

DEPARTMENT OF THE TREASURY

31 CFR Part 103

RIN 1506-AA21

Financial Crimes Enforcement Network; Proposed Amendment to the Bank Secrecy Act Regulations—Requirement of Brokers or Dealers in Securities to Report Suspicious Transactions**AGENCY:** Financial Crimes Enforcement Network ("FinCEN"), Treasury.**ACTION:** Notice of proposed rulemaking.

SUMMARY: FinCEN is proposing to amend the Bank Secrecy Act regulations to require brokers or dealers in securities ("broker-dealers") to report suspicious transactions to the Department of the Treasury. This is the fourth proposal to be issued by FinCEN concerning the reporting of suspicious transactions by the major categories of financial institutions operating in the United States, as a part of the counter-money laundering program of the Department of the Treasury.

DATES: Written comments on all aspects of the proposal are welcome and must be received on or before March 1, 2002.

ADDRESSES: Written comments should be submitted to: Office of Chief Counsel, Financial Crimes Enforcement Network, Department of the Treasury, P.O. Box 1618, Vienna, Virginia 22183-1618, *Attention:* NPRM—Suspicious Transaction Reporting—Brokers or Dealers in Securities. Comments also may be submitted by electronic mail to the following Internet address: regcomments@fincen.treas.gov, again with a caption, in the body of the text, "*Attention:* NPRM—Suspicious Transaction Reporting—Brokers or Dealers in Securities." For additional instructions on the submission of comments, see **SUPPLEMENTARY INFORMATION** under the heading "Submission of Comments."

Inspection of comments. Comments may be inspected, between 10 a.m. and 4 p.m., in the FinCEN reading room in Washington, DC. Persons wishing to inspect the comments submitted must request an appointment by telephoning (202) 354-6400.

FOR FURTHER INFORMATION CONTACT: Peter G. Djinis, Executive Assistant Director for Regulatory Policy, FinCEN, at (703) 905-3930; Cynthia L. Clark, Deputy Chief Counsel, FinCEN, at (703) 905-3590; Judith R. Starr, Chief Counsel, FinCEN, at (703) 905-3534.

SUPPLEMENTARY INFORMATION:**I. Background***A. General Statutory Provisions*

The Bank Secrecy Act, Public Law 91-508, as amended, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5331, authorizes the Secretary of the Treasury, *inter alia*, to issue regulations requiring financial institutions to keep records and file reports that are determined to have a high degree of usefulness in criminal, tax, and regulatory matters, or in the conduct of intelligence or counter-intelligence activities, to protect against international terrorism, and to implement counter-money laundering programs and compliance procedures.¹ Regulations implementing Title II of the Bank Secrecy Act (codified at 31 U.S.C. 5311-5330) appear at 31 CFR part 103. The authority of the Secretary to administer the Bank Secrecy Act has been delegated to the Director of FinCEN.

B. Suspicious Transaction Reporting

The Secretary of the Treasury was granted authority in 1992, with the enactment of 31 U.S.C. 5318(g),² to require financial institutions to report suspicious transactions. Subsection (g)(1) states generally:

The Secretary may require any financial institution, and any director, officer, employee, or agent of any financial institution, to report any suspicious transaction relevant to a possible violation of law or regulation.

Subsection (g)(2) provides further:

A financial institution, and a director, officer, employee, or agent of any financial institution, who voluntarily reports a suspicious transaction, or that reports a suspicious transaction pursuant to this section or any other authority, may not notify any person involved in the transaction that the transaction has been reported.

Subsection (g)(3) provides that neither a financial institution, nor any director,

¹ Language expanding the scope of the Bank Secrecy Act to intelligence or counter-intelligence activities to protect against international terrorism was added by Section 358 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001 (the "USA Patriot Act"), Public Law 107-56.

² 31 U.S.C. 5318(g) was added to the Bank Secrecy Act by section 1517 of the Annunzio-Wylie Anti-Money Laundering Act (the "Annunzio-Wylie Anti-Money Laundering Act"), Title XV of the Housing and Community Development Act of 1992, Public Law 102-550; it was expanded by section 403 of the Money Laundering Suppression Act of 1994 (the "Money Laundering Suppression Act"), Title IV of the Riegle Community Development and Regulatory Improvement Act of 1994, Public Law 103-325, to require designation of a single government recipient for reports of suspicious transactions.

officer, employee, or agent of any financial institution

that makes a disclosure of any possible violation of law or regulation or a disclosure pursuant to this subsection or any other authority * * * shall * * * be liable to any person under any law or regulation of the United States or any constitution, law, or regulation of any State or political subdivision thereof, for such disclosure or for any failure to notify the person involved in the transaction or any other person of such disclosure.

Finally, subsection (g)(4) requires the Secretary of the Treasury, "to the extent practicable and appropriate," to designate "a single officer or agency of the United States to whom such reports shall be made."³ The designated agency is in turn responsible for referring any report of a suspicious transaction to "any appropriate law enforcement or supervisory agency." *Id.*, at subsection (g)(4)(B).

In the USA Patriot Act, Congress specifically addressed the issue of suspicious transaction reporting by broker-dealers. Section 356 of the USA Patriot Act requires Treasury, after consultation with the Securities and Exchange Commission and the Board of Governors of the Federal Reserve System, to publish proposed regulations before January 1, 2002, requiring broker-dealers to report suspicious transactions under 31 U.S.C. 5318(g). Section 356 requires final regulations to be issued by July 2, 2002.⁴

³ This designation does not preclude the authority of supervisory agencies to require financial institutions to submit other reports to the same agency or another agency "pursuant to any other applicable provision of law." 31 U.S.C. 5318(g)(4)(C).

