Financial Institutions Webinar: SARs and Other Anti-Money Laundering Issues in the Securities Industry

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Webinar Guidelines

- Participants are in listen-only mode
- Submit questions via the Q&A box on the bottom right panel
- Questions will be answered as time permits
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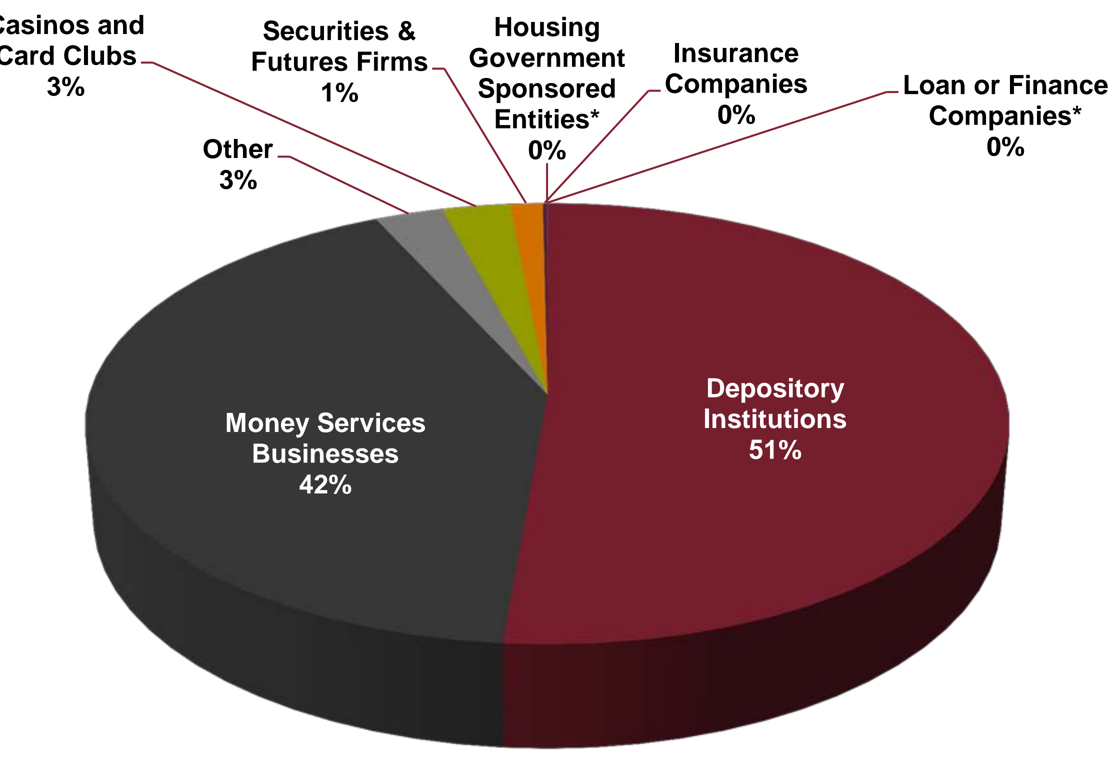
AML Authorities

Agency	Statute	Regulations	Description
DOJ	Bank Secrecy Act (as amended by USA PATRIOT Act and others), 31 USC §§ 5311, 5318(g), 5318(i), 5322	31 CFR § 1010.840	DOJ has criminal enforcement authority with respect to the BSA
FinCEN	Bank Secrecy Act (as amended by USA PATRIOT Act and others), 12 USC 1829b; 12 USC 1951-59; 31 USC 5311, et seq.	31 CFR Part 1023 (broker-dealers); 31 CFR Part 1024 (mutual funds)	FinCEN, as administrator of the BSA, has promulgated rules requiring broker-dealers in securities and mutual funds to, among other things, establish and implement an AML compliance program, maintain a Customer Identification Program, and report suspicious activity.
FINRA	N/A	FINRA Rule 3310	Rule 3310 requires FINRA member organizations to establish risk-based AML compliance programs.
SEC	Exchange Act of 1934 § 17(a)	Exchange Act Rule 17a-8	Rule 17a-8 requires broker-dealers to comply with the reporting, recordkeeping, and record retention requirements in the regulations implementing the BSA, including the requirement to maintain a Customer Identification Program and to report suspicious activity. The SEC does not have a general AML program requirement.

