UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

December 21, 1999

The Honorable John D. Dingell
Ranking Member
Committee on Commerce
U.S. House of Representatives
Room 2322 – Rayburn House Office Building
Washington, D.C. 20515-6115

Dear Congressman Dingell:

Thank you for your letter dated November 16, 1999 addressing the concerns we share regarding the potential for securities firms to be exploited by money launderers. The Commission works closely with other government departments and agencies to address these important issues, and appreciates your support of its work.

In order to respond to your specific questions, I have asked the staff to prepare the enclosed report which discusses: the application of the anti-money laundering laws to securities firms; coordination with federal banking regulators and other enforcement entities in combating money laundering; efforts to remind securities firms of their obligations under the anti-money laundering laws; and the examination program for money laundering.

If I can be of any further assistance to you or your staff, please do not hesitate to contact me.

Sincerely,

Arthur Levitt

Enclosure

U.S. Securities and Exchange Commission Staff Report on Anti-Money Laundering Compliance and Broker-Dealers

In his letter dated November 16, 1999, John D. Dingell, Ranking Member of the Committee on Commerce of the U.S. House of Representatives, asked several questions about the application of national anti-money laundering programs to broker-dealers. This report addresses those questions.[1]

The Application of the Anti-Money Laundering Laws to Securities Firms

Two principal anti-money laundering laws apply to broker-dealers. These laws are: the Currency and Foreign Transactions Reporting Act of 1970, better known as the Bank Secrecy Act (BSA); and title 18 of the United States Code, which criminalizes money laundering in sections 1956 and 1957.

Sections 1956 and 1957 prohibit the laundering of monetary instruments and prohibit engaging in monetary transactions in property derived from specified unlawful activity. They are criminal statutes enforced by the Department of Justice and the U.S. Attorneys' Offices. These provisions apply to all persons, including broker-dealers and their employees. Counsel for broker-dealers are aware of the potential risks to their clients if those clients allow others to launder money through their firms. Accordingly, compliance staff of broker-dealers have been meeting periodically for years to develop approaches to prevent and detect money laundering through their firms.

It is the BSA, however, which establishes compliance obligations for broker-dealers. The BSA authorizes the Department of the Treasury (Treasury) to adopt regulations applicable to financial institutions, including broker-dealers. These provisions require, for example, the reporting of transactions in currency, the reporting of the transportation of currency or monetary instruments, the reporting of foreign financial accounts, and the recording of information contained in wire transfers of funds. While the Commission does not have rulemaking authority under the BSA, it does have responsibility for examining broker-dealers to determine their compliance with the BSA. In 1982, the Commission adopted Rule 17a-8 under the Securities Exchange Act of 1934 (Exchange Act). That rule imports the BSA reporting, recordkeeping and record retention provisions into the Exchange Act. This in turn enables the self-regulatory organizations (SROs), in addition to the Commission's own examiners, to examine broker-dealers for compliance with the BSA.

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1 It is the Commission's understanding that the Congressman's staff would like the Commission to focus its attention in this report on the anti-money laundering regulations applicable to securities firms. The Commission appreciates the information included with Congressman's Dingell's letter regarding specific firms and related parties and will review it consistent with the Commission's responsibilities under the federal securities laws.

In the past, the most common money laundering activity addressed by these rules was the attempt by criminals to place illicit currency into the financial sector while avoiding the currency transaction reports required under the BSA regulations. The Commission brought a series of administrative and civil injunctive actions against securities firms or their employees for violations of these provisions in the 1980s and early 1990s. As a general matter, however, the securities business is not a cash business and cash transactions have not presented the volume of concerns that have arisen at depository institutions.

