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M E M O R A N D U M

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To Our Clients And Friends

Re: Final Rule Requiring Brokers-Dealers To Report Suspicious Transactions

SUMMARY

Last December, the Treasury Department published proposed regulations requiring broker-dealers in securities to report suspicious transactions. Based on comments received, the Treasury Department's Financial Crimes Enforcement Network ("FinCEN") has issued a final rule amending the Bank Secrecy Act ("BSA") regulations to implement this requirement of the USA Patriot Act. The rule is effective July 31 with compliance effective December 30 2002.

The final rule is generally consistent with the proposed rule (which was described in our memorandum of January 14, 2002) with the following material changes:

- the categories of reportable activities have been changed to clarify that all violations of law, except those specifically exempted, must be reported
- robberies and burglaries reported to appropriate authorities are not required to be reported
- only one report of a suspicious activity is required (e.g., an introducing and a clearing broker need only file one report for each suspicious transaction).

While certain broker-dealers (e.g., broker-dealers that are affiliates or subsidiaries of banks or bank holding companies) have been required to report suspicious transactions for several years, the final rule applies to all broker-dealers¹ regardless of whether they are affiliates or subsidiaries of banks or bank holding companies.²

¹ Brokers-dealers registered with the SEC but located outside the U.S. are not subject to the rule.

² FinCEN has requested that the federal banking supervisory agencies exempt brokers-dealers from having to report suspicious transactions under their regulations.

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REQUIREMENTS

Broker-dealers are required to report suspicious transactions relating to a possible violation of law or regulation to FinCEN on Suspicious Activity Report – Brokers or Dealers in Securities (“SAR-BD”) within 30 days after the broker-dealer initially detects the suspicious transaction.

A transaction is to be reported if it is conducted or attempted by, at or through a broker-dealer, involves funds or assets of at least \$5,000 and the broker-dealer knows, suspects or has reason to suspect that the transaction (or a pattern of transactions):

- involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity;
- is designed to evade the requirements of Bank Secrecy Act regulations;
- has no business or apparent lawful purpose, or is not the sort of transaction in which the customer would normally be expected to engage, and the broker-dealer knows of no reasonable explanation for the transaction, or
- involves use of the broker-dealer to facilitate criminal activity.

Transactions do not have to involve currency to be reported, and brokers-dealers are encouraged to develop a risk-based approach in monitoring transactions and to report suspicious transactions even when the rule does not explicitly require such reporting (e.g., the transaction involves less than \$5,000). However, such voluntary filings do not relieve a broker-dealer from complying with other reporting requirements of the Securities and Exchange Commission (“SEC”) or self-regulatory organizations (“SRO”).

The broker-dealer is to maintain separately any supporting documentation. Situations requiring immediate attention, such as ongoing money laundering schemes, are also to be reported immediately to the appropriate law enforcement authorities.

The following situations are exempt from these reporting requirements and are not required to be reported on an SAR-BD:

- a robbery or burglary committed or attempted of the broker-dealer that is reported to the appropriate law enforcement authorities
- lost, stolen, missing or counterfeit securities that are reported to the SEC in accordance with existing rules
- violations of federal securities law (or rules of an appropriate SRO) by an employee or registered representative of a broker-dealer that are reported under existing industry procedures. However, if such violations are exempt from reporting under the federal securities law (or SRO rules), they must then be reported on an SAR-BD.

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A broker-dealer is prohibited from notifying anyone involved in a suspicious transaction that it has been reported. The SAR-BD or supporting documentation cannot be disclosed to anyone except where such disclosure is requested by FinCEN, the SEC, an SRO or another appropriate law enforcement or regulatory agency.

A broker-dealer, and any director, officer, employee, or agent of such broker-dealer is not liable under any Federal or state law or regulation or under other legally enforceable agreement including arbitration, for a disclosure made in filing a suspicious transaction report, whether the reports are required or made voluntarily, or for failing to disclose that such a report has been filed.

DEFINITIONS

The term “broker-dealer in securities” has the meaning assigned to it by BSA regulations. However, insurance companies or their affiliates that are registered broker-dealers simply to permit the sale of variable annuities are subject to these suspicious transaction reporting rules.

The term “transaction” has the same meaning as that in the BSA regulations relating to suspicious transaction reporting except it is being broadened to include transactions involving any instrument that falls with the definition of “security “ in the Securities Exchange Act of 1934.

If you have any questions concerning FinCEN’s proposed rule, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700. A copy of the final rule can be found at <http://www.schwartzandballen.com/WhatsNew.htm>.