⁴ The Congressional mandate to extend suspicious transaction reporting to broker-dealers reflects the concern of other governmental and international bodies about the need for an appropriate suspicious transaction reporting regime in the securities industry. For example, one of the central recommendations of the Financial Action Task Force ("FATF"), an inter-governmental body whose purpose is development and promotion of policies to combat money laundering, is that:

If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the competent authorities.

Financial Action Task Force Annual Report (June 28, 1996), Annex 1 (Recommendation 15). The recommendation applies equally to broker-dealers as to banks. See also, the European Community's *Directive on prevention of the use of the financial system for the purpose of money laundering. EC Directive*, O.J. Eur. Comm. (No. L 166) 77 (1991), Article 6. Accord, *the Model Regulations Concerning Laundering Offenses Connected to Illicit Drug Trafficking and Related Offenses of the Organization of American States*, OEA/Ser. P. AG/Doc. 2916/92 rev. 1 (May 23, 1992), Article 13, section 2.

The International Organization of Securities Commissions ("IOSCO") recommended in 1992 that member states consider "together with their national regulators charged with prosecuting money

C. Anti-Money Laundering Programs

The provisions of 31 U.S.C. 5318(h), also added to the Bank Secrecy Act in 1992 by section 1517 of the Annunzio-Wylie Anti-Money Laundering Act, authorize the Secretary of the Treasury "[i]n order to guard against money laundering through financial institutions * * * [to] require financial institutions to carry out anti-money laundering programs." 31 U.S.C. 5318(h)(1). Those programs may include "the development of internal policies, procedures, and controls"; "the designation of a compliance officer"; "an ongoing employee training program"; and "an independent audit function to test programs." 31 U.S.C. 5318(h)(A-D).

Section 352 of the USA Patriot Act amended section 5318(h) to mandate compliance programs for all financial institutions defined in 31 U.S.C. 5312(a)(2). Section 352 of the USA Patriot Act is effective April 24, 2002.

D. Broker-dealer Regulation and Money Laundering

Broker-dealer operations are keyed primarily to the purchase and sale of securities both for customers and for their own accounts. Broker-dealers do not usually expect to receive from or disburse to customers significant amounts of currency, and they are not direct participants in the payment system. However, despite the limited use of currency in the normal course of broker-dealer business generally, there are broker-dealers that accept small amounts of currency or that accept currency transactions approved by a legal or compliance department.⁵ In addition, while broker-dealers are not direct participants in the payment system, they do facilitate transfers or transmittals of funds for their customers.

Money laundering occurs through broker-dealers, as it does through all

laundering offenses, the appropriate manner in which to address the identification and reporting of suspicious transactions" and "the appropriate means to ensure that securities and futures firms maintain monitoring and compliance procedures designed to deter and detect money laundering." IOSCO Report on Money Laundering, Conclusions 3 and 5, May 1992.

⁵ Report to the Chairman, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate, Anti-Money Laundering Efforts in the Securities Industry, GAO-02-111, October 2001 ("the GAO Report"). In addition, there are broker-dealers that accept cashier's checks, money orders, and traveler's checks. Of those broker-dealers that accept such financial instruments, 70 percent accept cashier's checks, nearly 40 percent accept money orders, and approximately 20 percent accept traveler's checks. See, the GAO Report at 26.

categories of financial institutions.⁶ Although the known experience of depository institutions with significant money laundering is greater than the known experience of the securities industry with money laundering, this difference may reflect the fact that criminal funds enter broker-dealer accounts at a later stage in the laundering process, when those funds are less immediately identifiable than at the placement stage. Past investigative attention, however, has focused more intensively on the "placement" stage of money laundering (especially the suspicious placement into the financial system of large amounts of currency) than on transfers or conversions of illicit funds once they are already in the financial system. In addition, there may be reason to fear a potential increased use of broker-dealers for laundering purposes in the wake of the growth of the broker-dealer industry and as criminals develop new ways to launder money. The attention previously given to the prevention of money laundering through banks reflects the central role of banking institutions in the global payments system and the global economy. But broker-dealers also play a global role and their array of financial services is increasingly competitive with that of banks, for example, for high net worth individuals.

The regulation of the securities industry in general and of broker-dealers in particular relies on both the Securities and Exchange Commission and the registered securities associations and national securities exchanges (so-called self-regulatory organizations or "SROs"). Broker-dealers have long reported possible securities law violations through existing relationships with law enforcement, the Securities and Exchange Commission and the SROs. Any effective system of suspicious transaction reporting needs to consider the existing broker-dealer regulatory structure, particularly existing

procedures for reporting violations of securities laws. Both the Securities and Exchange Commission and the SROs have taken measures to address money laundering concerns at broker-dealers.⁷ The Securities and Exchange Commission adopted rule 17a-8 in 1981 under the Securities and Exchange Act of 1934 ("Exchange Act"), which enables the SROs, subject to Securities and Exchange Commission oversight, to examine for Bank Secrecy Act compliance. Accordingly, both the Securities and Exchange Commission and SROs will address broker-dealer compliance with this rule.