The focus of anti-money laundering programs has shifted in recent years from reliance on objective currency transaction reporting by financial institutions to reporting suspicious activity. The BSA enables Treasury to require financial institutions to report suspicious transactions relating to possible money laundering. Treasury's Financial Crimes Enforcement Network (FinCEN), which administers the BSA, imposed requirements to file suspicious activity reports (SARs) on depository institutions in 1996. Since that time, FinCEN has been working on extending SAR reporting to a wide variety of other financial institutions. The Commission staff has been actively working with FinCEN's staff to develop a rule for the securities industry. FinCEN has identified other industry groups, however, as a priority on its rulemaking agenda. In the recent National Money Laundering Strategy for 1999 (National Strategy), Treasury recommitted to implementing SAR rules for a variety of financial institutions. Under the plan announced in the National Strategy, Treasury intends in 2000 to act on already proposed SAR rules for money services businesses and casinos, after which it intends to propose for public comment SAR rules for broker-dealers.

Although broker-dealer SAR rules have not yet been implemented, a number of broker-dealers, particularly the firms with a substantial percentage of customer accounts, have been voluntarily filing reports of suspicious transactions for years. In fact, two of the first litigated tests of financial institutions' ability to file voluntary SARs were cases involving broker-dealers. As noted above, firms are aware of litigation and reputational risks of dealing with potential money launderers, and have been seeking ways to identify and to report accounts that present those risks.

<u>Coordination with the Federal Banking Regulators and Other U.S. Authorities</u>

The Commission staff meets periodically with FinCEN and the bank regulators through a variety of groups, both domestically and internationally. Staff of the regulators meet within the Money Laundering Working Group (along with a number of enforcement agencies) to discuss anti-money laundering issues. Commission staff participates in the Bank Fraud Working group established by the Fraud Section of the Department of Justice, which at times addresses money laundering issues. Furthermore, Commission staff participates in the Law Enforcement, Intelligence, and Economic Policy Committees on the Magnitude of Money Laundering Project set up by FinCEN. In addition, financial institution regulators also meet through the Bank Secrecy Act Advisory Group (which also includes a number of private sector members.) More recently, the regulators are working together on a number of projects stemming from the National Strategy.

Commission staff also participates in the United States delegation to the Financial Action Task Force, the international body that addresses money laundering issues. The Commission staff initiated efforts, along with the Commodity Futures Trading Commission, within the International Organization of Securities Commissions (IOSCO) to raise awareness among securities regulators of risks posed by money laundering. Similarly, the Commission staff is addressing issues related to money laundering within the Financial Stability Forum, along with representatives of other agencies.

Reminding Firms of Their Obligations to Combat Money Laundering

Commission staff periodically address anti-money laundering issues in continuing education programs. Most recently, and after the press accounts relating to allegations involving depository institutions, senior Commission staff addressed the American Bankers Association/American Bar Association Annual Money Laundering Enforcement Seminar in Washington D.C. (October 1999), and participated in the Institute for International Research Anti-Money Laundering and Compliance Program in New York (September 1999). In addition, Commission staff has taken the opportunity to remind the broker-dealer community of its anti-money laundering obligations most recently at the Securities Industry Association Federal Regulation Committee Meeting (December 1999) and Chicago-Kent College of Law Illinois Institute of Technology Derivatives and Commodities Law Institute (October 1999). Furthermore, the staff has met with firms that have been submitting suspicious activity reports. These firms have been experimenting with different approaches for identifying accounts or transactions that warrant closer attention or reporting. The firms' efforts have been encouraged through meetings of senior representatives of the firms, FinCEN staff, Commission staff, SRO staff, and other government officials.

SEC Examinations of Securities Firms for Detecting and Deterring Money Laundering and SEC Referrals for Criminal Investigation

The Commission conducted special examination sweeps together with the New York Stock Exchange and National Association of Securities Dealers in 1982, 1983, and 1985 to determine the extent of broker-dealers' compliance with obligations under the BSA, and to educate the industry on the need to secure itself against use as conduits by money launderers. Once FinCEN adopts SAR rules for broker-dealers, it may be appropriate to initiate a new examination sweep in order to evaluate the compliance programs implemented to meet the new suspicious activity reporting obligations.

