

1 Patriot Act Presentation

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2 Overview

- Latest developments
 - The final CIP rule
- Compliance challenges
 - SAR reporting
 - Name checks
 - Transaction monitoring
- Responding to the first AML audit

3 Part I

Latest Developments
The Final CIP Rule

4 Final CIP Rule

- Takes effect 10-1-03
- Jointly adopted by the SEC and Department of Treasury
- Similar rule adopted for investment companies
- Reflects significant changes in response to comments

5 Overview of Final CIP Rule

- Must collect minimal identifying information about every new customer
- Must verify identity based on collected information
- Must maintain records of verifying information
- Must determine whether customer name appears on government lists
- Must provide notice

6 Verification Procedures

- Must be appropriate for size and business and other risk factors
- Must verify the identify of each new customer to extent reasonable and practical
- Must be risk-based
- Must enable the firm to form a reasonable belief that it knows the true identity of each customer

7 Minimum information

- Name
- Date of birth (for individual customer)
- Address
 - residential or business street address for individual; if none, then for next of kin or other contact individual
 - principal place of business or local office or other location for a non-individual
- Identification number
 - Taxpayer number for U.S. person
 - TIN, passport number, etc., for non-U.S. persons

8 Means of verification

- Like the original proposal, final CIP rule requires verification using documentary and/or non-documentary means
- New provision: CIP must include additional verification procedures in the case of certain non-individual customer accounts

- 9 **Documentary procedures**
- For individuals, government issued photo identification, such as a driver's license or passport
 - For entities, documents showing the entity's existing, such as certified articles or a government-issued business license
 - How realistic?
 - How burdensome?
- 10 **Non-documentary methods**
- **Examples:**
 - contacting the customer
 - use of a consumer reporting agency or public database
 - reference check with other financial institution
 - financial statements
- 11 **Which method to use?**
- **Regulators encourage firms to obtain more than one type of verification**
 - Adopting release recommends use of non-documentary methods to supplement documentary methods
 - **Regulators concerned with pervasiveness of fraudulent documents and identity theft**
- 12 **Retention requirements**
- **Final rule does not require retention of a copy of all documentary evidence (e.g., driver's license)**
 - **However, must retain description of documentary evidence, such as issue and expiry date**
 - **Identifying information must be kept for 5 years after account closed; verifying information must be kept for 5 years after date created**
- 13 **Who is a customer?**
- **A person who opens a new account**
 - **Applies to both natural and non-natural persons**
 - **But does not include:**
 - Financial institution regulated by a Federal functional regulator or a state-regulated bank
 - Governmental agencies
 - Publicly traded companies
- 14 **Existing customers**
- **The CIP rule does not apply to customers with existing accounts so long as the firm has a reasonable belief that it knows the true identity of the customer.**
 - How to establish reasonable belief for existing customers?
- 15 **Who is not a customer?**
- **Generally, only the person who opens the account can qualify as a customer**
 - Someone with authority over the account, but not the account-opener, would not be the customer
 - **Generally, no look-through to:**
 - beneficiaries of a trust
 - beneficial owners in an omnibus account
- 16 **What is an account?**
- **Defined in the rule as including a formal relationship with a broker-dealer established to effect transactions in securities**
 - Does account include situations in which a customer purchases mutual funds or variable products on a subscription way basis?
- 17 **Account transfers**
- **The final rule explicitly excludes from "account" any accounts acquired through an acquisition,**

- merger, purchase of assets or assumption of liabilities
 - Query: how does the acquiring firm satisfy the “reasonable belief” standard?
- 18 **Impact on new account forms**
 - Options:
 - Use new account form to collect the minimal information?
 - Develop supplemental form?
 - Additional information forms for higher risk accounts
- 19 **Retirement plans**
 - The final rule explicitly excludes from “account” any account opened for the purposes of participating in an ERISA plan
 - Query: what about non-ERISA plans?
- 20 **Comparison to Government List**
 - CIP rule requires comparison of customer name against government list
 - Treasury will designate the list for CIP purposes
 - No list has yet been designated
 - Not expected to be OFAC or other government lists that firms have been using
- 21 **Customer Disclosures**
 - New CIP rule requires that a notice be given to a customer when an account is opened
 - Sample notice provided in rule
 - Notice can be oral
 - Notice can posted in lobby or website
 - Query:
 - How to document the giving of the notice?
 - Combine with privacy notice?
- 22 **Part II**
 - Compliance Challenges**
- 23 **A. SAR Reporting**
 - SAR reporting rule became effective 12-30-02
 - Firms required to file a SAR to report a suspicious transaction if:
 - Transaction is conducted or attempted by, at or through a BD
 - Involves or aggregates funds or other assets of at least \$5,000
 - The BD knows, suspects or has reason to suspect that the transaction (or pattern including this transaction) meets any one or more of 4 tests
- 24 **Compliance Challenges**
 - Sufficiency of transaction monitoring
 - Standard to apply to identify activity as suspicious
 - Once activity is deemed suspicious, what action should be taken with respect to the account (close, freeze, monitor, liquidate account?)
 - How broadly to share the fact of the SAR filing with those servicing the account?
- 25 **B. Name Checks**
 - Name check requirements:
 - OFAC

- Various government lists
- Section 314(a) requests
- List to be designated under the CIP rule

26 **When to check the lists**

■ **OFAC**

- Must check before open the account
- Must check before distribute funds from the account
- Periodically?

■ **Other government lists**

- Discretion to determine when to check name against the government lists

27 **Compliance Challenges**

■ **Resource requirements**

■ **Responding to Section 314(a) requests**

■ **Turnaround times for responding to requests/following up on hits**

■ **Designating back-ups**

28 **C. KYC Compliance**

■ **Over the last year, firms have had to revisit their customer information collection procedures**

- AML KYC requirements
- SEC suitability recordkeeping requirements
- Anticipation of final CIP rule

29 **Compliance Challenges**

■ **Missing data for existing clients**

■ **Effort required to populate data**

■ **How to integrate data collection and updating into periodic client contacts**

■ **When to decline business if customer refuses to provide non-mandatory elements**

30 **Part III**

After the First AML Testing

31 **A. Annual Testing**

■ **NASD Rule 3011 requires firms to conduct an annual independent testing of their AML compliance programs**

■ **Regulators expected first testing would be completed prior to 4-24-03**

32 **Testing and Tester Standards**

■ **Who is independent and qualified?**

- Internal audit?
- Legal department?
- Outside consultant?

■ **Baseline for testing?**

- Industry practice?
- How to decide what is industry practice when industry practice is developing

33 **B. Transaction Monitoring**

■ **Initial focus on account opening . . .**

- Efforts to employ appropriate information collection procedures
- Analysis of collected information and other red flags

■ **. . . And account closing**

- Early surrenders, closings

34 **What's next?**

■ **Monitoring for other suspicious transactions in existing customer accounts**

- Third party transfers
- Inflows and outflows
- Balance fluctuations

35 **C. Training and Education**

■ **Tailored to functions:**

- Point-of-sale red flag training
 - What should reps look for?
- Branch managers
- Trade desk
- New accounts

36 **Other considerations**

- **Training should be job specific as well as general**
- **Training should take into account the audiences to be trained**

37 **Conclusion**

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