Finally, certain broker-dealers have been subject to suspicious transaction reporting since 1996. In particular, broker-dealers that are affiliates or subsidiaries of banks or bank holding companies have been required to report suspicious transactions by virtue of the application to them of rules issued by the federal bank supervisory agencies. In April 1996, banks, thrifts, and other banking organizations became subject to a requirement to report suspicious transactions pursuant to final rules issued by FinCEN⁸, under the authority contained in 31 U.S.C. 5318(g). In collaboration with FinCEN, the federal bank supervisors (the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration) concurrently issued suspicious transaction reporting rules under their own authority. See 12 CFR 208.62 (Federal Reserve Board); 12 CFR 21.11 (OCC); 12 CFR 353.3 (FDIC); 12 CFR 563.180 (OTS); and 12 CFR 748.1 (NCUA). The bank supervisory agency rules apply to banks, to non-depository

⁷ For example, in April 2001, the Director of the Office of Compliance Inspections and Examinations at the Securities and Exchange Commission announced that the Commission would undertake compliance sweeps of broker-dealers in the fall of 2001. See Money Laundering: It's on the SEC's Radar Screen, Remarks at the Conference on Anti-Money Laundering Compliance for Broker-Dealers Securities Industry Association (May 8, 2001) (transcript available at www.sec.gov/news/speech/spch486.htm). BSA compliance with non-SAR related provisions has been included in the SEC's examination and enforcement programs since the 1970s, and in the SROs' programs since 1982. The New York Stock Exchange and the National Association of Securities Dealers have both issued statements going back to 1989 regarding the importance of suspicious activity reporting to avoid money laundering charges. See the GAO Report at 22.

⁸ See 31 CFR 103.18. The suspicious transaction reporting rules under the BSA for banking organizations previously appeared at 31 CFR 103.21 before that section was renumbered as 31 CFR 103.18. See 65 FR 13683, 13692 (March 14, 2000).

⁶ See, e.g., *United States v. Kneeland*, 148 F.3d 6 (1st Cir. 1998) (funds obtained in "advance fee" fraud transferred from corporate to defendant's personal bank accounts, and from there to defendant's brokerage account, from brokerage account to commodities broker, and from commodities broker back to personal bank account); *United States v. Sabbath*, 125 F.Supp. Lexis 18999 (E.D.N.Y. 2000) (owner of failing company withdrew funds from corporation in months preceding bankruptcy, transferring those funds to a brokerage account in wife's maiden name, with mother-in-law's address, and a false social security number; money from corporation routed through several bank accounts before its final transfer to brokerage account); *United States v. Taylor*, 984 F.2d 298 (9th Cir. 1993) (funds received upon fraudulent export sale of cellular telephones laundered through brokerage account). See also, the GAO Report at 68-69.

institution affiliates and subsidiaries of banks and bank holding companies (including broker-dealers), and to bank holding companies (including bank holding companies that are themselves broker-dealers).⁹ The rule proposed today is intended to apply to all broker-dealers, without regard to whether they are affiliates or subsidiaries of banks or bank holding companies.¹⁰

Developing suspicious activity reporting rules appropriate to broker-dealers industry-wide involves taking into consideration many important issues. Appropriate suspicious transaction reporting by broker-dealers can provide significant information for criminal law enforcement, tax and regulatory authorities about potential criminal activity (as well as about previously undetected money laundering).

E. Suspicious Transaction Reporting by Broker-Dealers—General Issues

This notice of proposed rulemaking would generally require broker-dealers to report suspicious transactions to the Department of the Treasury. Several general issues cut across specific proposed provisions, and it may be helpful to note those issues at the outset.

1. *Definition of Broker-Dealer.* In light of the definition of “broker or dealer in securities” in 31 CFR 103.11(f), reporting would be required by any:

broker or dealer in securities, registered or required to be registered with the Securities Exchange Commission under the Securities Exchange Act of 1934.¹¹

⁹ For example, 12 CFR 225.4(f) subjects non-bank subsidiaries of bank holding companies to the suspicious transaction reporting requirements of Regulation H of the Board of Governors at 12 CFR 208.62. Broker-dealers to which the bank supervisory agency rules for suspicious transaction reporting currently apply represent approximately half of the business of the broker-dealer industry, though in terms of numbers, they are only a small percentage of the approximately 8,300 broker-dealers in the United States.

¹⁰ Money transmitters, issuers, sellers, and redeemers of money orders, and issuers, sellers, and redeemers of traveler's checks will become subject to a similar reporting requirement pursuant to a final rule published in the *Federal Register* on March 14, 2000. See 31 CFR 103.20. Under that rule, reporting will be required for suspicious transactions involving or aggregating at least \$2,000 in general or at least \$5,000 in the case of issuers of money orders and traveler's checks to the extent the transactions to be reported are identified from a review of clearance records and similar documents. Finally, FinCEN has proposed a rule that would require casinos and card clubs to report suspicious transactions involving or aggregating at least \$3,000. See 63 FR 27230 (May 18, 1998).

¹¹ The definitions of “broker,” “dealer,” and “security,” for purposes of the Securities Exchange Act of 1934 appear in sections 3(a)(4) (“broker”), 3(a)(5) (“dealer”), and 3(a)(10) (“security”) of that Act, 15 U.S.C. 78c(a)(4), (5), and (10).

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 would be subject, under the proposed rule, to suspicious transaction reporting obligations. This treatment represents a change from prior treatment of insurance companies required to register as broker-dealers in order to sell variable annuities. In 1972, Treasury exempted from the provisions of 31 CFR 103 persons required to register with the Securities and Exchange Commission as broker-dealers solely in order to offer and sell variable annuity contracts issued by life insurance companies. 37 FR 248986 (November 23, 1972). The exemption is inapplicable, however, if such a registered broker-dealer at any time offers and sells other types of securities in addition to variable annuities. FinCEN anticipates that this exemption will be withdrawn on the effective date of the final rule based on this notice of proposed rulemaking. Once the exemption is withdrawn, persons required to register as broker-dealers in order to offer and sell variable annuity contracts issued by life insurance companies will be required to comply with all applicable BSA requirements.

2. *Use of Suspicious Transaction Reports—Centralized Data Base.* As is the case with reporting by other categories of financial institutions subject to the Bank Secrecy Act, reports of suspicious activity made by broker-dealers under the proposed rule would be maintained in an automated data base containing information from all broker-dealer filings. The data base will permit rapid dissemination to appropriate agencies and self-regulatory organizations registered with the Securities and Exchange Commission of reports within their jurisdiction,¹² more thorough analysis and tracking of those reports, and, in time, the provision to the financial community of information about trends and patterns gleaned from the information reported, all as contemplated by the Congress.