In the interim, the staff has recently reorganized its BSA examination module in order to refocus examiner attention to the anti-money laundering provisions to which broker-dealers are already subject. Examiners review the firms' policies, procedures and written materials related to these provisions, and in that regard are gaining insights into how firms address money laundering risks. Examination findings relating to money laundering have been referred to appropriate law enforcement agencies with responsibility for prosecuting those cases.

A number of serious securities fraud cases are also criminally prosecuted as money laundering cases because of actions the defendants have taken to further their securities fraud. As with other Commission investigations or cases, the staff contacts criminal authorities as appropriate, usually a United States Attorney, to refer appropriate findings for possible criminal investigations. Criminal authorities, likewise, contact the Commission if they have a money laundering case in which they uncover securities law violations.

Recent examples of actions in which U.S. Attorneys' offices have brought money laundering charges in securities cases are discussed below.

U.S. v. Field. This matter involved the prosecution of John A. Field III. Field is a former U.S. Attorney for the Southern District of West Virginia (1972-1977) and a former Director of Enforcement for the CFTC (1977-1980). Field represented a witness in a Commission investigation of a boiler-room in southern New Hampshire that was selling securities fraudulently. The Commission's investigation developed evidence that the bulk of the assets derived from the boiler-room sales were transferred to Field's attorney trust account or, with Field's assistance, to a Turks & Caicos company controlled by Field's client. On the day the Commission filed its case, the Commission referred the matter to the U.S. Attorney's office in New Hampshire.

Field's client pleaded guilty to securities fraud and money laundering charges. He later cooperated with the criminal authorities in their investigation and prosecution of Field, who was soon revealed as a major figure in a nationwide network of boiler-rooms fraudulently hawking interests in wireless cable enterprises, off-exchange commodities futures, and other investments. Field provided the legal structure for the operation of the boiler-rooms, represented the boiler-room principals before state and federal law enforcement agencies, and, when enforcement action appeared imminent, assisted the boiler-room operators in laundering and secreting their ill-gotten gains.

In December 1998, Field pleaded guilty to charges of money laundering and racketeering. His plea was based principally on his conduct in the Commission's case. (He also cooperated by participating in a sting called "Operation Busy Signal" that resulted in successful criminal prosecutions against many of his former stable of boiler-room clients.)

SEC v. Future Vision Direct Marketing, Inc. and United States v. Ronald Henry Michel, William Richard Horne, Stephen Regen, and Daniel Kelly. Four defendants from an earlier Commission civil action were indicted in 1999 by the U.S. Attorney in the Central District of California for fraud and money laundering. The indictment arose out of a scheme to sell wireless cable television system investments that raised over $15 million. The Commission consulted with the FBI and U.S. Attorney's office on the case, and provided them access to investigative files and litigation materials. The scheme initially was uncovered and investigated simultaneously by the SEC staff, the FBI, and another U.S. Attorney's office in New Jersey.

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Mary L. Schapiro
President

December 20, 1999

The Honorable John D. Dingell
Ranking Minority Member
Committee on Commerce
U.S. House of Representatives
Room 2125, Rayburn House Office Building
Washington, DC 20515-6115

Dear Representative Dingell:

This is in response to your November 16, 1999, request for information about NASD Regulation's efforts to combat money laundering. In particular, you asked about the extent of our coordination with federal banking and law enforcement entities, as well as our own efforts to educate our members on their obligations to comply with money laundering laws. We are very much aware of the growing concern that money laundering presents for regulators and criminal authorities. While much remains to be done in this important area, we have already taken a number of significant steps to combat this problem. Our efforts and the results we have achieved are described below. In addition, we would be pleased to discuss with you and your staff in a private briefing our involvement in several ongoing, sensitive matters.

Monitor Investment Group, Inc.

Your letter specifically requests information about Monitor Investment Group ("Monitor"). Monitor ceased operations in 1996 and the NASD canceled its membership in 1997. In 1998, after an extensive investigation, NASD Regulation filed a 42-count complaint against the firm and 17 principals and brokers, including the firm's owners, president, head trader and operations and compliance officer. *Department of Enforcement v. Monitor Investment Group, Inc.*, Disc. Proceeding No. C10970145 (January 23, 1998). The complaint covered a broad spectrum of fraudulent activities, including allegations of manipulation of a bulletin board stock, fraudulently excessive markups, Rule 10b-6 violations, and failures to respond truthfully to NASD inquiries.

