

Preparing for AML-CFT Compliance Exams

Sarah Green, Senior Director, Enforcement and BSA Policy
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What to Expect from the AML Review of an Examination

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- AML reviews are completed based on risk during Sales Practice examinations.
- Examiners will request a copy of your AML program and procedures.
- Examiners will expect your firm to have an AML program tailored to its business.
- Examiners will expect to see evidence that your AML procedures have been implemented.

What to Expect from the AML Review of an Examination

■ Examiners will expect:

- The AML chief officer to understand how the firm's AML program is implemented on a day-to-day basis;
- The firm to have an appropriate staffing model for its size and the number of accounts it handles; and,
- Senior management to be engaged in the firm's AML program.

What to Expect from the AML Review of an Examination

■ During the onsite portion of the examination, examiners will expect to:

- Have an in-depth conversation with the AML chief officer regarding the firm's AML program and implementation;
- Speak with individuals (Operations staff, etc.) who implement the AML and Customer Identification Process (CIP) program on a day-to-day basis, as applicable to the firm's size and structure;
- Have access to books and records evidencing the firm's AML reviews, including books and records of a parent or affiliate to the extent the parent or affiliate is doing AML reviews for the broker-dealer; and,
- Get a demonstration of the firm's automated activity monitoring and CIP systems, to the extent a firm utilizes automated systems.

What to Expect from the AML Review of an Examination

■ During the onsite portion of the examination, examiners will ask for:

- Evidence of suspicious activity monitoring and resolution of alerts, suspicious activities escalated, etc.;
- Evidence of CIP verification and 312 due diligence;
- Evidence of 314(a) checks being performed;
- Evidence of the AML independent test(s) for the period under review, including any reports;
- Evidence of sampling and reviews conducted during the independent test, to the extent the report does not reflect this;
- Evidence of response and follow-up on exceptions noted in the independent test;
- AML training attendance lists (or other records reflecting attendance); and,
- AML training materials.

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Common Findings

Common Exam Findings

- **What percent of FINRA examinations that included an AML review had an AML deficiency?**

Common Exam Findings

- Independent testing
- Customer Identification Program (CIP)
- AML procedures
- 314(a)
- Training
- Suspicious activity monitoring and reporting

Common Exam Findings

■ Independent testing

- Failure to:
 - Have adequate procedures
 - Conduct a test
 - ***Conduct an adequate test***
 - Ensure the test is conducted by an independent party
 - Follow-up on test results and findings

Common Exam Findings

■ Customer Identification Program (CIP)

- Failure to:
 - Collect identifying information (name, address, DOB, SSN / TIN)
 - Verify customer identity (documentary and / or non-documentary), *particularly on DVP/RVP accounts*
 - Record-keeping
 - Have a risk-based CIP tailored to address the risks of the firm's business and customers

Common Exam Findings

■ AML procedural deficiencies

- Firms continue to lack sufficient procedures to address AML rules and regulations, particularly the more recent requirements of:
 - Section 311 of the USA PATRIOT Act – Special Measures
 - Section 312 of the USA PATRIOT Act – Due diligence for correspondent accounts of foreign financial institutions
 - Section 312 of the USA PATRIOT Act – Enhanced due diligence for certain foreign banking relationships

Common Exam Findings

■ Other AML procedural deficiencies

- Procedures don't address:
 - Timeframe for AML independent test
 - Timeframe for filing SAR (30 days in most circumstances)
 - Notifying law enforcement and FinCEN's Financial Institutions Hotline (**1-866-556-3974**) for situations involving violations that require immediate attention, such as terrorist financing and ongoing money laundering schemes

Common Exam Findings

■ 314(a) – Required information sharing

- Failure to:
 - *Review FinCEN's SISS system and firm records for matches*
 - Report a match to FinCEN
 - Designate an AML contact person in the FINRA Contact System
 - Keep 314(a) information secure

Common Exam Findings

■ Training

- Failure to provide:
 - Training, in general
 - Training to all appropriate personnel
 - Specialized training to certain employees based on their duties and responsibilities
- Failure to have procedures addressing which personnel are required to attend AML training

