

## **Regulatory Circular RG04-57**

**To: Members and Member Organizations**

**From: Regulatory Services Division**

**Re: Anti-Money Laundering (“AML”) Compliance Programs**

**Date: April 30, 2004**

This Regulatory Circular supplements Regulatory Circular 02-69 by elaborating on the requirements CBOE members and member organizations are expected to adopt with respect to CBOE Rule 4.20 Anti-Money Laundering Compliance Programs. CBOE Rule 4.20 is not substantially different than AML Compliance rules of other Exchanges. The requirements of the Rule relate to the implementation of written AML compliance programs, AML employee training programs and the independent testing of AML compliance programs. In addition, this Regulatory Circular 04-57 summarizes new compliance requirements in the area of Customer Identification Procedures ("CIP") that have been in effect since October 1, 2003, as required under the USA PATRIOT Act.

The Regulatory Services Division (the “Division”) is using this Regulatory Circular as an opportunity to remind broker-dealers exempt from the net capital rule of their regulatory requirements with respect to AML under CBOE Rule 4.20 and obtain certain information from those broker-dealers in an effort to verify their compliance with the rule.

### **Highlights:**

- This rule applies to all broker-dealers. CBOE members and member firms that have an effective broker-dealer registration and are **not** subject to an annual examination by the Department of Financial and Sales Practice Compliance will be required to complete the attestation included with this Regulatory Circular. The completed attestation demonstrating compliance with CBOE Rule 4.20 along with the broker-dealer’s AML compliance program, must be submitted to the Department of Financial and Sales Practice Compliance no later than **June 30, 2004**.
- To accommodate those CBOE members that are non-clearing, do not conduct a non-member customer business, and do not receive customer funds or securities, the Division has created a small-firm AML compliance program template, which is enclosed for your consideration. Please keep in mind that this template can only be used to satisfy the written procedures requirement of CBOE Rule 4.20. Broker-dealers are still required to meet the independent testing, designation and training requirements of the rule as set forth below. However, as stressed in Regulatory Circular 02-69, every broker-dealer must decide, based on the type of business it is conducting, whether it must adopt highly extensive procedures or whether something less detailed such as the template, will suffice. Failure to return the enclosed AML attestation and AML compliance program will result in disciplinary action by the Exchange. You may direct any questions you have regarding these requirements to Kristine Donnelly at (312) 786-7904.
- **Nominees, CBT Exercisers and Lessors:** Please note, if you are a nominee **and** a registered broker/dealer, or if you are a CBT exerciser or lessor **and** have an effective broker-dealer registration with the SEC, you may demonstrate compliance with Rule 4.20 by completing the attached attestation and submitting your AML program by **June 30, 2004** for your personal broker-dealer activity.

## **ANTI-MONEY LAUNDERING ("AML") COMPLIANCE PROGRAMS**

The Division issued Regulatory Circular 02-69 on August 19, 2002, to provide guidance with respect to the establishment of AML compliance programs. Regulatory Circular 02-69 stressed that ***all*** broker-dealers are required to put in place an AML compliance program that contains procedures that can reasonably be expected to promote the detection and reporting of suspicious activity. To accommodate those CBOE members that do not conduct a non-member customer business and that do not receive customer funds or securities, the Division has created a small-firm AML compliance program template, which is enclosed for your consideration. Please keep in mind that the small-firm AML compliance program template can only be used to satisfy the written procedures requirement of CBOE Rule 4.20.

CBOE Rule 4.20 sets forth the minimum standards for broker/dealers' AML compliance programs. The rule requirements are summarized below:

### Key Points

All broker/dealers must:

- (1) establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions;
- (2) establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and implementing regulations;
- (3) provide for independent testing for compliance to be conducted by member personnel or by a qualified outside party;
- (4) designate an individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the program; and
- (5) provide ongoing training for appropriate personnel

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### **Develop Internal Policies, Procedures, And Controls:**

Broker/dealers must develop written policies, procedures and controls to ensure compliance with AML laws. The firm's AML procedures should address the following, where applicable:

