

FINRA Dispute Resolution Arbitrator Training

Anti-Money Laundering Requirements and Suspicious Activity Reporting

Release Date: August 2011



Introduction

- In this training module you will learn about anti-money laundering requirements. As a FINRA neutral, it is essential that you know what to do should suspicious activity report (SAR) issues arise in arbitration proceedings, understand how suspicious activity reporting fits into anti-money laundering regulation, and understand and follow the confidentiality requirements for suspicious activity reports (or SARs).

Specifically, you will be able to answer the following questions:

- What is a Suspicious Activity Report?
- What steps should I take if I encounter a Suspicious Activity Report during an arbitration case?
- Why are Suspicious Activity Reports highly confidential?

Background Information

- The federal anti-money laundering requirements are found in the Bank Secrecy Act and its implementing regulations. The USA PATRIOT Act, which amended the Bank Secrecy Act (BSA), was signed into law on October 26, 2001. The PATRIOT Act amendments to the BSA extended certain anti-money laundering requirements to more types of financial institutions, including broker-dealers.
- Among other things, the BSA requires broker-dealers to implement an anti-money laundering (or AML) compliance program, identify and verify the identity of customers and to monitor for suspicious transactions and, where appropriate, report suspicious transactions to the government.

Anti-Money Laundering Statutes and Regulations

- FINRA Rule 3310 (formerly NASD Rule 3011) requires broker-dealers to have a “risk-based” AML program that is approved in writing by their senior management and is reasonably designed to achieve and monitor the member’s ongoing compliance with the requirements of the Bank Secrecy Act and implementing regulations. The five components of Rule 3310 are:
 1. Establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions;
 2. Establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations;
 3. Conduct independent testing;
 4. Designate an individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the program; and
 5. Provide ongoing training for appropriate personnel.

Suspicious Activity Reports

- Suspicious Activity Reports (or “SARs”), are reports filed with the Department of the Treasury’s Financial Crimes Enforcement Network, or “FinCEN,” the Treasury bureau charged with administration of the Bank Secrecy Act.

FinCEN Form 101 March 2011 Previous editions will not be accepted after September 30, 2011		Suspicious Activity Report by the Securities and Futures Industries Please type or print. Always complete entire report. Items marked with an asterisk * are considered critical. (See instructions.)		 OMB No. 1506 - 0019	
1 Check the box if this report corrects a prior report (See instructions) ☐					
Part I Subject Information 2 Check box a ☐ if multiple subjects box b ☐ subject information unavailable					
*3 Individual's last name or entity's full name			*4 First name		5 Middle initial
6 Also known as (AKA - individual), doing business as (DBA - entity)			7 Occupation or type of business		
*8 Address					*9 City
*10 State	*11 ZIP code	*12 Country code (If not U.S.) (See instructions)	13 E-mail address (If available)		
*14 SSN/ITIN (individual), or EIN (entity)		*15 Account number(s) affected, if any. Indicate if closed.			16 Date of birth
Acc't #		yes ☐ Acc't #			yes ☐
Acc't #		yes ☐ Acc't #			yes ☐
					MM / DD / YYYY

- SARs and other BSA reports are part of a government-wide data network maintained by FinCEN. Their purpose is to support the investigation of financial crime and terrorism. FinCEN shares SAR information with other agencies for criminal, tax, regulatory, and counter-terrorism purposes.

Suspicious Activity Reports - continued

- FinCEN issued an Advisory on November 23, 2010 titled “Maintaining the Confidentiality of Suspicious Activity Reports” [FIN-2010-A014](#) that outlines FinCEN’s role as administrator of the BSA, and explains its responsibility for safeguarding the information it collects and maintaining the integrity of the BSA records and reports, including SARs. FinCEN also recently issued amended SAR confidentiality regulations, see, 75 Fed. Reg. 75593 (Dec. 3, 2010).



Department of the Treasury Financial Crimes Enforcement Network

Advisory

FIN-2010-A014

Issued: November 23, 2010

Subject: Maintaining the Confidentiality of Suspicious Activity Reports

In conjunction with updating our regulations relating to the confidentiality of Suspicious Activity Reports (SARs),¹ the Financial Crimes Enforcement Network (FinCEN) is issuing this advisory to regulatory and law enforcement agencies, self-regulatory organizations (SROs), and financial institutions to reinforce and reiterate the requirement to preserve the confidentiality of SAR information.² As information contained in SARs becomes more widely used as a resource for investigations and examinations, the need to remain vigilant about protecting the confidentiality of SAR information increases. Recent media reports of possible disclosure incidents have increased concerns that SAR confidentiality requirements may not have been appropriately followed.

