Too Complex to Succeed: Citibank Incorrect Wires Out $900MM

How could one of the world's biggest and best run financial institutions have such a catastrophic failure of financial controls which led it making a payment error which saw Citibank incorrectly wire out $900 million. Citibank recovered approximately $400 million of the incorrect payments but lost a court case for the remaining $500 million. It is 2020's example of legacy accounting and payment systems, the over-complexity of business processes, failures in training, oversight and controls. In other words, it is a prime example that every compliance professional needs to study to help stop catastrophic failure of a multi-national compliance program.

I. Legal Issues

The basic facts of the matter and legal question answered by the Court are found in the Court decision, available here. At its most basic, the case was summarized by the Court as follows, "On August 11, 2020, Citibank N.A. ("Citibank"), acting in its capacity as Administrative Agent for a syndicated term loan taken out by Revlon, Inc. ("Revlon"), intended to wire approximately $7.8 million in interest payments to Revlon's lenders. Instead, it made one of the biggest blunders in banking history: It mistakenly wired, in addition to Revlon's $7.8 million, almost $900 million of its own money as well. The resulting payments equaled — to the penny — the amounts of principal and interest that Revlon owed on the loan to its lenders. The question in this case is whether Citibank is entitled to get the money back or whether the lenders are allowed to keep it."

For any lawyer, this case is simply too delicious. It involves the ancient legal principal, *finders keeper*s. I would initially note, with a nod to my Section 3 colleagues, the legal principal of *finders keeper*s is the antithesis of *Pierson v. Post and the rule of capture.* Moreover, this is not a 'fat finders' error, where some lowly clerk incorrectly typed in a payment amount. It was a full system, process and set of human errors.

From the legal perspective what this matter does embody is the rather arcane legal principial, found in Restatement of Torts (1937), the *discharge for value defense* which holds

> A creditor of another or one having a lien on another's property who has received from a third person any benefit in discharge of the debt or lien, is under no duty to make restitution therefor, although the discharge was given by mistake of the transferor as to his interests or duties, if the transferee made no misrepresentation and did not have notice of the transferor's mistake.

When you can cite back to any Restatement from 1937, you know you are in very good stead. This is the *finders keepers* legal principal. Indeed, there were New York courts which have interpreted this carve out to the rule around mistakes in payments. In the 1989 decision *Banque Worms*, 928 F.2d at 539, Security Pacific mistakenly wired $1,974,267.97 to BankAmerica for the account of Banque Worms. When a debt is due and owing, then fully paid by the creditor or its

agent to a party or even third-party, through no actions of that third-party, the finder gets to keep the money, even if it was sent in error.

II. The Facts

As noted, Citibank is the Administrative Agent for a syndicated term loan taken out by Revlon. The creditors held several different types of notes, with different due dates, repayment amounts and interest payments under multiple filings in the bankruptcy of Revlon. Revlon wanted to reorganize bring them into some uniformity in payments. Some of these creditors agreed to this and others refused and went so far as to issue notices of default. Note some of the creditors agreed to the new payment schedule while others did not. Citibank's role at this point in the sage was to send out interest payments to those creditors who agreed to the new repayment schedule.

This is where the problem began. Citibank had no mechanism, system or software product which could take multiple creditors and pay only a certain number of them who agreed to the new payout schedule. Citibank's Asset-Based Transitional Finance ("ABTF") team, a subgroup of Citibank's Loan Operations group, was charged with effecting the transaction. To make the payment, Citibank had to create a new account in its software which said to pay ALL creditors the FULL amount they were due. At that point the software Citibank used for wire transfers, Flexcube, comes into play. The Citibank team charged with making the payments happen created what was called a "Wash Account" into which all monies owed by Revlon was placed. The interest payments were to go out of this account but not the principal payments.

