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BROKER-DEALER NEWS

ALERT: NEW ANTI-MONEY LAUNDERING REGULATIONS IMPOSED ON BROKER-DEALERS AND OTHER INSTITUTIONS

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USA PATRIOT ACT OF 2001

In the aftermath of September 11, Congress has enacted significant and far-reaching new anti-money laundering legislation. Title III of the USA Patriot Act of 2001 is entitled the "International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001."

The statute has compliance implications for many institutions that were not affected by prior legislation. For the first time, broker-dealers, investment banks, mutual funds and insurance companies, among many other institutions, will be required to comply with a vast array of anti-money laundering requirements.

Pursuant to its new statutory authority, the Department of the Treasury is promulgating extensive regulations to implement the new act. Some proposed regulations have already been published. Many more are expected in the upcoming months.

SELECTED ANTI-MONEY LAUNDERING REQUIREMENTS

Primarily, the new statute will require affected institutions to comply with the following requirements:

- (i) Establish internal due diligence policies, procedures and controls designed to detect money laundering
- (ii) Maintain appropriate records
- (iii) Appoint a compliance officer
- (iv) Report suspicious activity
- (v) Establish anti-money laundering training programs for employees
- (vi) Perform independent audit functions to test programs

Of these requirements, as of March 1, 2002, the Department of the Treasury has only issued proposed regulations with respect to reporting suspicious activity. The proposed regulations define two categories of transactions that a broker-dealer must report as "suspicious" to the Department of the Treasury. In the first category are transactions that involve any known or suspected federal criminal

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violation committed or attempted through (or against) the broker-dealer. In the second category are transactions which the broker-dealer knows, suspects, or has reason to suspect fall within one of the following:

- (i) Transactions involving funds derived from illegal activity or intended or conducted in order to hide or disguise funds or assets derived from illegal activity
- (ii) Transactions designed (for example, through structuring) to evade the requirements of the Bank Secrecy Act (which, among other things, requires that financial institutions file reports concerning currency transactions in excess of \$10,000)
- (iii) Transactions that appear to serve no business or apparent lawful purpose, and for which the broker-dealer knows of no reasonable explanation after examining the available facts relating to the transaction and the parties

Significantly, the proposed language “or has reason to suspect” is specifically intended to incorporate a concept of due diligence in the reporting requirement.

Another feature of the legislation is the requirement that institutions take steps to ensure that correspondent accounts for foreign banks are not being used for the benefit of a foreign shell bank (i.e., a bank with no physical presence in any country). This obligation requires broker-dealers and other institutions to ascertain that account holders are not foreign shell banks; if they are, or if they fail to demonstrate that they are not, their accounts must be closed. Under proposed regulations, institutions can satisfy this requirement by securing appropriate written certifications from their foreign bank account holders.

Broker-dealers and mutual funds have a great deal of work to do, and little time in which to do it. In addition to the statutory and regulatory requirements, which will take effect at various times throughout 2002, the NASD has approved a proposed rule that will require

each member to develop and implement a written anti-money laundering program *no later than April 24, 2002*.

A report of the U.S. General Accounting Office dated October 10, 2001 has concluded that only 17% of broker-dealers and 40% of mutual funds surveyed have suitable anti-money laundering programs in place.

POTENTIAL PENALTIES

The financial community can expect rigorous enforcement of the new laws. Violations could result in civil and criminal penalties as high as one million dollars.

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