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FATF Report

Money Laundering and Terrorist Financing in the Securities Sector

October 2009



THE FINANCIAL ACTION TASK FORCE (FATF)

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TABLE OF CONTENTS

EXECUTIVE SUMMARY 5

CHAPTER 1: INTRODUCTION 6

1.1 Introduction 6

1.2 Need for the Typology 6

1.3 Scope 7

1.4 Methodology 8

CHAPTER 2: LITERATURE AND ACTIVITIES REVIEW 9

2.1 Overview 9

2.2 Previous Typologies Exercises 9

2.3 International Activities and Materials 11

2.4 Domestic Material 12

2.5 Main Gaps in Existing Material 13

CHAPTER 3: ML/TF VULNERABILITIES IN THE SECURITIES INDUSTRY 14

3.1 Introduction 14

3.2 Securities Products as Described in Questionnaire Responses 15

3.2.1 Vulnerabilities Associated with Particular Types of Securities Products 17

3.3 Markets and other Means of Access 22

3.3.1 Vulnerabilities Associated With Particular Types of Market Access 24

3.4 Payment Methods Relating to Securities Transactions 25

3.5 Entities Involved in the Offer, Sale, Advice, Management or Distribution of Securities ("Securities Intermediaries") 30

3.6 Clients and Account Types 38

3.7 Determination of Value 42

3.8 Rogue Employees 44

3.9 Terrorist Financing 47

CHAPTER 4: PREDICATE OFFENCES FOR MONEY LAUNDERING LINKED TO SECURITIES 48

4.1 Introduction 48
4.2 Insider trading 48
4.3 Market Manipulation 50
4.4 Securities Fraud 53

CHAPTER 5: SUSPICIOUS TRANSACTION REPORTING AND ENFORCEMENT ACTIONS 55
5.1 Suspicious Transaction Reports 55
5.2 Enforcement actions 57

CHAPTER 6: CONCLUSION AND RECOMMENDATIONS FOR FURTHER WORK 58
6.1 General 58
6.2 Terrorist Financing 58
6.3 Money Laundering 58
6.4 STRs, Law Enforcement and Co-operation 59
6.5 Definitions 60
6.6 Issues for consideration 60

ANNEX A: GLOSSARY OF TERMS 64

ANNEX B: SUSPICIOUS INDICATORS 70
Introduction 70

ANNEX C: SUSPICIOUS TRANSACTION REPORTS 78

ANNEX D: QUESTIONNAIRE AND RESPONDING JURISDICTIONS AND ORGANISATIONS 80

EXECUTIVE SUMMARY

1. The securities industry plays a key role in the global economy. Participants range from multinational financial conglomerates that employ tens of thousands of people to single-person offices offering stock brokerage or financial advisory services.

2. New products and services are developed constantly, in reaction to investor demand, market conditions, and advances in technology. Product offerings are vast, and many are complex, with some devised for sale to the general public and others tailored to the needs of a single purchaser. Many transactions are effected electronically and across international borders.

3. Some of the features that have long characterised the industry, including its speed in executing transactions, its global reach, and its adaptability, can make it attractive to those who would abuse it for illicit purposes, including money laundering and terrorist financing. Moreover, the securities sector is perhaps unique among industries in that it can be used both to launder illicit funds obtained elsewhere, and to generate illicit funds within the industry itself through fraudulent activities. Transactions and techniques associated with money laundering and the specific predicate securities offences are often difficult to distinguish, which is why specific indicators and case studies for insider trading, market manipulation and securities fraud are relevant and included in this study.

4. The case studies presented in this report illustrate the risks associated with the various types of intermediaries, products, payment methods and clients involved in the securities industry. Unlike other sectors, the risks lie mainly not in respect of the placement stage of money laundering, but rather in the layering and integration stages. Typical securities-related laundering schemes often involve a series of transactions that do not match the investor's profile and do not appear designed to provide a return on investment.

5. Some areas of vulnerability (for example, rogue employees) are not peculiar to the securities industry, and thus this study is of relevance to the wider financial services sector. In particular, some money laundering schemes involve products and transaction types that exist in the banking and insurance sectors as well.

6. Suspicious transaction reporting in the sector remains relatively low, which can be explained by a number of possible factors, including a lack of awareness and insufficient securities-specific indicators and case studies; issues that this report attempts to address. Consultations with the private sector conducted for this project outlined the need for enhanced securities-specific guidance by international organisations and national authorities.

7. The reported incidents of money laundering in the securities industry far outweigh those relating to terrorist financing. However, the sector remains vulnerable to both money laundering and terrorist financing.

CHAPTER 1: INTRODUCTION

1.1 Introduction

1. The securities industry, along with banking and insurance, is one of the core industries through which persons and entities can access the financial system. This access provides opportunities for criminals to misuse the financial system to engage in money laundering (ML) and terrorist financing (TF).

2. Whilst the securities industry has been the subject of international and domestic efforts relating to anti-money laundering (AML) and combating the financing of terrorism (CFT) for several years, ML/TF vulnerabilities specific to this industry have not been subject to global typology research.

1.2 Need for the Typology

3. The securities industry evolves rapidly and is global in nature. It provides opportunities to quickly carry out transactions across borders with a relative degree of anonymity. It is thus imperative to highlight and share current information about potential vulnerabilities.

4. The report previously published by the FATF in 2003[1] on the securities industry provided a relatively limited overview of ML/TF vulnerabilities due to the limited availability of securities typologies. In addition, MONEYVAL and the Asia/Pacific Group (APG) on money laundering, both FATF-Style Regional Bodies (FSRBs), have carried out work in this area. MONEYVAL published a securities typology report in 2008 and the APG incorporated a section on securities into its 2009 yearly typologies report. Both reports are limited in scope to those FSRBs' regional jurisdictions.

5. The FATF decided to conduct a global study in June 2008 in order to better understand the ML/TF vulnerabilities in the securities industry. It is anticipated that this study will be of benefit to the industry, law enforcement and regulators.

6. The need for this latest typology report is also driven by the comparatively low levels of suspicious transaction reporting in the securities industry relative to other industries, such as banking. The reason for lower levels of reporting is not entirely clear, but some possible explanations are explored later in the report.

7. The variation in the securities industry particular to different jurisdictions also contributes to the need for a global typology that addresses these variations. For example, jurisdictions differ in the types of products that they define as securities, as reflected in the numerous types of securities products mentioned in the current FATF Glossary definition linked to the activities of "financial institutions."

8. Moreover, while securities intermediaries in many jurisdictions do not accept cash for securities transactions, which is traditionally used in the placement stage of ML and where potential ML/TF activities may be easier to detect and report, some do. Finally, depending on the jurisdiction, trading in securities is often not limited to securities broker-dealers, but can also involve the banking and insurance industries.

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1 FATF (2003).

9. The following countries and international organisations joined the project team and contributed to the study: Australia, Belgium, Brazil, Canada (as project co-leader), France, Japan, Luxembourg, the Netherlands, Spain, Switzerland, the United Kingdom (U.K.) (as project co-leader), the United States (U.S.) (as project co-leader), the Asian Development Bank, the Offshore Group of Banking Supervisors ("OGBS"), the International Organisation of Securities Commissions ("IOSCO") and the World Bank. In total, over 40 countries and international organisations participated in the study.

1.3 Scope

10. The objectives of this typology report are to:

- Raise overall awareness of the ML/TF risk in the securities industry for industry participants, regulators and law enforcement;
- Identify specific ML/TF risks based on product type, intermediary, market type and payment/distribution channel;
- Provide a comprehensive set of suspicious indicators and case studies that are applicable to the securities industry; and
- Identify any current and emerging issues which would benefit from further consideration by the FATF.

11. This project examines ML/TF vulnerabilities in the securities industry based on typical products, markets, payment methods and intermediaries associated with the industry. Where practicable, the report seeks to identify the particular vulnerabilities, whether at the placement, layering or integration phase, associated with a particular product, market, payment method or intermediary. Where possible, particularly in the case studies, the report identifies the source of funds used in money laundering and any predicate offence used to generate the funds.

12. Importantly, this report highlights several situations that are of particular relevance or are unique to the securities industry.

13. For example, while money laundering generally encompasses the *introduction* of illicit assets into the financial system, securities can also be a vehicle for *generating* illicit assets within the financial system itself. The FATF glossary includes among the "designated categories of offences", three offences that are predicate offences to money laundering: insider trading, market manipulation, and fraud. Insider trading and market manipulation are particular to the securities industry, as is securities-related fraud.[2] Because these illicit activities are particular to the securities industry, they are addressed in this report in the hope that ML/TF can be reduced when these activities are themselves detected and prevented.

14. Also, the relatively detailed customer information many securities intermediaries collect as part of other regulatory obligations, such as suitability or know-your-customer (KYC), may allow for particular insights into potential ML/TF activities.

15. Although the focus of this report is on the unwilling use of the securities industry in ML schemes, typologies have demonstrated that, at times, securities industry professionals can also be complicit in

[2] Whilst insider trading and market manipulation can also occur in the commodities industry, in at least some jurisdictions commodities trading is included under the securities regulatory regime.

perpetuating ML schemes and securities-specific predicate offences. Accordingly, this report will address both phenomena.

16. Finally, although the report's primary focus is on issues particular to the securities industry, it is worth noting that a number of the vulnerabilities and suspicious indicators identified in this report overlap with those that occur in other financial services sectors, such as banking. Moreover, whilst the report is intended to be a comparative survey, it is not an exhaustive overview of all aspects of this wide-ranging industry.

1.4 Methodology

17. This report is based on four main sources. The first is a review of literature and related guidance that has been produced or undertaken by international groups, domestic regulators, trade associations, self-regulatory organisations (SROs)[3] and academia. The second is a compilation and analysis of the responses to a questionnaire that the project co-leaders distributed to FATF members and observers in November 2008. The third and fourth are the results of a typology workshop and consultations with the private sector, respectively.