Common Exam Findings

■ Suspicious activity monitoring and reporting

- Systems not adequate based on the nature and risk associated with the firm's business and customers, such as:
 - Significant penny stock business
 - Online firms
 - Bank-affiliated broker-dealers
 - Direct Market Access and Sponsored Access
- Systems don't adequately address certain potentially higher risk transactions, such as:
 - Securities transactions, money movements, check writing
 - Receipts and deliveries of certificates
 - Electronic transfers of securities (e.g. DWAC, DTC, journals)

Common Exam Findings

■ Suspicious activity reporting

- SAR filings not complete
 - Fields not complete
 - Information not accurate
 - Narrative not very descriptive for suspicious activity
- SAR filings not timely

Determining the Adequacy of AML Programs

- **Does money movement surveillance adequately cover all areas?**
 - Does surveillance exclude any types of activity (ATM, check, etc.)
- **Is surveillance of customer trading being conducted for AML concerns?**
 - We have found that some firms only surveil customer trading activity for suitability and other general sales practice concerns.
- **Are all customer and account types being fed into the surveillance systems?**
- **Is the AML Department adequately staffed?**
 - Compare the number of alerts and investigations to the number of staff.
- **Has there been significant turnover in the AML department?**
- **How is the culture of the AML department?**

Reviews of High Risk Customer Accounts

■ High risk customer account types to take into consideration (when activity is occurring in the account):

- Foreign financial institutions
- Foreign government run enterprises (BANDES, Petrobras, etc.)
- PEPs
- Money services businesses
- Cash intensive business
- Law firms and IOLTA accounts
- Import/export businesses
- Luxury and high value item investors or sellers
- Personal holding companies (PHCs or PICs)

Reviews of High Risk Customer Accounts

- ❑ Money movement activity that doesn't correspond with trading activity
- ❑ Send and/or receive funds involving individuals and entities located in high risk jurisdictions and/or financial secrecy haven
- ❑ Funds transferred in and immediately out
- ❑ Liquidate or trade in securities used for currency conversion
- ❑ Send and/or receive multiple third party transfers of funds
- ❑ Deposits followed by ATM withdrawals in foreign countries
- ❑ High risk customer types (FFIs, PEPs, MSBs, FBs, PICs, etc.) engaging in high risk activity
- ❑ Liquidate or trade in microcap securities
- ❑ Send and/or receive funds just under reporting thresholds (\$5,000 or \$10,000)
- ❑ Foreign currency activity with no corresponding trading
- ❑ Excessive cash and/or securities journals between accounts
- ❑ Deposits and immediate requests to transfer funds out

Can One Customer Damage Your Firm's Hard-Earned Reputation?

FINRA Hearing Panel Expels AIS Financial, Inc. for Systemic Anti-Money Laundering Violations (8/4/11)¹



“The hearing panel found that from November 2005 to December 2007, AIS failed to identify, investigate and report suspicious penny stock activity in three instances. Motivated by commissions the firm received from allowing its customers to liquidate billions of shares of penny stocks from numerous accounts, AIS turned a blind eye to the suspicious activity and concealed the activity from regulatory authorities.”

¹ <http://www.finra.org/Newsroom/NewsReleases/2011/P123429>

AIS Financial, Inc. – Expelled

■ Key allegations:

■ Inadequate suspicious activity monitoring

- Review consisted of daily/monthly review of trade blotter
- No monitoring for red flags in AMLCP

■ Failed to identify, further investigate and report suspicious activity in three instances:

- 1st instance - Two corporate accounts controlled by a Costa Rican money management firm whose owner was a stock promoter who had been the subject of significant regulatory actions by the SEC - charged for securities fraud for engaging in an Internet manipulative scheme.
- Two accounts deposited and liquidated billions of shares of penny stocks, generating more than \$3 million in proceeds for the customers and \$53,000 in commissions for the firm.
- No issues were identified, no investigations were completed and no SARs were filed.