FinCEN, as administrator of the Bank Secrecy Act (BSA), is responsible for both

What Does This Mean to You as a FINRA Neutral?

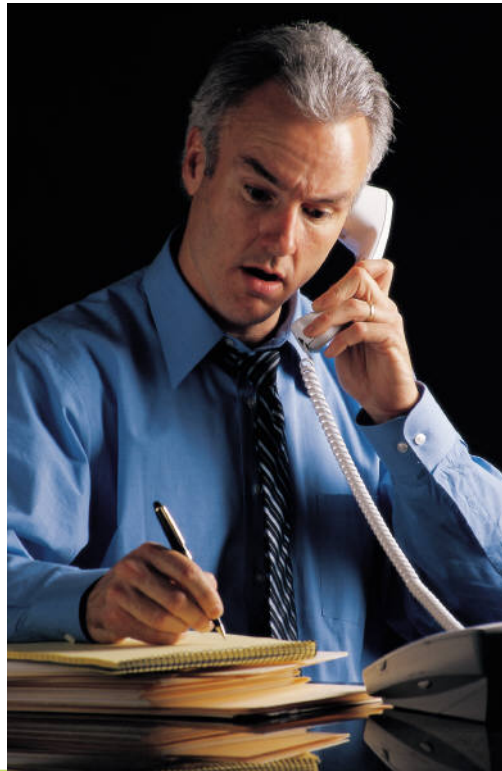
- As stated at the outset of this course, it is essential that FINRA neutrals know what to do if SAR issues arise in arbitration proceedings, understand how suspicious activity reporting fits into anti-money laundering regulation, and follow the confidentiality requirements for SARs.

Arbitrators must be sensitive to the strict confidentiality provisions in the SAR rule. Arbitrators may face requests for orders to produce SARs, or testimony or communications about them, in several different fact patterns, including, but not limited to, the following situations:

- an alleged subject of a SAR may be making a claim or asserting a counter-claim against a firm arising from the alleged filing;
- the victim of unlawful activity that may be reflected in a SAR seeks to obtain any SAR filed on the activity to support the victim's case against the firm or an associated person;
- a SAR may be attached as an exhibit to a pleading;
- a party may try to enter a SAR as evidence at the hearing;
- a party may attempt to obtain a SAR during the discovery process, including asking the Chairperson to sign a subpoena requesting that a SAR be produced; or
- a party in the proceeding may try to enter other evidence that discloses the existence of a SAR or that relates to the deliberative process of the firm in determining whether or not to file a SAR.

What Does This Mean to You As a FINRA Arbitrator?

- If one of the issues above, or any SAR confidentiality issue arises in your proceeding, you should **immediately** contact the FINRA staff member assigned to your case for further guidance.



Avoiding SAR Issues In Arbitration or Mediation

- Since broker-dealers and their agents are not permitted to reveal the existence of a SAR or anything that would indicate that a SAR was filed, questions about SAR reports must not be permitted. The production of SARs or information disclosing that a SAR was filed must never be required, and documents generated through a firm's SAR review process, both pre- and post-filing (or documents relating to a decision not to file), must not be subject to a disclosure order.
- As noted above, the underlying business records, including account statements and transactional records, are not subject to the same confidentiality requirements. However, questioning about the transactional or account activity reflected in the underlying documents should not be allowed to expand into questioning concerning the reporting of such activity in a SAR.

Avoiding SAR Issues In Arbitration or Mediation

- It is important to remember several things:
 - One, while SARs are confidential and may not be produced, the underlying transaction documents are not covered by the BSA prohibitions from disclosure. Therefore, all documents that evidence the transactions, such as account statements, wire records, orders, confirmations, account opening documents, and other documents may be requested and produced.
 - Second, SARs are not evidence of the underlying transactions or evidence that the transactions are in fact related to unlawful activity or money laundering. SARs contain a broker-dealer's opinion that the transaction is suspicious. Violations resulting from the transaction itself should be proven with the underlying transaction records and not the SARs.
 - Third, the unauthorized disclosure of a SAR is a violation of the BSA and may be punishable by civil and criminal penalties. Violations may be enforced through civil penalties of up to \$100,000 for each violation and criminal penalties of up to \$250,000 and/or imprisonment not to exceed five years.