18. The questionnaire results were obtained in December 2008 and January 2009 from 38 jurisdictions in the Americas, Asia, Australia, Europe, the Middle East, and two international organisations, giving a total of 40 respondents. [4] The responding jurisdictions varied in the size and organisation of their securities markets. These variations were taken into account to the extent practicable.

19. In November 2008, at about the same time that the questionnaire was distributed, a workshop on money laundering and the securities industry was held in Monaco as part of the 2008 FATF/MONEYVAL Typologies meeting. This workshop was very well supported by members of the FATF, MONEYVAL, and representatives of several international organisations. The following participants examined the issue in depth during a break out session: Australia, Belgium, Brazil, Canada, the European Commission, Finland, France, Germany, Luxembourg, the Netherlands, Norway, Russia, Switzerland, the U.K., the Ukraine, the U.S., the APG Secretariat, IOSCO, the MONEYVAL Secretariat and the Organisation for Economic Co-operation and Development ("OECD").

20. This study is also based on consultations with non-governmental persons, including the Investment Industry Regulatory Organization of Canada ("IIROC"), representatives of the private sector in the U.K. and U.S., and the Financial Industry Regulatory Authority, Inc. ("FINRA"), a U.S. SRO, and representatives of the private sector in some core group countries.

21. The project team would like to acknowledge the thoughtful work of all participants, including the FATF Secretariat. Their input has been greatly appreciated.

[3] An SRO is a non-governmental organisation that has the power to issue and enforce industry regulations and standards.

[4] The questionnaire and a list of the countries and jurisdictions that responded to it are attached as Annex D.

CHAPTER 2:
LITERATURE AND ACTIVITIES REVIEW

2.1 Overview

22. Information on ML/TF typologies, trends and techniques in the securities industry can be found in various sources. As previously mentioned, both the FATF and some FSRBs have conducted typologies in the past. In addition, financial intelligence units (FIUs), law enforcement and other agencies publish suspicious transaction indicators, trends and sanitised ML/TF cases. Significant materials have also been produced by international groups, domestic regulators, trade associations, SROs, and academics. A review of this material is provided below.

2.2 Previous Typologies Exercises

2002-03 FATF Typologies Report

23. In February 2003, the FATF published a general report on ML typologies (FATF Typology).[5] That report contained four chapters, including one devoted to ML through the securities industry. Other chapters of the 2002-03 FATF typology addressed terrorist financing, the gold and diamond markets, and other ML/TF trends.

24. The securities chapter in the FATF Typology made the following overall observations:

- The ability of the FATF to examine ML vulnerabilities in the securities industry was hampered by the lack of information regarding how, or indeed whether, the securities industry was being used for ML;
- ML in the securities industry occurs primarily at the layering and integration stages; and
- The securities industry provides the money launderer with a double advantage – the ability to launder illicit assets generated from outside the securities industry and the ability to use these external illicit assets to generate additional illicit assets within the securities industry, for example through market manipulation and securities fraud.

25. The FATF Typology also provided eight examples of the different stages through which the securities industry can be used for ML/TF, and illustrated the illicit activities that can generate illicit assets from within the industry.

26. The FATF Typology, however, did not provide a comprehensive set of suspicious indicators that compliance professionals in the securities industry could use when evaluating the particular risks that a client or series of transactions could pose. This may have been the result of the lack of information about how or whether the securities industry was actually being used for ML/TF purposes.

[5] FATF (2003).

2008 MONEYVAL Typologies Report (MONEYVAL Typology)[6]

27. The MONEYVAL securities typology report focuses on countries predominantly in Eastern Europe that, in some cases, have a developing securities industry.

28. The MONEYVAL typology identified the following areas as presenting the greatest ML vulnerabilities in the securities industry:

- Wholesale markets;
- Unregulated funds;
- Wealth management;
- Investment funds;
- Bearer securities; and
- Bills of exchange.

29. MONEYVAL acknowledged that, in rare instances, cash can be placed through the securities industry. Significantly, MONEYVAL devoted a section of its report to market manipulation and insider trading, providing a number of case studies to illustrate these illicit activities.

30. The MONEYVAL typology presented a number of sanitised case studies as well as schematics to illustrate the flow of funds and the relationships between persons and entities. The MONEYVAL report also addressed suspicious indicators at the account opening stage, the execution and settlement of transactions, and the use of fictitious companies.

31. The MONEYVAL typology also described how information is shared amongst and between financial regulators, FIUs and law enforcement. In particular, MONEYVAL identified information sharing as an important issue given that certain securities transactions are effected in different sectors and may be subject to different regulatory oversight. The report provided guidance on analysis and investigation techniques as well as information on how the FIUs of specific countries perform their analysis and how cases are investigated by law enforcement.

APG Typology Workshop and 2009 Report[7]

32. In October 2008, the APG held a typologies workshop during which several member countries provided presentations. A portion of the workshop featured the securities industry and was attended by several securities regulators. The cases and suspicious indicators included in those presentations focused more on predicate offences to money laundering, such as securities fraud, than on money laundering itself. This may be because fewer APG countries require the securities industry to report suspicious transactions. Where such requirements exist, securities related suspicious transaction reporting (STR) reporting levels are low, potentially impeding the ability of these jurisdictions to investigate money laundering. In any event, the overall experience of some APG countries is that the securities industry is a method of generating illicit assets instead of a conduit for laundering illicit assets generated outside of the industry.

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6 MONEYVAL (2008)

7 APG (2009)

33. Instances where ML was detected and reported were mostly at the placement stage because many APG countries still utilise cash as a payment method for securities transactions. For example, some APG country ML case studies focused on the laundering of proceeds of corruption through investments in the capital markets. As with the other typologies mentioned, the APG typology report did not present case studies where the securities industry was used for terrorist financing.

34. As reported by APG member countries, the following were the most common suspicious indicators and methods related to money laundering and predicate offences involving the securities industry:

- Changing share ownership in order to transfer wealth across borders;
- Redeeming a long-term investment within a short period;
- Opening multiple accounts or nominee accounts;
- Using brokerage accounts as long term depository accounts for funds;
- Effecting transactions involving nominees or third parties;
- Engaging in market manipulation, e.g. "pump & dump" schemes; and
- Engaging in boiler room operations.

35. There appeared to be a consensus that APG countries need to better understand the ML/TF risks and vulnerabilities of the securities industry. It was noted that although APG mutual evaluation reports have some useful information on the sector, they do not address securities related ML/TF risks in a significant manner.

2.3 International Activities and Materials

International Guidance and Best Practices

36. A number of guidance documents issued by international organisations and/or domestic authorities provide useful information on ML/TF vulnerabilities in the securities industry.[8] International organisations, such as IOSCO, the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors have produced documents that set out standards and best practices that national regulators and supervisors as well as banks, securities firms and insurance companies should follow.

37. Vulnerabilities identified by these organisations requiring enhanced due diligence or a particular focus on supervision are listed below:

- Transactions involving accounts in multiple jurisdictions;
- Securities accounts introduced from one intermediary to another without adequate customer due diligence/know your customer (CDD/KYC) investigations or from high risk jurisdictions;
- The use of front persons or entities (e.g. corporations, trusts);

[8] These documents are listed in the references and bibliography section.

- Entities with complex corporate structures;
- Politically-exposed persons (PEPs);
- Dealings with financial institutions and intermediaries or customers operating in jurisdictions with ineffective AML/CFT systems;
- Unregistered or unregulated investment vehicles;
- Cross-border omnibus and correspondent accounts; and
- Fictitious trading schemes.

38. Additional areas that are identified as low risk (and where reduced due diligence can, in some jurisdictions, be acceptable) also provide useful information on ML/TF vulnerabilities. These are generally products or accounts with restrictions, such as where:

- Cash withdrawals are not permitted;
- Redemption or withdrawal proceeds are not permitted to be paid to a third party; or
- It is not possible to change the characteristics of products or accounts at a future date to enable payments to be received from, or made to, third parties.

2.4 Domestic Material

Published Law Enforcement Cases

39. Some jurisdictions publish sanitised ML or other financial crime cases. Generally, these cases are published as part of an FIU's annual report, or as specific-topic trends or as typologies reports, and provide insights into ML or TF trends and methods, including statistics and other information. Such information is extracted from STRs and other reports, as well as investigations and other enforcement actions. These sources provide essential guidance to financial institutions and can be used by regulators and other government agencies to help develop their supervisory programmes, as well as in the assessment of AML/CFT system effectiveness.

40. Although the Egmont Group also posts sanitised cases on its website, they contain relatively few references to securities.[9]

Regulatory Guidance and Reports

41. Domestic regulators, FIUs and/or SROs produce guidance to assist their financial institutions and intermediaries in meeting their AML/CFT obligations. Some countries provide industry-specific guidance, including the securities industry, while other jurisdictions provide guidance that is applicable to financial institutions more generally. Guidance in respect of customer due diligence and risk assessment is intended to provide an indication of the types of transactions, customers and delivery channels that present higher ML/TF risks.

[9] The Egmont Group, www.egmontgroup.org/library_sanitized_cases.html

42. This regulatory guidance can involve, for example, a discussion of enhanced due diligence measures that are often recommended for specific types of products/customers, such as:

- Offshore trusts;
- Non-profit or charitable organisations;
- Significant cross-border activity;
- Internet/on-line accounts; and
- Omnibus and private banking accounts.