AIS Financial, Inc. – Expelled

■ Key allegations:

■ Failed to identify, further investigate and report suspicious activity:

- 2nd instance – Five accounts controlled by a customer & his nephew who had disciplinary histories and criminal indictments for organized crime and money laundering.
- Accounts deposited & liquidated 3.5 million shares of penny stocks just two months after the SEC had charged them with securities fraud.
- AMLCO said he was aware of their history but decided to keep the accounts open.
- He said he was comfortable doing business with them.
- Accounts engaged in penny stock liquidations – the same activity that was identified in their pending SEC and criminal actions.

AIS Financial, Inc. – Expelled

■ Key allegations:

- **Failed to identify, further investigate and report suspicious activity:**
 - Third instance - 20 customers sold over 65 million shares of a penny stock (AAGH) for proceeds of \$5.1 million, commissions of \$243K.
 - Sales accounted for 34% of firm's revenue.
 - Sales coincided with volume spikes.
 - New account forms had red flags – Nine of the forms were completed in the same handwriting and reflected the customers were Hong Kong citizens. Several had the same date, and other had financial status' inconsistent (much lower) than account activity, e.g., housewife with liquid net worth of \$15,000 sold over \$700,000 worth of AAGH.
 - *SEC and DOJ ultimately filed a complaint against associated persons for engaging in a manipulative scheme related to this stock.*
 - *AMLCO was also charged in a DOJ indictment on this scheme. He pled guilty to a felony.*

AIS Financial, Inc. – Expelled

In its decision, the Hearing Panel said:

“It is important as a matter of national policy that every FINRA member implement and enforce an effective AML program” and “AIS demonstrated a consistent disregard of Rules which poses a serious risk to the investing public.”

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Issues and Trends



What trends are we seeing in AML cases?

- **Penny Stocks (Low Priced/Microcap Stocks) – Suspicious Activity, Unregistered Distributions, Manipulation**
 - Focus: RVP DVP accounts-role of executing firm and custodial firm
- **Omnibus Accounts for Foreign Financial Institutions– Suspicious Activity**
 - Focus: Foreign affiliates
- **Currency conversion activity**
 - Focus: foreign bonds, ADRs
- **Use of brokerage accounts for banking activity**

Trend: Resources

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SUE

Firms pumping millions into their compliance departments to keep regulators at bay

In the face of a compliance surge, many industry executives and attorneys wonder whether the emphasis is worth it.

Oct 20, 2014 @ 10:04 am

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Trend: Staffing

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13,000 HIRED

Jamie Dimon, the chief executive of **JPMorgan Chase & Co.**, said in an April letter to shareholders that since 2012, JPMorgan had hired an additional 13,000 employees to handle regulatory issues and compliance.

John Shrewsberry, chief financial officer of **Wells Fargo & Co.**, which owns a wirehouse employing some 15,000 advisers, underscored rising compliance costs in a call with analysts this month to discuss third-quarter earnings.

“Our quarterly expenses related to risk and compliance have increased by approximately \$100 million over the past year and we’ve added over 1,500 team members in this area,” he said.

41% INCREASE IN STAFF

LPL, which has paid at least \$20 million in regulatory fines, restitution and settlements in the past few years, now has 636 employees in areas that focus on compliance and oversight, a 41% increase since the start of 2013, according to chief financial officer Dan Arnold. Just last week, LPL, which



Disciplinary Fines Collected



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Finra Fines Rising Rapidly

JULY 31, 2014 • FA STAFF

Fines imposed by the Financial Industry Regulatory Authority for 2014 are on track to greatly exceed the fines reported by the regulator last year, according to an analysis of Finra actions by Sutherland, Asbill and Brennan LLP, a Washington, D.C., law firm.

During the first half of 2014, Finra reported \$42.4 million in fines. During the first half of 2013, Finra reported fining broker-dealers and associated persons \$23 million, and \$57 million for the entire year.

According to Sutherland, if fines in 2014 continue at the current rate to an estimated \$85 million, this year will represent a 49 percent increase from the [total fines reported in 2013](#). That figure would represent the highest amount of fines reported by Finra since the financial crisis and the most fines reported since 2006 (\$111 million).

