Legal Risk Management Tip
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Anti-Money Laundering Programs

This is the third of five risk management tips addressing the process of building Internal Controls. In recent speeches, interpretive releases and industry examinations, much attention is given to Anti-Money Laundering ("AML") programs. In May 2006 we saw the first-ever SEC enforcement action under the USA PATRIOT Act for a broker-dealer's failure to properly document its customer identification program. As the global war on terrorism and awareness of national security heightens, regulators are focusing more closely and comprehensively on AML programs of banks and broker-dealers. Now as the Securities and Exchange Commission's (SEC) CCO Outreach Program addresses AML programs, investment advisers should focus on and be knowledgeable of these regulations and implement a process of complying with today's stringent AML requirements.

SEC and SRO regulations, Treasury rules and OFAC lists and requirements provide guidance to AML program development. Title 3 of the Patriot Act and the Bank Secrecy Act of 1970 are the primary sources of AML regulation. In addition, the Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") collects information relating to potential money laundering abuses, analyzes the information and disseminates news to the financial community to help stop money laundering from occurring.

Under Customer Identification Program ("CIP") requirements, banks, broker-dealers and its custodian are required upon account opening to collect information on clients, such as their name, date of birth and identification number, and then utilize FinCEN to verify these clients are not on the "suspicious persons" list. Additionally, firms also check with the Financial Action Task Force ("FATF") to ensure that client funds are not being transmitted to or from a country known for money laundering activities.

Although the Investment Adviser's Act of 1940 does not require investment advisers to establish an AML program, as a general practice, investment advisers should consider developing and banks and broker-dealers are required to have:

- A system of internal controls to ensure continuing requirements with AML regulations;
- Independent annual testing of AML compliance;
- Daily coordination of AML compliance by a designated person;
- Training for appropriate personnel; and
- A summary disclosure document provided to clients at account opening regarding the firm's AML and Customer Identification Programs.

As AML requirements are continuously updated it becomes increasingly challenging to manage an AML program. AML compliance requires firms to ask questions and make assessments by using "red flag" approaches. If you are not currently doing so, consider implementing the following "checks" for AML activities:

1. Do our surveillance systems detect and aggregate all relevant activities, including wires, check writing, employee transactions and proprietary trading?
2. How are we identifying risks based on the firm's customers, geography, business model and other factors?
3. How are we evaluating enterprise-wide functions and risks, including its branch offices and foreign business relationships?
4. Does our program consider the impact of new business acquisitions and outsourced activity on firms' AML compliance programs?

5. Have we evaluated AML in the introducing-clearing relationship and in our relationships with foreign financial institutions?
6. When was our last AML training to key personnel and was it affective?

Establishing a comprehensive AML program will aid you in documenting and fulfilling “know your customer requirements” and allow you to identify and report suspicious activities based on information gathered throughout your firm. Through detection, correction and prevention of money laundering, firms will enhance the robustness of their compliance programs and help to strengthen the integrity of the marketplace.

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