

E*TRADE Financial: AML Compliance Challenges in the On-Line World

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The SEC CIP Enforcement Order

- On July 30, 2008, the SEC issued a Cease and Desist Order citing ET Securities LLC and ET Clearing LLC's failure to verify secondary account holders CIP information. The conduct cited occurred from October 2003 through July 2005. The Order included a \$1 million fine and required the hiring of a Consultant to review our CIP process.

With regard to the Consultant, the Order requires:

- The hiring at our expense;
- approval of the SEC (“non-objection”);
- that they determine the adequacy of our CIP policies and procedures and whether we are in substantial compliance with our procedures and the rules;
- that they prepare a report for our Board; and the SEC’s Enforcement Division, Office of Compliance, Inspections and Examinations, and Division of Trading and Markets;
- after one year, a determination as to whether we have corrected any deficiencies that they note.

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The SEC’s Press Release Included the Following:

- E*Trade is one of the largest online brokerage firms in the world, and a compliance lapse of this type has the potential to undermine the nation's anti-terrorism and anti-money laundering efforts," said Linda Chatman Thomsen, Director of the SEC's Division of Enforcement. "The penalty and undertakings imposed in today's enforcement action reflect the critical nature of anti-money laundering rules, and will provide greater assurance that future compliance will be seriously and continuously monitored."
- The press release discussed the specific violation, failure to verify secondary accountholders information, in the 6th paragraph.

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FINRA Enforcement Order

- On January 2, 2009 FINRA announced its Authority Letter of Acceptance, Waiver, and Consent (“AWC”) with ET Securities LLC and ET Clearing LLC for failure to adequately monitor for potential market manipulation. The AWC included a \$1 million fine and censure.

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FINRA Enforcement Order

The AWC language included:

- Because the Firm's AML System did not flag and cause the review of accounts for suspicious trading activity unless accompanied by money movement, it was not reasonably designed to achieve compliance with the Bank Secrecy Act and implementing regulations there under, in contravention of NASD Conduct Rule 3011 (b), and the Firm's written procedures for detecting and reporting suspicious trading activity did not comply with NASD Conduct Rule 3011 (a).
- The sanctions set forth above take into account the Firm's prompt corrective action to remediate its AML system and procedures after the initiation of FINRA's investigation, but without prompting by FINRA, including the implementation of automated monitoring systems specifically designed to detect suspicious trading during the review period and the expansion of staff along with the retention of third party vendors dedicated to the monitoring function.

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Some Lessons Learned

- Communication and the importance of passing along Institutional Knowledge.
- Ongoing dialogue with and testing of Vendor provided services.
- Staying informed of regulatory guidance. Regular attendance at AML related forums and workshops.
- Make sure, even for self directed customers, you are monitoring for market manipulation.

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FINRA Press Release

- E*Trade Units Fined \$1 Million for Inadequate Anti-Money Laundering Program
Firms Failed To Adequately Monitor For Suspicious Trading Activity
- Washington, D.C. — The Financial Industry Regulatory Authority (FINRA) announced today that it has imposed a \$1 million fine against E*Trade Securities, LLC and E*Trade Clearing, LLC, collectively, for failing to establish and implement anti-money laundering (AML) policies and procedures that could reasonably be expected to detect and cause the reporting of suspicious securities transactions.

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E*TRADE'S BSA/AML ENHANCEMENTS

- As noted by FINRA within the AWC, E*TRADE has made a significant investment in its BSA/AML Compliance Program. Some of the enhancements include:
- Significantly expanded and fine tuned the automated suspicious activity monitoring system; we've worked closely with ACTIMIZE to enhance our ability to monitor for market manipulation and to keep current with new features.
- created a centralized AML Unit;
- increased staff devoted to AML Compliance, including hiring and designating a Global Head of AML;
- created a Trade Monitoring group within the AML Unit; and
- increased training for units with AML compliance responsibilities.

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Micro-Cap Certificate Deposit Review

E*TRADE reviews certificate deposits for micro-cap stocks.

This review includes:

- The activity in the account;
- the background information of the account holder;
- the company's history;
- the stock's trading history; and
- analysis of the transfer agent involved in the transaction.*

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Transfer Agents: Be Wary

- FINRA has increased their expectations with regard to the monitoring of Transfer Agents, particular issues include:
 - unrestricted shares of micro cap stocks;
 - shares transferred via DWAC method, which utilizes transfer agents as custodians;
 - inadequate reviews of attorney opinion letters; and
 - concern that they may be acting in concert with those attempting to manipulate the market.

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Risk Based Due Diligence Secondary Account Review Team (SART)

- If we can not verify the customer's address or social security number through the non-documentary process, we refer the account to the SART team. This unit performs a variety of procedures including internet based skip traces in order to verify identity.