Five "supersized" fines of \$1 million or more, totaling \$20.4 million, have been published in Finra's monthly disciplinary reports through June 2014. One of these cases was in February when [Brown Brothers Harriman](#) agreed to pay an \$8 million fine for alleged anti-money laundering compliance failures involving penny stock transactions.

Finra reported a 7 percent decline in disciplinary actions to 558 during the first six months of 2014, from 597 for the same period last year.

The percentage of cases that involved firms, as opposed to individuals, was very similar to that of the first six months of 2013 -- 36 percent in 2014 compared with 38 percent in 2013.

Administrative and technical issues have resulted in the most cases so far this year. There have been 61 cases regarding books and records resulting in \$13.7 million in fines, and 92 cases of trade reporting violations resulting in \$6.7 million in fines.

Issue: Culture of Compliance



FIN-2014-A007

August 11, 2014

Advisory

Advisory to U.S. Financial Institutions on Promoting a Culture of Compliance

BSA/AML shortcomings have triggered recent civil and criminal enforcement actions — FinCEN seeks to highlight the importance of a strong culture of BSA/AML compliance for senior management, leadership and owners of all financial institutions subject to FinCEN's regulations regardless of size or industry sector.

Shortcomings identified in recent Anti-Money Laundering examinations. Regardless of its size and business model, a

Hypothetical

Your long-standing client is a prominent businesswoman from the Dallas, Texas area.

She owns and controls a number of accounts on the books of your brokerage firm that are titled in her own name, in the name of a charitable foundation in which she is the sole administrator and in the name of a corporation in which she is the sole officer and shareholder.

Hypothetical

- **On January 6, 2015, after being alerted by your Firm’s Margin Department manager, you observe a series of fund transfers between the client’s accounts commencing at the end of December 2014 as follows:**
- **On December 21, 2014 at the direction of the client, your Firm transferred \$7,500,000 from her personal account to the account of her charitable trust. A written instruction signed by the client stated that the transfer was for a “charitable contribution.”**

Hypothetical

- On December 28, 2014, at the direction of the client, your Firm transferred \$7,000,000 from the account of the charitable foundation to the account of her corporation.
- The client provided another written instruction, this one on the charitable foundation's letterhead, along with an invoice from the corporation stating the \$7,000,000 was a reimbursement of various expenses previously advanced by the corporation on behalf of the charitable foundation.

Hypothetical

- On January 3, 2015, the client sent your Firm another written instruction to transfer \$7,000,000 from the corporate account to her personal account.
- The Margin Department manager, questioned the instruction and has refused to process the transfer. He calls to let you know he is following the Anti-Money Laundering Training program that you recently gave to his department, and he is reporting his concern to you.
- He tells you he will not process the transfer request until he gets your approval.

Hypothetical

- You link the 1/3/15 request to transfer funds back to the transfers that had occurred on 12/21/14 and 12/28/14.
- You note that although there appears to have been legitimate securities investment in each of the accounts, none of the transfers that you have focused on appear connected with any investment activity.

Hypothetical

- You relay to your Firm's Account Executive with the client relationship that you suspect the series of transfers lacks any bona fide business purpose and that you do not want to approve the client's latest transfer request.
- The Account Executive is annoyed. He argues with you that he has known the client for over twenty years, she has an impeccable reputation in her local business community and she is known to be very philanthropic. She is one of his best clients. Over the years, she has built up a huge portfolio of blue chip stocks and a number of other investments.

Hypothetical

- **The Account Executive is reluctant to question her at all about her motive for the transfers, but he points out to you that the account documents for each of the accounts evidences her authority to direct the transactions, and the transactions you are questioning are no different that others she has directed previously.**
- **So, “why all of a sudden are you preventing money transfers that the Firm had permitted her to conduct so many times in the past?”**

Hypothetical

- You convince the Account Executive that a person-to-person conversation with the client is necessary. The client, in a very cordial tone, explains to you that the transfers are each completely legitimate and she accurately explained the purpose for the transfers in the written instructions she had sent to the Firm.

* * *

- Let's discuss...