The hearing took place earlier this year during which 44 witnesses testified. On December 10, 1999, an NASD hearing panel issued a 140-page decision in which it sustained findings of violation with respect to all 42 causes of action, and permanently barred from the securities industry six of the eight remaining respondents.[1] The panel also imposed multi-year suspensions against the other two. A copy of the panel's decision is attached as Addendum A.[2]

__Assistance to Criminal Authorities__

As you know, NASD Regulation's jurisdictional reach in investigating criminal matters such as money laundering, is quite limited. While we can require our member firms and their employees to provide documents and testimony, we do not have jurisdiction to compel this information from non-registered entities and persons. Bank records and funds transfer records too are not generally available to us. As a result, when we are dealing with potential money laundering activity, our district and home offices often work to provide assistance and expertise to law enforcement agencies and regulators with broader jurisdictional reach.

The centerpiece of our cooperation with and assistance to criminal authorities is our Criminal Prosecution Assistance Group ("CPAG"). As you may know, we created this specialized unit to assist criminal prosecutions in securities cases in 1998 as part of our efforts to combat microcap fraud. The purpose of CPAG is to make available to criminal prosecutors and investigating agents throughout the country, the expertise and experience of the NASD for the identification, investigation, and prosecution of securities fraud and related offenses such as money laundering. In it's first 20 months of operation, it has provided assistance to law enforcement agencies in more than 130 different matters.

CPAG has been particularly active in the area of money laundering. Below is a summary of some of the major criminal prosecutions involving money laundering in which CPAG provided assistance:

- **Teletek *(U.S. v. Swan)***
  This federal investigation and trial -- conducted in the federal district of Nevada -- involved payoffs to promoters and brokers to manipulate Teletek, Inc., a microcap stock. CPAG's Chief Counsel was designated as a Special Assistant U.S. Attorney and successfully prosecuted the case. The owner of a brokerage firm, Robert Orkin, was convicted of eighteen counts of money laundering in addition to conspiracy, securities fraud, and wire fraud. Orkin was sentenced to approximately five years in prison and ordered to forfeit more than $325,000. A

[1] The firm and nine of the 17 individual respondents defaulted prior to the commencement of the hearing.

[2] Your letter also mentioned another entity, Summit International Investment Corp. ("Summit"). Summit was not at any time a member of the NASD and therefore is an entity over which we have no jurisdiction.

total of thirty-two defendants have pled guilty to felony charges, including money laundering, structuring, racketeering, securities fraud, and tax evasion. Just last month, the former president of Teletek, Michael Swan, pled guilty to 27 counts of money laundering in addition to 21 counts of securities fraud and 21 counts of wire fraud. The trial continues for the two remaining defendants.

- **Hanover Sterling** ***(U.S. v. Catoggio, et al.)***
  CPAG assisted in this investigation by the U.S. Attorney's Office for the Eastern District of New York. The investigation led to the indictment of fifty-five individuals for their participation in a massive stock manipulation involving four broker-dealers and seventeen microcap securities. In addition to securities fraud, the defendants were charged with money laundering, RICO violations, and mail and wire fraud.

- **Sterling Foster** ***(U.S. v. Randolph Pace, et al.)***
  CPAG provided significant assistance to prosecutors in the U.S. Attorney's Office for the Southern District of New York where numerous individuals and brokerage firms have been indicted in a stock manipulation involving eleven alleged fraudulent public offerings. The charges include securities fraud, mail and wire fraud, and for two individuals (Randolph Pace and Warren Schreiber) conspiracy to commit money laundering.

- **Internet Touting** ***(U.S. v. Napolitano, et al.)***
  With CPAG's assistance, the U.S. Attorney for the Eastern District of New York charged four individuals with conspiracy to commit securities fraud and conspiracy to commit money laundering for their participation in an Internet stock fraud scheme involving eight microcap securities.