43. Other guidance appears in the form of published suspicious transaction indicators. These indicators are often developed and published by FIUs and can be industry-specific or apply generally to all financial institutions and designated non-financial businesses and professions (DNFBPs). Some FIUs present the indicators in the context of specific cases that they have built and analysed. Each indicator individually is not an automatic trigger for reporting, but rather serves as a tool for determining whether a suspicious transaction report (STR) should be filed. A comprehensive list of such indicators has been compiled using responses to the project questionnaire, published sources, and consultation with the private sector, and is available in Annex B.

Articles and Papers

44. Specialised periodicals in the area of law, crime or finance publish research or analytical papers on topics related to money laundering written by regulators, law enforcement representatives, academics and members of the private sector. Even among such sources, little is found concerning securities. A few papers discuss the vulnerabilities of the securities industry, in particular at the layering stage, and provide indicators, cases, and discuss implications for regulators and broker-dealers.[10]

2.5 Main Gaps in Existing Material

45. In comparison to several other sectors and financial products, there is significantly less documentation on the ML risks and vulnerabilities related to the securities industry. In many jurisdictions, the literature on TF is less still.

46. By contrast, there is much more abundant information on predicate crimes committed using securities, such as market manipulation and insider trading, in particular with respect to investigations, prosecutions and convictions. The possible connections between predicate offences and money laundering in the securities industry will be examined in this report.

47. As noted above, a number of sanitised cases involving securities have been published, some of which provide detailed information on persons and entities involved and on the flows of funds. However, published cases rarely include information on the suspicious indicators or circumstances that led, or should have led, to the filing of an STR. In some cases, this limited information may be the result of the disclosure restrictions applicable to the STR filing itself. Also absent is information on any enforcement actions, e.g. prosecution or seizures, in respect of the specific case.

[10] A list of articles and papers is provided in the references and bibliography section.

CHAPTER 3:
ML/TF VULNERABILITIES IN THE SECURITIES INDUSTRY

3.1 Introduction

48. The FATF Glossary defines a "financial institution" as including a person or entity that, among other things, conducts as a business the following activities:

- The transfer of value or money;
- Trading in :

  (a) money market instruments such as cheques, bills, certificates of deposits (CDs), derivatives, etc.;

  (b) foreign exchange;

  (c) exchange, interest rate and index instruments;

  (d) transferable securities;
- Participation in securities issues and the provision of financial services related to such issues;
- Individual and collective portfolio management;
- The safekeeping and administration of cash or liquid securities on behalf of other persons;
- Otherwise investing, administering or managing funds or money on behalf of other persons; and
- Underwriting and placement of life insurance or other investment related insurance.

49. While the activities of securities industry participants do not constitute a distinct activity category under the 40+9 Recommendations[11], the activities described in the questionnaire responses fall squarely within the FATF's definition of a financial institution. However, and perhaps not surprisingly, the full scope of securities industry activity is broader still. As such, a more detailed overview of the industry is needed in order to fully appreciate its ML/TF vulnerabilities. As the complexity of products and the diversity of the actors in the securities industry continue to expand, it is suggested that the FATF keep under consideration the extent to which the definition of "financial institution" still covers persons engaged in activities associated with the securities industry.

50. The content of this chapter is principally based on the 40 responses to the questionnaire, which asked participant jurisdictions to use the definition of "financial institution" in the FATF Glossary as a point of reference for identifying:

- Products that are classified as "securities" within a jurisdiction;

[11] The FATF 40 and 9 Special Recommendations have been recognised by the International Monetary Fund and the World Bank as the international standards for combating money laundering and the financing of terrorism. They are available at www.fatf-gafi.org/document/28/0,3343,en_32250379_32236930_33658140_1_1_1_1,00.html.

- The type of market access and payment methods involved e.g. securities exchanges, over-the-counter markets, use of cash or cheques for payment;

- The type of intermediaries involved in the offer, sale, recommendation, or distribution of securities e.g. broker-dealers, financial advisers, banks, insurance companies; and

- The vulnerabilities associated with each, as well as some relevant case studies.

Organisation of Material

51. This chapter is organised into eight topical sections: (1) products classified as securities according to questionnaire responses; (2) markets and other means of access; (3) payment methods; (4) securities intermediaries; (5) client and account types; (6) determination of value; (7) rogue employees; and (8) terrorist financing. Each section provides an overview of the topic area, followed by a discussion of its particular ML/TF vulnerability. When available, these sections also present case studies.

3.2 Securities Products as Described in Questionnaire Responses

52. The FATF Glossary does not define the term "security." Because of jurisdictional differences in defining the term, this report will not attempt to provide a universal definition. However, this report does provide an overview of the products that were identified as securities by the jurisdictions that responded to the questionnaire.

53. The questionnaire asked that respondents categorise securities products under the following three broad categories: (1) ***Transferable Securities;*** (2) ***Units in Collective Investment Schemes;*** and (3) ***Derivatives***.[12]

Transferable Securities

54. The questionnaire listed: (1) equities; (2) bonds and similar debt instruments; (3) certificates of deposit; and (4) bills of exchange as transferable securities. Jurisdictions were asked to include in their questionnaire responses any other products that were considered transferable securities in their jurisdictions or indicate which, if any, of the broad categories were not.

55. Most jurisdictions indicated that the products listed in the questionnaire as transferable securities were designated as such under their laws. However, jurisdictions also identified additional products to those identified in the questionnaire that were considered transferable securities, such as:

- Bank bills and guarantees;

- Bonds that are convertible to other shares;

- Bonds with a share warrant;

- Certificates of participation;

- Commercial notes;

- Debentures;

12 A glossary is provided in Annex A that defines selected terms used in this report.

- Mortgage bonds, securities and certificates;
- Notes issued in a series that obligates a corporation to pay a certain sum at a certain date; and
- Share warrants.[13]

56. It should be noted that, while most jurisdictions treat certificates of deposit as securities, seven did not. In addition, only twelve jurisdictions treat bills of exchange as securities. The fact that they are not defined as a "security" does not in itself mean that there is any gap in the regulatory or supervisory system of the jurisdiction concerned, but highlights the complexity of the terminology used to define these products, and that different authorities (for example a banking supervisor) might be responsible for AML/CFT supervision of these products.

Units in Collective Investment Schemes (CISs)

57. The questionnaire listed: (1) unit trusts; (2) investment trusts; (3) mutual funds; (4) open-ended investment companies (OEICs); (5) open-ended collective investment schemes (SICAV/Fs); and (6) closed-end companies as units in collective investment schemes (UCIS).

58. Although jurisdictions included some variants, many of these differences may be attributable to regional language differences.[14]

Derivatives

59. The questionnaire listed: (1) options; (2) futures; (3) swaps; (4) forward rate agreements; and (5) commodity derivatives contracts; and (6) foreign exchange contracts as derivatives.

60. As with transferable securities and CISs, most jurisdictions consider these instruments to be securities, with some variations.[15]

61. In most jurisdictions where instruments are not treated as securities by law, they are generally treated as "financial instruments" or "derivatives." In some jurisdictions where particular products were not considered to be securities, it was not necessarily clear what alternative regulatory regime (if any) applied to those products. This gives rise to concerns that ML/TF risks relating to those products might not be fully identified. In any event, the complexity of and ability to customise derivatives products makes it difficult to assess the full scope of products in the marketplace.

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13 While jurisdictions identified other instruments as transferable securities, the products listed here are intended simply to illustrate the wide scope of the instruments that were included in the questionnaire responses.

14 For example, a number of jurisdictions do not treat unit trusts as securities. In addition, OEICs, SICAV/Fs, and closed-end companies are treated as securities in 18 (mainly European) jurisdictions, but do not exist in a small number of jurisdictions.

15 Five jurisdictions do not define options as securities; six jurisdictions do not define futures as securities; seven jurisdictions do not define swaps as securities and one jurisdiction indicated that swaps do not exist in its jurisdiction; ten jurisdictions do not define forward rate agreements as securities, and three jurisdictions indicated that forward rate agreements do not exist in their jurisdictions; ten jurisdictions do not define commodity derivatives contracts as securities and three jurisdictions indicated that commodity derivatives contracts do not exist in their jurisdictions.

Other

62. The questionnaire also asked jurisdictions to list any other products that would be classified as securities but that were not captured in the categories listed in the questionnaire. Jurisdictions identified:

- Annuities;
- Credit-default swaps;
- Equity-indexed annuities;
- Profit sharing agreements/certificates;
- Subscription rights; and
- Variable life insurance and variable annuities.

63. Foreign exchange (Forex) trading is an example of an activity that is technically covered by the FATF definition, but is not always consistently treated as an activity undertaken in the securities sector. Limited suspicious indicators and typology information were available for this activity. This is an area that may benefit from further study. [16]

3.2.1 Vulnerabilities Associated with Particular Types of Securities Products

64. As illustrated by the responses to the questionnaire, different jurisdictions classify a wide range of products as securities. In this respect, any of the products listed above can be utilised in the layering and integration stages of money laundering once illicit assets are placed in the financial system. As noted above, however, the securities industry is relatively inhospitable to the placement of illicit assets into the financial system Nevertheless, as discussed below, certain securities products do pose identifiable ML/TF vulnerabilities even at the placement stage.

Physical Securities (Including Bearer Securities and Bills of Exchange)

65. Although many jurisdictions have dematerialised securities, the questionnaire responses indicated that physical and bearer securities are still available in some jurisdictions. Bearer securities consist of both physical equity and debt securities that, unlike registered securities, do not necessarily require that the owner be registered with an issuer or a transfer agent. The transfer of bearer securities can be as simple as handing the security over to a new owner. It is important to note that the transfer of ownership can, in some jurisdictions, be almost as easily accomplished through electronic means that inhibit tracking any change of ownership.[17] In addition, some bearer bonds are almost equivalent to cash because they can be easily redeemed at financial institutions.

