Securities Broker-Dealers: USA Patriot Act Imposes New Obligation Under Money Laundering Laws

TO: Clients and Friends of Sutherland Asbill & Brennan LLP

The USA PATRIOT Act, signed into law on October 26, 2001 imposes new obligations on securities broker-dealers under the anti-money laundering statutes and the Bank Secrecy Act. It also requires quick action by regulators to propose new broker-dealer regulations by year-end concerning anti-money laundering efforts. These new requirements are in addition to existing requirements of the law which already apply to broker-dealers.

The enclosed paper provides a practical overview of both the existing and new obligations of broker-dealers under the money laundering statutes and rules.

Please contact us if you have any questions or if we can assist you in any way.

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Enclosure
Securities Broker-Dealers and
Money Laundering:
The Obligations of Broker-Dealers
Under Money Laundering Laws

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Money laundering has been a “hot issue” for securities regulators for some time, and it just got even hotter. On October 26, 2001, President Bush signed into law the USA PATRIOT Act\(^1\) (the “Act”) which includes new anti-terrorist and anti-money laundering initiatives, including significant new requirements for securities broker-dealers. Within six months, all financial institutions, including broker-dealers, must establish anti-money laundering compliance programs meeting certain minimum standards. In addition, by year-end, the Treasury Department, working with the SEC, must propose new regulations that will require all broker-dealers to file “Suspicious Activities Reports”.

But these provisions are not entirely new – they merely supplement existing money laundering laws, rules and regulations that already impose significant obligations on broker-dealers. In May 2001, the SEC announced that anti-money laundering compliance is “on the radar screen” and would be the subject of joint “sweep” examinations, which are currently underway. In the wake of September 11, 2001 and with passage of the Act, money laundering compliance has become one of the highest priorities for the SEC and other regulators, and should be for broker-dealers as well. This paper provides an overview of the existing laws, the new requirements, and how they apply to broker-dealers; the consequences of failure to comply; and practical suggestions for anti-money laundering compliance programs.

What is Money Laundering?

Money Laundering may be defined generally, in layman’s terms, as engaging in financial transactions that involve income derived from criminal activity. The money laundering law applies to laundered income derived not only from narcotics offenses and drug trafficking, but from a wide array of crimes, such as securities fraud, bank fraud,
wire fraud, mail fraud, copyright infringement, gambling, terrorism, and even water pollution. The law covers nearly every imaginable financial transaction.

Money is laundered in three stages. “Placement” occurs when cash generated from illegal activities is introduced into the financial system. In the “layering” stage, these funds are transferred or moved to other accounts to further obscure their origin. In the “integration” stage, the funds are reintroduced into the economy in a way that makes them appear legitimate. Many believe that broker-dealers are most at risk of being used for money laundering during the “layering” and “integration” stages of money laundering. Of course, broker-dealers should also beware of placement of laundered money.

How much money is laundered? No one knows for sure, but the International Monetary Fund has estimated that between 2% to 5% of global gross domestic product is laundered each year. In the United States, this translates to perhaps a much as $1 trillion or more laundered every year.

Why Should Broker-Dealers Pay Attention?

There are significant reasons for broker-dealers to pay attention to the money laundering laws and to establish their own compliance programs. First, the money laundering laws apply to everyone, including securities broker-dealers. The law imposes heavy penalties for violations, including criminal fines up to $500,000 per violation and prison sentences as long as 20 years. The law also authorizes civil penalties and fines as well as forfeiture of amounts equal to double the amount that was laundered through a firm. Further, the reputational costs can be severe where a broker-dealer or its associated persons are found to have played some role in money laundering.

Second, as noted above, the SEC has stepped up its focus on money laundering. In May 2001, Lori Richards, Director of the SEC’s Office of Compliance Inspection and Examinations (OCIE) announced that money laundering is “on the radar screen” of the SEC. As this article is being written, joint sweep examinations by the SEC, the NASD and the NYSE are underway to examine the money laundering compliance procedures of broker-dealers. Historically, sweep examinations have been followed by a series of enforcement actions focusing on the particular area of interest.