SAR Stats: SARs Filed in 2014

Institution Type	SARs
Depository Institutions	886,927
Money Services Businesses	720,985
Other	46,899
Casinos and Card Clubs	46,575
Securities & Futures Firms	22,448
Insurance Companies	2,897
Housing Government Sponsored Entities*	160
Loan or Finance Companies*	84
Total SARs Filed in 2014	**1,726,975**



*Aug 13, 2014 through Dec 31, 2014

SOURCE: FinCEN, SAR Stats (Oct. 2015)

SEC Broker-Dealer Task Force

SEC's Broker-Dealer Task Force has "identified those firms that have filed few or no SARs over extended periods of time and whose failure raises questions about their compliance with their BSA obligations. Working with examination staff, they have then done a preliminary analysis to determine whether the lack of filing can be easily explained. If not, they have determined whether an examination or investigation is warranted. The early efforts of this initiative have resulted in dozens of examinations and investigations potentially focused on BSA violations."

- **Andrew Ceresney, Director, SEC Division of Enforcement**
  Remarks at SIFMA's 2015 AML & Financial Crimes Conference

FINRA Exam Priorities: AML Monitoring

Suspicious Activity Monitoring

- Routinely test systems and verify the accuracy of data sources to ensure that all types of customer accounts and customer activity, particularly higher-risk accounts and activity, are properly identified and reviewed in a manner designed to detect and report potentially suspicious activity
- In situations where a risk-based decision is made to exclude certain customer transactions from one or more aspects of AML surveillance, the rationale for the decisions should be documented and will be checked
- Consider reviewing customers' activity over a period of time sufficient to identify patterns and ensure they assess the full picture of activity

FINRA, 2016 Regulatory and Examination Priorities Letter (Jan. 5, 2016), at 4-5.

FINRA Exam Priorities: AML/Microcap

Microcap Securities

- Assess whether process for conducting due diligence on deposits of large blocks of microcap securities is appropriate to ensure compliance with the registration provisions of the Securities Act of 1933
- Review deposits of microcap securities to determine compliance with or exemptions from registration requirements
- Re: customer trading activity in microcap securities, have processes in place to identify suspicious trading activity, with a particular focus on securities that exhibit "red flags" of "pump-and-dump" schemes, such as news of stock promotion campaigns, and significant price and volume spikes
- Focus on red flags of potentially manipulative trading, like pre-arranged trades and marking the close, particularly when securities are thinly traded

FINRA, 2016 Regulatory and Examination Priorities Letter (Jan. 5, 2016), at 5.

SEC Exam Priorities

EXAMINATION PRIORITIES FOR 2016

SEC will use data analytics to identify signals of potential illegal activity, including in the following areas:

- **Anti-Money Laundering ("AML")**. We will continue to examine clearing and introducing broker-dealers' AML programs, using our analytic capabilities to focus on firms that have not filed the number of suspicious activity reports ("SARs") that would be consistent with their business models or have filed incomplete or late SARs. We will also continue to assess broker-dealers' AML programs, with a particular emphasis on (1) the adequacy of the independent testing obligation, to ensure that these programs are robust and are targeted to each firm's specific business model, and (2) the extent to which firms consider and adapt, as appropriate, their programs to current money laundering and terrorist financing risks.

- **Microcap Fraud**. We will continue to examine the operations of broker-dealers and transfer agents for activities that indicate they may be engaged in, or aiding and abetting, pump-and-dump schemes or market manipulation. We will also assess whether broker-dealers are complying with their obligations under the federal securities laws when publishing quotes for or trading securities in the over-the-counter markets.

Microcap Enforcement Cases

Cantor Fitzgerald, FINRA (Dec. 2015)

Cantor Fitzgerald agreed to pay FINRA approximately $7.3 million to settle – on a no-admit, no-deny basis – alleged AML and supervisory failures relating to the sale of microcap securities. Two of the firm's executives were suspended and fined.

Oppenheimer, FinCEN, SEC (Jan. 2015)

FinCEN and the SEC assessed a $20 million penalty against Oppenheimer for admitted AML violations including failing to identify and file SARs on potentially suspicious microcap trading. Oppenheimer agreed to hire an independent consultant to review its AML program.

Brown Brothers Harriman, FINRA (Feb. 2014)

BBH agreed to pay FINRA $8 million to settle – on a no-admit, no-deny basis – allegations that it failed to have an adequate AML program in place to detect suspicious penny stock transactions. BBH's AML Compliance Officer was suspended and fined $25,000.