66. The anonymity and easy transferability of bearer securities presents a significant ML/TF vulnerability at all three stages of money laundering. Illicit assets can be placed in the securities industry through the purchase of bearer securities. Once a bearer security has been issued, money launderers or terrorist financiers can hold these securities or transfer them to an intended recipient without necessarily having to use facilities that would record a transaction, conduct CDD or impose KYC obligations.

[16] Ten jurisdictions do not define foreign exchange contracts as securities and four jurisdictions indicated that foreign exchange contracts do not exist in their jurisdictions.

[17] *Marco Arnone* & *Pier Padoan* (2008).

Recipients of bearer securities can deposit them into brokerage accounts in order to purchase other assets, or liquidate them and withdraw or wire transfer their proceeds out of the jurisdiction, thus layering and integrating the illicit assets. Bearer securities can also be used to conceal the identities of the beneficial owners of shell companies, as discussed below.

67. In some jurisdictions, bills of exchange are treated as securities. A bill of exchange (e.g. cheque, bank draft) is a written unconditional order by a drawer to a drawee to pay money on demand or at a fixed or determinable future time to a payee (the specified person or to the bearer). Bills of exchange can be payable on sight or at a future date and can be transferred by making an endorsement or signature. The risk posed by a bill of exchange is similar to that of a bearer security: ease of transfer and redemption. Although jurisdictions did not provide specific suspicious indicators for bills of exchange, those for bearer securities may be applicable.

Suspicious Indicators for Physical Securities*[18] *(including Bearer Securities and Bills of Exchange)

68. The following are suspicious indicators that are applicable to physical securities, including bills of exchange:

- The customer deposits a large number of bearer securities at the securities firm and quickly redeems the securities or sells them in the open marketplace;
- The customer requests cashing of bearer securities without first depositing them into an account;
- The customer frequently deposits bearer securities or bills of exchange into an account;
- The bearer securities or bills of exchange, if titled, are titled differently than the name on the account;
- The customer's explanation regarding the method of acquiring the bearer securities or bill of exchange does not make sense or changes;
- The customer frequently deposits bearer securities in amounts just below a jurisdiction's threshold reporting requirement;
- Payments for bills of exchange made by way of third party cheques are payable to, or endorsed over to, the customer; and
- The physical security does not bear a restrictive legend, even though the history of the security and/or the volume of shares being traded suggest that it should have such a legend.

Insurance Products

69. In some jurisdictions, insurance contracts that contain an investment component are considered to be securities, and thus are sold through a securities intermediary. For example, a variable annuity is a contract issued by an insurance company under which an investor provides the insurer with a lump-sum premium payment or series of periodic payments. In return, the insurer agrees to make periodic payments to the investor beginning immediately or at some future date. The investor is usually permitted to invest the purchase payments in a range of investment options, such as mutual funds or unit investment trusts.

[18] Physical securities are also implicated in market manipulation, as discussed in Chapter 4.

The value of the variable annuity will vary, depending on the performance of the investment options that have been chosen.

70. In addition, variable annuity contracts typically have a "free look" or "cooling off" period of ten or more days during which the investor may terminate the contract without paying any penalties and receive a refund for the amount of the contract. The amount of the refund may equal either the account value when the contract is terminated or the amount of purchase payments, depending on the terms of the contract and applicable legal requirements.

71. This "free look" period gives rise to a particular risk: a money launderer can purchase a variable annuity and then seek a refund during the free look period. The cheque received from the insurance company may not draw suspicion when deposited at a bank.[19]

72. From a supervisory or regulatory perspective, there is potential duplication, but also a potential gap, if countries have two separate supervisory authorities looking at the insurance and securities industries. Although this is outside the scope of the current study, this is an area which might benefit from further investigation.

Suspicious Indicators for Insurance Company Products

73. The following have been identified as suspicious indicators involving insurance company products:

- The customer cancels an insurance contract and directs that the funds be sent to a third party;
- The customer deposits an insurance annuity check from a cancelled policy and immediately requests a withdrawal or transfer of the funds;
- The customer cancels an annuity product within the "free look" period;[20]
- The customer opens and closes accounts with an insurance company only to open a new account shortly thereafter with the same insurance company, but with new ownership information;
- The customer purchases an insurance product with no concern for investment objective or performance;
- The customer purchases an insurance product with unknown or unverifiable sources of funds, such as cash, sequentially numbered money orders, traveller's cheques, and/or cashier's cheques;
- The customer is particularly interested in the product's early surrender and in the amount that he will then have at his disposal;
- The customer purchases an insurance contract using a single large premium payment, particularly with an unusual payment method, such as cash or cash equivalent;

19 The placement stage risks of cheques and money orders are discussed more fully below in Section 3.4 on payment methods.

20 Although this will often be a legitimate transaction, it could also signal a method of laundering funds if accompanied by other suspicious indicators, such as purchasing the annuity with several sequentially numbered money orders, traveller's cheques, or cashier's cheques and/or the customer's having a history of cancelling annuity products during the "free look" period.

- The customer purchases a single premium policy using cash, money orders, traveller's cheques, or cashier's cheques for an amount that is clearly out of proportion to the customer's income;

- The customer enters into a contract for a considerable sum subject to payment of the premiums from abroad, particularly from an offshore financial centre;

- The customer substitutes, during the life of the contract, the initial beneficiary for a person without any apparent link to the policyholder;

- The customer cancels the contract without concern for the considerable tax or other cancellation charges that he or she has to pay as a result; and

- The customer secures a policy loan against the cash value soon after the policy is issued and repays the loan with cash or various monetary instruments.

Low Priced Securities and Private Issuers

74. Low priced securities, also known as penny stocks, refer to low-value equity interests in companies that are publicly traded or are about to become so. The issuers of these shares generally have legitimate business operations and revenue streams. However, some publicly traded penny stocks are really shell companies that may be used for a reverse merger. In any event, shares in these issuers will often be represented with physical securities that can be deposited with a securities intermediary. These shares are not likely to be traded on traditional exchanges, but rather in over-the-counter ("OTC") markets or on bulletin boards, which are discussed below. Penny stocks typically have very low trading volume but, unlike bearer securities, ownership of these shares will often be registered with the issuer and/or a transfer agent.

75. The ML/TF vulnerabilities posed by these securities are two-fold. First, these types of securities are often used to generate illicit assets through market manipulation, insider trading, and fraud. Illicit actors can either use existing shares that are already publicly traded, or start a shell company for the express purpose of engaging in those illicit activities. In addition, criminal organisations have also been known to use illicit assets generated outside the securities industry to engage in market manipulation and fraud. This first vulnerability is discussed more fully in Chapter 4.

76. Second, these securities can be acquired by investing illicit assets into a company that is about to become public. Once the company goes public, the money launderer can sell his or her stake, thereby giving funds the appearance of having been derived from a legitimate securities transaction. Moreover, criminal organisations can also initially invest in a private company that they can then use as a front company for comingling illicit and legitimate assets. They can then take this company public through an offering in the public securities markets, thus creating what appear to be legitimate offering revenues. Alternatively, criminal organisations can acquire a publicly traded company and use it to launder illicit assets.

Suspicious Indicators and Case Studies for Low Priced Securities and Private Issuers

77. The suspicious indicators associated with low priced securities and private issuers are, for the most part, identical to those that are discussed in the market manipulation section of Chapter 4.

Case Study 1: Laundering by acquisition of publicly traded shell company

Offence:	Money laundering
Securities Related Predicate Offence (if any):	N/A
Jurisdiction:	Israel
Subject:	Individual
Instruments, methods and techniques:	Front companies, publicly-traded shares of a shell company
Indicators:	• Use of a public shell company (traded on the stock exchange); • Use of a front company/straw man to perform the acquisition; • Transferring funds through several accounts; • Use of a money services business (MSB) to transfer funds; • Withdrawing the funds shortly after the acquisition by means of loans; and • Transferring funds to the same MSB.

Suspicious transaction/activity report information

The FIU received an STR from a bank regarding D, a man in his twenties with a student account. The STR stated that D bought a controlling interest in public shell company X and then proceeded to open a bank account in the name of that company. A few days later, the account received a deposit of approximately US$2.5 million.

Case description

In addition to company X, D was also the sole owner of a private company, Y. D used company Y to purchase a controlling interest in company X through the OTC market. Part of the US$2.5 million that was credited to company X was derived from a company Y account. Company Y received large deposits from several private accounts managed by criminal entities involved in drug trafficking. In one case the funds were transferred from the person known to be involved in criminal activity through an MSB account to the account of company X to further distance the source of the funds. The new controlling owners appointed new directors, including family members.
Shortly after the US$2.5 million was transferred to the account of company X, it was transferred back to the MSB account. Some of the money was transferred as a loan to company W, which was associated with the same criminal organisation that originally transferred funds to Company Y.
D and his family were well-known to the FIU for having acquired public shell companies in the past for money laundering purposes, including committing other predicate offences. They were also suspected of fraudulently influencing the movement of the stock share prices of companies owned by them, performing circular transfers of funds, and fraudulently removing funds from the companies.

Options

78. An option is a contract where one party (option seller) agrees to either buy a specified number of securities from, or sell a specified number of securities to, another party (option buyer) at a specified price per share (strike price). The option seller receives an upfront payment (premium) in exchange for assuming the obligations under the option. A put option gives the option buyer the right to sell the securities to the option writer at the specified price. A call option gives the option buyer the right to buy the securities from the option writer at the strike price. Typically, the option buyer has the right, but not the obligation, to exercise the option contract. Options can be traded on exchanges or OTC. They can be physically-settled (i.e. settled by delivering the securities) or cash-settled (i.e. settled by making a cash payment equal to the difference between the strike price and the market price of the security times the number of securities specified in the contract).

