



**Securities Industry Association**

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Via Electronic Mail and U.S. Mail

March 1, 2002

Office of Chief Counsel  
Financial Crimes Enforcement Network  
Department of the Treasury  
P.O. Box 1618  
Vienna, VA 22183-1618

Attention: NPRM – Suspicious Transaction Reporting – Brokers or Dealers in Securities

Re: Proposed Amendment to the Bank Secrecy  
Act Regulations – Requirement of Brokers  
or Dealers in Securities to Report  
Suspicious Transactions

Ladies and Gentlemen:

The Securities Industry Association (“SIA”)<sup>1</sup> appreciates this opportunity to comment on the proposal, pursuant to section 356 of the USA PATRIOT Act<sup>2</sup>, issued by the Financial Crimes Enforcement Network (“FinCEN”)

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<sup>1</sup> The SIA brings together the shared interests of nearly 700 securities firms to accomplish common goals. SIA member firms (including investment banks, brokers-dealers and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly 80 million investors directly and indirectly through corporate, thrift and pension plans. The industry generates \$358 billion of revenue and employs approximately 760,000 individuals. (More information about the SIA is available on its home page: <http://www.sia.com>.)

<sup>2</sup> “Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001,” (“Patriot Act”) Pub. L. No. 107-56 (2001), signed into law by President Bush on October 26, 2001.

of the Department of the Treasury to amend the Bank Secrecy Act (“BSA”) regulations to require broker-dealers to file suspicious activity reports (“SARs”). The SIA supports the proposed rule as an important measure in the prevention of money laundering and the financing of terrorism, which are strongly held goals of our member firms. We have outlined below suggested modifications to the proposal that will enhance the effectiveness of suspicious activity reporting for broker-dealers.

As Treasury is aware, the SIA and the securities industry have actively worked for many years with Treasury and the Securities and Exchange Commission on the development of a SAR rule for broker-dealers. The input we provided on the shaping of an effective broker-dealer SAR rule have been part of our ongoing efforts with Treasury to help implement sound procedures to prevent money launderers from utilizing securities firms to accomplish their illegitimate goals. Accordingly, we applaud the implementation of the requirement for broker-dealers to file SARs.

The SIA has substantial experience in filing SARs. Firms that are subsidiaries or affiliates of bank holding companies or banks have been required to file SARs under rules issued by the Federal bank regulatory agencies, and many other firms have filed SARs voluntarily as a matter of good business practice. We think that the filing of SARs plays an important role in alerting regulators of suspicious activity, and we will work to educate the industry to ensure widespread compliance.

Our recommendations are aimed at providing clarification of the rule’s requirements to broker-dealers, enhancing the effectiveness of suspicious activity reporting, and assuring uniformity with the bank SAR rule. The SIA’s recommendations include: 1) harmonizing the broker-dealer and bank rules to effectively create a uniform reporting structure by adopting the bank suspicious activity reporting threshold for activity where there is no identifiable suspect, and the same definition of “transaction” and penalties as the bank rule; 2) clarifying in the text of the rule that broker-dealers may adopt a risk-based approach in satisfying their suspicious activity reporting requirements; and 3) providing guidance that broker-dealers are not required to report “possible” violations of the securities laws or regulations on a SAR, not required to report violations of state law, and able to share information in determining whether to file a SAR.

## **I. Reporting Requirements Should Be Consistent with Bank Reporting Requirements**

We commend Treasury and FinCEN for attempting to draft a broker-dealer SAR rule that is on par with the bank SAR rule. This approach is in accord with the Patriot Act, which sought to apply comparable requirements to all sectors of the financial services industry. Because we believe it is important to have consistent rules across the financial services industry, SIA has supported the \$5,000 threshold for reporting suspicious transactions – the same as the bank rule – even though transactions in the securities industry are typically much higher.

