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Bank Secrecy Act Compliance: Focus on the Fundamentals

Senior management is engulfed in the greatest challenge of its generation. The global credit crisis has evaporated assets, exploded liabilities, and destroyed long-standing relationships. While senior management focuses on rebuilding and buttressing depleted balance sheets, failed national and international regulatory frameworks are undergoing significant changes. Regulatory resources are strained due to enhanced safety and soundness testing. This is a time of unprecedented capital needs and unprecedented money laundering opportunities.

What can financial institutions with Bank Secrecy Act (BSA) requirements do at this critical time to sustain their BSA compliance? There are two fundamental BSA risks that your company must account for. First, the risk that your current anti-money laundering (AML) program is not considered adequate by your regulator. Second, the risk that money laundering is occurring undetected within your company.

What Is Your Company's AML Program Risk?

AML programs are a means to an end. Their purpose is to provide law enforcement officials with the tips and records they need to investigate and prosecute serious financial crimes. Regulators are charged with conducting periodic examinations of AML programs to obtain assurances that they are adequately designed and sufficiently implemented to meet the BSA requirements for continuous recordkeeping and reporting.


AML program risk is rules-driven and proscriptive. To best manage AML program risk, financial institutions should focus on their industry's BSA regulatory requirements and their regulator's guidance. Regulatory guidance and published formal actions provide insight regarding standards of sufficiency and sound practices. They also provide details regarding your regulator's concerns and how you should address them. For example, the qualifications and training of senior management's designated AML Compliance Officer.

How to Mitigate AML Program Risk

Elements of an AML program change slowly, but they do change. The required independent testing of your AML program provides an opportunity to continuously verify the completeness of AML program requirements. Ongoing reporting by internal audit, compliance, and the designated AML Compliance Officer should incorporate regulatory guidance and formal actions in order to assess the adequacy of your company's current program.

Boards of Directors are required to review and approve written AML programs whenever significant changes occur; it is imperative that these individuals have the requisite knowledge to effectively meet these oversight responsibilities.

NOTABLE

- AML continuing education now available! Producers can earn CE credits from LIMRA's initial and ongoing anti-money laundering (AML) training.
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LIMRA Compliance and Regulatory Services
300 Day Hill Road, Windsor, CT 06095
Phone: 877-843-2641
Email: Compliance-RegSvs@limra.com
www.limra.com/compliance

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Money Laundering Risk

The risk of money laundering is that financial transactions associated with criminal activities are occurring and reoccurring undetected within your company. Because criminals drive money laundering, their methods evolve continuously to escape detection. Individuals who commit financial crimes frequently enlist sophisticated professionals and persons within financial institutions to exploit operational weaknesses and circumvent internal controls. Accordingly, managing the risks of money laundering requires an array of procedures and controls.

Senior management can mitigate money laundering risk through focused reporting that documents the robust functioning of monitoring procedures, prudent adherence to reporting requirements, and appropriate responses to relationships that represent a heightened and continuous risk to the financial institution.

Using Dynamic Risk Assessments

Companies can effectively mitigate money laundering risk through dynamic risk assessments built on vigorous transaction monitoring and employee referrals of suspicious activities, including internal fraud investigations and receipt of criminal subpoenas. Regulators expect financial institutions to maintain detailed risk assessments tailored to a company's actual money laundering risks. To mitigate the risk of money laundering, companies must conduct risk-based transaction monitoring.

The AML Compliance Officer's reports to senior management should always include metrics that summarize transaction monitoring, employee referrals, investigations, required BSA reporting, and relationships terminated due to BSA risks. Ongoing reporting by internal audit, compliance, and the AML Compliance Officer should include breaches of controls and assessments of investigations that resulted in conclusions that a BSA reporting requirement was not met and/or not reported.

AML training should include current trends and methods for laundering money. Procedures must be implemented to escalate employees' observations of potential criminal activities. Those activities identified through transaction monitoring and employee observations must be investigated to determine a BSA reporting requirement. When existing relationships represent a recurring risk of money laundering, companies should consider terminating the relationship to prevent the possibility of facilitating criminal activity.

Criminal Subpoenas

Criminal subpoenas constitute definitive tests of AML program effectiveness. Criminal subpoenas alert financial institutions to the real possibility of criminal activity within the company. Accordingly, the receipt of criminal subpoenas must be part of the employee escalation procedures that trigger investigations to determine a Suspicious

Activity Reporting (SAR) requirement. Equally important, criminal subpoenas that represent potential consequences to the financial institution must be an inherent part of your company's reporting process to senior management and the Board of Directors in order to allow sufficient time to evaluate the risks and implement an appropriate response to protect the company.

Conclusion

The regulator's examination of your company's AML program is the definitive test of the AML program's risk. Too often, financial institutions do not vigorously follow up on their regulator's recommendations. Repeat findings of significance almost always result in a Cease and Desist Order.