79. An OTC option presents a ML/TF vulnerability if one party agrees to enter into an options contract on terms worse than those available in a rational market to guarantee that the counterparty receives a net payment. In this respect, an OTC option can be used as a method of transferring funds.

80. For example, assume Party A has funds in a brokerage account that he wants to transfer to Party B. Assume there is a security with a market price of $7 per share. Instead of transferring the funds via a wire transfer or cheque, Party A may sell for a nominal premium to Party B, a cash-settled put option on the security with a strike price of $15 per share for 10,000 shares. Party B exercises the option

immediately, and because the option is cash settled, Party A pays Party B the difference between the strike price and the market price of the security, or $80,000. In addition, funds transfers using options may be accomplished without exercising an option, such as by charging a high premium for a worthless contract (e.g. a call option with a strike price hundreds of times higher than the market price), by exercising an out-of-the money option, or through other options contract variations.

3.3 Markets and other Means of Access

81. With the demise of the traditional trading floor located in a bricks-and-mortar securities exchange, many securities transactions are now effected electronically. In addition, some securities transactions are not conducted through an exchange at all. The following section examines the markets and mechanisms through which securities are sold and purchased.

Traditional Exchanges

82. The term securities exchange typically refers to centrally organised entities that operate as trading markets for publicly held securities. Exchanges generally have listing standards, such as minimum operating histories and revenue streams. While some exchanges only trade equity securities, other exchanges specialise in particular products, such as debt, options, and other types of derivative instruments. In addition, exchanges may require that intermediaries, such as broker-dealers, become exchange members and adhere to certain financial and operational standards.

Over-the-Counter (OTC) Markets

83. Many equity securities are traded in the OTC market and not on exchanges. The OTC market generally refers to all trading of securities otherwise than on an exchange, including various arrangements by which securities intermediaries arrange trades amongst themselves. Some OTC markets are organised and have automated quotation systems. Penny stocks, as discussed above and in Chapter 4, are also traded on the OTC markets, with their prices sometimes quoted on electronic bulletin boards.

84. Unlike traditional exchanges, organised OTC markets generally do not establish listing requirements and may not regulate issuers or trades, or have members. In some jurisdictions, however, there may be a regulator for the OTC markets as a whole. Securities traded on OTC markets may be more speculative than the securities listed on more traditional exchanges.

Alternative Trading Platforms (ATPs), Electronic Communications Networks (ECNs) and Internet-Based Trading Accounts

85. While trading on exchanges and OTC markets typically requires the use of a securities intermediary, new technologies permit institutional investors and some retail investors to engage in securities transactions with limited involvement of an intermediary.[21] Alternative trading platforms and electronic communications networks can operate in a way that, in some instances, may permit investors to trade with relative or complete anonymity.

86. Broker-dealers and others institutions licensed to effect securities transactions offer their clients the ability to transfer securities held electronically (e.g. from broker to broker, or from one customer to the account of another, such as a spouse). Some jurisdictions have indicated that this service can be abused and poses a ML vulnerability. This vulnerability results from the relative ease of the instrument's transfer,

[21] ATPs and ECNs, however, are traditionally registered as securities intermediaries.

the lack of transparency associated with some transfers, the ability to effect cross-border transfers, and even unjustifiable reliance on the CDD/KYC investigations done by others.

87. A particularly attractive feature (in some jurisdictions) to persons who wish to abuse this service for ML purposes is its lack of transparency. In some instances, a transfer can be effected without the individual having an account with the financial institution, for example through a breach in the financial institution's data security, or through the transfer of an instrument similar to a bearer security. Payment for the transferred securities can also be made in cash. As such, account statements may not reflect the fact that a share transfer has taken place. In some cases investigated, transfers of securities were confirmed to the customer by separate statements that were not consecutively numbered. Moreover, such statements were not included as part of the year-end bank reconciliation effort.

Case study 2: Securities transfers

Offence:	Tax evasion
Securities Related Predicate Offence (if any):	N/A
Jurisdiction:	The Netherlands
Subject:	Individuals and service providers
Instruments, methods and techniques:	Transfer of securities held electronically
Indicators:	• Misuse of service provided by financial institutions; • Ante-dating of documents; • Transactions without an apparent economical rationale; and • Use of false documentation.

Case description

The Tax Administration and the Fiscal Intelligence and Investigation Service has discovered methodologies involving the allocation of securities as a means to effect tax fraud. These activities involved the use of false documents, in violation of tax and criminal laws. To date, 14 cases have been detected, involving six different financial institutions. Seven cases have been investigated in greater depth. The key role played by the facilitating financial institutions in these cases was examined by the Dutch Central Bank and The Netherlands Authority for the Financial Markets.

The cases investigated have in common the misuse of a normal and legitimate service provided by banks, broker-dealers and other institutions licensed to trade in securities: the ability to transfer securities held electronically.

The misuse in the Dutch cases was triggered by a difference in the way capital gains and losses were treated for the income and corporate tax purposes. In short, capital losses are not deductable for income tax purposes, but are included in the tax base for corporate tax.

In these cases, individuals transferred securities between their personal portfolio and a corporate securities portfolio over which they had control. Depending on what was necessary in the specific case, securities were transferred in either direction. In the case of a loss that occurred in the personal portfolio, the relevant securities were transferred to the corporate stock portfolio and vice versa.

The attractive feature of the misuse of the securities-transfer service is its lack of transparency. In a transfer there is no mandatory current account relationship. As is the case with regular sale and purchase instructions, payment for securities transferred can be arranged by other means, such as cash payments. As a consequence, bank statements do not have to show that a share transfer has taken place. In the different cases that were investigated, transfers of securities were communicated to the client by separate statements that were not consecutively numbered and that did not have any connection with the year-end bank reconciliation.

What was surprising in the cases investigated was:

1. The number of cases detected;
2. The similarity of modus operandi;
3. The relative ease in which employees of financial institutions were persuaded to co-operate in the scheme;
4. The fact that the cases took place at different players in the financial sector;
5. The involvement of accountants and tax advisors;

6. The lack of AML/TF monitoring for this specific kind of transactions; and

7. The possible AML/TF risks related to share transfers were perhaps not sufficiently familiar to supervisory bodies.

Enforcement actions

All cases investigated resulted in administrative or criminal sanctions. Some financial institutions also were required by financial regulators to amend their internal procedures.

88. Although case study 2 involved tax fraud, the transfer of securities can also play a role in insider trading. It is also a vulnerability in the context of money laundering, due to the relative ease of transfer, lack of transparency, lack of indicators and the international dimension.

89. It would be possible for criminals to approach individuals and offer them cash for their securities portfolio. Subsequently these individuals could transfer their securities from their securities portfolio to the securities portfolio of the criminal. This would give criminals access to the financial system while circumventing existing AML/CTF measures.

3.3.1 Vulnerabilities Associated With Particular Types of Market Access

90. Although the survey results did not identify actual abuses involving internet trading platform services, several areas of vulnerability were noted. For example, with the continued development of technology, the number of firms providing internet trading platform services has increased. Such firms offer trading in financial contracts (so-called contracts for difference or CFD) on their trading platform linked to different kinds of underlying reference points: mostly Forex but also market indexes, and commodities (such as oil and precious metals), as well as on shares of companies. The investors are typically required to pay a margin deposit into the bank account of the firm.

91. Such website trading platforms are often designed for day trading, and can have substantial transaction volumes. As such, the trading platform could turn into a "black box" for the financial institution (often a bank) with which the trading platform firm holds its accounts, making it very difficult for the financial institution to understand transactions occurring in the account.

92. Moreover, obtaining a licence for a trading platform has become increasingly inexpensive. By providing a trading platform through a company registered in an unregulated jurisdiction, a criminal organisation could pose as a securities dealer and use this structure to launder money and/or defraud investors.

93. Internet-based securities trading accounts pose particular challenges to the implementation of CDD/KYC procedures because of the lack of face-to-face interaction between the intermediary and the customer when an account is opened. This can hamper the ability of a firm to establish an adequate customer profile, which in turn can hamper the firm's ability to detect suspicious activity. Moreover, although investors must open accounts with intermediaries to access their systems, some of these accounts allow the investor to directly access an exchange or trading system, potentially hampering the ability of an intermediary to identify suspicious transactions and trading patterns. Because positive identification of an individual can be more difficult with internet-based account opening methods, identity thieves and other illicit actors have been known to open these types of accounts to engage in market manipulation, insider trading, securities fraud, or to deposit illicit assets that can be wire transferred out of that account.[22]

[22] Please see Chapter 4 for a fuller discussion of market manipulation, insider trading and securities fraud.

94. In addition, legitimate internet-based brokerage accounts are often compromised by online intrusions from unauthorised persons. To cite one example, a criminal can effect an intrusion into multiple customer accounts. The intruder can liquidate securities in those accounts and use the proceeds to buy a penny stock. This has the effect of "pumping" up the price of the penny stock, which the intruder then liquidates at the inflated price, with profits transferred out of the intruded accounts.

Case study 3: Rapid transactions using an internet-based trading account

Offence:	Money laundering
Securities Related Predicate Offence (if any):	Insider trading
Jurisdiction:	Austria
Subject:	Individuals
Instruments, methods and techniques:	Internet-based trading account, shares
Indicators:	• High profits within one day; • Rapid purchase and sale of shares; and • Use of the same password by several clients.

Suspicious transaction/activity report information

The FIU was informed by an Austrian internet bank about suspicious bank accounts. The suspicions were prompted by the suspicious behaviour of several clients (high profits within one day, purchase of shares and sale of the shares one day later, purchase of calls, five different clients from the same country, use of the same passwords, the same shares/calls, etc).