II. Specific Provisions

A. 103.11(ii)—Transaction

The definition of “transaction” in the Bank Secrecy Act regulations for purposes of suspicious transaction reporting conforms generally to the definition Congress added to 18 U.S.C. 1956 when it criminalized money laundering in 1986. See Public Law 99–570, Title XIII, 1352(a), 100 Stat. 3207–

18 (Oct. 27, 1986). This notice proposes to amend that definition explicitly to include transactions involving any instrument that falls within the definition of “security” in section (3)(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10), and to add a corresponding definition of “security” to 31 CFR part 103. These changes are necessary so that the reporting rules will conform to the definition of broker or dealer in securities in 31 CFR 103.11(f) and cover all activity that should be reported under the proposed rule.

B. 103.19—Reports of Suspicious Transactions

General. Proposed section 103.19 contains the rules setting forth the obligation of broker-dealers to report suspicious transactions that are conducted or attempted by, at, or through a broker-dealer and involve or aggregate at least \$5,000 in funds or other assets. It is important to recognize that transactions are reportable under this rule and 31 U.S.C. 5318(g) whether or not they involve currency.¹³

The obligation extends to transactions conducted or attempted by, at, or through, the broker-dealer. However, paragraph (a) also contains language designed to encourage the reporting of transactions that appear relevant to violations of law or regulation, even in cases in which the rule does not explicitly so require, for example in the case of a transaction falling below the \$5,000 threshold in the rule.

Paragraph (a)(1) contains the general statement of the obligation to file. To clarify that the proposed rule creates a uniform reporting requirement for broker-dealers and banking organizations, the language of the reporting obligation incorporates language from suspicious activity reporting rules contained in both Title 12 and Title 31. Thus, the rule requires the reporting of all activity “relevant to a possible violation of law or regulation,” including “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”. It is anticipated that, when this proposed rule becomes effective, the federal bank

¹³ Many currency transactions are *not* indicative of money laundering or other violations of law, a fact recognized both by Congress, in authorizing reform of the currency transaction reporting system, and by FinCEN in issuing rules to implement that system (See 31 U.S.C. 5313(d) and 31 CFR 103.22(d), 63 FR 50147 (September 21, 1998)). But many non-currency transactions, (for example, funds transfers) *can* indicate illicit activity, especially in light of the breadth of the statutes that make money laundering a crime. See 18 U.S.C. 1956 and 1957.

¹² See 31 U.S.C. 5319, as amended by the USA Patriot Act.

supervisors will amend or repeal, as appropriate, any duplicative suspicious activity reporting requirements for broker-dealers.

Paragraph (a)(2) specifically describes two categories of transactions that require reporting. The first category, described in proposed paragraph (a)(2)(i), would require broker-dealers to report any known or suspected Federal criminal violation, committed or attempted against, or through, a broker-dealer. This language is intended to clarify the fact that broker-dealers must report all suspicious transactions that are relevant to a possible violation of law or regulation. Similar language appears in the suspicious activity reporting rules imposed by the federal bank supervisors under Title 12.

The second category of reportable transactions is contained in proposed paragraph (a)(2)(ii), which would require broker-dealers to report to the Treasury Department a transaction if the broker-dealer knows, suspects, or has reason to suspect that it is one of three classes of transactions (described more fully below) requiring reporting. The "knows, suspects, or has reason to suspect" standard incorporates a concept of due diligence in the reporting requirement.

The first class, described in proposed paragraph (a)(2)(ii)(A), includes transactions involving funds derived from illegal activity or intended or conducted in order to hide or disguise funds or assets derived from illegal activity. The second class, described in proposed paragraph (a)(2)(ii)(B), involves transactions designed, whether through structuring or other means, to evade the requirements of the Bank Secrecy Act. The third class, described in proposed paragraph (a)(2)(ii)(C), involves transactions that appear to serve no business or apparent lawful purpose, and for which the broker-dealer knows of no reasonable explanation after examining the available facts relating to the transaction and the parties.

It should be noted that the standard of reporting for the second reporting category differs from that of the first. Under the first reporting category, the broker-dealer must report "known or suspected" criminal activity. In contrast, the second category of reportable activity requires reporting if a broker-dealer "knows, suspects, or has reason to suspect" (emphasis added) that a transaction should be reported under the rule. The inclusion of two distinct reporting standards in the proposed rule is consistent with the suspicious activity reporting regime to

which banking organizations are currently subject.¹⁴

A determination as to whether a report is required must be based on all the facts and circumstances relating to the transaction and customer of the broker-dealer in question. Different fact patterns will require different types of judgments. In some cases, the facts of the transaction may indicate the need to report. For example, frequent and large-scale usage of wire transfer facilities within a brokerage, with nominal or nonexistent securities purchases or sales may be indicative of suspicious activity. Similarly, the fact that a customer refuses to provide information necessary for the broker-dealer to make reports or keep records required by this Part or other regulations, provides information that a broker-dealer determines to be false, or seeks to change or cancel a transaction *after* such person is informed of currency transaction reporting or information verification or recordkeeping requirements relevant to the transaction would all indicate that a Suspicious Activity Report-BD (SAR-BD)¹⁵ should be filed. (Of course, as the proposed rule makes clear, the broker-dealer may not notify the customer that it intends to file or has filed a suspicious transaction report with respect to the customer's activity.)