Regulators impose serious penalties on financial institutions that fail to meet their BSA requirements. Since we are currently in a period of extreme risk for money laundering, this time period will undoubtedly receive increased regulatory scrutiny. Regulators have demonstrated their willingness to levy significant fines and penalties, restrict strategic plans, or exercise leverage to restructure senior management and Boards of Directors in order to correct significant regulatory concerns, including BSA failures. Financial institutions can sustain their BSA compliance in these critical times by focusing on the fundamentals.

By Robert Goecks, CPA, CAMS, CFE, CPP, LIMRA Senior Regulatory Consultant with 37 years of BSA/AML experience. Call Robert at 877-843-2641 to learn more about LIMRA's AML Independent Testing and Dynamic Risk Assessments.

FINRA Rule 8210 Proposal and Implications

Under FINRA Rule 8210, FINRA has the authority to compel a broker-dealer, person at a member firm, or anyone under FINRA's jurisdiction, to produce documents, provide testimony, or supply written responses or electronic data in connection with an investigation, complaint, examination, or adjudicatory proceeding. Those who do not comply will face sanctions.

FINRA recently proposed changes to Rule 8210 sections (a) and (d) which define who can be served and clarify that former registered persons or unregistered associated persons and persons represented by counsel can be "noticed." In addition, the records produced would be limited to those "under the member or person's possession, custody, or control."

This is not a dramatic change, since FINRA rules previously applied to associated persons and former registered persons. Registered persons were already required to keep their CRD/U4 record up to date for 2 years following termination of their registration (see NTM 99-77). The change explicitly spells out the authority of FINRA staff, and states that these registered and unregistered former associates can

be the subject of a Rule 8210 request. The rule filing also reminds member firms that directors and officers listed in Schedule A of Form BD, including those who may not have been required to be registered (see FINRA Rule 1060[a]), can also be the subject of these requests.

Firms should remind their registered persons and unregistered associated persons that these obligations continue even after they leave the firm or industry; and to keep their U4 address and contact information up to date and accurate. Former associated persons should be aware they may be “noticed”, meaning the request may be served on them by the usual means.

It is also advisable to review email procedures and controls, which are often a target of Rule 8210 requests. Ensure that emails relating to the business of the member are being appropriately retained. This includes emails that are sent to or from unregistered associated persons, officers, or directors listed on Schedule A of Form BD.

Legal and compliance staff should be aware that for members and persons represented by counsel, FINRA staff can now recognize that representation and serve “notice” of a Rule 8210 request for documents, testimony, or copying of records on counsel, following the American Bar Association’s “Rules of Professional Conduct.” Firms should make appropriate arrangements with their counsel to stay informed of such notices and to coordinate prompt responses.

Finally, the proposed changes to Rule 8210 spell out that the required records would be limited to those “under the member’s or person’s possession custody or control.” This definition is intended to parallel the Federal Rules of Civil Procedure regarding document requests or subpoenas for documents. Once effective, these rules give FINRA broad authority to request not only records at the firm, which are clearly within their custody, but also any records the firm may “have the legal right, authority, or ability to obtain upon demand.” This may compel the person or member to produce records such as client files in possession of former representatives, but still available to the firm by contract agreement or transaction logs or other third-party records. The message from FINRA is that you may not be able to deflect the response to such a request made to a third-party if you have the right to obtain those records on behalf of the firm.

By Larry Niland, LIMRA Senior Regulatory Consultant and former CCO of the John Hancock Financial Network. Call Larry at 877-843-2641 if you have questions regarding FINRA Rule 8210 compliance.

Will One-Stop Multi-State Insurance Agent Licensing Become a Reality?

H.R. 2554, the National Association of Registered Agents and Brokers (NARAB) Reform Act of 2009, appears to be on a fast track through Congress. The legislation was introduced in May and assigned to the House Financial Services Committee. Committee Chair Barney Frank recently announced that the Committee will forgo action on the proposal and it will go directly to the House floor. The bill appears to have broad, bipartisan support and is identical to legislation passed by the full House last year that later failed in the Senate. This broad support extends to a number of industry associations, including the NAIC (National Association of Insurance Commissioners), NAMIC (National Association of Mutual Insurance Companies), and IIABA (Independent Insurance Agents and Brokers of America).

H.R. 2554 allows insurance agents to become licensed in multiple jurisdictions with streamlined, one-stop registration through a newly created NARAB. In the current system, agents marketing in multiple jurisdictions must register with each state, meet each state’s varying compliance requirements, and pay a fee to each. In addition, agents licensed in multiple jurisdictions may be burdened with varying compliance requirements.