- Customer Identification Procedures ("CIP") related to account opening and maintenance, including verification of the identity of the customer
- Opening and maintaining "correspondent accounts" for foreign banks
- The monitoring of account activities, including trading and the flow of money into and out of the account, the types, amount, and frequency of different financial instruments deposited into and withdrawn from the account, and the origin of such deposits and the destination of withdrawals
- The monitoring of employee accounts, including the AML Compliance Officer's accounts for potential signs of money laundering. The firm must subject employee accounts to the same account identifying and monitoring procedures as customer accounts. Firms should establish controls and monitor employees' trading and financial activity in employee accounts
- Separating the duties of employees where feasible to ensure a system of checks and balances (for example, firms may want to ensure that persons who handle cash do not open accounts or file Currency Transaction Reporting forms)

- Reviewing supervisors' performance of their AML responsibilities
- Monitoring for, detecting, and responding to "red flags"
- Responding to regulatory requests for AML information
- Ensuring that AML compliance programs contain a mechanism or process for the firm's employees to report suspected violations of the firm's AML compliance program procedures and policies to management, confidentially and without fear of retaliation

### **Establish An Ongoing Training Program:**

The Rule requires that broker-dealers provide ongoing training for appropriate personnel. AML employee training should be developed under the leadership of the AML Compliance Officer or senior management. The Exchange is currently in discussions with the Securities and Exchange Commission (the "SEC") and other Self Regulatory Organizations ("SROs") as to how frequently training should be conducted for broker-dealers that are conducting a market-maker business with no more than an occasional investment transaction. Guidance issued by other SROs up to this point has recommended that training be conducted at least annually. The Division will disseminate that information to members in a regulatory circular once a decision has been reached. Broker-dealers should document the content of the training and maintain a list of the participants as part of the firm's books and records retention policy. Members should have all participants sign an attestation acknowledging that they have participated in the training and understand the firm's AML program. The attestation should direct any questions to the firm's AML Compliance Officer. In addition, firms should update their training materials, as necessary, to reflect new developments in the law. **The NASD (<http://www.nasdr.com/money.asp>) and SIA (<http://www.sia.com/moneylaundering>) websites have on-line training and guidance available to all broker-dealers, which would be considered appropriate training for CBOE market-makers that are non-clearing and do not conduct a non-member customer business.** The CBOE Regulatory Division urges firms to instruct their employees, at a minimum, about the following topics:

- How to identify "red flags" and possible signs of money laundering that could arise during the course of their duties;
- What to do once the risk is identified;
- What their roles are in the firm's compliance efforts;
- How to perform their roles;
- The firm's record retention policy; and
- Disciplinary consequences, including civil and criminal penalties for non-compliance with the Money Laundering Abatement Act

### **Establish An Independent Testing Function:**

- Broker/dealers must have an independent testing function to review and assess the adequacy of and level of compliance with the firm's AML compliance program at least annually.

- Either member personnel or a qualified outside party may perform the testing function, depending in part on the firm's size and resources. If a firm uses internal personnel, sufficient separation of functions should be maintained to ensure the independence of the internal testing personnel.
- After a test is complete, the internal testing personnel or qualified outside party should report its findings in writing to senior management or to an internal audit committee, as appropriate. The firm should ensure that there are procedures for implementation of any of the internal testing personnel's or third party's recommendations and corrective or disciplinary action, as the case may warrant.

### **Customer Identification Procedures ("CIP")**

On October 1, 2003, new rules jointly adopted by the Department of the Treasury became effective, which, among other things, require the CIP to be in writing and to be part of the firm's AML compliance program. If the adoption of the CIP procedures materially changes the firm's current AML compliance program, senior management must approve the revised program. ***Note that this regulation applies only to "customers" who open new "accounts" with a broker/dealer.***

In addition to the information required by CBOE Rules 9.7 Opening of Accounts, 9.8 Supervision of Accounts, 9.10 Discretionary Accounts and SEC Rules 17a-3(a)(9) Beneficial Ownership regarding Cash and Margin Accounts and 17a-3(a)(17) Customer Accounts, require firms to:

- Establish, document and maintain a written CIP appropriate for the firm's size and business
- Collect the following information, if applicable, for any person, entity, or organization whose name is on the account:
  - name;
  - date of birth (for an individual);
  - address, which must be (i) a residential or business street address (for an individual), (ii) an Army Post Office or Fleet Post Office number or a residential, or business street address of next of kin or another contact individual (for an individual who does not have a residential or business street address), or (iii) a principal place of business, local office or other physical location (for a person other than an individual); and
  - identification number, which must be (i) a taxpayer identification number for U.S. persons or (ii) for non-U.S. persons, one or more of the following: a taxpayer identification number, a passport number and country of issuance, an alien identification card number or the number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or other similar safeguard. When opening an account for a foreign business or enterprise that does not have an identification number, firms should request alternative government-issued documentation certifying the existence of the business or enterprise.
- Comply with Treasury's Office of Foreign Asset Control rules prohibiting transactions with certain foreign countries or their nationals [See the OFAC Web Site at [www.treas.gov/ofac](http://www.treas.gov/ofac), which is also available through an automated search tool on [www.nasdr.com/money.asp](http://www.nasdr.com/money.asp)]

- Utilize risk-based measures to verify the identity of each customer who opens an account, to the extent reasonable and practicable. The procedures must enable the firm to form a reasonable belief that it knows the true identity of each customer within a reasonable time before or after the customer's account is opened. In addition, the procedures must describe when the firm will use documents, non-documentary methods or a combination of both for verification purposes. Among the risks to consider are the various methods of opening accounts provided by the firm. If the firm believes that certain risk factors increase the likelihood that it will need more information to know the true identity of a customer, it should determine (i) what additional identifying information might be necessary to form a reasonable belief that it knows the true identity of the customer and (ii) when such additional information should be obtained. In analyzing the verification information, firms should consider whether there is a logical consistency among the identifying information provided.
- Record (i) customer identification information, (ii) documents, if any, relied on, and (iii) the verification methods and results
- Provide notice to customers that the firm will seek identification information and compare customer identification information with government-provided lists of suspected terrorists

**Please be advised that firms may not be able to open an account or carry out transactions for customers who refuse to provide information.**

Firms may, under the following circumstances, rely on the performance by another financial institution (including an affiliate) of some or all of the elements of the CIP with respect to any customer that is opening an account or has established an account or similar business relationship with the other financial institution to provide or engage in services, dealings or other financial transactions, provided that:

- such reliance is reasonable under the circumstances;
- the other financial institution is subject to a rule implementing the anti-money laundering compliance program requirements of 31 U.S.C. 5318(h) and is regulated by a Federal functional regulator; and
- the other financial institution has entered into a contract with the firm requiring it to certify annually to the firm that it has implemented an AML program, and that it will perform (or its agent will perform) specified requirements of the firm's CIP

**Note that the firm will not be held responsible for the failure of the other financial institution to fulfill adequately the firm's CIP responsibilities, provided that the firm can establish that its reliance was reasonable and it obtained the requisite contracts and certifications.**

**Introducing Brokers and Clearing Brokers:**

The Division wishes to emphasize that both introducing brokers and clearing brokers have responsibilities under the Money Laundering Abatement Act. Both introducing brokers and clearing brokers must establish and implement the appropriate AML procedures identified above to comply with the Money Laundering Abatement Act's requirements.

In order to detect suspicious activity, it is imperative that introducing and clearing brokers work together. Specifically, the introducing broker and clearing firm should:

- exchange information, records, data, and exception reports as necessary to comply with AML laws;

- both file the necessary annual certifications for such information sharing, which can be found at [http://www.fincen.gov/fi\\_infoappb.html](http://www.fincen.gov/fi_infoappb.html);
- agree that the clearing firm will monitor customer activity on the introducing broker's behalf and the introducing broker will provide the clearing firm with proper customer identification information as required to successfully monitor customer transactions; and
- allocate the responsibilities provided above in the clearing agreement

You are encouraged to consult with your Compliance and Legal Counsel to ascertain the steps necessary for you to be in compliance with the AML requirements of the USA PATRIOT Act. *Preliminary Guidance For Deterring Money Laundering Activity*, published by the Securities Industry Association's Anti-Money Laundering Committee, highlights key elements for consideration in the development of AML programs. This publication is available at <http://www.sia.com/moneylaundering>. You may also find additional information on the NASD website at <http://www.nasdr.com/money.asp>.