In other situations a more involved judgment may need to be made to determine whether a transaction is suspicious within the meaning of the rule. Transactions that raise the need for such judgments may include, for example, (i) transmission or receipt of funds transfers without normal identifying information or in a manner that indicates an attempt to disguise or hide the country of origin or destination or the identity of the customer sending the funds or of the beneficiary to whom the funds are sent; or (ii) repeated use of an account as a temporary resting place for funds from multiple sources without a clear business purpose therefor. The judgments involved will also extend to whether the facts and circumstances and the institution's knowledge of its customer provide a reasonable explanation for the transaction that removes it from the suspicious category.

31 U.S.C. 5318(g)(1) authorizes Treasury to require suspicious transaction reporting not only by financial institutions but by "any director, officer, employee, or agent of

any financial institution." This proposed rule addresses reporting by broker-dealers, but not by individual employees of a broker-dealer who are "associated persons" of that broker-dealer. FinCEN does not intend to reduce in any way the obligations of broker-dealer employees or agents, within the context of a broker-dealer's general regulatory or specific Bank Secrecy Act compliance programs, but simply to avoid at this time creating an obligation on the part of broker-dealer employees and agents *independent* of those general obligations.

The means of commerce and the techniques of money launderers are continually evolving, and there is no way to provide an exhaustive list of suspicious transactions. FinCEN hopes to continue its dialogue with the securities industry about the manner in which a combination of government guidance, training programs, and government-industry information exchange can smooth the way for operation of the new suspicious activity reporting system in as flexible and cost-efficient a way as possible.

Reporting Threshold. The proposed rule requires the reporting of suspicious transactions of at least \$5,000.¹⁶ FinCEN is aware of concern on the part of some broker-dealers that the threshold would operate mechanically to require broker-dealers to establish programs to examine every transaction occurring at the threshold level.¹⁷ The suspicious transaction reporting rules, however, are not intended to operate (and indeed cannot properly operate) in a mechanical fashion. Rather, the suspicious transaction reporting requirements are intended to function in such a way as to have financial institutions evaluate customer activity

¹⁶ Broker-dealers covered by the bank supervisory rules for suspicious transaction reporting already comply with a \$5,000 threshold for suspicious transactions relating to money laundering, BSA violations, and other criminal violations with respect to which a suspect can be identified. However, under those rules, a \$25,000 reporting threshold applies to other criminal violations with respect to which a suspect cannot be identified. The proposed rule does not adopt this two-tiered approach.

¹⁷ The GAO report includes information, based on a survey conducted by the GAO, regarding the average size of transactions for retail customers of broker-dealers. The report concludes that the average dollar size of individual transactions (those involving securities trades) was \$22,306 (with \$5,000 as the most frequent size transaction). The report cautions, however, that GAO was not able to develop meaningful estimates for the entire industry because of the low number of firms that provided information and the wide range of responses.

¹⁴ See, e.g., 12 CFR 208.62(c) and 31 CFR 103.18(a)(2).

¹⁵ The term "BD" is an abbreviation for "broker or dealer in securities" and is used to distinguish the form from forms for reporting by other non-bank institutions.

and relationships for money laundering risks.¹⁸

Section 352 of the USA Patriot Act will require broker-dealers to develop and implement programs designed to guard against money laundering.¹⁹ FinCEN anticipates that these changes to section 5318 will be further addressed in a separate rulemaking prior to that date. Current securities self-regulatory organization rules will also require broker-dealers to have compliance programs for suspicious transaction reporting.²⁰ It is important to note however, that a risk-based approach to developing compliance procedures that can be reasonably expected to promote the detection and reporting of suspicious activity should be the focus of a broker-dealer's anti-money laundering compliance program. A compliance program that captures for review only those transactions that are above a threshold set at a mechanically high level, regardless of the money laundering or other risks such transactions may involve, and regardless of the money laundering or other risks that transactions at a lower dollar threshold may involve, would likely not be a satisfactory program. Of course, the particular contents or size of a compliance program must vary, as it does at banking organizations, to reflect the size and nature of a particular broker-dealer's operations.

Filing Procedures. Paragraph (b) sets forth the filing procedures to be

followed by broker-dealers making reports of suspicious transactions. Within 30 days after a broker-dealer becomes aware of a suspicious transaction, the business must report the transaction by completing a SAR-BD and filing it in a central location, to be determined by FinCEN. The SAR-BD will resemble the SAR used by banks to report suspicious transactions, and a draft form will be made available for comment by publication in the **Federal Register**.

Supporting documentation relating to each SAR-BD is to be collected and maintained separately by the broker-dealer and made available to law enforcement, regulatory agencies, and SROs as permitted in paragraph (g) of the rule, upon request. Special provision is made for situations requiring immediate attention, in which case broker-dealers are to telephone the appropriate law enforcement authority and the SEC in addition to filing a SAR-BD.

Exceptions. The proposed rule would create two exceptions from reporting. The first exception deals with the reporting of lost, stolen, missing or counterfeit securities; that reporting is to occur in accordance with existing Securities and Exchange Commission rules. The second exception permits the reporting of a violation of federal securities laws (or rules of an appropriate SRO) by an employee or other registered representative of a broker-dealer, under existing industry procedures rather than through a SAR-BD. The second exception does not apply, however, if the securities law or SRO rule violation is a possible violation of 17 CFR 240.17a-8 or 17 CFR 405.4. These exceptions are designed to permit the reporting of those potential violations according to present procedures and modes in the securities industry.

Retention of Records. Paragraph (d) provides that filing broker-dealers must maintain copies of SAR-BDs and the original related documentation for a period of five years from the date of filing. As indicated above, supporting documentation is to be made available to FinCEN, the SEC, other appropriate law enforcement and regulatory authorities, and, as explained below, to SROs as permitted in paragraph (g) of the rule, on request.

