TRINIDAD AND TOBAGO SECURITIES AND EXCHANGE COMMISSION

MONEY LAUNDERING RISK AND MITIGATION IN THE SECURITIES INDUSTRY

ADDRESS BY

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AT A BREAKFAST MEETING OF

KPMG'S GLOBAL SURVEY ON ANTI-MONEY LAUNDERING

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Good Morning, Ladies and Gentlemen.

I am thrilled to have the opportunity to address this forum at the invitation of the Principal Partners of KPMG. It pleases me to state that I have had a long, mutually profitable and beneficial association with some of them. In respect of that long association I might for example make reference to certain comments that were made recently and which brought strong reminders of my long association with KPMG.

Last Thursday evening, First Citizens Bank launched a beautiful publication called "On Becoming First" which is a well written and well documented history of the growth of the indigenous banking sector in Trinidad and Tobago. I commend the publication to you all, as it highlights the efforts and challenges faced by sections of the society who were for long periods considered neither to be capable of undertaking the business of banking nor to be worthwhile customers of the foreign banks that dominated the banking sector since Colonial times.

Starting with the history of the Cooperative Bank – which the older ones of us knew as the Penny Bank in 1914, the book chronicles the growth and problems of the Penny Bank, the National Commercial Bank, Workers Bank and Workers Bank (1989) Limited with which I was associated, and the eventual rise of First Citizens from the long history of the efforts and challenges of its precursors.

Part of the story that was revealed on Thursday night gave praises to me for my iconoclastic stance in insisting on and standing up for the

implementation of an innovative information technology platform when I was Managing Director of Workers Bank (1989) Limited. That platform, first implemented in 1993, remains today the backbone of the banking technology employed by First Citizens, allowing that institution to achieve several innovations such as “all branch banking” and internet banking among others, adding to the history of the Coop Bank with its penny deposits and low to middle income residential mortgages, NCB with the first merchant bank and the first credit cards and Workers Bank with the first ATMs.

My achievement of that important milepost in the life of the bank and in my own professional career was done with the support of KPMG in the person primarily of Raoul John and his team. Raoul now wants me to help turn back – or turn forward the clock – by partnering with him again to carry the Securities and Exchange Commission into the next generation of business support technology. Of course we have to wait to see how that particular development goes.

Buy the book!

Let me turn now, after that long digression of recounting my association with KPMG, to the subject at hand.

Today, I'd like to share with you our plans for a new SEC examination initiative designed to focus attention on money laundering compliance by broker-dealers and my thoughts about why the issue of money laundering should be a key part of your compliance efforts. I also wish to share with

you some ideas to consider as you develop or enhance your anti-money laundering compliance program.

Money laundering is a crime that deserves serious attention by securities firms. Under the Proceeds of Crime Act (POCA), securities dealers and investment managers *are* subject to significant compliance obligations and to criminal money laundering provisions. Securities firms need to be aware – if they are not already – of the grave risks that they face if they allow others to launder money through their institutions.

Some of you may ask: Why should the SEC care about money laundering? The securities business is not, for the most part, a cash business readily susceptible to money laundering abuses.

Why? Let's look at the big picture. Trillions of dollars flow through the international securities industry each year. Securities firms are major global financial institutions, either being integral parts of global institutions, or being accessible through their networks of relationships and contacts. The use of our financial system – and the global system as well - by criminals to facilitate fraud could well taint our vibrant capital markets – which help to fuel our economy and hold the savings of our nation's investors. Moreover, as you know, securities firms face potential civil and criminal exposure when they are used to launder profits derived from illegal activities. The large monetary fines and forfeiture provisions that are part and parcel of the existing money laundering laws – POCA provides for fines as high as $10 million dollars and $25 million dollars for certain offences - could seriously impact the financial stability of a securities firm, affecting all those who do

business with that firm. We need to recall that in contrast to these hefty fines under POCA, the minimum required capital for a securities firm in Trinidad and Tobago is only five (5) million dollars.

Almost any of our securities firms that may be faced with a fine under POCA is likely to be completely wiped out with very deleterious consequences for large numbers of ordinary investors.

