintain confidentiality. In the end, it is crucial for financial institutions to implement sound controls in favor of SAR confidentiality, which will ultimately enable their legal counsel to effectively protect SAR privilege with the support of FinCEN and federal regulators.
References


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