Non-Disclosure. Paragraph (e) reflects the statutory bar against the disclosure of information filed in, or the fact of filing, a suspicious activity report (whether the report is required by the proposed rule or is filed voluntarily). See 31 U.S.C. 5318(g)(2) and 31 CFR 103.18(e)(for depository institutions).

Thus, the paragraph specifically prohibits persons filing SAR-BDs from making any disclosure, except to law enforcement and regulatory agencies, and, as explained below, to SROs as permitted in paragraph (g) of the rule, about either the reports themselves or supporting documentation.

Safe Harbor from Civil Liability. 31 U.S.C. 5318(g), as amended by the USA Patriot Act, provides protection from liability for making reports of suspicious transactions, and for failures to disclose the fact of such reporting, contained in 31 U.S.C. 5318(g), as amended by the USA Patriot Act. Section 351 of that Act clarifies that the safe harbor applies to the voluntary reporting of suspicious transactions, and the proposed rule reflects this clarification.

The USA Patriot Act clarifies that the safe harbor is available in the arbitration of securities industry disputes. In this regard, FinCEN recognizes that disputes between broker-dealers and their customers most typically are resolved through arbitration. It is therefore anticipated that disputes arising out of suspicious transaction reporting by broker-dealers generally will be resolved through arbitration.

The safe harbor provision of 31 U.S.C. 5318(g) clearly protects any financial institution from civil liability for reporting suspicious activity.²¹ While the applicable law in this area is unambiguous, FinCEN understands that arbitration, unlike litigation, is an equitable forum where the decision makers have some degree of flexibility in resolving the disputes before them. FinCEN further understands that, as a practical matter, it may be difficult to overturn an arbitration award, even where an arbitrator did not correctly apply the law.

The specific reference to arbitration in the safe harbor provision of the proposed rule clarifies that the mere switch in venue from the courts to arbitration for many securities industry disputes does not alter the effect of the safe harbor from liability for suspicious transaction reporting. In doing so, the proposed rule reflects the recent amendment to section 5318(g) by the USA Patriot Act, which clarifies that the safe harbor for suspicious transaction reporting shall apply in arbitration. Section 351 of the USA Patriot Act states that a financial institution that reports suspicious activity shall not be

¹⁸ Thus, for example, transactions involving securities trades by the 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 such as those involving customers who wish to deposit currency in their brokerage account or to open a brokerage account using money orders even though the dollar amounts in those latter cases may be relatively small.

¹⁹ See 31 U.S.C. 5318(h). Section 312 of that Act amends section 5318 by adding a new paragraph (i) requiring financial institutions to establish enhanced due diligence procedures for certain private banking accounts and correspondent accounts, including reasonable steps to guard against money laundering and report suspicious activity involving these accounts.

²⁰ Existing securities law and self-regulatory organization rules will ensure that broker-dealers have suspicious activity reporting rule compliance programs in place. In particular, Section 19(g) of the Exchange Act provides that "Every self-regulatory organization shall comply with the provisions of this title, the rules and regulations thereunder, and its own rules, and . . . absent reasonable justification or excuse enforce compliance." To give effect to Section 19(g), both the National Association of Securities Dealers and the New York Stock Exchange promulgated compliance program rules. See NASD Rule 3010 and NYSE Rule 342, including Supplemental Material .30. Rule 17a-8 of the Exchange Act requires broker-dealers to comply with applicable BSA rules. Accordingly, broker-dealers will be required under existing rules to develop compliance programs for the broker-dealer SAR rule proposed in this document.

²¹ See *Lee v. Bankers Trust Co.*, 166 F.3d 540, 544 (2nd Cir. 1999) (stating that in enacting 31 U.S.C. 5318(g), the Congress "broadly and unambiguously provide[d] * * * immunity from any law (except the federal Constitution) for any statement made in a SAR by anyone connected to a financial institution").

liable for filing such a report “under any law or regulation of the United States, any constitution, law or regulation of any State or political subdivision of any State, or under any contract or other legally enforceable agreement (*including any arbitration agreement*).” (Emphasis added.) FinCEN intends to work with the SEC, SROs, and industry representatives to ensure that appropriate educational materials are delivered to compliance and litigation personnel.

It must be noted that, while the proposed rule reiterates and clarifies the broad protection from liability for making reports of suspicious transactions and for failures to disclose the fact of such reporting, contained in the statutory safe harbor provision, the regulatory provisions do not extend the scope of either the statutory prohibition or the statutory protection. Inclusion of safe harbor language in the proposal is in no way intended to suggest that the safe harbor can override the non-disclosure provisions of the law and regulations. The prohibition on disclosure (other than as required by the proposed rule) applies regardless of any protection from liability. This means, for example, that during an arbitration proceeding, a broker-dealer cannot give a SAR-BD, or disclose that one was filed, to any participant in the proceeding, including the arbitrator.

Examination and Enforcement. Paragraph (g) notes that compliance with the obligation to report suspicious transactions will be examined, and provides that failure to comply with the rule may constitute a violation of the Bank Secrecy Act and the Bank Secrecy Act regulations. This paragraph also makes clear that a broker-dealer must provide access to SAR-BDs that the broker-dealer has filed pursuant to this requirement, to SROs registered with the Securities and Exchange Commission that have jurisdiction to examine a broker-dealer for compliance with this rule. In examining any particular failure to report a transaction as required by this section, FinCEN and the SEC may take into account the relationship between the particular failure to report and the adequacy of the implementation and operation of a broker-dealer’s compliance procedures.

Proposed Effective Date. Finally, paragraph (h) provides that the new suspicious activity reporting rule would be effective 180 days after the date on which the final regulations to which this notice of proposed rulemaking relates are published in the **Federal Register**.