Under the new proposal, agents will still be required to register with their home state, but through a single filing with NARAB an agent can become authorized in multiple jurisdictions. The agent would pay a fee equivalent to the fee of the state or states covered by NARAB’s licensing. This streamlined system of rules and standards would simplify compliance, and reduce administrative costs for agents. Membership in NARAB would be optional and an agent could choose to continue to handle their licenses as they do now. In addition to licensing, NARAB would also regulate producer qualifications, continuing education, experience, and training. Producers who choose NARAB membership would be governed by NARAB’s standards. No state other than a producer’s home state could impose additional requirements.

A potentially significant change under H.R. 2554 is that agents who choose to file through NARAB will be required to submit to a criminal background check. While such checks are standard practice for agents registered to sell securities products, only 17 states currently require a criminal check to issue an insurance license.

It is important to note that the legislation does not create a national regulator of insurance agents, such as the optional federal charter (OFC) legislation proposed earlier this year by the Treasury Department. The NARAB approach is consistent with the views of supporters of continued state regulation — that the federal government should only serve to impose targeted and very limited reforms of

the current state insurance regulatory system. It preserves the right of states to license, supervise, discipline, and establish licensing fees for insurance producers, and to prescribe and enforce laws and regulations with regard to insurance-related consumer protection and unfair trade practices. The proposal does, however, create a system that allows NARAB-licensed agents to easily offer their products and services across all jurisdictions. It also may reduce the situations where consumers that move to a new state are forced to change agents if their agent is not licensed in that state. NAMIC predicts that this bill will lead to more product choices and lower costs for insurance consumers.

While many industry groups support H.R. 2554, the ACLI (American Council of Life Insurers) reiterated its support for a robust federal regulator of insurance. In a press release following the introduction of NARAB, the ACLI stated that: “The insurance regulatory system needs comprehensive reform. Legislation that only addresses discrete concerns will not provide consumers with the modern, efficient, world-class system they deserve.” While a national insurance regulatory scheme as envisioned by the ACLI may have to wait, it appears likely that administrative relief in the form of streamlined multi-jurisdictional licensing will become a reality.

By Jim Yoakum and Antone Balbo, LIMRA Consultants.

Financial Institution Networking Arrangements

There are myriad reasons why banks, thrifts, and credit unions utilize third-party marketing (TPM) programs to provide non-depository investment or insurance offerings within their financial institution (FI). From the viewpoint of the FI, TPM may present an opportunity to expand the breadth of their services, to compete with larger institutions for market share with less expense, and to increase revenue. Concurrently, well-positioned financial services professionals and associated TPMs benefit from an additional distribution channel, revenue stream, and increased local visibility.

For both parties it is important to put networking agreements in place and to supervise each site. Guidance can be found within FDIC, OTS, NCUA, and state regulation. TPM staff should be familiar with the framework of the FIs they serve. Further, programs offering registered representative services should become familiar with FINRA Conduct Rule 2350. Jurisdictional statutes may have similar requirements for exclusively insurance-oriented programs.

Board Approval and Branch Registration/Licensing

Before giving written approval of the networking arrangement, the FI Board should ensure a thorough, recorded due diligence process — and TPM staff should

be prepared for such a request. These areas are likely review items for regulatory bodies of both entities. Also, agreements should state that TPM supervisors, audit personnel, and regulatory staff for either entity are permitted access for examination purposes. Form BR and/or Form ADV Schedule D may need an amendment. The notification of state securities and insurance divisions and local business licensing may also be required.

Supervision and Notary/Signature Guarantees

Develop supervisory policies and procedures that identify the unique aspects of the networking arrangement within the FI. Frequent reviews with customized checklists would be beneficial. Ensure that TPM and FI policies provide adequate separation of duties or oversight, since most FIs offer notary or signature guarantee services.

Privacy Regulations

Each agreement should include discussion of adherence to respective privacy regulations (e.g., GLBA, Reg. S-P) and processes established to mitigate various risks. Companies should also focus on data security measures and information that may be transmitted outside the FI. Both parties should identify actions and responsibilities to be taken in the event of a privacy breach.

Disclosure and Staff Training

Conduct Rule 2350(c) provides guidance on the use of disclosure documents with customers and TPM advertising, seminars, newsletters, etc. Issuers and TPMs should consider using applications that clearly denote the FI customer is not purchasing a depository product. Both the TPM and FI staff should be educated on processes and their responsibilities.

Referrals

Various industry and jurisdictional regulations apply to referral arrangements, and should be addressed in written policy for TPM and FI staff to understand. Compensated referrals should be disclosed as a best practice. Many such referrals may require licensing on the part of the referring party and in some states may be subject to restrictions.

Communications

Consider communication and disclosure requirements, opt-outs such as a maturing CD list, seminars topics and setting, newsletters, email, and Web site usage policies. Consistent processes and coordination between FI marketing and TPM compliance staff is recommended.

Physical Setting

TPM activity should occur away from retail deposit areas such as teller lines, and should clearly indicate the services as those of the TPM — not the FI. This is easily accomplished through signage or placard displays.

By Paul King, LIMRA Consultant and former CCO of American Securities Group, Inc.