Transaction Monitoring

Increasing regulator focus on AML transaction monitoring, with emphasis on:

- Threshold testing and tuning
- Reduction of false positives, but not at expense of missing SARs
- Linking related accounts
- Consistent customer risk ratings that drive monitoring

Transaction Monitoring Pitfalls

Threshold Tuning

- **Gibraltar** (Feb. 2016) – FinCEN fined the bank $4 million for, among other things, failing to tune system to reduce false positives
- **NYDFS Proposed Rule** (Dec. 2015) – would prohibit tuning to reduce alerts based on resource constraints; would require ongoing analysis of threshold and parameters
- **Commerzbank** (Mar. 2015) – NYDFS fined the bank $610 million for, among other things, tuning its monitoring system to reduce alerts and investigations

Rule Book Consistency

- **Standard Chartered** (Aug. 2014) – fined $300 million by NYDFS when monitor found problems with detection scenarios, including inconsistency between Rule Book and how scenarios were actually programmed

Account Linkages

- **Gibraltar** (Feb. 2016) – FinCEN criticized the bank's failure to link related accounts in its AML monitoring system
- **Charles Schwab** (Dec. 2013) – FINRA fined Schwab $175,000 for AML violations and criticized the firm's failure to link related accounts in its AML monitoring system

SARs: Considerations before Filing

- Collect information from across the enterprise
- Consider applicable self-reporting regimes
  - Cybersecurity
  - Foreign Corrupt Practices Act
- Leverage the knowledge of front-line business personnel – but don't tip off the customer
- Document the decision not to file a SAR

After Filing: Continuing Activity SARs

- Regulators have begun to focus on continuing suspicious activity that goes unreported
- Timeframe for filing continuing activity SARs where subject is identified:*

Day 0	Identification of suspicious activity and subject
Day 30	Deadline for initial SAR filing
Day 120	End of 90-day review
Day 150 (120 days after initial filing)	Deadline for continuing activity SAR with subject information
If the activity continues, this timeframe will result in three SARs filed over a 12-month period	

* *See* FinCEN, SAR FAQ #16, http://www.fincen.gov/whatsnew/html/sar_faqs.html

After Filing: SAR Confidentiality

SARs are confidential. Be careful about requests to produce SARs or information that would reveal the existence of a SAR.

Requests from Regulators / Law Enforcement

- A financial institution can provide SARs directly to FinCEN, federal, state, and local law enforcement agencies, and to a regulator who examines it for BSA compliance, but not to other regulators. *See, e.g.*, 31 C.F.R. § 1023.320(e)(1)(ii)(A)(1).

- Thus, a broker-dealer can provide a SAR filed on securities activity to the SEC and FINRA, but not to the OCC.

Litigation Requests

- SARs, and information that would reveal the existence of a SAR, generally cannot be produced in response to a subpoena. If a broker-dealer receives a civil subpoena requesting SAR information, it should decline to produce the information, citing the applicable SAR confidentiality rule and 31 U.S.C. § 5318(g)(2)(A)(i), and notify FinCEN. *See, e.g.*, 31 C.F.R. § 1023.320(e)(1)(i).

Individual Accountability

Agency	Action
DOJ	***Yates Memorandum*** (Sept. 2015) – Requires a self-reporting company seeking cooperation credit to make a full disclosure to the DOJ, including the identities of all culpable individuals.
FinCEN	***Thomas Haider*** (Dec. 2014) – FinCEN ordered former MoneyGram chief compliance officer ("CCO") Thomas Haider to pay $1 million for his institution's AML compliance failures. Haider is challenging FinCEN's order in federal court.
FINRA	***Halcyon Cabot Partners*** (Oct. 2015) – FINRA barred the firm's CEO and CCO from the securities industry for fraud, sales practice abuses and widespread supervisory and anti-money laundering failures.
	Aegis Capital Corp. (Aug. 2015) – FINRA fined two officers $15,000 and suspended them for two years for AML failures relating to microcap transactions.
FRB	***BNP Paribas*** (June 2014) – Fed prohibited bank from re-employing or otherwise engaging 11 individuals who were involved in sanctions violations.
NYDFS	***Bank Leumi*** (Dec. 2014) – NYDFS ordered bank, which allegedly assisted U.S. customers with tax evasion, to terminate former Regional Manager and to ensure that its former U.S. CCO would not be involved in compliance going forward.
	Proposed Rule (Dec. 2015) – Would require CCOs annually to certify compliance with AML transaction monitoring and watch list filtering requirements.

FinCEN's Proposed RIA AML Rule

Background

- Sept. 1, 2015 - FinCEN issued Proposed Rule that would require Registered Investment Advisers (RIAs) to establish AML programs and report suspicious activity
- Proposed Rule would *not* require RIAs to maintain Customer Identification Programs

Coverage

- Applicable to all Investment Advisers registered or required to register under the Investment Advisers Act of 1940 (generally, those with ≥ $100 million in regulatory AUM)
- FinCEN requested comment on whether certain, lower risk, classes of RIAs (such as those that advise registered open- and closed-end investment companies and certain private funds) should be exempt from the AML requirements of the Proposed Rule

Questions?

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