

## THE SAGA OF AN AML COMPLIANCE OFFICER

By Dennis Lormel

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**Dennis Lormel** is President of DML Associates and a recognized subject matter expert in the anti-money laundering, terrorist financing, and fraud communities. He spent 30+ years in Government Service, Law Enforcement and the FBI. After the tragedy of 9/11, Mr. Lormel realized that the terrorists needed a financial infrastructure to accomplish the attacks. He established an investigative organization within the FBI that, within days, identified the funding stream that supported these attacks.

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### Introduction

This is the true and compelling real-life story of a Bank Secrecy Act (BSA) and Bank Compliance Officer. She had been recently hired by a small community bank. Shortly into her tenure at the bank, she realized something was seriously wrong. The compliance officer determined that the bank was processing an inordinate and unreasonable amount of transactions per month; well in excess of what a bank that size should have been handling. She learned that the bank was dealing with third party processors and subsequently found out that the third-party processors were transacting on behalf of internet poker companies. The compliance officer knew this activity was illegal. She went to the bank president and other executives to attempt to exit the business relationships and file suspicious activity reports (SARs). Although the compliance officer continuously attempted to do the right thing, she was constantly rebuffed or misled.

What became apparent was that the tone at the top was not compliance friendly. Regardless of how dedicated and committed to doing the right thing a compliance professional is, if executive management does not adhere to a culture of compliance and exhibit the proper tone at the top, the compliance function is destined to fail. For approximately one year, the cultural conflict played out until state regulators closed the bank.

During that year, as the gripping story unfolded, the compliance officer experienced many emotions ranging from stress and sleeplessness, to intimidation, guilt and fear for her safety. In addition, she incurred legal expenses to retain a lawyer. Despite her distress, she continued to try to do the right thing. As things progressed, the compliance officer cooperated with law enforcement and regulatory authorities.



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## Background

This saga contained various backstories involving a number of colorful characters. The law enforcement investigation began as an organized crime investigation into gambling. Organized crime led investigators to information regarding offshore payment processing in Costa Rica. Investigation led to third party processing; processing for a range of illicit activities to include gambling on internet poker. Most banks would not wittingly service internet poker companies. Third party processors relied on shell and shelf companies, nominees, and other mechanisms, to create the appearance that funds were being moved for licit and innocuous activities and not for illicit purposes.

There were organized crime figures in New York associated with the Gambino and Genovese families. There was Anurag Dikshit, a citizen of India, who owned PartyGaming, an internet gaming business. Dikshit pled guilty to internet gambling in December 2008, and agreed to forfeit \$300 million. There was Daniel Tzvetkoff, an Australian, who made an estimated \$82 million processing for PokerStars, Full Tilt Poker and Absolute Poker. In 2010, Tzvetkoff was accused by the poker companies of stealing about \$100 million from them. He was subsequently arrested and agreed to cooperate with law enforcement regarding other payment processors, to include Chad Elie, a key player in the SunFirst Bank case. There were PokerStars, Full Tilt Poker, and Absolute Poker, along with their owners, who were taken down on what was known as poker's Black Friday, April 15, 2011.

The focus of this case study is on third party processors working with an insider at SunFirst Bank to process transactions for PokerStars and Full Tilt Poker. Developments in the multi-faceted investigation led the FBI to SunFirst Bank. SunFirst Bank was a small community bank located in St. George, Utah.

The most important player in this aspect of the case is Cathy Scharf. Cathy was the BSA and Bank Compliance Officer at SunFirst Bank. Her commitment to her compliance responsibilities is a demonstration of "courage in compliance."

Cathy Scharf is a Certified Anti-Money Laundering Specialist. She has over 25 years of experience in the financial services industry. Cathy joined SunFirst Bank as the BSA and Bank Compliance Officer in 2010. She served in that position until 2011, after the bank was closed by state regulators. Cathy tried repeatedly to take action against illegal internet account holders at the bank. She wanted to exit those relationships and file SARs. She was continuously rebuffed by bank officials, including John Campos, Vice Chairman of the Board of Directors and part owner. This experience took a personal and emotional toll on Cathy.

