

# ENFORCEMENT AND FIRM VULNERABILITIES

## Eradicating human slavery: the impact on financial services of fulfilling growing regulatory expectations

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Human trafficking is slavery, the trade in human beings. It involves recruiting, transporting, harboring or receiving human beings, by the use of force, threats of force, fraud, or other forms of coercion, including the abuse of power or a position of vulnerability.<sup>5</sup>

Human beings are trafficked for purposes of sexual exploitation, forced labor, or even for the removal of organs. Apart from the drug trade, human trafficking represents the world's fastest growing, and second most profitable, criminal enterprise.<sup>6</sup> For good reason, human trafficking receives growing law enforcement and regulatory attention. We expect the trend to continue in 2015. In particular, two sectors should expect higher levels of regulatory scrutiny with respect to the issue: financial institutions and federal contractors that maintain labor-intensive supply chains.

### Financial institutions

In September 2014, the US Department of the Treasury Financial Crimes Enforcement Network (FinCEN) issued guidance designed to help financial institutions identify and report financial transactions

involving human trafficking activity.<sup>7</sup> FinCEN's guidance signals clearly that financial institutions need to understand human trafficking-specific typologies, evaluate their exposure to relevant activity in their AML risk assessments and tailor their AML monitoring systems to identify and report it. Simply stated, in 2015, financial institutions should expect regulators to ask them what they are doing about human trafficking.

Many financial institutions will be able to provide regulators exemplary answers. In recent years, many financial institutions have grappled with human trafficking, and dedicated substantial AML compliance resources to identify human trafficking-related transactions. Examples of successfully developed human trafficking-related AML typologies include low-dollar, high-volume transfers for the

benefit of internet classified advertising agencies promoting adult services, and late night, after-closing-hours high-dollar credit card transactions at nail salons (both typologies present high risk that trafficked individuals are being sexually exploited). Learning the tell-tale signs of human trafficking transactions empowers AML investigators both to protect their institutions and to provide law enforcement real, actionable intelligence.

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<sup>5</sup> Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children, supplementing the United Nations Convention against Transnational Organized Crime, Dec. 25, 2003, art. 3, T.I.A.S. No. 29574, 2237 U.N.T.S. 319, available at [http://www.uncjin.org/Documents/Conventions/dcatoc/final\\_documents\\_2/convention\\_%20traff\\_eng.pdf](http://www.uncjin.org/Documents/Conventions/dcatoc/final_documents_2/convention_%20traff_eng.pdf) (last viewed Sept. 30, 2014).

<sup>6</sup> See, e.g., “End Trafficking,” Unicef, available at <http://www.unicefusa.org/sites/default/files/assets/pdf/End-Child-Trafficking-One-Page.pdf> (last viewed Sept. 30, 2014); “Human Trafficking,” State of California Department of Justice, Office of the Attorney General, available at <http://oag.ca.gov/human-trafficking> (last viewed Sept. 30, 2014).

<sup>7</sup> “Guidance on Recognizing Activity that May be Associated with Human Smuggling and Human Trafficking – Financial Red Flags,” Advisory, FinCEN, Sept. 11, 2014, FIN-2014-A008, available at [http://www.fincen.gov/statutes\\_regs/guidance/pdf/FIN-2014-A008.pdf](http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2014-A008.pdf) (last viewed Sept. 30, 2014).

## Federal contractors

Federal contractors with long, labor-intensive supply chains should also expect heightened regulatory scrutiny in 2015. Since 2006, federal contractors have faced an increasingly complex array of human trafficking compliance-related requirements.<sup>8</sup>

Proposed US regulations require federal contractors to focus on well-known indicia or “red flags” of trafficked labor such as unfair recruitment practices, low wages and poor living conditions, and to report such activity if it is detected. These rules, expected to become final later this year, would also require certain government contractors to develop and implement an anti-human trafficking compliance plan and annually certify that their agents and subcontracts are not engaged in human trafficking.<sup>9</sup> In addition, California is the first state to require certain retailers and manufacturers doing business in the state to publicly disclose steps taken to eliminate human trafficking in supply chains.<sup>10</sup>

Financial institutions monitoring transactions for indicia of human trafficking-related activity should be aware of these regulatory expectations for federal contractors, as they may inform their human trafficking-focused AML efforts, including with respect to on-boarding new customers and enhancing potential transaction-related inquiries to existing clients. Below, we describe these expectations.

Similar to the construction of a financial institution’s AML compliance program, the basic elements of a regulatory sufficient human trafficking compliance plan will require US government contractors to:

1. Create anti-human trafficking policies and procedures to detect, deter and report human trafficking-related activity
2. Develop training programs
3. Provide for responsible internal program oversight
4. Allow for third-party testing and review

For federal contractors, a well-executed risk assessment is essential to informing the design and implementation of an effective anti-human trafficking compliance program. Following completion of a risk assessment, companies should develop and implement, or be prepared to enhance, relevant controls to prevent and detect human trafficking-related activity. This includes appointing someone to be responsible for the overall compliance program. Common controls include conducting and documenting due diligence, inserting representations and warranties into contracts, developing and executing a training program and creating protocols allowing individuals to report confidentially allegations of human trafficking. These controls should be tested periodically by an independent third party.

In addition, financial institutions that know about these increased regulatory expectations may be better positioned to identify human trafficking-related risk presented by their customers’ transactions and to pose inquiries to their clients about questionable activity. We discuss each of these compliance expectations in turn overleaf.