Third, rulemaking in this area is imminent. For several years, the Treasury Department and SEC have indicated that such rules were on the way. Passage of the USA PATRIOT Act has ensured a swift conclusion of the process because the Act requires the Treasury Department, in consultation with the SEC, to propose new broker-dealer specific rules no later than January 1, 2002, which must go into effect by July 1, 2002.
More importantly, with one exception, the existing rules discussed in this article already apply to broker-dealers. The only exception is the requirement to report suspicious transactions, which currently applies only to broker-dealers that are subsidiaries of banks or bank holding companies. But this distinction is about to disappear, because the Act mandates that the new rules to be promulgated by year-end must require all broker-dealers to file Suspicious Activities Reports (SARs), as discussed below. Moreover, the Act requires all financial institutions, including broker-dealers, to establish anti-money laundering compliance programs that meet certain minimum standards. These programs must be in place within six months, that is, by April 2002. Thus, broker-dealers should start now to evaluate their compliance with existing laws, and to develop compliance programs that meet the requirements of the new law.

Money Laundering Laws That Apply to Broker-Dealers

Several statutes include money laundering laws that apply to broker-dealers. The criminal statutes prohibit financial transactions involving proceeds of 176 “specified unlawful activities” (that is, certain crimes.) In addition to primary liability under the criminal statute, a person or entity could be liable for aiding and abetting violations of the money laundering statutes if they know or are willfully blind to the fact that the transaction involved illegal funds. Thus, a showing of “willful blindness” can satisfy the “intent” element of the crime. This means that a party to a financial transaction cannot simply ignore indications of irregularity or wrongdoing (“red flags”) that could give reason to suspect that the other party is engaging in money laundering activity.

The Bank Secrecy Act (“BSA”) is the other major law pertaining to money laundering. The BSA is a reporting and record-keeping law. The rules promulgated under the BSA contain three main reporting requirements applicable to broker-dealers: (1) Suspicious Activity Reports, (2) Currency Transactions Reports, and (3) Currency and Monetary Instrument Transportation Reports. Each of these is discussed below.

Suspicious Activity Reports (“SAR”)

Currently, the rules require banks and others to report suspicious activities and suspicious transactions. These rules also apply to broker-dealers that are subsidiaries of banks or bank holding companies. The reports are made on the Suspicious Activity Report Form (commonly referred to a “SAR”). Broker-dealers not affiliated with a bank are not required to file SARs at this time, but as noted above, new rules requiring all broker-dealers to file SARs are on the way. As such, all broker-dealers would do well to include SAR filing as part of their money laundering compliance programs because such filings will soon be mandatory.
It is worth noting that long before anyone contemplated a broad rule applying to all broker-dealers, both the NYSE and the NASD issued directives that urge voluntary reporting of suspicious activities. The NASD stated in Notice to Members 89-12 that member firms are “strongly advised” to be alert to suspicious non-cash transactions and wire transfers that may involve illegal activities such as money laundering, and noted that such transactions could violate the money laundering laws and “should be reported.” The Notice urges members not only to report the activities but to maintain written records providing evidence that such reports were made. The Notice further states that “failure to report such transactions could be construed as aiding and abetting [violations of the money laundering laws], for which the member may face civil and criminal charges.” The NYSE has issued similar directives.6

It is expected that the new regulations will include SAR reporting requirements similar to those already imposed on banks and their broker-dealer subsidiaries. These existing requirements are discussed below.

**What is a “Suspicious Activity”?**

When noticed, a suspicious transaction should be reported on a “Suspicious Activity Report” form, or “SAR”. But what is a “suspicious activity” that must be reported? The rule requiring banks and their broker-dealer subsidiaries to make such reports states that a transaction is suspicious and must be reported if it involves in the aggregate at least $5,000 in funds or other assets, and the bank (or the broker-dealer) knows or has reason to suspect that the funds were derived from illegal activities, or that the transactions are intended to hide or disguise the illegal source of the funds.7 It should be noted that this rule applies not only to currency transactions, but could involve assets of any type, including monetary instruments (money orders, traveler’s checks, cashier’s checks, etc.), wire transfers, or securities of any kind. Typically, a suspicious transaction might seek to hide or disguise the ownership, nature, source, location, or control of the funds. But concealment is not necessarily the only hallmark of suspicious transactions. A transaction in the “layering” phase of money laundering might simply be one of a series of transactions that would raise suspicion only when viewed in the context of a pattern of transactions or in conjunction with other factors.