Adopting the same suspicious activity reporting requirements for broker-dealers and banks is a complicated task because banks are subject to two different sets of SAR rules – FinCEN’s rule and the bank regulatory agencies’ rules.<sup>3</sup> FinCEN’s rule (31 C.F.R. § 103.18) requires the reporting of suspicious activity related to money laundering and violations of the BSA. The bank rules combined the criminal referral rules of the federal financial institutions regulatory agencies with FinCEN’s suspicious activity reporting requirements. The result was a single SAR form for reporting of known or suspected federal criminal violations and suspicious activity related to money laundering and BSA violations. Most of our comments are addressed to the bank regulatory agencies’ rule. We recommend harmonizing the differences between the proposed rule and the bank rule in order to achieve the purposes of the Patriot Act.

- ***Higher Reporting Threshold Where There Is No Identifiable Suspect – Exception to SAR Filing for Robberies Reported to Law Enforcement***

The proposed rule should have the same threshold for Federal criminal violations not involving money laundering activity - where there is no identifiable suspect - as the bank rule. When a suspect cannot be identified for non-money laundering related activity, banks are only required to report suspected criminal violations involving \$25,000 or more. Under section 103.19(a)(2) of the proposed rule, broker-dealers will be required to report suspected criminal violations involving amounts of at least \$5,000, even where a suspect cannot be identified. This difference in the reporting threshold does not harmonize the

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<sup>3</sup> The rules issued by the bank regulatory agencies – the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision and the Federal Reserve Board – are all substantially the same. See, for example, the Federal Reserve’s rule at 12 C.F.R. § 208.62.

reporting requirements of financial institutions, but rather places a greater burden on broker-dealers than is currently placed on banks.<sup>4</sup>

Most importantly, we submit that the resources of industry and law enforcement are better served focusing on suspicious activity related to money laundering or the financing of terrorism than the SARs that will be filed where there is no identifiable suspect for amounts over \$5,000 but under \$25,000 – because these will undoubtedly relate to crimes involving stolen credit cards or checks used by unknown persons. This would be in keeping with Congress's intent that the Patriot Act not interfere with effective law enforcement by requiring unnecessary filings. See Patriot Act at § 366 (a)(3).

The proposed rule should have an exception, as in the bank SAR rule, to filing a SAR form for a robbery or burglary or attempted robbery or burglary when the incident is reported to appropriate law enforcement authorities. See 31 C.F.R. § 103.18(c) and 12 C.F.R. § 208.62(f)(1).

Although broker-dealers typically handle much less cash than banks, securities and other instruments may be stolen. As such, it seems appropriate that an explicit exception be added to the broker-dealer SAR rule for robberies, burglaries, and attempted robberies and burglaries that are reported to appropriate law enforcement authorities.

- ***The Definitions of “Transaction” and the Penalty Provisions Should Be Harmonized With the Bank Rule***

The proposed rule also incorporates several reporting requirements that are not consistent with the requirements for banks. For instance, the proposed definition of “transaction” is broader than the bank rule definition of transaction for money laundering violations.<sup>5</sup> The proposed broker-dealer rule, unlike the bank rule, includes within the definition of transaction a “purchase, sale, loan, pledge, gift, transfer, delivery, or other disposition” including the purchase or sale of any “security, purchase or redemption of any money order, payment or order for any

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<sup>4</sup> In the Proposed Rule at footnote 16, Treasury notes that the bank \$25,000 threshold has not been adopted in the proposed regulations, but offers no explanation for such omission. However, the proposed rule adopts the same filing deadlines as the bank rule, requiring that a SAR be filed within 30 days if a suspect can be identified and 60 days if one cannot. Thus, Treasury recognized – to some extent – the distinction in reporting requirements when a suspect can be identified, and when one cannot.

<sup>5</sup> The banking agency rules only define “transaction” for the money laundering and BSA violation reporting provisions. See for example, the Federal Reserve’s rule at 12 C.F.R. § 208.62.

money remittance or transfer.” In addition, the definition of “security” provided in the proposed rule is somewhat broader than the bank SAR rule.