Case description

A number of securities deals were made in connection with a company sale (takeover of shares) yielding a stock price gain of around US$6 million. These sales were later found to have been facilitated by insider trading; Austrian accounts were used for buying and selling shares.
Thorough investigations revealed that several accounts were linked to this securities deal, i.e. the account owners (Croatian nationals residing in Germany, Croatia, and the U.S.) obtained huge profits within a very short time by (almost simultaneously) buying and selling these shares.

Enforcement actions

The FIU initiated not only the necessary financial analysis but also analysis regarding the shares (company based in the U.S. press information – insider trading) and evidence regarding the involved persons.
It was rather urgent to secure evidence (including seizure of banking accounts and/or transmitting information to other agencies to trace the money flow) therefore the FIU met the FBI to cooperate in the case.
The FIU immediately informed the prosecutor of potential money laundering and insider trading charges.

Suspicious Indicators and Case Studies Associated with Market Access

95. The questionnaire responses did not specifically identify suspicious indicators associated with market types and other means of access. However, the suspicious indicators associated with market manipulation, insider trading and securities fraud may have some relevance in this area for detecting money laundering. Accordingly, Chapter 4 contains a fuller discussion, including case studies, regarding OTC markets and internet-based securities trading. In addition, the suspicious indicators related to Customer Due Diligence in Annex B are also generally relevant.

3.4 Payment Methods Relating to Securities Transactions

96. Many of the payment methods associated with securities transactions are not unique to the securities industry, and are to be found in other areas of the financial services industry. However, there are certain peculiarities in the purchase of securities which benefit from further elaboration.

Cash

97. The questionnaire responses indicated that the use of cash in the securities industry is uncommon. However, in some jurisdictions cash is still a permissible payment method. In addition, in some jurisdictions securities can be purchased through depository institutions, where acceptance of cash is much more prevalent.

Vulnerabilities and Suspicious Indicators for Cash

98. Depository institutions and securities intermediaries that permit the use of cash for the purchase of securities products can be used to place illicit assets in the securities industry, as well as integrate and layer the assets through securities trading and redemptions.

99. The following, which are not necessarily unique to the securities industry, were identified as suspicious indicators involving the use of cash:

- The customer refuses to identify a legitimate source for the funds or provides the securities firm with information that is false, misleading, or substantially incorrect;
- The customer makes many small cash deposits that are eventually used to purchase a particular securities product which is sold or redeemed shortly thereafter;
- The customer deposits a large amount of small-denomination currency to fund the account or make securities purchases;
- There are many incoming cash deposits into a customer's account from third parties that coincide with or are close in time to outgoing cheques or wire transfers to other third parties; and
- The customer has accounts primarily used for deposits and other accounts primarily used for outgoing payments.

Case study 4: Structuring of cash deposits

Offence:	Money laundering (structuring)
Securities Related Predicate Offence (if any):	Fraud
Jurisdiction:	Australia
Subject:	Individual
Instruments, methods and techniques:	Cash deposits, contract for difference account
Indicators:	• Abuse of internet registration systems; • Multiple same day transactions; • Structuring of cash deposits; and • Use of false identification documentation.

Suspicious transaction/activity report information

D became the subject of a STR submitted to the FIU that detailed activity involving the structuring of cash deposits into an account.

Case description

A "contract for difference" (CFD) is a type of derivative where an agreement is made to exchange the difference in value of a particular security (or other financial instrument) between the time at which a contract is opened and the time at which it is closed. In this particular investigation, the profits were deposited in a major Australian bank.
D used false identification documents, including a false citizenship certificate and driver's licence, to open a trading account over the internet.
The individual became the subject of an STR because of the structuring of cash deposits into an account. The STR highlighted that over an eight-day period, approximately AUD$ 400,000 was deposited into the account in amounts

below the jurisdiction's threshold reporting requirement (i.e. structuring), and in some instances deposits were made on the same day at branches in two different locations.
The investigation identified that the account had traded and increased in value to over AUD$ 750,000, which was subsequently restrained by means of crime restraining orders.

Enforcement actions

An investigation into this resulted in criminal restraining orders being placed on the individual's assets

Cheques and Wire Transfers

100. Questionnaire responses indicated that cheques can be used to fund a securities account with a securities intermediary or used to directly purchase some securities products without an intermediary. In addition, jurisdictions indicated that the use of cheques is not limited to those drawn from a depository account, but also can involve money orders, traveller's cheques, and cashier's cheques (i.e. bank drafts).

101. While many wire transfers occur through and between banks, in some jurisdictions a securities account can be used in lieu of a depository account to wire funds.

Vulnerabilities and Suspicious Indicators for Cheques and Wire Transfers

102. Money launderers can purchase money orders, traveller's cheques, and/or cashier's cheques with cash over a period of time or through a series of transactions in order to avoid threshold currency reporting requirements. These cheques can then be deposited into securities accounts until a desired amount is reached and used to purchase a security, which is then sold or transferred. Alternatively, a money launderer can also wire the illicit assets out of a jurisdiction.

103. Cheques or wire transfers from a depository account also present an ML/TF vulnerability because they may unreasonably affect the securities intermediary's risk analysis, in particular with respect to CDD/KYC obligations. For example, if a cheque or wire transfer originates from another financial institution subject to an AML/CFT regulatory regime, a securities firm may not conduct a thorough CDD/KYC investigation because it believes that the originating financial institution has already conducted its own CDD/KYC investigation, or because the firm perceives a reduced risk because the customer was able to open an account at another financial institution. This vulnerability can become systemic if numerous securities intermediaries perceive a reduced risk based on the activities of others.[23]

104. In addition, even if the financial institution from which the cheque or wire transfer originated has conducted thorough CDD/KYC and not detected anything suspicious, there may still be an ML/TF risk that the securities intermediary, through its own knowledge of the investor, may be in a unique position to identify. In particular, CDD/KYC not only involves mere customer identification but establishing the purpose and intended nature of the business relationship.

105. Another vulnerability identified is the increasing use of the securities industry in offshore jurisdictions by criminals attempting to avoid domestic seizure of their assets. The ease by with which funds could be transferred electronically facilitates this. The use of this method of disguising funds has resulted in a reduction in the effectiveness of domestic seizure/forfeiture actions, marking a change in the laundering techniques used by criminals. The advantage of this method over, for example, the purchase of domestic real estate is that it is more difficult for law enforcement to trace and seize assets held offshore.

[23] It is noted that reliance on CDD/KYC investigations undertaken by a foreign financial institution should also involve an assessment of the AML/CFT regime operating in the country from which the institution relied upon operates. Given the global nature of the securities industry, this issue may be of particular importance.

106. The following, which may not be unique to the securities industry, have been identified as suspicious indicators involving the use of cheques and wire transfers:

- Many small incoming deposits are made using cheques, money orders, traveller's cheques, and cashier's cheques;
- Incoming payments are made by third-party cheques or cheques with multiple endorsements;
- Money orders, traveller's cheques or cashier's cheques are sequentially numbered in denominations that avoid threshold reporting requirements (i.e. structuring);
- Outgoing cheques to third parties coincide with or are close in time to incoming cheques from other third parties;
- Wire transfers are made to or from financial secrecy havens, tax havens or high-risk geographic locations (i.e. jurisdictions known to produce illegal narcotics/psychotropic drugs or are related to terrorism);
- Wire transfers or payments are made to or from unrelated third parties (foreign or domestic) or where the name or account number of the beneficiary or remitter has not been supplied;
- Many small, incoming wire transfers are made, either by the customer or third parties, that are almost immediately withdrawn or wired out in a manner inconsistent with customer's business or history;
- There is wire transfer activity that is unexplained, repetitive, unusually large or shows unusual patterns or has no apparent business purpose;
- The securities account is used for payments or outgoing wire transfers with little or no securities activities i.e. account appears to be used as a depository account or a conduit for transfers;
- Funds are transferred to financial or depository institutions other than those from where the funds were initially directed, specifically when different countries are involved;
- Transfers with no apparent business purpose are made between different accounts owned by the customer;
- Wire transfer logs, when viewed over a period of time, reveal suspicious or unusual patterns;
- The customer requests that certain payments be routed through nostro or correspondent accounts held by the financial intermediary instead of its own account; and
- Outgoing wire transfers to third parties coincide or are close in time to incoming wire transfers from other third parties.

Case study 5: Use of foreign exchange broker

Offence:	Money laundering
Securities Related Predicate Offence (if any):	N/A
Jurisdiction:	Mexico
Subject:	Individual
Instruments, methods and techniques:	Deposits of cheques, currency exchange, wire transfers
Indicators:	• Activity reported by senders to financial institutions is not related in any way to the beneficiary of funds; • Amounts transferred are not congruent with the purchase of products; • FX dealer/broker or bureau de change order the transfers abroad (and not the senders); • Common beneficiaries with other customers using the same operating procedure; and • Same day withdrawal of funds.

Case description

During the course of an investigation made by the FIU regarding proceeds from drug trafficking, an individual was identified acting as branch manager of a local foreign exchange broker involved in ML activities and, later on, acting as account executive for a broker-dealer who was arranging wire transfers for one of his customers.
Accordingly, the FIU informed the broker-dealer of this activity, and it submitted an STR, with no specific information. Further investigations showed that an account at this broker-dealer was used to send money abroad in the following way:
The broker/dealer received several cheques in local currency, in the name of different persons but all of them endorsed to the same account holder (the sender). Funds were withdrawn immediately (the same day) with a purchase of US$ and a further wire transfer abroad was arranged for one single beneficiary (different from the sender). This money was ultimately used to partially pay for the acquisition of real estate properties in the USA.

Enforcement actions

The outcome of this investigation was the seizure of many assets, including among others, bank accounts and aircraft, and the closing of the foreign exchange broker involved.