Let me draw some evidence taken from a Report of the General Accountability Office of the United States Government in 2001. In its Report entitled "Anti Money Laundering Efforts in the Securities Industry" published in October 2001, the US GAO reports:

Statistics on the number of cases in which money was laundered through brokerage firms and mutual funds were not readily available, but we compiled a listing of cases in which illegal funds were laundered through brokerage firms or mutual funds from information provided primarily by two of the law enforcement agencies we contacted. At our request, the Internal Revenue Service and Executive Office for U.S. Attorneys collected information from some of its field staff that identified about 15 criminal or civil forfeiture cases since 1997 that involved money laundering through brokerage and mutual fund accounts. Some cases in which money laundering is alleged involved securities fraud or crimes committed by securities industry employees who then moved their illegally earned proceeds to other institutions or used them to purchase other assets, thus violating the anti-money laundering statutes. However, we only included

such cases if broker-dealer or mutual fund accounts were alleged to have been used to launder the money.

These lists contain examples of cases that involve charges of money laundering through brokerage or mutual fund accounts and do not represent an exhaustive compilation of all such known cases. For example, law enforcement officials indicated that they were unable to provide information on many relevant pending cases in the area and further emphasized that not all field offices and staff had been formally queried. Specific case information presented in the tables was extracted from public documents provided primarily by the Internal Revenue Service and Executive Office for U.S. Attorneys.

I have reproduced the tables from the GAO's report in full in order to bring home to you all the strong possibility that securities firms are at severe risk of money laundering and terrorist financing abuses.

The Commission has been developing a regime of rules and guidelines that are designed to focus our attention on money laundering and counter terrorist financing, for which we have two goals. First, we hope to ensure that all firms in the securities industry institute policies and procedures to combat money laundering. Second, we hope that our interest will spur those firms who already have anti-money laundering programs to ensure that they are top-notch and are being implemented effectively.

While the Commission does not at this stage have clear statutory authority for conducting on-site examinations, this power is clearly provided for in the

new Draft Securities Industry Act which is before the Minister of Finance. In any event, securities firms have been cooperative with the efforts of the Commission to develop an on-site examination capacity and, although not legally obligated to do so have acquiesced to the conduct of examinations by SEC staff. These examinations that were conducted did not specifically review anti-money laundering systems, their coverage does go a significant way towards meeting those requirements because rules currently in force by the SEC and the Stock Exchange already aid in anti-money laundering efforts. For example:

- Securities firms obtain a significant amount of information about their customers such as a customer's employment, income, investment objectives and investment history in order to "know their customers";
- Securities firms and other securities practitioners must maintain records that identify beneficial owners of accounts;
- Employees are screened for criminal or other disciplinary history;
- The Stock Exchange rules require member firms to develop compliance and supervisory programs appropriate for their business. Similarly, securities firms are subject to comprehensive supervisory obligations under SEC and SRO rules, and may be subject to stiff sanctions in the event of a failure to supervise.

In tandem with developing norms and patterns, securities firms, and I daresay a wide range of other professionals, including accountants, lawyers and real estate brokers, need to be alert to indicators of suspicious activity – of abnormal customer or account activity – that are suggestive of potential money laundering activity.

Customer risk indicators include suspicious activity that relates to a customer's identity or the nature of the customer's account. As you know, broker-dealers have existing obligations to identify beneficial owners of accounts, and to ascertain the essential facts relative to every customer. A variety of information about customers is thus available during the account opening process as well as on an ongoing basis and can be used in your compliance efforts. Here are a few examples of "common sense" risk indicators that may be used to trigger additional scrutiny:

Risk Indicators During the Account Opening Process:

- The customer wishes to engage in transactions that lack business sense, apparent investment strategy, or are inconsistent with the customer's stated business/strategy;
- The customer exhibits unusual concern for secrecy, particularly with respect to his identity, type of business, assets or dealings with firms;
- Upon request, the customer refuses to identify or fails to indicate a legitimate source for his funds and other assets;
- The customer exhibits a lack of concern regarding risks, commissions, or other transaction costs;
- The customer appears to operate as an agent for an undisclosed principal, but is reluctant to provide information regarding that entity;
- The customer has difficulty describing the nature of his business;
- The customer lacks general knowledge of his industry;

- For no apparent reason, the customer has multiple accounts under a single name or multiple names, with a large number of inter-account or third party transfers;
- The customer is from, or has accounts in, a country identified as a haven for money laundering;
- The customer, or a person publicly associated with the customer, has a questionable background including prior criminal convictions;