Another type of suspicious transaction would be one designed to evade the Bank Secrecy Act reporting requirements or some other provision of the law. “Structured” transactions—those broken down into amounts of less than $10,000 so as to avoid the currency transaction reporting requirements (discussed below)—are an example of such evasion.
Finally, the rule states that a transaction that has no business or apparent lawful purpose, or is not the sort in which the customer normally would be expected to engage, and the firm knows of no “reasonable explanation” for the transaction “after examining the available facts”, would also be a suspicious transaction that must be reported. (This is where the broker-dealer “know your customer” rules come in. A broker-dealer must know what a customer’s normal or expected trading pattern is, in order to identify when out-of-the-ordinary transactions are taking place.)

As noted above, both the NASD and NYSE, as early as 1989, urged their members to voluntarily report suspicious activities, even though not mandated for all broker-dealers. NASD Notice to Members 89-12 provides some examples of possible suspicious transactions that might need to be reported, including large international funds transfers to or from the accounts of domestic customers in amounts or of a frequency not consistent with the nature of the customer’s known business activities; and, receipt of funds in the form of multiple cashier’s checks, money orders, traveler’s checks, bank checks or personal checks in dollar amounts below the $10,000 reporting threshold and that are subsequently wire transferred to a financial institution outside the United States.

The following list provides other examples of “red flags” that could raise suspicion that money laundering activities are taking place, thus warranting further investigation and, depending on the results of the investigation, possibly reporting the activity on a SAR:

- “Structured” transactions (transactions in amounts less than $10,000).
- Wiring of funds without normal identifying information or in a manner that indicates an attempt to hide the identity of a sender or recipient.
- Anomalous transactions, trends or patterns.
- Wire transfers, especially originating offshore, with little or no corresponding long-term investments, or investments that are small relative to the size of the wire transfers.
- Investment decisions that do not make economic sense (for example, large sums resting in money market accounts).
- A customer who maintains multiple accounts, or maintains accounts in the names of family members or corporate entities, for no apparent business or other good reason.
- Accounts with inflows of funds or other assets well beyond the known income or resources of the customer.
- Unusual transactions disproportionate to the known business of the customer, or inconsistent with the customer’s normal profile.
- A customer who exhibits unusual concern for secrecy, especially as to his identification, business, etc., or a customer who delays in providing identifying documents and information.
• A customer who exhibits a lack of normal concern for investment risks, commissions and other costs of investing.
• A customer who is from, or has accounts in, a country identified as a haven for money laundering or a country identified as a bank secrecy haven.
• Unexplained or extensive wire activity, especially if there has been little or no previous activity.
• Numerous transactions involving cashier’s checks, money orders, currency or similar monetary instruments aggregating to significant amounts.
• A high level of activity, but a low level of securities transactions.
• Computer intrusion (that is, an unauthorized person gains access to a computer system that could affect funds or critical information of the firm or its customers).

What If a Broker-Dealer Detects “Suspicious Activities”?  

If a broker-dealer detects suspicious activities giving rise to a belief or suspicion that money laundering or other illegal activity is occurring, the firm is required to file a Suspicious Activity Report (SAR) if the firm is a bank subsidiary. Even if it is not a bank subsidiary, the broker-dealer should voluntarily file the SAR anyway, especially in light of the NASD Notice to Members and NYSE guidance published on the subject. In any event, within the next year, SAR filings will be mandatory for all broker-dealers, under a provision of the USA PATRIOT Act which mandates rules to that effect.

SARs are filed with FinCEN (the Financial Crimes Enforcement Network, a division of the U.S. Treasury Department). The SAR form, available on the FinCEN website, provides instructions about where to file. In addition to filing the SAR, the rules require the filing firm to retain a copy of the SAR and maintain “any supporting documentation” for six years from the date of filing.