To aid in the formulation of a written AML compliance program, NASD members are welcome to use its Updated AML template, which can be found at [http://www.nasdr.com/aml\\_template.asp](http://www.nasdr.com/aml_template.asp).

**Members are advised that should the nature or structure of their business change, they should review their anti-money laundering program to ensure that it is sufficient to be deemed in compliance with the USA PATRIOT Act and the related rules and regulations promulgated thereunder.**

Questions concerning this memorandum may be directed to:

**Department of Financial and Sales Practice Compliance:**

- Kristine Donnelly at (312) 786-7904

# **Broker-Dealer Attestation for Non-Capital Computing Members That Do Not Conduct a Non-Member Customer Business and Do Not Receive Customer Funds or Customer Securities**

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**Reminder:** Broker-dealers that are not capital computing and therefore, not subject to an annual examination by the Department of Financial and Sales Practice Compliance (the "Department"), are required to submit (i) a copy of the broker-dealer's AML Compliance Program, approved by a member of senior management, and (ii) the completed broker-dealer AML attestation provided below, to the Department no later than **June 30, 2004** in order to demonstrate the broker-dealer's compliance with CBOE Rule 4.20 - Anti-Money Laundering Compliance Program.

**Broker Dealer Number:** 8 - \_\_\_\_\_

**Broker Dealer Name:** \_\_\_\_\_

**Address:** \_\_\_\_\_

\_\_\_\_\_

**Day-Time Phone:** \_\_\_\_\_

**AML Program (Approved by Senior Management):** Included \_\_\_\_\_

**Designated Anti-Money Laundering Compliance Officer:**

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Email: \_\_\_\_\_

Address: \_\_\_\_\_

\_\_\_\_\_

Phone: \_\_\_\_\_

Fax (If applicable): \_\_\_\_\_

**Broker-Dealer Annual Training:**

Attendees: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

The broker-dealer training was conducted on \_\_\_\_\_, 200\_\_ and  
date

was done \_\_\_\_\_. The program was  
( internally/externally/via an internet website)

sponsored by \_\_\_\_\_. Some of the topics  
(ie: vendor name, SRO or website address):

covered were\_\_\_\_\_.

\* **Broker-Dealers are required to maintain evidence of the training conducted and a list of participants**

**Independent Review:**

The independent review of the broker-dealer AML program was conducted on

\_\_\_\_\_, 200\_\_, by \_\_\_\_\_,  
date name

of \_\_\_\_\_.  
company name (internal or external)

\* **Broker-Dealers are required to maintain written documentation of the Independent Review conducted.**

I \_\_\_\_\_, as \_\_\_\_\_, of  
name title

\_\_\_\_\_, certify that the information listed  
broker-dealer name

above is accurate.

**Member Signature:** \_\_\_\_\_ **Date** \_\_\_\_\_



# Small Firm Template for Members Who Do Not Conduct a Non-Member Customer Business and Do Not Receive Customer Funds or Customer Securities

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## [Firm Name/Individual Name] Anti-Money Laundering (AML) Compliance Program

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### 1. Member Policy

It is the policy of \_\_\_\_\_ [Name] to prohibit and actively prevent money laundering and any activity that facilitates money laundering or the funding of terrorist or criminal activities. Money laundering is generally defined as engaging in acts designed to conceal or disguise the true origins of criminally derived proceeds so that the unlawful proceeds appear to have derived from legitimate origins or constitute legitimate assets. Generally, money laundering occurs in three stages. Cash first enters the financial system at the "placement" stage, where the cash generated from criminal activities is converted into monetary instruments, such as money orders or traveler's checks, or deposited into accounts at financial institutions. At the "layering" stage, the funds are transferred or moved into other accounts or other financial institutions to further separate the money from its criminal origin. At the "integration" stage, the funds are reintroduced into the economy and used to purchase legitimate assets or to fund other criminal activities or legitimate businesses. Terrorist financing may not involve the proceeds of criminal conduct, but rather an attempt to conceal the origin or intended use of the funds, which will later be used for criminal purposes.

