

FINRA Takes Enforcement Actions Against Two Broker-Dealers for AML Program Failures

As part of Daylight’s continuing efforts to keep financial institutions informed of regulatory developments relating to anti-money laundering compliance, we are sending you a summary of recent activity by the Financial Industry Regulatory Authority (FINRA).

I. INTRODUCTION

On February 2, 2010, FINRA announced enforcement actions against two registered broker-dealers, Penson Financial Services, Inc. and Pinnacle Capital Markets, LLC, based on, among other things, various deficiencies in their anti-money laundering compliance programs (AML programs).¹ The firms settled the matters by consenting to FINRA’s findings as well as fines and disciplinary actions.

II. ALLEGED VIOLATIONS

A. Penson Financial Services, Inc.

FINRA alleged that from October 1, 2003 through May 31, 2008, Penson failed to establish and implement an adequate AML program. As such, the firm violated requirements under the Bank Secrecy Act, USA PATRIOT ACT and FINRA rules. Specifically, according to FINRA, Penson failed to:

1. Develop and implement an AML program reasonably designed to detect, investigate and report suspicious transactions as well as allocate sufficient resources to ensure that suspicious activity was appropriately monitored and reviewed in a timely fashion;
2. Provide a customized AML training program for employees that had “greater exposure to financial transactions”;
3. Assess and consider the money laundering risks potentially posed by certain correspondent accounts for foreign financial institutions; and
4. Document AML procedures that address (i) its identification and risk assessment of correspondent accounts for financial institutions; (ii) the use of its automated system designed to assist with conducting AML reviews; and (iii) updates and enhancements to the AML program as recommended by independent testing reviews.

¹ FINRA’s press release can be found at <http://www.finra.org/Newsroom/NewsReleases/2010/P120859>.

Person was censured and fined \$450,000. Additionally, its AML compliance personnel were required to take 16 hours of enhanced AML training.

B. Pinnacle Capital Markets, LLC

According to FINRA, from January 2006 to September 2009, Pinnacle failed to establish and implement AML procedures reasonably designed to verify customer identities and to detect and cause the reporting of suspicious activity. Pinnacle, which operates an online business providing services primarily to foreign customers, giving them access to the U.S. securities markets, entered into arrangements with foreign financial institutions that establish omnibus accounts. According to FINRA, notwithstanding the fact that the majority of Pinnacle's clients resided in foreign jurisdictions known for heightened money laundering risks, Pinnacle failed to implement and establish an AML program tailored to its risk profile. Specifically, Pinnacle's AML program failed to include an appropriate Customer Identification Program and a program designed to reasonably detect and report suspicious activity. As a result of these failures, FINRA noted that unknown traders were able to facilitate an online "pump and dump" scheme through Pinnacle accounts.

In connection with FINRA's regulatory actions, Pinnacle was (i) censured; (ii) fined in the amount of \$300,000; (iii) required to administer three hours of training to registered persons; and (iv) required to hire an independent consultant to review and issue a written report on its AML program.

III. WHAT THIS CASE MEANS FOR BROKER-DEALERS

A. Importance of a Robust, Risk-Based AML Compliance Program

FINRA Rule 3310 requires broker-dealers to establish and implement an AML program that complies with the Bank Secrecy Act (BSA). The first step in developing an effective AML program is to understand the particular risks associated with a firm's business and customers. Further, the AML program should be customized to the firm's business to identify, manage, monitor and mitigate its risks. Susan Merrill, FINRA Executive Vice President and Chief of Enforcement, emphasized the importance of the implementation of a tailored and risk-based AML program when she stated, "Firms must tailor their AML programs to fit their business models and must consider the technological environment in which they operate and the nature of their client base.... They also must adopt adequate procedures for an AML compliance program, be vigilant in monitoring for suspicious transactions, and allocate adequate resources to their AML compliance efforts."

B. Importance of Training

A firm should undertake efforts to ensure that it develops and maintains an AML training program that not only addresses all regulatory requirements but that is customized to its business model and risks. In addition, firms should ensure that individuals with AML and BSA responsibilities receive training tailored to their specific functions.

C. The Role of Independent Testing

Testing of a broker-dealer's AML program is the last line of defense in ensuring that it satisfies applicable regulatory requirements. To effectively evaluate a firm's AML program, the party conducting the testing must have a comprehensive understanding of the firm's compliance program and the applicable regulatory requirements. In addition, robust testing that includes an assessment of the compliance and information technology aspects of the AML program is vitally important. Finally, testing should provide for communication to senior management as well as tracking the satisfactory resolution of the findings raised during the testing.

IV. HOW DAYLIGHT CAN HELP

Daylight has unparalleled anti-money laundering expertise and our professionals provide a complete array of anti-money laundering services to broker-dealers and other financial institutions. These services include assessing, enhancing, developing and implementing policies, procedures and internal controls, providing training services and conducting independent testing to ensure that a broker-dealer's anti-money laundering compliance program complies with applicable regulatory requirements.

If you would like further information on Daylight's services in these areas, please contact Ellen Zimiles at (212) 554-2602 or Carmina Hughes at (202) 552-8402.