The timing of filing a SAR is important. The SAR must be filed within 30 days of the date of the initial detection of the suspicious activity, unless no suspect can be identified, in which case the time can be extended to 60 days. FinCEN has provided additional guidance on SAR filings in a “Frequently Asked Questions” publication on its website. FinCEN explains that an organization will conduct a review to determine whether a need exists to file a SAR. The decision to conduct a review, however, is not necessarily a basis to file the SAR, and FinCEN recognizes that the review itself will take time. Thus, the time for filing the SAR starts when the organization, in the course of its review or because of other factors, either knows or has reason to suspect that the activity under review meets one or more definitions of suspicious activity that should be reported. Any review should be conducted in an expeditious manner, and the rule states that “in no case” shall reporting be delayed more than 60 calendar days after the date of initial
detection of a reportable transaction. In addition, situations involving ongoing money laundering schemes or other violations that could require immediate attention should be reported immediately by telephone to an appropriate law enforcement authority, in addition to filing a timely SAR.

A firm that has filed a SAR may have a continuing obligation to supplement it. As a general rule of thumb, the firm should report any continuing suspicious activity with a new SAR report at least every 90 days. FinCEN advises that a firm should report continuing suspicious activity even if, after filing the initial SAR, a law enforcement agency has indicated that it has started investigating or has stated that it is declining to investigate, based on earlier filings. The subsequent SAR will help notify law enforcement agencies of the continuing nature of the activity, and will also provide a reminder to the firm that it must continue to review for suspicious activity. As part of that review, the firm should consider whether other actions may be appropriate, such as terminating the relationship with the customer or terminating an employee that is the subject of the filing.

It should be noted that filing a SAR does not relieve a broker-dealer of the obligation to file a Currency Transaction Report (CTR), if called for. These are separate filings. Thus, if the broker-dealer engages in a cash transaction exceeding $10,000 and the transaction also involves suspicious circumstances, then the broker-dealer may be required to file both reports. (CTR filing requirements are discussed below.)

Confidentiality Requirements for SARs

The law imposes strict confidentiality requirements on SAR filings, but with an important exception contained in the newly enacted USA PATRIOT Act. Any financial institution or its directors, officers, employees or agents who report a suspicious transaction are expressly forbidden to notify any person involved in the transaction that it has been reported. In its published guidance on SARs, FinCEN has explained that the prohibition on disclosure applies to both the content of an SAR filing and the fact of the filing. A person can disclose the facts that are the basis of a filing, but only so long as the manner of disclosure does not reveal or imply that an SAR was filed or that such information was included in a SAR.

The confidentiality rule further provides that if anyone other than FinCEN or an appropriate law enforcement or bank supervisory agency subpoenas or otherwise requests a person to disclose a SAR filing or the information contained in it, the person receiving the subpoena or request “shall decline” to produce the SAR or provide any information, and instead shall notify FinCEN of any such request and the response made to it. Broker-dealers should take note that at present, the NASD, NYSE and other self-regulatory organizations are not authorized to receive disclosures of SAR filings, according to the
guidance published by FinCEN. Therefore if a broker-dealer receives a request from its examining authority, such as the NASD or NYSE, which would call for production of a SAR or information that would disclose that a SAR has been filed, the broker-dealer should not provide the information but instead should notify FinCEN of the request.

As noted, the USA PATRIOT Act includes an important new exception to the confidentiality rules. The Act provides that “upon notice to the Secretary [of the Treasury],” financial institutions may share information with one another regarding individuals, entities, organizations or countries suspected of possible terrorist or money laundering activities. This information sharing should be limited, however, to sharing for “the purposes of identifying and reporting activities that may involve terrorist acts or money laundering activities.” If limited to that purpose, the financial institution “shall not be liable” for such disclosures or for failure to provide notice to any person mentioned in the disclosures.\(^\text{10}\) The Act also provides that such disclosures would not violate the privacy provisions of the Gramm-Leach-Bliley Act.

While these new provisions allow broader disclosure of SARs than was previously the case, permissible disclosures are still very limited. A broker-dealer thus should take steps to prevent improper disclosures, and should not overlook maintaining confidentiality within the firm. Any SAR filings and supporting documentation should be maintained separately from the other books and records of the firm, and only certain persons should have access to these records. In addition, if an individual within the organization who ordinarily would have access to such records (such as a board member or officer) becomes the subject of a SAR filing, the procedures should include alternatives that ensure that such person does not become aware of the filing.