III. Submission of Comments

An original and four copies of any written hard copy comment (but not of comments sent via E-Mail), must be submitted. All comments will be available for public inspection and copying, and no material in any such comments, including the name of any person submitting comments, will be recognized as confidential. Accordingly, material not intended to be disclosed to the public should not be submitted.

IV. Regulatory Flexibility Act

FinCEN certifies that this proposed regulation would not have a significant economic impact on a substantial number of small entities. All broker-dealers, regardless of their size, are currently subject to the Bank Secrecy Act. Procedures currently in place at broker-dealers to comply with existing Bank Secrecy Act rules should help broker-dealers identify suspicious transactions. In addition, the limited use of currency in the broker-dealer industry will likely reduce the number of suspicious activity reports required to be filed. Finally, certain small broker-dealers may have an established and limited customer base whose transactions are well-known to the broker dealer.

V. Executive Order 12866

The Department of the Treasury has determined that this proposed rule is not a significant regulatory action under Executive Order 12866.

VI. Unfunded Mandates Act of 1995 Statement

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104-4 (Unfunded Mandates Act), March 22, 1995, requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a federal mandate that may result in expenditure by state, local and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, section 202 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. FinCEN has determined that it is not required to prepare a written statement under section 202 and has concluded that on balance this proposal provides the most cost-effective and least burdensome alternative to achieve the objectives of the rule.

VII. Paperwork Reduction Act

Recordkeeping Requirements of 31 CFR 103.20. The collection of

information contained in this notice of proposed rulemaking is being submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Alexander T. Hunt, Office of Information and Regulatory Affairs, Office of Management and Budget, New Executive Office Building, Room 3208, Washington, DC 20503, with copies to FinCEN at Department of the Treasury, Financial Crimes Enforcement Network, Post Office Box 39, Vienna, Virginia 22183. Comments on the collection of information should be received by March 1, 2002. In accordance with requirements of the Paperwork Reduction Act of 1995, 44 U.S.C. 3506(c)(2)(A), and its implementing regulations, 5 CFR 1320, the following information concerning the collection of information as required by 31 CFR 103.19 is presented to assist those persons wishing to comment on the information collection.

FinCEN anticipates that this proposed rule, if adopted as proposed, would result in the annual filing of a total of 2,000 Suspicious Activity Report-BD forms. This result is an estimate extrapolated from the number of suspicious activity reports currently being filed by the broker-dealer industry either on a mandatory basis under the bank supervisory agency rules or voluntarily.

Description of Respondents: Brokers or dealers in securities registered or required to be registered with the United States Securities and Exchange Commission under the Securities Exchange Act of 1934.

Estimated Number of Respondents: 8,300.

Frequency: As required.

Estimate of Burden: The reporting burden of 31 CFR 103.19 will be reflected in the burden of the form, Suspicious Activity Report-BD. The recordkeeping burden of 31 CFR 103.19 is estimated as an average of 3 hours per form, which includes internal review of records to determine whether the activity requires reporting.

Estimate of Total Annual Recordkeeping Burden on Respondents: Recordkeeping burden estimate = 6,000 hours.

FinCEN specifically invites comments on the following subjects: (a) Whether the proposed collection of information is necessary for the proper performance of the mission of FinCEN, including whether the information shall have practical utility; (b) the accuracy of FinCEN’s estimate of the burden of the

proposed collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology.

In addition, the Paperwork Reduction Act of 1995 requires agencies to estimate the total annual cost burden to respondents or recordkeepers resulting from the collection of information. Thus, FinCEN also specifically requests comments to assist with this estimate. In this connection, FinCEN requests commenters to identify any additional costs associated with the completion of the form. These comments on costs should be divided into two parts: (1) any additional costs associated with reporting; and (2) any additional costs associated with recordkeeping.

List of Subjects in 31 CFR Part 103

Authority delegations (Government agencies), Banks and banking, Currency, Investigations, Law enforcement, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

For the reasons set forth above in the preamble, 31 CFR Part 103 is proposed to be amended as follows:

PART 103—FINANCIAL RECORDKEEPING AND REPORTING OF CURRENCY AND FOREIGN TRANSACTIONS

1. The authority citation for part 103 continues to read as follows:

Authority: 12 U.S.C. 1829b and 1951–1959; 31 U.S.C. 5311–5330.

2. In § 103.11, paragraph (ii)(1) is revised and new paragraph (ww) is added to read as follows:

§ 103.11 Meaning of terms.

* * * * *

(ii) *Transaction*. (1) Except as provided in paragraph (ii)(2) of this section, transaction means a purchase, sale, loan, pledge, gift, transfer, delivery or other disposition, and with respect to a financial institution includes a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument, or security, purchase or redemption of any money order, payment or order for any money remittance or transfer, or any other payment, transfer, or delivery by,

through, or to a financial institution, by whatever means effected.

* * * * *

(ww) *Security*. Security means any instrument or interest described in section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10).

3. In Subpart B, add new § 103.19 to read as follows:

§ 103.19 Reports by brokers or dealers in securities of suspicious transactions.

(a) *General*. (1) Every broker or dealer in securities (for purposes of this section, a “broker-dealer”) shall file with the Treasury Department, to the extent and in the manner required by this section, a report of any suspicious transaction relevant to a possible violation of law or regulation. This includes any known or suspected violation of Federal law, or a suspicious transaction related to a money laundering violation or a violation of the Bank Secrecy Act. A broker-dealer may also file with the Treasury Department a report of any suspicious transaction that it believes is relevant to the possible violation of any law or regulation but whose reporting is not required by this section. A voluntary filing does not relieve a broker-dealer from the responsibility of complying with any other reporting requirements imposed by the Securities and Exchange Commission or a self-regulatory organization (“SRO”) (as defined in section 3(a)(26) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(26)).