Moreover, the proposed rule places broker-dealers, for money laundering activity, in a position of having to review records to detect “patterns of transactions.” Specifically, the rule requires reporting when “the broker-dealer knows, suspects, or has reason to suspect that the transaction (**or a pattern of transactions of which the transaction is a part**)(emphasis added)” is related to money laundering. *See* 66 Fed. Reg. 67,676. In contrast, FinCEN’s rule and the bank rule simply require reporting of “any transaction” that the bank “knows, suspects, or has reason to suspect” is related to money laundering and does not require a bank to observe patterns of transactions.

The proposed rule also requires broker-dealers to report any suspicious transaction “relevant to a possible violation of law or regulation.” This broad language is incorporated in FinCEN’s rule, but is not used in the bank rule. As a result, banks, unlike broker-dealers, do not have to report -- for non-money laundering violations -- activity relevant to a possible violation of regulation.

In addition, to achieve the intent of the Patriot Act, the penalties for failing to file a SAR under the proposed rule should be the same as those imposed on banks. That is not the case because the penalties of the proposed rule for all reporting violations, including non-money laundering suspicious activity, are governed by Title 31, while the penalties that are applicable to banks for violations related to the reporting of non-money laundering related activity are governed by the banking laws under Title 12. For instance, under Title 31, civil penalties can be imposed for willful violations up to the amount involved in the transaction (not to exceed \$100,000) or \$25,000. *See* 31 U.S.C. § 5321. Criminal penalties for willful violations can be imposed up to \$250,000, five years in prison or both. *See* 31 U.S.C. § 5322. The bank statutes, on the other hand, contain different civil penalties and do not provide for criminal penalties.

The SIA requests the definitions of transaction and security, the use of “pattern of transactions,” and the penalty provisions in the proposed rule and the bank rule be brought into conformity, unless different treatment in the rules is justified.

## **II. The Rule's Requirements Should Be Clarified To Ensure Effective Reporting**

SIA recommends the following modifications to the proposed rule in order to clarify broker-dealer reporting obligations and enhance the effectiveness of SAR reporting.

- ***Treasury Should Clarify that the Proposed Rule Adopts a Risk-Based Approach To Monitoring For Suspicious Transactions***

SIA supports Treasury's acknowledgement in the preamble to the rule that a broker-dealer's compliance program should adopt a "risk-based" approach that can be "reasonably expected to promote the detection and reporting of suspicious activity." We also agree with Treasury's statement in the preamble that "suspicious transaction reporting requirements are intended to function in such a way as to have the financial institution evaluate customer activity and relationships for money laundering risks." See 66 Fed. Reg. 67,673-674.

Given the complexity of the securities industry, and the considerable differences among and within securities firms, a risk based approach is essential to effective anti-money laundering compliance. To this end, Treasury acknowledges that transactions of a "pension fund of a publicly traded corporation, even though involving a large dollar amount, would likely require a more limited scrutiny than less typical transactions" involving relatively small dollar amounts such as where a customer wishes to open an account using money orders. See 66 Fed. Reg. 67,674, fn. 18. Broker-dealers will follow this same approach for other transactions and accounts that do not raise significant money laundering risks, such as underwritings, loan syndications and ERISA accounts.

Accordingly, in order to ensure that the rule's requirements are applied appropriately throughout the industry, SIA recommends that the text of the final rule – and not just the preamble – make clear that suspicious activity reporting requirements entail a risk-based approach that allows broker-dealers to evaluate their business models, customer activity and relationships for possible money laundering risk.

- ***Treasury Should Clarify That The Proposed Rule Does Not Require Reporting of Possible Violations of Federal Securities Laws or SRO Rules***

Under the proposed rule, a broker-dealer is not required to file a SAR for

possible violations of Federal securities laws or rules of SROs “by the broker-dealer or any of its officers, directors, employees or other registered representatives” “so long as such violation is appropriately reported” to the SEC or a Self-Regulatory Organization (“SRO”). Based on this language, it is unclear whether transactions which are merely “possible” violations of Federal securities laws or SRO rules, but which are not required to be reported to the SEC or SROs, must be reported on a SAR.