**Safe Harbor Provisions**

Federal law provides “safe harbor” protection from civil liability for filing SARs to report suspected or known criminal violations and suspicious activities, regardless of whether such reporting is mandatory or is done on a purely voluntary basis. The Bank Secrecy Act provides that a financial institution and its directors, officers, employees and agents who file a SAR “shall not be liable to any person” for such disclosure or for any failure to notify the person involved in the transaction or any other person of such disclosure.

Courts have interpreted the safe harbor provision to provide broad protection from civil liability for reporting suspicious transactions.\(^\text{11}\) However, some case law shows that the safe harbor protection is not absolute. Some courts have construed the provision to require good faith on the part of the reporting entity. In one case, for example, the court held that the financial institution that filed a SAR was not entitled to immunity under the safe harbor provision because certain “mitigating information” about the activity had
been withheld from the report. Thus, while the safe harbor provision provides broad protections, it probably is not a source of absolute immunity. The reporting entity must act in good faith, and there should be a good faith basis for believing that there is some connection between the suspicion of illegal activity and the information that is disclosed. Thus, in reporting suspicious activities, a financial institution should be careful to report what is necessary to make a complete report, but no more, and should be careful to follow all statutory requirements.

As discussed above, the USA PATRIOT Act adds a new “safe harbor” which applies to sharing of information among financial institutions about suspected terrorists and money laundering, provided it is done for the “for the purpose of identifying and reporting activities that may involve terrorist acts or money laundering activities.” To gain the protection of this safe harbor, a broker-dealer must first notify the Treasury Secretary that it intends to do so.

**Currency Transaction Reports (CTRs)**

Under the Bank Secrecy Act and related rules, all financial institutions, including broker-dealers, are required to report transactions involving currency in amounts which in the aggregate exceed $10,000 in one day. These transactions must be reported on the Currency Transaction Report form, or “CTR”. CTRs are filed with FinCEN. The form, which is available on the FinCEN website, provides instructions as to where it should be filed. A copy of the CTR and records of the transaction should be maintained for a period of six years.

It is important to note that the rule applies to multiple transactions which aggregate to $10,000. Thus, multiple transactions that occur within one business day must be aggregated to determine whether the $10,000 threshold has been reached. This includes transactions at all branches or locations of the firm. If a transaction is received on a weekend, overnight or on a holiday, it is counted as being received the following business day for purposes of aggregation.

The rules prohibit “structuring” transactions for the purpose of evading the currency transaction reporting requirements. “Structuring” occurs when a person breaks down a transaction into amounts less than $10,000 in order to evade the reporting requirement. Structuring can be done “in any manner,” including a series of transactions in lesser amounts, transactions by one or more persons, transactions that occur at one or more financial institutions, and transactions that span one or more days. It should be noted that if a broker-dealer suspects that someone is structuring transactions, this could constitute a suspicious activity that the broker-dealer should report as a suspicious activity, that is, by filing a SAR.
In addition to filing a CTR, a broker-dealer or other financial institution that engages in a currency transaction of $10,000 or more must verify and record the name and address of the person presenting the transaction, plus the identity, account number, and social security or tax ID number of the person on whose behalf the transaction is done. For aliens, the verification must consist of a passport or other similar official document. For citizens and domestic residents, verification must be made with a document that is normally acceptable within the banking community, such as a driver’s license.

Notably, under a provision of the USA PATRIOT Act, regulations will be forthcoming to set minimum requirements for procedures to verify the identity of all persons seeking to open accounts, for maintaining records of the verification, and for consulting lists of known or suspected terrorists as part of the account opening process. The new verification requirements will likely apply to the opening of all accounts, and not just to $10,000-plus currency transactions.

Currency and Monetary Instrument Transportation Reports (CMIRs)

Any person who physically transports, mails or ships currency or other monetary instruments into or out of the United States, in aggregated amounts exceeding $10,000 at one time, must make a report of this event. In addition, any person who receives such a transport or shipment, including financial institutions such as broker-dealers, must report the receipt. These reports are made on the Currency and Monetary Instrument Transportation Report Form, or CMIR. “Monetary instruments” are defined as including such items as traveler’s checks, personal checks, business checks, cashier’s checks, third party checks, and money orders. They also include securities in bearer form (that is, bearer instruments for which title passes upon delivery).