(2) A transaction requires reporting under the terms of this section if it is conducted or attempted by, at, or through a broker-dealer, it involves or aggregates funds or other assets of at least \$5,000, and:

(i) The broker-dealer detects any known or suspected Federal criminal violation, or pattern of criminal violations, committed or attempted against the broker-dealer or involving a transaction or transactions conducted through the broker-dealer, where the broker-dealer was either an actual or potential victim of a criminal violation, or series of criminal violations or that the broker-dealer was used to facilitate a criminal transaction. (If it is determined prior to filing this report that the identified suspect or group of suspects has used an “alias,” then information regarding the true identity of the suspect or group of suspects, as well as alias identifiers, such as drivers’ licenses or social security numbers, addresses and telephone numbers, must be reported); or

(ii) 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):

(A) Involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation;

(B) Is designed, whether through structuring or other means, to evade any requirements of this part or of any other regulations promulgated under the Bank Secrecy Act, Public Law 91–508, as amended, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951–1959, and 31 U.S.C. 5311–5330; or

(C) Has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the broker-dealer knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.

(b) *Filing procedures*—(1) *What to file*. A suspicious transaction shall be reported by completing a Suspicious Activity Report—Brokers or Dealers in Securities (“SAR-BD”), and collecting and maintaining supporting documentation as required by paragraph (d) of this section.

(2) *Where to file*. The SAR-BD shall be filed with FinCEN in a central location, to be determined by FinCEN, as indicated in the instructions to the SAR-BD.

(3) *When to file*. A SAR-BD shall be filed no later than 30 calendar days after the date of the initial detection by the reporting broker-dealer of facts that may constitute a basis for filing a SAR-BD under this section. If no suspect is identified on the date of such initial detection, a broker-dealer may delay filing a SAR-BD for an additional 30 calendar days to identify a suspect, but in no case shall reporting be delayed more than 60 calendar days after the date of such initial detection. In situations involving violations that require immediate attention, such as ongoing money laundering schemes, the broker-dealer shall immediately notify by telephone an appropriate law enforcement authority and the Securities and Exchange Commission in addition to filing a SAR-BD.

(c) *Exceptions*. (1) A broker-dealer is not required to file a SAR-BD to report:

(i) Lost, missing, counterfeit, or stolen securities with respect to which it files a report pursuant to the reporting requirements of 17 CFR 240.17f-1; or

(ii) A possible violation of any of the federal securities laws or rules of a self-regulatory organization ("SRO") (as defined in section 3(a)(26) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(26)), by the broker-dealer or any of its officers, directors, employees or other registered representatives, other than a possible violation of 17 CFR 240.17a-8 or 17 CFR 405.4, so long as such violation is appropriately reported to the Securities and Exchange Commission or an SRO.

(2) A broker-dealer may be required to demonstrate that it has relied on an exception in paragraph (c)(1)(ii) of this section, and must maintain records of its determinations to do so for the period specified in paragraph (d) of this section. To the extent that a Form RE-3, Form U-4, or Form U-5 concerning the transaction is filed consistent with the self-regulatory organization rules, a copy of that form will be a sufficient record for purposes of this paragraph (c)(2).

(3) For the purposes of this paragraph (c) the term "federal securities laws" means the "securities laws," as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(47), and the rules and regulations promulgated by the Securities and Exchange Commission under such laws.

(d) *Retention of records.* A broker-dealer shall maintain a copy of any SAR-BD filed and the original or

business record equivalent of any supporting documentation for a period of five years from the date of filing the SAR-BD. Supporting documentation shall be identified as such and maintained by the broker-dealer, and shall be deemed to have been filed with the SAR-BD. A broker-dealer shall make all supporting documentation available to FinCEN, any other appropriate law enforcement agencies or federal or state securities regulators, and an SRO registered with the Securities and Exchange Commission in accordance with paragraph (g) of this section, upon request.

(e) *Confidentiality of reports.* No financial institution, and no director, officer, employee, or agent of any financial institution, who reports a suspicious transaction under this part, may notify any person involved in the transaction that the transaction has been reported. Thus, any person subpoenaed or otherwise requested to disclose a SAR-BD or the information contained in a SAR-BD, except where such disclosure is requested by FinCEN, the Securities and Exchange Commission, or another appropriate law enforcement or regulatory agency, or an SRO registered with the Securities and Exchange Commission in accordance with paragraph (g) of this section, shall decline to produce the SAR-BD or to provide any information that would disclose that a SAR-BD has been prepared or filed, citing this paragraph and 31 U.S.C. 5318(g)(2), and shall notify FinCEN of any such request and its response thereto.

(f) *Limitation of liability.* A broker-dealer, and any director, officer, employee, or agent of such broker-dealer, that makes a report of any possible violation of law or regulation pursuant to this section or any other authority (or voluntarily) shall not be liable to any person under any law or regulation of the United States (or otherwise to the extent also provided in 31 U.S.C. 5318(g)(3), including in any arbitration proceeding) for any disclosure contained in, or for failure to disclose the fact of, such report.

(g) *Examination and enforcement.* Compliance with this section shall be examined by the Department of the Treasury, through FinCEN or its delegates under the terms of the Bank Secrecy Act. Reports filed under this section shall be made available to an SRO registered with the Securities and Exchange Commission examining a broker-dealer for compliance with the requirements of this section. Failure to satisfy the requirements of this section may constitute a violation of the reporting rules of the Bank Secrecy Act and of this part.

(h) *Effective date.* This section is effective [date that is 180 days after the date on which the final regulation to which this notice of proposed rulemaking relates is published in the **Federal Register**].

Dated: December 20, 2001.

James F. Sloan,

Director, Financial Crimes Enforcement Network.

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