Case study 6: Company director misused family trust

Offence:	Tax evasion / False Invoicing
Securities Related Predicate Offence (if any):	N/A
Jurisdiction:	Australia
Subject:	Individual / Company
Instruments, methods and techniques:	Purchase of shares in foreign jurisdiction
Indicators:	• Several significant wire transfers into Australia from a tax haven.

Case description

An Australian resident company that was receiving funds from a known tax haven was the subject of an audit. The director/shareholder of the company was also connected to a company established in a tax haven. This tax haven company had purchased shares in a U.K. company and then sold them for a substantial capital gain. Some of the profits were repatriated to Australia via the use of false invoices issued by the Australian resident company. The funds entered the country through large wire transfers.

Enforcement actions

The director/shareholder was assessed on income earned from world wide sources and agreed, as part of a settlement, to cease his involvement in the tax haven based company and repatriate all funds held in overseas jurisdictions.
As a result, approximately AUD$ 1.4 million in tax and penalties were raised.

Case study 7: Unlicensed securities intermediary

Offence:	Money laundering
Securities Related Predicate Offence (if any):	Providing investment services without a licence
Jurisdiction:	Belgium
Subject:	Individuals, company
Instruments, methods and techniques:	Cross-border funds transfers, use of third parties
Indicators:	• Significant wire transfers by multiple individuals; • Messages accompanying the wire transfers referred to investments; • Transactions happening shortly after opening of the bank account; • Account opened for personal use; and • Account not used as anticipated.

Suspicious transaction/activity report information

X and Y were managers of company A, active in purchasing securities for third parties. Shortly after company A's establishment, X and Y opened an account in their name for personal use. A few days later this account was credited with several transfers by order of third parties for a total amount of several thousand EUR.
The parties to the transfers were not linked to the individuals in any way. Furthermore, the references of these transfers referred to an investment fund. The name of the account also referred to an investment fund. The debit transactions consisted of transfers to accounts opened abroad in tax haven countries and the registration to investment products.

Case description

Information from the supervision authorities showed that company A did not have a licence to offer investment services.
The name of the individuals' personal account, the person receiving the transfers, the regularity and the references accompanying the transfers as well as the destination of the funds showed that the transactions were not performed for X and Y but for a third party. The money was laundered through transfers abroad and registration to investment products.

Enforcement actions

The case for providing investment services without a licence was referred in 2005 to the public prosecutor for ML.

Exchange of Securities as Means of Payment

107. One payment method that is unique to the securities industry is the use of securities in exchange for other securities. This can occur when shares of a different type are issued or new shares issued in a take-over. The exchange of shares is a potential way of moving value from one company to another, and the possibility for disguising the origin of funds is clear. For example, if illicit funds are used to purchase shares in the initial company, these may be harder to trace once the shares are exchanged for those in another company. The situation can be exacerbated when other factors are involved, such as shares traded off exchange or those from countries without robust AML/CFT controls.

3.5 Entities Involved in the Offer, Sale, Advice, Management or Distribution of Securities ("Securities Intermediaries")

Broker-dealers

108. One of the most active participants in the securities market is the broker or dealer in securities. A broker typically acts in an agency capacity for an investor, and enters the securities markets on behalf of an investor to buy or sell a security. In some jurisdictions, a dealer acts in a principal capacity and sells to investors from the dealer's own inventory or buys from an investor in order to add to the dealer's inventory. In buying and selling in this manner, some dealers also provide liquidity to the market.

109. Based on the questionnaire responses, brokers and dealers exist in most of the jurisdictions that responded to the survey. However, they are often referred to using a variety of terminology such as:

- Financial Instruments Business Operator;
- Firms for Placement in Orders in Financial Instruments;
- Investment Firms;
- Investment Service Provider; and
- Underwriters.

110. A common type of brokerage relationship involves an introducing broker-dealer and a clearing broker-dealer who allocate among themselves the tasks that would normally be performed by a single broker-dealer. Under this sort of relationship, the introducing broker-dealer typically interacts directly with the customer, opening and monitoring the customer's account and accepting orders. The clearing broker provides securities record-keeping, trade execution, clearing and settlement services, custodial services, account statements and extensions of credit in margin accounts. In contrast to a clearing broker, an introducing broker usually cannot maintain custody of a customer's cash and securities.

Vulnerabilities Associated with Broker-Dealers

111. A specific vulnerability associated with broker-dealers is their reliance on another financial institution's CDD/KYC investigation, as discussed in Section 3.4 regarding payment methods. A broker-dealer might assume that, because another financial institution has opened an account for a customer, the customer does not raise ML/TF issues. The CDD/KYC vulnerability is most problematic in relation to the funding of a securities account. If illicit assets are successfully placed at a depository institution, the broker-dealer may assume that, because the funds are from an institution which is subject to AML/CFT rules, the customer does not pose a ML/TF risk and therefore will accept cheques or wire transfers from that institution to fund a securities account. Once a securities account is funded, a customer can engage in a number of transactions that further conceal the source of his or her illicit funds, thereby successfully layering and integrating illicit assets that were placed through a depository institution.

112. With respect to introducing and clearing broker-dealers, in some jurisdictions introducing brokers delegate the responsibility of monitoring for suspicious transactions to their clearing brokers. However, it is important to note that in some jurisdictions, while a task may be delegated to another entity, responsibility for that task's execution cannot be. As a result, it may continue to be the responsibility of both the introducing broker and the clearing broker to monitor transactions for suspicious activity in brokerage transactions that occur through their respective institutions.

113. Furthermore, some jurisdictions explicitly permit a clearing broker to rely on the introducing broker to conduct certain parts of the CDD/KYC process. Some of these jurisdictions may also extend this reliance to allow the clearing broker to rely on the CDD/KYC undertaken by a *secondary* introducing broker that has itself introduced accounts to the primary introducing broker. ML/TF vulnerabilities are amplified when any of the introducing brokers come from jurisdictions that have lax AML/CFT regimes, in particular with respect to correspondent or omnibus accounts, as discussed below. As a result, some jurisdictions allow reliance on another intermediary (whether foreign or domestic) *only if* that intermediary has in place adequate AML/CFT controls.

114. Although most broker-dealers do not accept cash payments, some do. For those broker-dealers that do, the relevant suspicious indicators associated with cash have been addressed in Section 3.4. In addition, because most securities transactions require the use of a securities intermediary, the majority of the suspicious indicators listed in previous sections, as well as the indicators in Annex B, are applicable to broker-dealers. Accordingly, specific indicators are not listed here.

Case study 8: Account held by an institution located in a high risk area/jurisdiction

Offence:	Money laundering
Securities Related Predicate Offence (if any):	Proceeds of various crimes (including drug trafficking) invested in the securities industry
Jurisdiction:	Canada
Subject:	Individuals (lawyers), bank and trust company
Instruments, methods and techniques:	Wire transfers, bank drafts
Indicators:	• Accounts used as pass-through; • Involvement of several jurisdictions; and • Transactions below the reporting threshold.

Suspicious transaction/activity report information

Securities dealers have identified transactions involving accounts in the name of what appeared to be a bank or a trust company incorporated in an island in the Pacific. Money was moving from the Asia-Pacific region to investment accounts in Canada then to beneficiaries in the U.S.

Case description

The bank was incorporated in an island in the Pacific know for the ease of setting up financial institutions.
A securities dealer reported that the client (bank or a trust company)'s account was managed (activity of buy, sell, wire transfers, etc) by two individuals employed by a law firm in a major Asian city. The two individuals were suspected to be lawyers.
In a notice issued by a regulator of financial institutions, the Canadian public was warned that the bank or trust company was not authorised to conduct banking services in Canada.
An analysis of the financial transactions involving the institution and information retrieved from public documents led to suspicions that the bank was facilitating deposits of funds generated by various criminal activities (particularly heroin and opium trade in Asia), then transferring the money to accounts at securities dealers in Canada under the supervision of the two lawyers in Asia.
The two individuals in Asia were ordering numerous wire transfers on behalf of the bank from accounts held at different locations in the Asia–Pacific region, to investment accounts in Canada and other beneficiaries. Once received, the money was transferred to different individuals whose addresses were at different locations in the United States. The purpose of the wire transfers and the relationship between the bank and the beneficiaries of the transactions could not be determined.
Although not mentioned by the securities dealers when reporting the suspicious activity, it was suspected that the primary purpose of the wire transfers from the Asia-Pacific region was to send funds to beneficiaries in the United States. The beneficiaries in Canada were just acting as intermediaries in the money laundering process; an analysis of the transaction flows revealed that they were in fact nominees.

Enforcement actions

The case was referred to law enforcement for investigation.

Case study 9: Use of margin account with little trading

Offence:	Money laundering
Securities Related Predicate Offence (if any):	N/A
Jurisdiction:	Hong Kong
Subject:	Individual
Instruments, methods and techniques:	Deposit and withdrawals of funds
Indicators:	• Client deposited funds into the broker's account and requested repayment of funds within a short period of time with no apparent reason; • Little or no trading was recorded during the period; and • The amount of funds deposited was not in line with the client's profile.

Case description

Profits from illegal bookmaking were transferred from the bank account of the syndicate head's wife and sister-in-law to the margin account of the syndicate head.
Little or no trading occurred in the margin account.
Funds were then withdrawn as cashier's cheques and subsequently deposited into the bank account of the syndicate head.

Case study 10 : Activity of wash trading

Offence:	Money laundering
Securities Related Predicate Offence (if any):	Stock manipulation
Jurisdiction:	Canada
Subject:	Insiders
Instruments, methods and techniques:	Securities accounts, wire transfers, cheques, bank drafts
Indicators:	• Insiders conducting similar transactions; and • Purchases and sales involving stocks of specific companies in a short period of time.

Suspicious transaction/activity report information

A number of suspicious transaction reports were filed by securities dealers on three individuals suspected of involvement in wash trading. The individuals were purchasing and selling shares of three public companies for no apparent reason. The three individuals had accounts at different securities dealers.