The CMIR requirement only applies to physical transport, mailing or other shipment of such instruments. The rule does not apply to transactions made through normal banking channels. Also, the rule makes an exception where someone who is not a U.S. citizen or resident transports or ships currency or other monetary instruments from abroad to a securities broker-dealer through the postal service or by common carrier, in which case the shipment does not need to be reported by the recipient. Otherwise, transports or shipments of currency or other monetary instruments exceeding $10,000 must be reported.

A CMIR report must be made within 15 days after the transport occurs, and the form is filed with the U.S. Customs Service in accordance with instructions on the form, which is available on the FinCEN website.
Enforcement

Notably, SEC Rule 17a-8, which applies to all broker-dealers, incorporates the requirements of the Bank Secrecy Act to file reports and maintain records. As noted above, the SEC announced in May 2001 that it would be conducting “sweep” examinations in conjunction with the NYSE and NASD to examine broker-dealers’ compliance with the law and their anti-money laundering compliance programs.\(^\text{13}\)

The new broker-dealer-specific regulations that will soon be promulgated will likely increase the opportunities for administrative actions by the SEC and other securities regulators, including actions for violations based on failure to have anti-money laundering procedures and failure to report suspicious activities, even when there is no evidence that a broker-dealer was actually used to launder money.

In addition to administrative penalties, a broker-dealer could be subject to civil penalties, including fines of up to $100,000 per violation and forfeitures of double the amount of assets laundered through the firm. A broker-dealer could also be subject to criminal liability, including liability for aiding and abetting violations of the money laundering statues. Criminal penalties include fines of up to $500,000 per violation and imprisonment of up to 20 years. Of course, individuals such as associated persons of a broker-dealer would also be subject to administrative, civil and criminal sanctions if they violate the money laundering laws.

OFAC Compliance

In addition to the money laundering statutes and the Bank Secrecy Act, broker-dealers are subject to the provisions of various sanctions programs administered by the Office of Foreign Assets Control (“OFAC”), a part of the Treasury Department. OFAC programs involve prohibitions against trading with certain identified enemies of the United States as set forth in various lists prepared by OFAC and other government agencies. The lists include known or suspected terrorists, narcotics traffickers and money launderers, as well as persons, governments and entities subject to sanctions imposed by the government for policy reasons. Examples of prohibited transactions include those with persons in or government entities of certain countries (such as Libya, Iraq, North Korea and Cuba); transactions with individuals and commercial enterprises that appear on the OFAC list of “Specially Designated Nationals”; and transfers of funds to any person in Iraq.

OFAC programs differ from the anti-money laundering laws in certain important ways. Under the money laundering statutes, assets derived from criminal activity are subject to forfeiture and seizure after the fact. OFAC's programs, in contrast, have historically emphasized blocking or rejecting transactions before they are completed.
Depending on the program a transaction falls under, financial institutions must either (a) reject and report the transaction, or (b) block the transaction, place the funds or assets in a separate blocked transaction account, and report the matter to OFAC.

By processing a transaction that should have been blocked or rejected, a broker-dealer could be liable for facilitating a prohibited transaction. OFAC jurisdiction extends to all U.S. citizens and permanent residents, companies located in the United States, and overseas branches of U.S. companies. OFAC can impose civil penalties for violations of its programs of up to $250,000 per violation. The existence of a OFAC compliance program, however, may be a mitigating factor in determining the sanction. OFAC violations can also result in criminal penalties, including fines as high as $1,000,000 and up to 12 years imprisonment.

OFAC maintains a master list of embargoed countries and specially designated nationals and blocked persons (the “SDN” list). This is an alphabetical listing of all entities and individuals who are subject to various OFAC sanctions programs, and is available from the OFAC website. The website includes the master list in a form that can be downloaded, as well as access to all OFAC-related executive orders, U.N. resolutions, statutes, regulations and other information. The master list of SDNs is frequently updated and the date of any changes appears on the list so that users can determine whether they have the most current list.