Risk Indicators as Part of Customer Account Activity:

- The customer account has unexplained or sudden extensive wire activity, especially in accounts that had little or no previous activity;
- The customer's account shows numerous currency or cashiers check transactions aggregating to significant sums;
- The customer's account has a large number of wire transfers to unrelated third parties;
- The customer's account has wire transfers to or from a bank secrecy haven country or country identified as a money laundering risk;
- The customer's account indicates large or frequent wire transfers, immediately withdrawn by check or debit card;
- The customer's account shows a high level of account activity with very low levels of securities transactions.

Clearly, this is not an exhaustive list of risk indicators. Also note that identifying risk indicators is a fluid undertaking, as money launderers will change techniques to avoid detection. These indicators are, however,

suggestive of the types of patterns that may warrant further investigation to determine how the firm should respond.

Let me outline a few steps that securities firms and other securities and professional participants may take now – if they haven't already – to combat money laundering and terrorist financing.

- **First, designate a compliance officer.** A firm should designate a person (or committee) as responsible for the firm's entire money laundering program. Vest this person (or committee) with full responsibility and authority to make and enforce the firm's policies and procedures relating to money laundering.
- **Second, develop written policies and procedures.** A firm should clearly state its anti-money laundering policy, and procedures to implement the policy should be set forth in the firm's compliance manual. At a minimum, procedures should include controls and systems designed to identify and capture the information required by anti-money laundering laws, and suspicious activity reporting.
- **Third, ensure management support.** A firm's management – at the most senior level – should be "on board" and very supportive of the firm's anti-money laundering efforts. This needs to be made clear to all employees.
- **Fourth, cover all aspects of the firm's business.** A firm's money laundering detection function should include a variety of different employees and departments that have contact with customers – retail and institutional brokers, margin and credit departments, and new accounts, for example. If a firm does a multi-service business, all aspects of the firm's business should be covered as well.

- **Fifth, train employees.** A firm should train its staff regarding its anti-money laundering efforts. Each segment of a firm's staff should be trained to recognize possible signs of money laundering that could arise during the course of their duties, and know what to do once the risk is identified. Employees need to know their role in the firm's detection efforts, and be trained to knowledgeably perform their roles.
- **Sixth, audit the program.** A firm should have its anti-money laundering program audited by its internal audit department or a suitable third party. Policies and procedures need to be reviewed and tested to ensure that they are actually being implemented, and that they are working as intended.

Really, implementing an anti-money laundering program using these steps is just like implementing any other securities firm compliance programme.

As I have indicated, the Commission is well advanced in its efforts to introduce anti money laundering and counter terrorist financing guidelines for the industry. A considerable part of these guidelines identifies concerns with the Know Your Customer and Customer Due Diligence procedures that firms are expected to introduce, monitor and enforce. In addition the guidelines speak to the requirements for dealing with Politically Exposed Persons, including important Government, political and public sector officials and senior members of political parties.

I want to conclude with a few words on one area which is of particular interest to all securities and financial regulators with concerns about money laundering. Regulators are concerned when financial and securities

transactions take place through anonymous accounts in which it is difficult to readily identify the true beneficiaries of the relevant transactions. All Money Laundering rules that meet international standards prohibit dealing and trading in such accounts. However Trinidad and Tobago is a jurisdiction in which participants love the use of nominee accounts and of trust accounts and so we expect to receive strong resistance in regard to such prohibitions.

Let me indicate that the concern is not so much the existence of such accounts, but there are standards of disclosure that must be met in relation to such accounts that provide for the identification of the trustee and all beneficiaries of such accounts. This information must be available to the securities company that may be conducting transactions on behalf of such accounts and by the regulators when they are conducting oversight or investigatory activities.

Trinidad and Tobago has set itself an important set of targets in regard to its performance as an international financial centre. The country would certainly not achieve any of those targets if it does not rapidly come into compliance with international standards for securities regulation and for the regulation of anti money laundering and counter terrorist financing protocols. The Commission shall shortly be publishing its guidelines in these areas and we look forward to the ready and comprehensive compliance by all participants in the securities industry in our goal to ensure that our market remains fair, stable and attractive to investors and issuers from all parts of the world.

I thank you.