Some of the red flags discussed are also useful in considering the development of human trafficking-related AML typologies.

### *Due diligence*

Adequate and effective due diligence helps identify third-party risk, i.e., the risk that someone the company hires to perform services will utilize trafficked labor. Key elements of third-party due diligence include:

- Examining the third party’s corporate structure
- Ensuring qualifications for the proposed engagement
- Considering business reputation
- Assessing involvement in industries or sectors high risk for human trafficking (e.g. restaurants, hotels, nail salons, factories, farming and agriculture)
- Understanding the business rationale for engaging the third party, including whether the cost of the contract reflects market and industry practice

<sup>8</sup> See, e.g., Exec. Order No. 13627 (Sept. 25, 2012), available at <http://www.gpo.gov/fdsys/pkg/DCPD-201200750/pdf/DCPD-201200750.pdf> (last viewed Sept. 30, 2014); National Defense Authorization Act for Fiscal Year 2013, Pub. L. No. 112-239, §§ 1701-08, 126 Stat. 1632, 2092-98 (2012).

<sup>9</sup> Federal Acquisition Regulation; Ending Trafficking in Persons, 78 Fed. Reg. 59317, 59317 (to be codified at 48 C.F.R. pts. 1, 2, 9, 12, 22 and 52).

<sup>10</sup> California Transparency in Supply Chains Act of 2010, CAL. CIV. CODE § 1714, 43 (2010).

Common red flags include a third party's assertion that it will complete work in an unreasonably short period of time or below market rates, that it implements workplace practices that impede worker freedom (e.g. passport retention), or that it maintains poor living conditions for its workers. For third parties posing higher human trafficking risk, periodic monitoring protocols could be employed. These protocols might include updating due diligence more frequently, performing on-site visits, exercising audit rights, providing periodic training to the third party and requesting annual certifications that the third party does not use trafficked labor.

### Contractual representations and warranties

Contractual representations are often used to control risk. Anti-human-trafficking contractual provisions may include:

- Representations and undertakings that the third party will comply with human trafficking laws
- Access to audit the counterparty's books and records
- Indemnity provisions if the third party violates human trafficking laws
- Rights to terminate the engagement for violations of human trafficking laws

### Confidential reporting and internal investigations

Effective human trafficking compliance programs should include procedures that allow individuals to report allegations of trafficking confidentially, without fear of retaliation. Employee training on hotline reporting procedures should reference the importance of reporting human trafficking concerns, and the individuals operating the hotline should receive training on how to handle such calls.

### Training program

Training is vital to communicating the policies and procedures employees are expected to know and follow. Who receives training, how often it is provided and the method in which it is provided (e.g. online module, in-person, etc.) will be driven by the risk assessment results. The highest-risk employee populations should receive more in-depth training. Training sessions should also be well-documented, reflecting the attendees, date of training, length of training, training method and the list of materials provided at the training session.

### Independent testing

Testing ensures that a compliance program exists not just on paper, but that its policies and procedures have been integrated into the company's operations and culture in both principle and substance. A company's general audit group may perform this testing function; however, to demonstrate a robust compliance program to regulators, it is beneficial to have an independent, external group conduct the testing.

### Conclusion

In 2015, we expect regulatory pressure related to human trafficking to increase. As the law governing human trafficking-specific compliance evolves, there will be increased pressure placed on companies to develop compliance programs that identify and report human trafficking in supply chains. Per the recently-issued FinCEN guidance, financial institutions have a key role to play in monitoring transactions and data as part of their regulatory duty to report suspected illegal activity. Understanding the increased scope of the regulatory expectations placed on their customers should help financial institutions fulfill this role.



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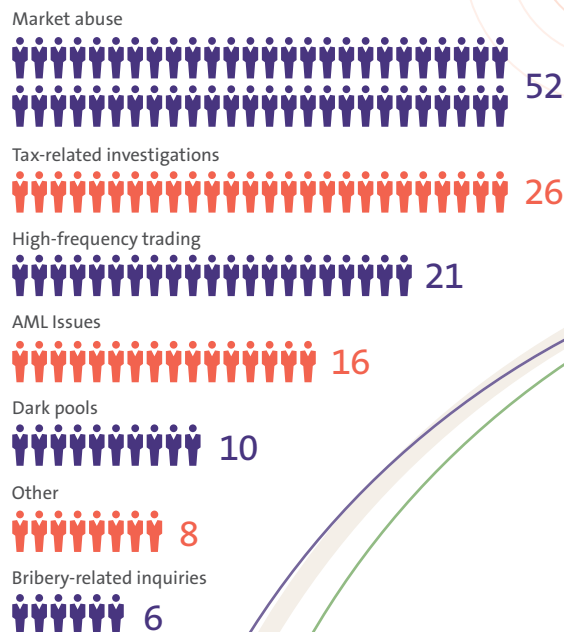
## COMMENT

“Regardless of size, almost all financial institutions are subject to multiple regulators and making sense of the differing requirements is quite overwhelming and has led to a significant increase in costs. Greater co-ordination between national regulators can help ease this burden.”

**FIGURE B - Key focus areas for regulators**

IN WHICH AREA DO YOU EXPECT REGULATORS TO FOCUS MOST IN THE COMING YEAR?\*

Number of C-Suite Respondents\*\*



\*All figures taken from our GRO 2015 survey

\*\* Note: respondents could select more than one option if applicable