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FINRA Focuses on Anti-Money Laundering Procedures and Red Flags

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Last week, the Financial Industry Regulatory Authority (FINRA) publicized penalties against three companies – as well as four associated individuals – that it found had failed to establish and implement adequate procedures for detecting money laundering and other suspicious transactions in violation of the Bank Secrecy Act, 31 U.S.C. § 5318. The enforcement actions and accompanying announcement demonstrate FINRA's continued focus on anti-money laundering (AML) compliance programs, and why implementing effective procedures will help firms avoid regulatory actions or scrutiny.

FINRA's announced settlements of three formal disciplinary proceedings that imposed a total of $900,000 in sanctions and suspensions on multiple securities-industry professionals. FINRA ordered Atlas One Financial Group ("Atlas One"), a Miami, Florida-based brokerage firm, to pay a $350,000 fine for failing to implement sufficient procedures to detect and monitor suspicious transactions, and fined and suspended the firm's former chief compliance officer and AML compliance officer. FINRA also levied a $300,000 penalty against Firstrade Securities, Inc. ("Firstrade"), a Flushing, New York-based company that operates an online platform for securities trading. Finally, FINRA imposed a $250,000 fine against World Trade Financial Corporation (WTFC), a San Diego, California-based broker-dealer, and fined and suspended its president, chief compliance officer, and trade desk supervisor.

Central to each action was a finding by FINRA that the firms had failed to identify red flags of money laundering activities, and therefore had failed to investigate suspicious activity and/or file a suspicious activity report. Broker-dealers and other financial institutions should consider the following examples of the red flags that went unnoticed by the firms, but that ultimately caught FINRA's attention. The ability to detect and the investigation of such red flags are important components of an adequate AML program.

FAILURE TO IDENTIFY RELATED ACCOUNTS

Atlas One's systems failed to flag numerous instances of suspicious account activity. For example, during the period covered by FINRA's disciplinary proceeding, the Department of Justice (DOJ) had charged two individuals with a scheme to launder millions of dollars in an Italian judicial bribery scheme. As part of its action, DOJ froze six Atlas One accounts with the same billing address in San José, Costa Rica – all of which utilized the same email address belonging to an Atlas One customer called "HP." Despite this action by DOJ, Atlas One failed to identify or close an additional 18 accounts that had the same HP mailing address, and that listed HP as the beneficial owner.

DISCONNECT BETWEEN ACCOUNT'S STATED OBJECTIVES OR MEANS AND ACTUAL TRANSACTIONS

FINRA criticized Atlas One's lack of established procedures to detect transactions outside the stated objectives of an account or outside the accountholder's ostensible means. In multiple instances, Atlas One maintained accounts that had a stated purpose of securities trading where the accounts actually traded very few securities and instead simply conducted a series of wire transfers. One of the HP accounts, for example, was opened with the stated purpose of engaging in securities trading activities, but executed only three securities transactions and conducted 125 wire transfers and journals totaling $10.6 million in the relevant time period. Indeed, with respect to another account, Atlas One's clearing firm recommended that the account be transferred to a commercial bank, since the account's extensive wire transfer activity did not appear to be securities related.

Similarly, accounts at Atlas One executed transactions vastly exceeding in size the annual income and/or net worth of the owners of those accounts. In one instance, Atlas One's clearing firm raised questions about certain transactions, and Atlas One relied on the verbal representations of the customer that the purpose of the transaction was to put a down payment on an aircraft, even though that representation made little sense in light of the customer's stated income and liquid net worth.

INDICATIONS OF MANIPULATIVE CONDUCT

Instances of market-manipulative conduct at the three firms likewise caught FINRA's attention. FINRA found that Firstrade did not review the substantial price movements that coincided with these transactions, nor the investors' relationships with each other or the issuer. In particular, Firstrade did not flag instances in which customers traded shares in a Chinese company whose mailing address matched the mailing address on those customer accounts, and in which such trading coincided with significant increases in stock price.

Firstrade also missed suspicious trading between two related accounts that made up nearly all of the daily trading volume in two Chinese companies. These trades resulted in a substantial increase in the value of both companies and did not appear to have any legitimate business purpose. Nor did Firstrade inquire into instances of apparent wash sales, including purchases and sales purportedly executed by different accounts, but whose accounts contained the same address, social security number, telephone number or account name.

FINRA detailed similarly problematic transactions at Atlas One, which permitted multiple purchases and sales of securities through a third party, all of which appeared to be arranged simultaneously, and generated millions of dollars in profits on a single day.

In addition, FINRA took issue with activity at WTFC, where a customer executed a high volume of trades in little-known thinly traded penny stocks, then deposited and sold the same large position in a matter of days or weeks. FINRA found it especially problematic that this customer's business represented a majority of WTFC's revenue.

The suspicious nature of the conduct found by FINRA at each of these firms speaks for itself. More significant for most financial institutions are FINRA's findings that each of the firms either failed to adequately implement its AML compliance program, or failed to even establish a system reasonably designed to monitor for suspicious activity. While some of the firms had procedures that listed red flags that are potential indicia of suspicious activities, the firm failed to implement these procedures and thus did not adequately detect, investigate and respond to these red flags. It is apparent that FINRA will continue to review suspicious trading activity, and penalize firms that do not create programs and implement effective practices to detect this activity.

Firms must be especially conscious of their obligations to identify suspicious transactional activity as part of an effective AML compliance program, and should heed the advice of third parties such as clearing firms who raise concerns regarding the legitimacy or propriety of certain transactions. Failure to implement appropriate procedures and to identify suspicious activity, as this announcement shows, may invite costly regulatory or enforcement action.

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