



COMPLIANCE CLARIFIED

How To Avoid AML Enforcement Actions

The Financial Industry Regulatory Authority's latest annual examination priorities letter, released in March, is a must-read for all broker/dealers. Among other things, it makes clear anti-money laundering compliance continues to be a top regulatory focus. As FINRA officials noted, the self-regulatory organization last year took numerous actions against firms for failing to establish and/or implement procedures to detect and report suspicious transactions in the face of undetected red flags. Enforcement reports from the first half of 2010 reveal that this trend is not abating.

FINRA is not alone in its vigilance against AML violations. In announcing a recent enforcement action, George Canellos, director of the Securities and Exchange Commission's New York office, stated, "Securities professionals who turn a blind eye to suspicious customer conduct are not fulfilling their duties as gatekeepers and risk violating the securities laws themselves."

So what lessons are to be learned from the recent AML-related guidance and enforcement actions? Simply put: get ahead of the game. To avoid an enforcement action, firms should regularly conduct comprehensive reviews of their AML programs and—at the minimum—take the following steps:

Tailor AML Procedures

FINRA has emphasized that AML procedures should not be one size fits all. Each firm must tailor risk-based procedures to account for the firm's size, business model, products and services offered, the technological environment in which the firm operates and types of customers it serves. In 2009, for example, FINRA settled an action for \$300,000 against a firm for allegedly using what officials described as "cookie cutter" AML procedures that did not apply to the firm's business model.

Know Your Customers

A key aspect of AML compliance is tackling the know-your-customer rule to assess the risks customers present. Procedures to document and verify the identity of customers who open new accounts are routinely reviewed by SEC and FINRA examiners

and, when not properly executed, can form the basis for an enforcement proceeding.

Firms that have foreign correspondent accounts should expect greater scrutiny due to the difficulties in customer identification and higher risk of overseas money laundering activities. Earlier this year, for example, FINRA brought an action against a firm providing foreign customers with direct online access to U.S. securities markets. In this action, the firm was alleged to have held accounts for a number of foreign financial institutions, which opened sub-accounts for customers. FINRA levied a \$300,000 fine over allegations that the firm failed to adopt procedures to verify the sub-account holders' identities.

Monitor More Than Money Laundering

A firm's AML compliance officer must disclose on a suspicious activity report a range of activities not necessarily connected with money laundering. Specifically, on Form 101, B/Ds are required to report securities fraud, insider trading, market manipulation and commodity futures/options fraud, among other types of a customer's suspicious activity. In other words, identification and reporting of suspected garden-variety securities fraud must be a part of an AML program. Importantly, suspicious transactions are not necessary for a violation. Many recent enforcement actions have concerned the absence of, or weakness in, AML programs without finding that the lapse allowed for suspicious transactions that warranted a SAR.

Be Aware of Independent Obligations

The SEC and FINRA have made it clear that both introducing and clearing firms have independent AML compliance duties and cannot be relieved of AML obligations to the extent that the other is monitoring.

Designate Appropriate AML Staff

Firms should make sure that they are providing adequate training to employees responsible for administering their AML program. FINRA and the SEC require that such persons have sufficient knowledge and training to carry out their AML responsibilities. Similarly, firms should assess whether there is sufficient staffing of employees to conduct timely investigations of activity identified as potentially suspicious. FINRA recently brought an enforcement action against a clearing firm for allegedly failing to timely review 130 instances in which suspicious activity had been flagged by automated systems.

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Compliance Clarified is a regular feature in which industry professionals explain how to deal with new rules and handle complex compliance issues. For details on making submissions contact Ben Maiden, managing editor, at +212 224 3281 or bmaiden@iinews.com.