SAR Confidentiality

- SARs contain important law enforcement sensitive information. Financial institutions, FINRA and law enforcement and regulatory agencies with access to SARs, as well as the financial institutions that file them, have an important obligation to protect the confidentiality of these documents -- both to protect possible law enforcement investigations focused on the activity covered by the SARs and to protect those involved in the filing of the SAR (both the firm and the subject of the SARs since SARs may be filed based on suspicions of certain conduct).

Suspicious Activity reports - Firm Responsibility

- To help you better understand this issue as a whole, let's now focus on the responsibilities of financial institutions when dealing with SARS.

Financial institutions, including broker-dealers, must file Suspicious Activity Reports for:

Any transaction conducted or attempted by, at, or through a broker-dealer involving (separately or in aggregate) funds or assets of at least \$5,000, and which the broker-dealer knows, suspects, or has reason to suspect that a transaction (or pattern of transactions of which the transaction is a part):

- involves funds related to illegal activity, or is hiding or disguising funds or assets derived from illegal activity;
- is designed, whether through structuring or other means, to evade requirements of BSA or other federal reporting requirement;
- has no business or apparent lawful purpose, or is not the sort in which this particular customer would normally be expected to engage; or
- involves use of broker-dealer to facilitate criminal activity.

Suspicious Activity Reports - Firm Responsibility – continued

- The rule requires broker-dealers in securities to file reports of suspicious activity on the SAR-SF (“Securities-Futures”) form within specified time frames of identifying the activity as suspicious. The financial institution does not have to have knowledge that the customer is engaged in any particular illegal activity, and does not even have to know that the customer is engaged in illegal activity at all. Rather, the standard is whether the firm has a “reason to suspect” or has knowledge of facts that suggest that the transactions are not legitimate, may be related to unlawful activity, or just doesn’t make economic sense. The potential conduct covered is very broad.
- When firms identify indicators or “red flags” of unlawful or inappropriate behavior, they need to investigate the conduct – perform due diligence – to determine whether the conduct or activity should be reported as “suspicious activity.” Red flags should be described in the firm’s written policies and AML compliance procedures. The procedures also should describe how the firm will monitor activity to detect the various “red flags.”
- To be useful, red flags should be specific to the firm’s customers and operations, and identified as part of the firm’s risk assessment. For example, a customer who refuses to provide information requested by the broker-dealer, provides incomplete information, or in placing a transaction is completely unconcerned with the commissions paid or cost of the transaction may be “red flags” regarding the customer’s identity, activity or motivation for engaging in certain transactions.

Suspicious Activity Reports - Firm Responsibility – continued

- The broker-dealer should conduct due diligence in order to understand whether there is a reasonable explanation for the questions raised or, if the questions cannot be resolved, then the firm should file a SAR.

- It is critical to note that suspicious activity reporting covers activity occurring at, by, or through the broker-dealer beyond money movements, including securities transactions. Therefore, the securities transaction activity and other illegal activity identified on the SAR-SF form include:
 - Market manipulation
 - Prearranged or other non-competitive trading
 - Wash or other fictitious trading
 - Insider trading
 - Securities fraud
 - Computer intrusion

Suspicious Activity Reports - Firm Responsibility – continued

- Supporting documentation must be segregated and deemed “filed with the SAR” so that law enforcement can receive the documentation upon request. Firms are required by the rules to keep copies of SARs they file, as well as the underlying and backup documentation that formed the basis of the SAR filing. These documents are required to be kept for five years and segregated at the firm. That way, the documentation is available for law enforcement when they want to follow up with the firm regarding the suspicious activity that was the subject of the filing.
- State, federal and local law enforcement agencies, including the SEC, have electronic access to FinCEN’s BSA database and rely heavily on SARs to initiate investigations, to further existing investigations, and to identify trends and patterns of money laundering and other illegal activity.

SAR Confidentiality

- Congress recognized that protection of the sensitive information in SARs – and the very act of a financial institution's filing a SAR – was necessary to encourage robust reporting of suspicious activity while protecting privacy interests as well as the confidentiality of law enforcement investigations.
- Therefore, the BSA provides an unqualified privilege against compelled disclosure of SARs or of documents or testimony relating to their filing. The statute prohibits any financial institution, and its officers, directors, employees, or agents, from notifying any person involved in a transaction that the transaction has been reported. As a result, SARs and the fact that the transactions were reported to the government are highly confidential.
- In fact, the BSA absolutely prohibits a firm from disclosing SARs or information disclosing the existence of a SAR to anyone other than appropriate law enforcement, regulatory or supervisory agencies, or the Self-Regulatory Organization (SRO) who examines the institution. Firms may also share SARs with a parent entity or certain domestic affiliates. There are NO other exceptions to the rule prohibiting the disclosure of SARs.