While OFAC compliance can seem daunting, the criteria for taking action is relatively straightforward and objective (that is, whether the person or entity appears on a list provided by OFAC), and only those countries and parties that appear on the lists need be considered. By contrast, the determination of whether to file a Suspicious Activity Report (SAR) under the Bank Secrecy Act can require a comparatively subjective evaluation of a variety of factors, and all transactions, customers and employees potentially could be the subject of a SAR.
Anti-Money Laundering Policies and Procedures

In light of the rules and regulations that already apply to broker-dealers, as well as additional rules that will soon be issued, all broker-dealers should establish policies and procedures to comply with the Bank Secrecy Act and other anti-money laundering laws. The USA PATRIOT Act mandates that all financial institutions establish anti-money laundering compliance programs no later than six months after the date of the Act, that is, by April 26, 2002. The Act requires that, at a minimum, such programs must include: (1) the development of internal policies, procedures and controls, (2) the designation of a compliance officer responsible for anti-money laundering compliance, (3) an ongoing employee training program, and (4) an independent audit function to test compliance programs. These requirements apply to all broker-dealers, including fully disclosed introducing firms and clearing firms.

There is no “one size fits all” formula for money laundering compliance programs, and each broker-dealer should tailor its policies and procedures to fit its business. The “right fit” will depend on such factors as the firm’s size, the nature of its business, available resources, and any identified risks or vulnerabilities to money laundering.

The starting point for any program is thorough and meaningful compliance with the “know your customer” rules. Certain features will probably be common to most programs. Some common features include the following:

• Designate a compliance officer responsible for anti-money laundering compliance.
• Establish written policies and procedures pertaining to anti-money laundering efforts. These should specify who is responsible, what steps they are required to take, and how their actions must be documented.
• Agreements with clearing firms should clearly allocate responsibilities for money laundering prevention efforts. (Realistically, there are some responsibilities that an introducing broker-dealer cannot allocate to its clearing firm.)
• Conduct regular training on the requirements of the law, the firm’s policies and procedures relating to money laundering compliance, and how to identify “red flags” that could denote suspicious activities.
• Establish internal controls, for example, ensuring that the person who handles the receipt of any cash is not the same person who is required to file Currency Transaction Reports.
• Screen employees for criminal and disciplinary history.
• Require reasonable efforts to determine and verify the true identity of customers and of ownership of funds. For individuals, this would include a
driver’s license, passport or other picture identification. For businesses, this would include a certificate of incorporation, business license or similar document.

- Require customers opening accounts to provide verification of their identifying information at the time the account is opened or within a relatively short time period, to avoid delays in obtained required documentation.
- When opening accounts, gain an understanding of what the customer’s likely trading patterns will be, so that anomalies can be identified later on, if they occur.
- Maintain records that identify not only the legal owners of accounts but the beneficial owners.
- Require customers to provide a street address to open an account, and not simply a P.O. Box or “mail drop” address.
- Contact customers periodically to verify accuracy of addresses, place of business, telephone, and other identifying information.
- Require registered representatives to make reasonable efforts to verify the source of funds for all transactions.
- Aggregate cash transactions daily to find any instances where Currency Transaction Reports are required.
- Aggregate transactions involving monetary instruments, such as money orders, cashier’s checks, etc. to ascertain whether significant funds are being deposited in this manner.
- Consider prohibiting transactions in cash, money orders, cashier’s checks or similar monetary instruments.
- Develop surveillance programs to discern patterns that reveal “red flags”.
- Establish procedures for the filing of suspicious activity (SAR) reports, even if the broker-dealer is not currently required to file them.
- Establish procedures to review SAR filings and if the suspicious activity is continuing, to update with additional SARs at least every 90 days.
- Require all SAR filings to be reported periodically to the Board of Directors and to the President or other senior executive. Require reports to be made immediately in high risk circumstances.
- Establish procedures to maintain confidentiality of SAR filings, including both the content and the fact of the filing. Notably, procedures to report periodically to the Board of Directors or other senior executives should include an exception for those rare instances where a board member or officer becomes the subject of a SAR, in which case the procedures should designate an alternate person within the organization who would receive reports of such filings.
- Establish procedures to maintain copies of SAR, CTR, and CMIR filings and all supporting documentation for a six-year period.
• Segregate SAR filings and supporting documentation from other books and records of the firm in order to avoid violating the prohibition on disclosure of these records. This includes establishing procedures to prevent disclosure to NASD or other examiners, until such time as disclosure to them is authorized under the rules.
• Establish procedures for what to do when the firm receives a subpoena or other requests that will call for disclosure of a SAR (that is, contact FinCEN and decline to make any disclosure).
• With respect to OFAC sanction programs, establish surveillance programs such as reviewing all international transactions against the OFAC lists, and establish procedures to keep lists updated at all times.
• Incorporate procedures into the firm’s internal audit modules to audit and test your compliance program at least annually under NASD Rule 3010(c).
• Incorporate training on money laundering compliance into the firm element continuing education program, both for registered representatives and supervisors.
• Don’t forget to evaluate employees and associated persons (in addition to customers) to consider whether they might be engaging in suspicious activities.