To affect the transfer the below screen had to be accurately completed. As the court opinion noted, "The Fund Sighting Manual explains that, in order to suppress payment of a principal amount, "ALL of the below field[s] must be set to the wash account: FRONT[;] FUND[; and] PRINCIPAL" — meaning that the employee had to check all three of those boxes and input the wash account number into the relevant fields." However, for reasons never made clear, the three Citibank employees in charge of the transaction "all believed — incorrectly — that the principal could be properly suppressed solely by setting the "PRINCIPAL"".

BDLL | Borrower LIBOR Drawdown Prod | Drawdown
001BDLL201480094 | 001BDLL201480094
024462 | REVLON CONSUMER PRODUCTS CORP
Facility Name | REVLON TERM LOAN 2016

GL Detail

Component	Internal GL	Overwrite default settlement instruction
COLLAT		☐
COMPINTSF		☐
DEFAUL		☐
DFLFTC		☐
FRONT		☐
FUND		☐
INTEREST		☐
PRINCIPAL	3003000023	☑
		☐

As a control, Citibank had a process called "six-eye". The Court stated, "The transaction was also subject to Citibank's "six-eye" approval procedure, which requires three people to review and approve a transaction before it is executed. Under this procedure, (1) the "maker" — in this case, Ravi — first inputs the payment information into Flexcube; (2) the "checker" — here, Raj — then reviews and verifies the transaction; and finally (3) the "approver" — here, Vincent Fratta, a Citibank senior manager based in Delaware — serves as a final check on the maker and checker's work. It was approved and the money was sent out."

III. Compliance Lessons

This is as delicious a legal opinion as I have seen in some time. In addition to stating the age-old adage of *finders keepers* in modern day legal parlance, there were numerous compliance angles to the case which bear consideration. For a more verbal take on the case, listen to Matt Kelly and myself on this week's Compliance into the Weeds.

a. Complexity

It took the court almost 30 pages just to go through the background facts. That alone tells you how complex the matter was to describe. Citibank, like most multinationals is a company built through acquisitions and therefore has multiple legacy ERP systems. At issue was the bank's software system Flexcube, a software application and loan product processing program that the bank uses for initiating and executing wire payments. The only way to execute the transaction "was to enter it in the system as if paying off the loan in its entirety, thereby triggering accrued

interest payments to all Lenders, but to direct the principal portion of the payment to a "wash account" — "an internal Citibank account that shows journal entries . . . used for certain Flexcube transactions to account for internal cashless fund entries and . . . to help ensure that money does not leave the bank.""

For this transaction to go through an exception to the standard controls was required. The Order noted that according to the Flexcube software training materials, in order to make this type of wire transfer, three separate boxes approving the exception had to be checked. The Order revealed that only one box was checked by all persons involved in the transaction, including "the maker, the checker and the approver" or the Citibank's 'six-eyes' principal in action.

Compliance Lesson - *To paraphrase Andre Agassi, if something appears too complex, it is too complex.*

b. Training

Another key question is regarding training. The Order made clear that it was not a software documentation or training manual issue, stating, "Notwithstanding these instructions, Ravi, Raj, and Fratta all" incorrectly executed the instructions. What the Court did not address was the training issue at all. Had they been incorrectly trained? Did they receive any training for anomalous wire transfers like the one involved herein? If they received training it obviously was not effective as "the maker, the checker and the approver" all believed they only had to click one box instead of three to affect the transaction correctly.

Many non-compliance functionaries view compliance training as a *click the box* exercise at best. They will spend the absolute minimum when it comes to training. Yet this misses not only the importance of training but also the power that *effective* compliance training can bring to bear for an organization. This is just one of the reasons the Department of Justice (DOJ) has increasingly insisted on both *effective* and *targeted* training. Imagine if the Citibank's Loan Operations subgroup, the Asset-Based Transitional Finance (ABTF), that is focused on processing and servicing of asset-based loans and charged with handling this type of transaction, had received targeted training and was then tested at some interval to see if the training had been effective? Perhaps this type of action would have moved the action from simply a detect mode to an actual prevent mode.