SAR Confidentiality - continued

- The unauthorized disclosure of SARs could undermine ongoing and future investigations by tipping off suspects, deter financial institutions from filing SARs, and threaten the safety and security of institutions and individuals who file such reports. Further, such disclosure of SARs compromises the essential role SARs play in protecting our financial system and in preventing and detecting financial crimes and terrorist financing.
- FinCEN's broker-dealer SAR rule further provides that any person subpoenaed or otherwise requested to disclose a SAR or information contained in it, except where disclosure is requested by law enforcement or the firm's regulator, shall decline to produce a SAR or disclose any information that a SAR has been prepared and filed, and notify FinCEN of the demand.
- To further encourage financial institutions to file SARs, Congress also provided them with a “safe harbor” from liability. The statute protects financial institutions and their agents from liability to any person under state, federal, or local law, or under a contract, including an arbitration agreement, as a result of filing a SAR or failing to disclose the filing of the SAR.

Case Law - SAR Confidentiality

- There have been several cases in which courts have upheld the prohibition on disclosure of SARs in civil litigation. While SARs are not producible, the underlying account and transactional information are not subject to the same restrictions. Cites for these cases -- *Whitney National Bank v. Karam* (02/20/04), the *International Bank of Miami v. Shinitzky* (11/23/03), and *Sherman Cotton v. Privatebank and Trust Company* (11/02/02) – may be found on FinCEN’s website – www.fincen.gov.
- In the *Whitney National Bank* case, the litigant disclaimed interest in obtaining a SAR of which he allegedly was the subject, but sought communications between a bank and law enforcement about the matter. The court found that such communications fell within the scope of the privilege for SARs. Specifically, the court identified five types of communications protected by the privilege:
 1. The SAR itself;
 2. Communications pertaining to the SAR or its contents;
 3. Communications preceding the filing of the SAR or preparatory to it;
 4. Communications that follow the filing of the SAR and are explanations or follow-up; and
 5. Communications concerning possible violations that did not result in a filing.

Case Law - SAR Confidentiality - continued

- The privilege does not extend to underlying transactional documents, such as account statements, transaction confirmations, and the like. Such ordinary business records are subject to the production standards of the particular proceeding. Nothing in the SAR rule or the BSA protects such documents from disclosure; rather it is the existence of the SAR and the matter contained within it, as well as related communications with law enforcement, that are protected.
- FINRA, the SEC and other law enforcement regulatory and supervisory agencies are also prohibited from producing SARs or SAR information in response to a subpoena in an arbitration or other civil action.

Steps a Party Should Take if a SAR is Disclosed in an Arbitration or Mediation

- Again, to broaden your understanding of this issue, we'll now focus on the responsibilities of parties in arbitration or mediation relating to SARs.
- If a party in an arbitration or mediation discloses a SAR or SAR information in the proceeding, even inadvertently, the parties should:
 - Be directed to the SAR confidentiality regulations.
 - Under an advisory recently issued by FinCEN, the disclosing party should also notify FinCEN of the unauthorized disclosure.
 - In addition to notifying FinCEN, member firms should notify FINRA of any unauthorized disclosure they make.

Conclusion

- In this training you learned about several aspects of suspicious activity reporting, the steps that you must take if these issues arise in your proceedings and the confidentiality requirements applying in this area.
- And rememberIf a SAR confidentiality issue arises in your proceeding, you should immediately contact the FINRA staff member assigned to your case for further guidance.

Available Resources

- Link to the information referenced in the training are posted below the link for this training module. The following is a summary of the information provided:
 - ❑ Copy of this presentation
 - ❑ [Sample Suspicious Activity Report](#)
 - ❑ [FIN-2010-A014](#) Department of the Treasury Financial Crimes Enforcement Network Advisory -- Maintaining the Confidentiality of Suspicious Activity Reports Issued: November 23, 2010.
 - ❑ [FINRA Rule 3310](#)
 - ❑ [FinCEN website](#)
 - ❑ [Case Law](#) cited

Training Credit

- To receive credit for this training and to have it included on your Arbitrator Disclosure Report, please confirm completion by sending an email to: ArbitratorTraining@finra.org and include your name, neutral identification number and state that you viewed the Anti-Money Laundering/Suspicious Activity Report Training module.

Thank you for participating in this training.