As noted earlier, we would be pleased to provide you with a private detailed briefing on these and other ongoing matters.

<u>Examination Procedures</u>

Our written examination procedures or "modules" have long included procedures designed to detect violations of the money laundering laws both in routine examinations and examinations for cause. Our Financial and Operational Examination Module (Module II) contains two sections devoted to determining member firm compliance with federal record keeping and reporting requirements designed to detect money laundering. Section 8.400 is that portion of the examination module that assists the examiner in reviewing for member firm compliance with SEC Rule 17a-8. Rule 17a-8 requires brokers/dealers to file reports and preserve records pursuant to the Currency and Foreign Transaction Reporting Act of 1970 and Department of the Treasury regulations contained in Title 31 of the Code of Federal Regulations (together with other regulations they form what is known as the Bank Secrecy Act). This section also contains an overview of Rule 17a-8 and a description of its provisions, as well as questions for the examiner to answer to determine if the member is in compliance with the rule.

Section 12.000 of the Financial and Operational Examination module assists the examiner in reviewing for compliance with the enhanced record keeping requirements related to transmittals of funds as set forth in the rule jointly adopted by the Financial Crimes Enforcement Network (FinCEN) of the Department of the Treasury and the Board of Governors of the Federal Reserve System. This rule and a companion rule requiring intermediary parties to include all the information received about such wire transfers in their re-transmittal of the wire are called the "Joint and Travel Rules." This section also contains a description of the rules, their provisions, definitions of their terms, and what a member must do to comply with them.

Since at least 1994, the NASD has reported to the SEC, on a semi-annual basis, the number of NASD Regulation examinations completed during the previous six months that discovered actual or apparent violations of Rule 17a-8. In addition, NASD Regulation provides to the SEC copies of examination reports that identified those violations. During 1998, the NASD conducted 2,286 routine examinations and reported 175 violations of Rule 17a-8 to the SEC. Eighty violations were reported to the SEC for routine examinations conducted in the first six months of 1999. Most of the violations reported involved a firm's failure to have adequate supervisory procedures necessary to ensure compliance with the rule.

Member Firm Awareness and Education

In conjunction with our examination procedures, we have educated our members about their responsibilities in the area of money laundering.[3] In January 1989, securities dealers were warned by the New York Stock Exchange and the NASD of their duties in this regard. Both SROs instructed their members of the duty to report non-cash suspicious transactions, including suspected money laundering and BSA violations.

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[3] In 1986, the NASD issued Notice to Members 86-80 that discussed the proposed amendments to the implementing regulations of the Bank Secrecy Act. The proposed amendments included changes to the financial recordkeeping and reporting required of broker-dealers with regard to such transactions. A similar Notice to Members, 87-51, was published the following year. This notice described the final amendments to the regulations. The final rules changed the requirements concerning reporting multiple, same-day currency transactions; the time periods for filing reports; verifying customer identity when filing currency transaction reports; and recording taxpayer identification numbers.

In February 1989, the NASD said this in Notice to Members 89-12:

> "Members also should know that money launderers and others may seek to hide their profits by engaging in transactions that do not involve currency. (The money laundering law) makes it a federal criminal offense to engage in financial or monetary transactions involving the profits from illegal activities that are aimed at, among other things, concealing or disguising the source, ownership, location or nature of profits from unlawful activity or aimed at avoiding . . . reporting statutes . . . . It was the specific intent of Congress . . . to address the laundering of illegal proceeds through wire transfers and other non-cash transactions . . . . A member that, as a matter of policy, does not accept cash still has an obligation to report suspicious transactions. Failure to report such transactions could be construed as aiding and abetting, for which the member may face civil and criminal charges."[4]

The NASD repeated that warning in Regulatory and Compliance Alerts in 1990 and 1991. Copies of the NASD Notices to Members referenced in this letter are attached as Addendum B. The referenced Regulatory and Compliance Alerts are attached as Addendum C.