Compliance Lesson - *Training must be both targeted and effective. Targeted training comes from assessing the risk of who needs specific gatekeeper training (i.e., a maker, a checker and an approver). Effective training involves post-training assessment of the training presented to the employee.*

c. Internal Controls

This issue is ripe for exploration in this matter. Obviously the 'six-eyes' principal is an internal control. Yet this control failed. Was it due to non-existent or ineffective training? The court

decision made clear that the software documentation was correct. Although somewhat less clear in the decision, it appears that the ABTF had executed the same or similar transactions previously without the error. What happened to the control environment?

When you have an exception to a standard control, you need some type of compensating control as a backup. Anytime you have a non-standard transaction, that is where the risk occurs. You can require additional approvals up the line so that maybe eight or 10 eyes are put on a transaction. You could have a control which affirmatively states you have reviewed the software documentation. This really is a transactional control for a very rare event. I think this is something you can easily build this type of control into your control environment.

Kelly advocated a more macro approach with a process level control for such now-standard events. However, the beauty of Matt's approach is that it provides a compensating control for both standard and non-standard transactions. That control could consist of Citibank sending out advanced notice to the recipients of wire transferred funds. This type of information was readily available to the bank as it was generated when the transaction was being created. This notice would give the amount of the transaction and if the recipient received a different amount it would put the receiver on notice of both the correct amount and if an incorrect amount was inadvertently paid, the receiver would be on notice to contact Citibank to arrange return of the funds.

Compliance Lesson - *Here I quote to the Coolest Guy in Compliance, Matt Kelly, who succinctly stated in our Compliance into the Weeds podcast, "But because it did not have the process level controls above that to help steer all transactions the right way, they wound up with a mess on their hands. And here we are."*

IV. Black Swan Events

To conclude, I want to consider whether the matter was so unusual as to qualify as a *Black Swan* event and what that might mean in a court of law and in the court of public opinion. First, with a tip of the hat to the Ex-Pats and Section 3; let us explore the reason this case is influenced by a long-ago case involving the rule of capture; *Pierson v. Post,* decided in 1805. Post was on the trail of a fox. As he neared killing it, one Pierson came upon the scene and did so, taking the fox as his capture. Post sued claiming he held the right to the fox under the right of pursuit and won at the trial court. The decision was reversed by the appeals court, which found giving chase was not enough. The Court stated, "If the first seeing, starting, or pursuing such animals, without having so wounded, circumvented or ensnared the animal, so as to deprive them of their natural liberty, and subject them to the control of their pursuer, should afford the basis of actions against others for intercepting and killing them, it would prove a fertile course of quarrels and litigation."

The way *Pierson v. Post* influences the Citibank case is its grounding in public policy reasons for the decision. That policy was that mere pursuit alone, was not enough to invoke capture. A hunter had to slay the quarry. Only through the finality of slaying would you have one clear determinant of ownership. Otherwise, there could be numerous claimants alleging chase alone is enough to

convey property rights. Finally, and as I noted those many years ago, I still object to the description of the fox as a "wild and noxious beast".

a. Black Swan or Foreseeable Event

Citibank tried to argue the erroneous payment of $900 million to the creditors of Revlon was a *Black Swan* event. The court stated, "In other words, the mistake here was the proverbial "Black Swan" event. See generally NASSIM NICHOLAS TALEB, THE BLACK SWAN: THE IMPACT OF THE HIGHLY IMPROBABLE (2007)." The Black Swan event was not that a mistake happened but one of the size of the payment which erroneously went out the door, nearly $1 billion.