Requiring broker-dealers to file SARs for “possible” violations that are not reported to the SEC or SROs would be inconsistent with industry practice, likely to cause confusion and be burdensome. If a transaction arose that appeared to violate the Federal securities laws or rules of an SRO, a broker-dealer would be required to evaluate whether the transaction is reportable under two different standards – SEC/SRO reporting standards and SAR standards.<sup>6</sup> Moreover, the reporting thresholds for the SRO forms are higher than the threshold for a SAR-BD. While the SAR threshold is \$5,000, some transactions must exceed \$10,000 before becoming reportable to an SRO. For other SRO forms, there are reporting thresholds of \$15,000 and \$25,000, depending upon the circumstances of the incident being reported. See NYSE Rule 351(a)(7).

SIA believes that the proposed rule should be clarified to generally except broker-dealers from suspicious activity reporting for Federal securities law violations and violations of SRO rules. (The rule could be clarified simply by eliminating the language “so long as such violation is appropriately reported to the Securities and Exchange Commission or an SRO.”) This interpretation seems to be supported by the preamble to the rule, which states that securities laws violations may be reported “under existing industry procedures rather than through a SAR-BD.” Treasury further explains in the preamble that the exceptions “are designed to permit the reporting of those potential violations according to present procedures and modes in the securities industry.”

In addition, under the proposed rule, a broker-dealer need not report "a possible violation of any of the federal securities laws or rules of" an SRO "by the broker-dealer or any of its officers, directors, employees or other registered

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<sup>6</sup> Broker-dealers file Form U-4 with the National Association of Securities Dealers (“NASD”) to apply for securities industry registration or transfer, Form U-5 with the NASD to terminate securities industry registration, and Form RE-3 with the New York Stock Exchange (“NYSE”) to report incidents that fall under NYSE Rule 351. Rule 351 requires members of the NYSE to report incidents including violations of “any provision of any securities law or regulation.”

representatives" on a SAR-BD "**other than a violation of 17 CFR 240.17a-8 or 17 CFR 405.4.**" The SIA requests that Treasury clarify what is meant by "other than a violation of 17 CFR 240.17a-8 or 17 CFR 405.4." These sections make a violation of the BSA regulations a violation of the SEC rules.

The failure to file a SAR-BD would be a violation of the BSA and, under the existing regulatory scheme, also a violation of SEC Rule 17a-8. Thus, the exception as drafted, would cover all reporting on a SAR-BD, even possible violations of the federal securities laws. Therefore, the proposed rule should be revised simply to state that currency reporting violations, the unlawful transportation of monetary instruments and structuring are not exempt from reporting on a SAR-BD.

- ***The Rule Should Make Clear That Reporting of Possible Violations of State Law Are Not Required***

The rule could be read to require the reporting of suspicious activity related to violations of state law. The rule (in proposed 31 C.F.R. § 103.19) requires the reporting of "any suspicious transaction relevant to a possible violation of law or regulation." Reporting of "any" transaction relevant to a possible violation of "law or regulation" could be interpreted to include possible violations of state law or even foreign law. However, the rule goes on to specifically enumerate transactions that must be reported and references only violations of Federal law. Specifically, the rule requires reporting of "any known or suspected violation of Federal law, or a suspicious transaction related to a money laundering activity or a violation of the Bank Secrecy Act."

We do not believe it was Treasury's intent to require the reporting of activity related to state or foreign law violations. Moreover, the bank rule does not contain this ambiguity because it states that a SAR must be filed when a bank "detects a known or suspected violation of Federal law." Thus, the SIA requests that the rule be clarified to require broker-dealers to report any suspicious transaction relevant to a possible "violation of Federal law."