We have continued to notify our members through Notices to Members of their regulatory responsibilities in the area of money laundering. Our Notices to Members have reported proposed and final changes to recordkeeping and reporting requirements; procedures for handling of wire transfers; and a reminder that members' continuing education programs specifically address money laundering detection as well as more traditional securities-related violations. Below is a list of those Notices:

- 95-69 (August 1995) "Treasury Amends Bank Secrecy Act; Requires Additional Recordkeeping Requirements for Wire Transfers"

- 95-88 (October 1995) "Treasury Delays Effective Date of Wire Transfer Recordkeeping Requirements Until April 1, 1996; Proposes Clarifying Amendments"

- 95-105 (December 1995) "Treasury Offers Revised Currency Transaction Report Form" (with Frequently Asked Questions)

- 96-67 (October 1996) "Bank Secrecy Act Recordkeeping Rule for Funds Transfers and Transmittals of Funds" (with Frequently Asked Questions)

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[4] NTM 89-12 also encouraged our members to use the Treasury's toll-free hotline for reporting suspicious currency transactions and to use the Customs Department's toll-free hotline to report suspicious non-cash activities.

- 97-13 (March 1997) "Bank Secrecy Act Recordkeeping Rule for Funds Transfers and Transmittals of Funds" (with Frequently Asked Questions)

- 98-68 (August 1998) "Update On the Securities Industry Continuing Education Program"

We have also provided our member firms with additional guidance and information on money laundering. In a Regulatory and Compliance Alert in 1989, we notified our members of a hotline established by the U.S. Treasury to report suspicious transactions. In subsequent years, our Alerts reiterated to our members their responsibilities to report certain cash transactions and what types of information to collect and maintain when using money wires.

In 1997, NASD Regulation announced enhancements to its website to allow investors and regulators to use our website to consult the Treasury Department's Office of Foreign Asset Control's (OFAC) list of individuals and companies subject to economic or trade sanction. Securities firms are prohibited from dealing in securities issued from target countries and must "block" or "freeze" accounts, assets and obligations of a large number of blocked entities and individuals from around the world. Through its link to the Treasury Department's OFAC website, NASD Regulation is able to provide brokers around the world with access to the information they need to help prevent money laundering and other illegal activities.

Staff Training

In light of the growing importance of monitoring our member firm's effectiveness for detecting and preventing money-laundering abuses, we have recently bolstered our efforts to train NASD Regulation staff in this area. Toward that end, we have provided training by experts on this subject to our two largest investigative offices. In October, 1998, our Washington, D.C. Enforcement staff received training from the staff of the Department of Justice's Asset Forfeiture & Money Laundering Section. Part of this training was conducted by the Assistant Chief of that Section. Our District 10 staff in New York received similar money laundering training from a Special Agent of the Treasury Department's IRS Criminal Investigation Division just last month. Training materials from each session are attached as Addendum D. Additional money laundering training for our New York examination and enforcement staff is now being arranged. This training will be conducted by federal law enforcement officials in the New York City area.

Finally, one of the primary research tools available to all NASD Regulation staff, Books on Screen, has detailed information on money laundering. These materials include sections on the Bank Secrecy Act, Federal Reserve Board BSA Examination Manual, Criminal Money Laundering Laws, FinCEN guidance, and Money Laundering Alerts. In addition to the pertinent laws and regulations, it also contains the text of the penalties and the related settlement agreements on penalty actions that have been carried out by the U.S. Treasury Department under the Bank Secrecy Act. Another helpful resource that is included in the Money Laundering Edition are the portions of the examiners manuals of the various U.S. financial institution supervisory agencies, including the Federal Reserve Board and the OCC, that deal with the Bank Secrecy Act and money laundering.

I hope this information is helpful. We would be pleased to brief you or members of your staff on any of the matters raised in this letter, as well as provide details of current confidential matters under investigation.

Sincerely,

Mary L. Schapiro

Mary L. Schapiro
President
NASD Regulation, Inc.

Attachments

cc The Honorable Tom Bliley
The Honorable Michael G. Oxley
The Honorable Edolphus Towns
Frank Zarb