In conclusion, a broker-dealer that ignores its obligations under the money laundering statutes and related rules could be exposing itself to significant monetary penalties, reputational costs, administrative actions by the SEC, and even criminal liability. Anti-money laundering techniques should be part of every broker-dealer’s compliance and training programs.

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For further information on money laundering compliance or for assistance, please contact Sarah Estes (404.853.8540), Peter Anderson (404.853.8414) or Neil Lang (202.383.0277).
ENDNOTES

1 USA PATRIOT is an acronym for the title of the Act, “Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism”, Public Law 107-56.
3 The Treasury Department has already promulgated rules specific to casinos and money services businesses, which supplement the rules that apply to banks and other depository institutions and their subsidiaries. Rules specific to broker-dealers are next on the agenda. Passage of the USA PATRIOT Act will accelerate this process.
4 The criminal statutes discussed in this paper are located at 18 U.S.C. §§1956-1957. The Bank Secrecy Act is located at 31 U.S.C. §§5311, et seq. The regulations promulgated under the Bank Secrecy Act are located at 31 C.F.R. §§101.11, et seq.
5 E.g., United States v. Gensen, 69 F.3d 906, 912 (8th Cir. 1995) (government can rely on “willful blindness” to prove culpability under money laundering statute); United States v. Rodriguez, 53 F.3d 1439, 1447 (7th Cir. 1995)(“willful blindness . . . is the legal equivalent of knowledge”).
7 The report by the General Accounting Office of Congress issued in October 2001, “Anti-Money Laundering Efforts in the Securities Industry” (GAO-02-111) states that regulators involved in drafting the new rules are considering whether the dollar threshold for reporting in the securities industry should be higher than $5,000, given that securities transactions typically are larger.
8 All forms referred to in this paper are available on the web page for FinCEN, located at http://www.treas.gov/fincen.
9 The website address is http://www.treas.gov/fincen/bsaquestions.html.
10 The Act also requires the Treasury Secretary to promulgate regulations within 120 days to promote cooperation among financial institutions. Presumably the new rules will describe how notice to the Secretary is to be made, how the information sharing is to take place, and the scope of the “safe harbor” provision.
12 Digby v. Texas Bank, 943 S.W.2d 914 (Tex. Ct. App. 1997). See also, Coronado v. Bank Atlantic Bancorp, Inc. 129 F.3d 1186 (11th Cir. 1997). In Coronado, the financial institution disclosed information to federal agents about 1,100 accounts, including the plaintiff’s account, but it was unclear whether there was actually a suspicion surrounding all 1,100 accounts, and the court refused to apply the safe harbor provision to dismiss the complaint.
13 A GAO report issued in March 2001 stated that under the current “functional regulation” scheme of the Gramm-Leach-Bliley Act, neither the banking regulators nor the SEC believe that they have authority to examine the broker-dealer subsidiaries of banks for compliance with SAR filing requirements. This loophole will be corrected in the new broker-dealer regulations required by the USA PATRIOT Act. See “Money Laundering: Oversight of Suspicious Activity Reporting at Bank-Affiliated Broker-Dealers Ceased”, GAO-01-474.
14 The website is located at http://www.treas.gov/ofac.