The problem with this characterization is that the basic issue, wiring monies out of the bank, in the manner prescribed by the specific facts of this transaction were known within Citibank. Initially, the Court stated, "On Flexcube, the easiest (or perhaps only) way to execute the transaction". Clearly this type of transaction was anticipated because the software could handle it. Next, the Flexcube software had specific instructions (Documentation) on how to handle the transaction. The Court opinion stated, "The Fund Sighting Manual [Documentation] explains that, in order to suppress payment of a principal amount, "ALL of the below field[s] must be set to the wash account: FRONT[;] FUND[; and] PRINCIPAL" — meaning that the employee had to check all three of those boxes and input the wash account number into the relevant fields." Apparently either the software manufacturer had anticipated this type of transaction or it could have been Citibank employees themselves who created the Documentation. The Court opinion is silent upon that question. But whichever it is, the same conclusion can be drawn, the event was foreseeable.

Citibank tried to argue that the unforced error was so large, that alone qualified it as a *Black Swan* event. Here the Court opinion stated, "Citibank's own witnesses could not identify a single instance in which the bank — or, indeed, any bank — had made an error of similar magnitude. "[Q:] Can you recall any instance in your 15-year career . . . in which Citibank made a mistake in transferring more than $50 million? [A:] I don't recall."; "[Q:] [I]n your 22 years in the industry, you are not aware of an error of this size having occurred anywhere, whether within Citibank or any other bank? [A:] Correct."). [citations omitted]

Yet it was this seeming logic which fed upon itself, dooming Citibank and favoring the creditors. Here the Court stated, "Given a choice between assuming that Revlon had paid off the 2016 Term Loan early — as borrowers sometimes do and assuming that Citibank or Revlon had mistakenly transferred over $900 million — something no bank may have ever done before (and may never do again) — it would have been borderline irrational to choose the latter. "It seemed far more likely to me that Citibank had made the August 11th payments on purpose but without a contemporaneous notice, than that Citibank had accidentally transferred hundreds of millions of dollars to multiple lenders in the exact amounts they were owed.". [citations omitted]

The Court thus concluded, "the Lenders' inference was rationally and reasonably based on the fact the Calculation Statements, sent shortly before the payments, characterized the interest

payments as “due” — in each case, no fewer than six times, in fact. Put another way, it was not reasonable for the creditors receiving the money to conclude a mistake had been made. “Considering this fact together with the other reasons recipients of the August 11th wire transfers would have reasonably thought the payments were intentional — the fact that they equaled to the penny the amount of principal and interest outstanding and the fact that no bank had ever made a mistake of a similar nature or magnitude — it would have been downright irrational to conclude that a mistake had occurred.”

This entire argument around *Black Swan* events seems to me to be almost a red herring. Citibank did handle transactions of this type and had done so in the past. The only question was how costly the mistake could be for the bank. There were software instructions in the form of documentation which clearly instructed Citibank employees (or those outsourced workers) handling the Citibank account on the precise steps to take. Was this documentation consulted? Was there effective training? Those questions were not addressed by the Court.

In other words, it was foreseeable that a mistake could occur. That also means it was foreseeable to have an internal control in place around this issue. Whether you want to go with a Tom Fox style transaction control or a Matt Kelly style process control; either one would have provided yet more oversight to ensure the event did not occur. For the compliance professional or anyone in charge of a risk register, the matter presents an awful lesson on what can happen when the worst happens.

How does all this tie into *Pierson v. Post?* Both cases relate to the need for certainty in the law. The *discharge for value* exception is based upon a public policy formulation. Obviously there needs to be a way to unwind transactions which are in error. Yet, equally importantly, any debtor who receives not only the full payment but exact down to the penny payment should be able to rely on that payment. It should not be the burden of every discharged creditor to check and see if a final payment was intentionally and correctly sent. That burden should be on the person or entity making the payment.

I would urge readers, especially lawyers, to read the entire opinion which details the actions and decisions made after the payment which influenced the Court’s approval of the *discharge for value* doctrine in this case. Finally, as to the question of whether Revlon who any monies back to Citibank for the error. The Court did not have that question before it and did not decide it.