Law enforcement conducted a long-term investigation. It was initiated based on wiretaps conducted by the Rockland County, New York Sheriff's Office. The case was referred to the Federal Bureau of Investigation (FBI) based on organized crime implications. The FBI was assisted by Homeland Security Investigations (HSI) and the New York High Intensity Financial Crimes Area (HIFCA) task force. The investigation started as an organized crime case that evolved into an investigation of money going into illegal internet gambling. The government dedicated considerable time and resources to this investigation. The investigation involved three waves of indictments, the first focused on organized crime; the second on payment processors; and the third on poker companies. SunFirst Bank was one of about 12 banks involved in the payment process.

Law enforcement sources described SunFirst Bank's processing activity as blatantly unreasonable considering its size. The poker companies, through third party processors, were able to exploit the fact that SunFirst Bank was undercapitalized and required an infusion of funds. Law enforcement sources advised that this was a multi-dimensional long-term investigation that led to many subjects. Over the course of time, they required considerable information from U.S. banks. Law enforcement sources noted that they received outstanding cooperation from the U.S. banks they dealt with.

## The Unlawful Internet Gambling Enforcement Act (UIGEA)

In 2010, global revenue for online gambling was estimated to be nearly \$30 billion. As of June 30, 2010, one survey found 2,679 internet gambling sites owned by 665 companies. These sites included, online casinos, online poker rooms, sports betting sites, lottery and other sites. Between 2000 and 2010, an estimated 10 million Americans gambled on internet websites. From 2003 to 2010, Americans spent approximately \$30 billion to gamble online. The continued growth in online gambling was a major cause for concern in some political circles and resulted in the passage of legislation in the United States (U.S.) prohibiting payment to online sites. It should be noted there were also political interests opposed to the legislation because they believed it helped the economy.

The Unlawful Internet Gambling Enforcement Act (UIGEA) was signed into law by President George W. Bush on October 13, 2006. Because of the opposition to the legislation, it was added to unrelated legislation to avoid floor debate in Congress. According to an article written in the Economist on April 23, 2011, UIGEA was “hastily tacked onto unrelated legislation”. None the less, UIGEA is the law.

The Safe Port Act was passed by the U.S. Senate on September 14, 2006. The Act focused on port security. It came about in light of the controversy about a foreign company acquiring a U.S. port. UIGEA was added to the Safe Port Act on September 30, 2006. Its focus was on internet gambling. Final regulations regarding the Safe Port Act, including the UIGEA provisions, were released on November 12, 2008. The law came into effect on January 19, 2009. Compliance was not required until December 1, 2009.

UIGEA prohibits the transfer of funds from financial institutions to internet gambling sites. It excluded fantasy sports, horse and harness racing, and online lotteries. There is much confusion surrounding UIGEA. It does not prohibit online gambling. This has been a defense used by subjects in this investigation to justify their online poker activities. As noted above, UIGEA prohibits the transfer of funds from financial institutions to internet gambling sites. As mentioned earlier, there is considerable opposition to UIGEA.

## Facilitation Tools

There were a number of facilitation tools used by third party processors to hide the fact they were processing transactions on behalf of poker companies. Such facilitation tools included:

### *Shell and Shelf Companies*

Shell and shelf companies were used as mechanisms to create phony non-gambling companies which banks would accept as customers. Shell companies are non-publically traded corporations, limited liability companies (LLCs), and trusts that typically have no physical presence. Shelf companies are a form of shell company that have been put on the shelf and aged to create an appearance of corporate longevity.



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Shell and shelf companies are mechanisms bad guys use, as they did in this case, to provide anonymity and hide beneficial ownership.

### ***Third Party Processors***

Third party processors were behind the use of hundreds of shell and shelf companies as bank customers processing illegal internet gambling transactions in this matter. Third party processors are bank customers that provide payment processing services to merchants and other business entities. In this instance, the processors used shell companies to shield the involvement of the poker companies.