### 2. AML Compliance Officer Designation and Duties

\_\_\_\_\_ [Name] is designated as the Anti-Money Laundering Program Compliance Officer, with full responsibility for the firm's AML program. \_\_\_\_\_ [Name] is qualified by experience, knowledge and training, including \_\_\_\_\_ [Describe]. The duties of the AML Compliance Officer will include monitoring AML compliance, overseeing communication and training for employees, and \_\_\_\_\_ [Add any other duties to be assigned to the AML Compliance Officer]. The AML Compliance Officer will also ensure that proper AML records are kept. When warranted, the AML Compliance Officer \_\_\_\_\_ [Add if appropriate: "in consultation with {Name or title}" OR "with the approval of {Name or title}"] will ensure Suspicious Activity Reports (SARs) are filed with the Financial Crimes Enforcement Network (FinCEN).

### 3. Training Programs

We will develop ongoing employee training under the leadership of the AML Compliance Officer and senior management. Our training will occur at least \_\_\_\_\_[Describe how often training is conducted]. It will be based on our firm's size, its customer base, and its resources.

Our training will include, at a minimum: how to identify red flags and signs of money laundering that arise during the course of the employees' duties; what to do once the risk is identified; what employees' roles are in the firm's compliance efforts and how to perform them; the firm's record retention policy; and the disciplinary consequences (including civil and criminal penalties) for non-compliance with the PATRIOT Act.

We will develop training, or contract for it. Delivery of the training may include educational pamphlets, videos, intranet systems, in-person lectures, and explanatory memos. Currently our training program is: \_\_\_\_\_

\_\_\_\_\_ [Insert specifics, such as "all registered representatives must view the video entitled "Spotting Money Laundering" by X date or within two weeks of being hired, etc.] We will maintain records to show the persons trained, the dates, and the subject matter of their training.

We will review our operations to see if certain employees, such as those in compliance, margin, and corporate security, require specialized additional training. Our written procedures will be updated to reflect any such changes.

### 4. Independent Testing of the AML Program

#### **Staffing:**

The testing of our AML program will be performed by \_\_\_\_\_[Name and Title], an independent third party. Their qualifications include \_\_\_\_\_[Describe].

OR

The testing of our AML program will be performed by \_\_\_\_\_[Names]. Their qualifications include \_\_\_\_\_[Describe.] To ensure that they remain independent, we will separate their functions from other AML activities by \_\_\_\_\_[Describe].

#### **Evaluation and Reporting:**

AML testing will be completed at least annually. After we have completed the testing, staff will report its findings to \_\_\_\_\_[Senior Management or to an Internal Audit Committee]. We will address each of the resulting recommendations.

## **5. Approval**

I hereby attest that I do not conduct a non-member customer business and do not receive customer funds or customer securities. I have approved this AML program as reasonably designed to achieve and monitor ongoing compliance with the requirements of the USA Patriot Act and the implementing regulations under the BSA.

Signed:\_\_\_\_\_

Print Name: \_\_\_\_\_

Title:\_\_\_\_\_

Broker-Dealer Number: \_\_\_\_\_

Date:\_\_\_\_\_

**Please note: CBOE Rule 4.6 states in part, no member, person associated with a member or applicant for membership shall make any willful or material misrepresentation, including a misstatement or false statement, or omission in any application, report or other communication to the Exchange, or to the Clearing Corporation.**

**If you make a false statement you may be subject to disciplinary action by the Exchange.**

**Finally, please be advised that the Department of Financial and Sales Practice Compliance may randomly audit the supporting documentation for the attestations received.**