- ***The Proposed Rule Should Make Clear That Introducing Firms and Clearing Firms Are Able To Share Information In Order To Determine If A SAR Needs To Be Filed***

SIA requests that the proposed rule's provision that prohibits the disclosure of a SAR should be clarified to permit introducing brokers and clearing

brokers or prime brokers to share information regarding SAR filings in order to ensure that the parties are satisfying their reporting obligations. This is necessary because the present regulatory scheme allows such firms contractually to allocate account responsibilities between themselves. *See* NYSE Rule 382(b). Being able to share information is important because introducing firms are in the best position to know the customer, while clearing firms may have certain other information regarding account activity.

The rule should also allow financial institutions that are affiliated to share information regarding the filing of SARs. This would permit affiliated entities, such as a broker-dealer and a bank that are part of the same holding company, to discharge their reporting obligations by filing one SAR on behalf of the entire organization. The result would be a reduction in duplicative or unnecessary filings.

- ***Applicability To Insurance Companies Registered as Broker-Dealers/Futures Commission Merchants***

The proposal's application to insurance companies registered as broker-dealers needs to be clarified. The rule defines "broker-dealers" to include insurance companies or their affiliates that are registered broker-dealers simply to permit the sale of variable annuities treated as securities under the Securities Exchange Act of 1934. Thus, it is not clear whether the rule applies to all transactions performed by insurance companies registered as broker-dealers, or if it applies only to transactions in the variable annuities for which the companies are registered as broker-dealers.

We believe the purpose of the rule is to detect money laundering in securities transactions, and not to regulate non-securities insurance products. In light of this, the only additional obligation which should be placed on broker-dealer insurance companies is an obligation to file SARs for suspicious transactions related to variable annuities.

Treasury should also clarify whether the proposed rule applies to futures transactions. If futures transactions are covered, then Treasury should also revise the rule to reflect that futures commission merchants are protected by the safe harbor.

- ***Safe Harbor for Arbitration, Duplicative Reporting and Burden Estimates***

Treasury acknowledges in the proposed rule that there may be some practical difficulty in applying a statutory safe harbor provision in arbitration and states that FinCEN “intends to work with the SEC, SROs, and industry representatives to ensure that appropriate educational materials are delivered to compliance and litigation personnel.” See 66 Fed. Reg. 67,675. The safe harbor provision, by shielding those who file SARs from liability, is essential to meaningful suspicious activity reporting. Thus, we concur with Treasury that those who conduct arbitrations – the SROs – need to be trained in the safe harbor and its application to arbitration in order for the extension of the safe harbor to arbitration to be effective. We commit to work with the agencies to prepare educational materials and whatever training is necessary.

Treasury also states that it anticipates that “when this proposed rule becomes effective, the Federal bank supervisors will amend or repeal, as appropriate, any duplicative suspicious activity reporting requirements for broker-dealers.” See 66 Fed. Reg. 67,672-673. SIA encourages Treasury to coordinate expeditiously with the Federal banking agencies to repeal prior to the effective date of this rule any suspicious activity reporting rules of those agencies that apply to broker-dealers. Failure to repeal any such duplicative reporting could create uncertainty in reporting obligations, and possible additional burdens.

Finally, in estimating that the burden imposed by the proposed rule will be on average three hours per form, Treasury drastically underestimates the time involved in filing an SAR. Treasury states that the three-hour estimate includes the time involved in reviewing records to determine whether the activity requires reporting. SIA’s experience is that in most cases three hours would be the minimum time involved in making a suspicious activity report. Rather, because of the difficulty of analyzing very complex transactions, in most cases the process of determining whether an activity requires reporting will take much more time, and in some cases can take several days, and at times weeks.

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We appreciate the opportunity to comment on the proposed rule and the time Treasury has given to consider industry's views. If you wish to receive additional information related to our comments, please feel free to contact us.

Sincerely,

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