### ***Nominees***

Nominees were used to deceive banks regarding the ownership of shell companies in this case. In addition, they were used to hide assets for certain processors. The use of nominees was a further layer of insulation to conceal beneficial ownership.

### ***Banks***

Banks were used wittingly or unwittingly to facilitate illegal transactions. Through third party processors, three online poker companies used about a dozen banks to facilitate their illegal activities. Most banks were unwitting participants. When they identified illicit activity, they closed accounts and exited relationships. In order to find witting participants, processors identified small banks that were undercapitalized. They promised to invest millions of dollars in addition to infusing millions of dollars in transactions if the banks agreed to process for the poker companies.

## **Countermeasures**

In assessing the facilitation tools used by the third-party processors in this matter, there is one common theme: anonymity. Anonymity protects beneficial ownership. Beneficial ownership in this case represents a significant vulnerability. As with the use of nominees, it is not the owner in name, it's who holds beneficial control of the assets. Identification of beneficial ownership requires customer due diligence and, in some instances, enhanced due diligence.

To peel the layers of beneficial ownership, a good know your customer program requires a sound process, verification and documentation. This should help in identifying and addressing customer risk. Assessing customer risk requires recognition, mitigation, understanding adaptability and maintaining a living process to identify risk. Through this entire process, you should continuously assess the reasonableness of business activity and consider taking enhanced due diligence steps.

## **Crime Problem**

In order to address the crime problem, you must recognize and understanding the landscape. This requires knowledge of the elements of the criminal activity and what level of evidence is required to prove a case or demonstrate suspicious activity. Vigilance for related suspicious or criminal activity is important. In this case, law enforcement was vigilant and identified a variety of activities that led them to focus on third party processors. From an institutional perspective, it is important to be knowledgeable of institutional policies and procedures. It is equally important to understand the tone at the top. Is executive management compliance friendly? In the case of SunFirst Bank, the answer was a resounding no.

The importance of planning and preparation cannot be understated. Law enforcement conducted a long-term investigation. The success of this investigation is a tribute to meticulous planning and preparation. Good planning should include addressing potential contingencies and being aware of consequences. In this case, Cathy Scharf understood and was undeterred by potential consequences. She stayed the course and did the right thing.

The criminal activity that occurred in this matter included:

- Unlawful internet gambling
- Operation of an illegal gambling business
- Bank fraud
- Wire fraud
- Money laundering

## Scheme to Defraud

The scheme evolved based on the fact that banks were largely unwilling to process payments for illegal activity such as internet gambling. PokerStars, Full Tilt Poker and Absolute Poker used fraudulent methods to avoid restrictions and receive billions of dollars from U.S. residents. Money received from U.S. gamblers was disguised as payments to hundreds of non-existent online merchants and other non-gambling businesses. The poker companies relied on highly compensated third-party processors through the creation of phony companies and websites used to disguise payments to the poker companies. Poker companies and third-party processors conspired together to deceive banks.

Knowing that banks were not permitted to process payments related to internet gambling, third party processors established mechanisms to circumvent the law. They operated through deceptive means designed to trick U.S. banks into processing gambling transactions on behalf of internet poker companies. Some of the mechanisms they used included:

- Fraudulent credit card processing, wherein the processors falsified transaction codes
- Use of pre-paid credit cards that were loaded with funds from credit cards
- Fraudulent e-check processing (ACH) wherein transactions would appear to be non-gambling transactions through the creation of phony companies and websites

When the poker companies lost substantial money because e-check processing was frozen by and forfeited to law enforcement, the poker companies wanted processors to find “transparent” processing. This meant that the poker companies wanted the processors to find banks who knew they were processing online gambling proceeds and who were willing to facilitate this activity, although it was illegal. Processors found a few banks like SunFirst Bank who were facing serious financial difficulties and as a result agreed to accept the online gambling transactions. They referred to this as “transparent” processing.