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ON-LINE VIRTUAL GAMES

World of Warcraft

- World of Warcraft (WoW) is a multiplayer online role-playing game (MMORPG) by Blizzard Entertainment
- Symantec reports that WoW poses a risk for money laundering
 - "... a criminal enterprise could open several thousand MMOG accounts. Each could be used to trade with other players in the purchase or sale of in-game assets, the funds from which would ultimately be withdrawn from the accounts. Since thousands of accounts may engage in millions of transactions, each with small profits or losses, it would be difficult to trace the true source of the funds when they are withdrawn. These transactions can be conducted worldwide without the oversight that typically accompanies international bank remittances."
- Gold Farming
 - Players earn virtual gold by completing tasks in the game.
 - Can trade virtual gold for weapons, supplies, etc. or sell for cash to other players – even those with trial memberships.
 - The Seoul Metropolitan Police Agency caught a group involved in gold farming activity trying to move \$38 million in laundered money between China and Korea.

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The scary world of virtual gaming and third party payment processors

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Second Life

- Virtual World
- 'Linden Dollars' used to purchase buildings, vehicles, jewelry
- Linden Dollars can be purchased from Second Life or independent currency exchange service providers
- Linden Dollars can be traded and earned between users

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3rd PARTY PAYMENT PROCESSORS Liberty Reserve

- Revolution MoneyExchange (RME) is a payment processing company based in St. Petersburg, FL. Start-up venture capital was provided by Citi, Morgan Stanley and Deutsche Bank. It is not a registered MSB.
- Services Offered:
 - Transfer funds between MoneyExchange accountholders
 - Add or withdraw funds to external bank accounts with no fee
 - Withdraw funds via check for \$2.50 fee
 - Withdraw funds via ATM for \$1.50 fee
 - Business accounts for merchants to accept payments
 - Accounts issued by FDIC Member Bank (First Bank and Trust, Brookings, SD)
- Notes:
- Revolution Money Exchange requires account holders to provide a SSN in order to comply with US AML regulations
- RME does not operate internationally – funds can only be sent and received within the United States

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WebMoney

- WB Transfer LTD incorporated in Belize in 1998
- Targets Russian customers
- Services Offered:
 - Exchange ordinary money for WebMoney (WM) units
 - Use WM currency to transfer money to other WM users (as payment)
 - Add or withdraw funds via bank wire
 - Add or withdraw funds at an exchange agency (many locations around the world)
 - Purchase pre-paid WM card on sale in Russia, Ukraine and Uzbekistan
- WM allows users to make transactions up to 150 euros without identity disclosure
- Negative News:
- "U.S. officials worry that WebMoney's Moscow location has added to its appeal among online criminals. Getting cooperation from Russian courts and obtaining documents from Russian companies is time-consuming and difficult, U.S. investigators say. That makes it easier for cybercriminals -- already adept at using fake identities -- to obscure their money trails. In April, the Financial Crimes Enforcement Network (FinCEN), the U.S. Treasury Dept.'s anti-money-laundering unit, cited WebMoney, along with e-gold, as a digital currency used to move funds from the sale of stolen identity and financial data into a Latvian bank that FinCEN labeled "a primary money-laundering concern" (*Business Week*)
- "Officials with the U.S. Postal Inspection Service say they worked with Eastern European authorities in 2004 to shut down two cybergangs, known online as dumpsmarket and carderportal. According to the postal inspectors, the gangs had laundered proceeds from the sale of stolen credit cards through two digital currencies, including WebMoney." (*Business Week*)

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MoneyBookers

- UK company, FSA regulated
- Requires identity verification prior to use
- Accepted currencies include: Euro, British Pound, Bulgarian Lev, U.S. Dollar, Australian Dollar, Canadian Dollar, Czech Koruna, Danish Krone, Estonian Koruna, Hong Kong Dollar, Hungarian Forint, Israeli Shekel, Japanese Yen, Lithuanian Litas, Latvia Lat, Malaysian Ringgit, New Taiwan Dollar, New Turkish Lira, New Zealand Dollar, Norwegian Krone, Polish Zloty, Singapore Dollar, Slovakian Koruna, South-African Rand, South-Korean Won, Swedish Krona, Swiss Franc and Thailand Baht
- Appear to have strong CIP, KYC and monitoring procedures

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ePassporte

- ePassporte, N.V. is a Curacao (Netherland Antilles) limited liability company
- Services Offered:
 - Transfer funds to anyone with an ePassporte account
 - Receive funds from anyone with an ePassporte account
 - Use ePassporte account as payment where ePassporte is accepted
 - Virtual Visa – make purchases using a 16 digit visa card number (can use anywhere Visa is accepted)
 - Visa Electron card – Accepted at any location with a Visa merchant and can be used to make ATM withdrawals
- Can load account with US dollars from a Visa debit/credit cards or from a US checking account
- Business accounts can be used to make/accept payments from vendors/customers
- Ceased use on online gambling sites in 2007

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