The link between the online poker companies and SunFirst Bank began with Chad Elie. Chad was a third party processor, who processed transactions for PokerStars, Full Tilt Poker and Absolute Poker. He needed a bank he could work with as a transparent processor. Enter Jeremy Johnson. Jeremy was an alleged telemarketing fraudster, who is still under investigation by the Federal Trade Commission (FTC). He met Chad Elie at an online marketing symposium in Las Vegas. Chad and Jeremy formed a processing company together, Elite Debit. Jeremy had a bank, SunFirst Bank. Employees of the bank used to joke that SunFirst Bank was “the bank of Jeremy Johnson”. SunFirst Bank was experiencing financial difficulties and they enlisted Johnson to be an investor and part owner. Jeremy introduced Chad Elie to John Campos, Vice Chairman and part owner of SunFirst Bank. Elie promised to invest \$10 million in the bank and to bring in

millions of dollars through processing transactions for the online poker companies. Campos agreed with “trepidations” about the gambling processing.

SunFirst Bank was a beneficiary of the real estate boom in 2006 and subsequently a victim of the subprime mortgage crisis in 2008. The bank found itself seriously undercapitalized. In October 2009, the Federal Deposit Insurance Corporation (FDIC) ordered SunFirst Bank to increase its capital reserves by at least 11%. In December 2009, following investments in the bank made by Johnson and Elie, the bank began processing internet poker transactions. SunFirst Bank processed more than \$200 million in payments from PokerStars and Full Tilt Poker from December 2009 to November 2010. Elie and Johnson paid John Campos what Campos described as a “bonus” of \$20,000. The indictment handed down in this case described the payment to Campos as a “bribe”. State regulators shut down SunFirst Bank on November 4, 2011.

April 15, 2011 was referred to as the poker world’s “Black Friday”. On that date, the U.S. Government seized the domains of the three largest online poker sites servicing the U.S. market, PokerStars, Full Tilt Poker and Absolute Poker. A number on indictments were handed down to founding members and executives responsible for the three online poker companies. John Campos and Chad Elie were also indicted. They were subsequently convicted for their roles in using SunFirst bank to facilitate the processing of illegal gambling activity. Jeremy Johnson was not charged in this case. However, he was indicted as a result of the ongoing FTC case, involving his company I Works, in what has been described by the FTC as one of the largest and most intricate online marketing frauds ever perpetrated in the U.S.

## Lessons Learned

From the time she was hired as the BSA and Bank Compliance Officer, in the summer of 2010 until after SunFirst bank was shut down in November 2011, Cathy Scharf dealt with the illegal processing of online poker transactions as the bank’s Compliance Officer. By her own account, she was in the wrong place at the right time. Cathy repeatedly told the bank president and other executives that they had to exit customer relationships and file SARs. The president and other executives regularly made misrepresentations about addressing compliance issues. They continued to conduct business as usual. This clearly demonstrated that the tone at the top was poor and not compliance oriented. To Cathy’s credit, she remained undeterred and tried to perform her compliance duties and do the right thing. As the case unfolded, Cathy cooperated with authorities, despite attempts made to intimidate her by lawyers representing the bank. Another impediment Cathy dealt with was being an outsider. SunFirst Bank was located in St. Georges, Utah. It was an established community. Most people were members of the Mormon religion and were cliquish. Cathy is not a Mormon. She was new to the area and the bank. She remained an outsider. This was an extremely stressful period for Cathy.

This case study demonstrates the importance of the BSA Compliance Officer and the compliance function. Compliance professionals are truly on the front line in the fight against fraud and money laundering. One of the strongest lessons learned was that if the tone at the top in an organization does not support a culture of compliance, the compliance function is in serious trouble. Doing the right thing can be challenging under good circumstances. Doing the right thing under bad circumstances can be a nightmare, as Cathy experienced. In the end, no matter how difficult, doing the right thing is always the proper course of action to take.

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