Case description

Three individuals, who appeared to be associates, were purchasing shares of three companies (A, B, and, C) and selling them a short time later.
One of the individuals was listed as a CEO of Company A, the other two as members of the senior management team of Company B. According to public documents, Company A was linked to Company B and Company C.
The group traded shares of the companies through personal accounts held at different securities dealers.
The three individuals were conducting the same transactions at the same time. The activity was similar to a money laundering technique known as "structuring" since the three individuals in reality were dividing the purchase-sale scheme between them.
The proceeds of sales were deposited into personal securities accounts and moved shortly to bank accounts held by the same individuals or others that are suspected to be nominees.

Proceeds of crime (wash trading) in the case

- Money from the sales of shares of Company A, Company B and Company C conducted by the three associates.

Specific money laundering transactions

- Movement of money from the securities account to bank accounts (that can be used to purchase other assets or make wire transfers).

- Movement of money to suspected nominees.

Enforcement actions

The case was referred to law enforcement for investigation.

Case study 11: Rapid purchase and sale of shares

Offence:	Money laundering
Securities Related Predicate Offence (if any):	Stock manipulation
Jurisdiction:	Canada
Subject:	Individuals, corporations
Instruments, methods and techniques:	Wire transfers, use of multiple securities accounts
Indicators:	• Buying and selling securities with no discernible purpose in circumstances that appear unusual; • Use of multiple accounts at a single securities dealer for no apparent reason (movement of funds from one account to another); and

- Proceeds of sale used to purchase monetary instruments payable to nominees.

Suspicious transaction/activity report information

A bank reported that large wire transfers ordered from a securities dealer were received into a business account administered by Person A. Once received, money was used to purchase bank drafts, and cheques were issued payable to various individuals and entities. The purpose of the transfers between the securities dealer and the bank is not known, since the individual has refused to respond to questions asked by the bank's anti-money laundering section. It was suspected, however, that the client was "dumping" in the market a large number of shares purchased earlier (evidenced by previous wire transfers sent to the securities dealer) once they reached a certain value.
The securities dealer that sent the wire transfers also reported the following on Person B:

- Listed investment advisor: Person A;
- Was the signing authority of 24 accounts held by two corporations located in two Central American countries. The review of the accounts activity revealed movement of funds from one account to another;
- Was purchasing shares of specific companies, selling them a short time later and wiring the proceeds to bank accounts held by the corporations at financial institutions located in Central America and the Caribbean; and also to a bank account administered by Person A; and
- Never held stocks long enough to take advantage of future dividend distributions.

Another securities dealer reported that an individual, whose investment advisor was also Person A, purchased a large number of shares and sold them a short time later with no economic gain. When purchasing the stocks, the client never used wire transfers but rather cheques drawn on an account held in a financial institution located in a foreign country. The transactions always involved one particular company.

Case description

The case relates to eight individuals and two corporations involved in a stock manipulation scheme:

- Person A was the investment advisor of a group of 7 individuals.
- Person B was listed as the signing officer of two corporations.
- The two corporations had addresses in two different Central American countries but also held bank accounts in other Caribbean locations.

According to information posted in a market regulator's website:

- Person A was the main subject of a stock manipulation investigation.
- One person of the group was under investigation for banking fraud in an Asian country; the fraud cost investors close to CAN$100 million (awaiting extradition).

Person A appeared to be providing information on when to purchase and sell stocks of specific firms to the rest of the group. The investors did not hold the stocks enough to take advantage of dividend distributions. Proceeds of stocks sold were:

- Wired to bank accounts held overseas;
- Used to purchase banks drafts or to issue cheques payable to individuals and entities (it was suspected that the beneficiaries were nominees).

Analysis of the financial transactions of the remaining individuals of the group revealed constant purchases and sales of securities whose proceeds were deposited in bank accounts followed by issuance of cheques or bank drafts payable to individuals and entities. Some transactions involved penny stocks and stocks traded on the pink sheets (which are less regulated, and therefore more easily manipulated).

Proceeds of crime (stock manipulation) in the case

- Wire transfers received into a business account administered by Person A.
- Money received from the sale of securities conducted by Person B and other members of the group.

Specific money laundering transactions

- Funds wired by Person B to accounts held by the corporations in financial institutions located in Central America and the Caribbean.
- Funds wired by Person B to the business account administered by Person A.
- Movement of funds between accounts (review of Person B's accounts activity).
- Purchase of bank drafts and issuance of cheques payable to individuals and entities.

Enforcement actions

The case is being investigated by law enforcement and a provincial securities regulator.

Investment Advisers and Wealth Managers

115. Brokers and dealers in securities can be distinguished from those securities intermediaries that are regulated as advisers and wealth managers. In some jurisdictions, the role of a broker and a dealer are clearly delineated from those of advisers or managers. In fact, different registration and regulatory standards may apply. Nonetheless, functions can be housed in the same entity by means of multiple registrations. In other jurisdictions, advisory functions and broker-dealer functions may be conducted under the same registration.

116. Regardless of whether a jurisdiction has dual registration regimes, the role of the investment adviser and wealth manager is generally to advise on the composition of an investment portfolio or to manage the contents of investment accounts for retail or institutional clients.

117. Wealth management typically involves the provision of financial services in a managed relationship with clients who are often of high net worth. The value and complexity of products offered to high net worth clients, together with the international nature of the business, make the provision of wealth management services potentially attractive to money launderers.

Suspicious Indicators Associated with Advisory Services/Wealth Management

- Wealthy/powerful and PEP clients – who are reluctant to provide full CDD information, and who seek confirmation that their affairs will be kept confidential;
- Clients with multiple and complex accounts in more than one jurisdiction, either within the same firm or group, or with different firms;
- Clients using wealth management services in conjunction with offshore trusts/shell companies to disguise beneficial ownership;
- Wealth management activities in countries with a tradition of banking secrecy;

- The transmission of funds and other assets by private clients that involve high value transactions, requiring rapid transfers to be made across accounts in different countries and regions of the world; and

- The use of pooled/omnibus type accounts that are used together to collect funds from a variety of sources and clients for onward transmission.

Depository Institutions

118. The survey responses indicated that in some jurisdictions, depository institutions also serve as intermediaries for transactions in securities or provide investment advice/financial planning services.

119. The most common vulnerability associated with depository institutions involves the placement of illicit assets into the financial system. Once these illicit assets are placed they can be wire transferred out of a jurisdiction or used to purchase different assets, such as securities products. The risk that illicit assets will be used to purchase securities products is increased in jurisdictions where customers can purchase securities directly through the depository institution or through an affiliated securities intermediary. Moreover, as discussed above, if illicit assets are successfully placed at a depository institution, a securities intermediary, whether affiliated or not, may unjustifiably rely on the depository institution's CDD/KYC investigation and assume that the customer poses no ML/TF risk.

120. In this regard, the vulnerabilities and suspicious indicators associated with payments methods, market access and securities intermediaries are all applicable.

121. In addition, as discussed in Chapter 4, depository institutions may be in the best position to identify and report on securities fraud that may not necessarily require the use of a securities intermediary.

Insurance Companies

122. Insurance companies issue products that in some jurisdictions are considered to be securities. The vulnerabilities and suspicious indicators associated with these products were discussed above in Section 3.2.1. In addition, where permitted, insurance companies can also serve as a securities intermediary. The vulnerabilities and suspicious indicators associated with payments methods and the previously discussed securities intermediaries are all applicable to insurance companies that engage in comparable activities.

Use or Creation of a Financial Institution for ML/TF Purposes

123. The criminal use of a financial institution for the purpose of laundering money or financing terrorism is possible in any area of the financial services system. Criminal elements can either create or gain direct control of such an entity or seek to exert influence over the management or staff in furtherance of their aims.

124. It is possible for a securities broker-dealer, for example, to be created or used for the specific purpose of laundering funds/financing terrorism. The FATF 40 + 9 Recommendations require measures to prevent criminals or their associates from "holding or being the beneficial owner of a significant controlling interest or holding a management function."[24] Clearly the risk of criminal penetration of the securities market is heightened by opaque corporate structures, but also increases when dealing with other financial institutions from countries with lax AML/CFT measures.

[24] FATF Recommendation 23.

Suspicious Indicators Associated with Criminal Influence in a Financial Institution:

- Corporate structures where beneficial ownership is difficult to determine; and
- Companies incorporated in countries without adequate AML/CFT controls.

Case study 12: Criminally-controlled securities intermediary

Offence:	Money laundering
Securities Related Predicate Offence (if any):	N/A
Jurisdiction:	Canada
Subject:	Individuals, companies
Instruments, methods and techniques:	Wire transfers, bank drafts (i.e. cashier's cheques)
Indicators:	• "Shady" or criminally-associated or criminally-convicted officers, directors and/or major shareholders. One individual was associated with a South American criminal organisation; • Cash was used to pay dividends to investors; • Establishing multiple corporations: one individual was the administrator of several corporations, all located at the same address; • Several transactions between associated and related companies: funds wired to associated entities and then quickly sent outside the group; and • Minimal movement in share price: investment in an entity whose financial statements show no economic activity.

Suspicious transaction/activity report information

In 2004, a MSB reported to the FIU financial transactions that were conducted for the benefit of a securities company operating from a Caribbean country. Two individuals (a husband and a wife) were reported to have used cash to purchase two drafts payable to the securities company. The individuals appeared to be structuring the transactions to fall below the $10,000 reporting threshold.
A foreign FIU, law enforcement agencies in Canada and the United States and a Caribbean newspaper indicated that the securities company was incorporated by a Canadian citizen suspected of being involved in laundering, through stock markets, proceeds of a cocaine trafficking operation which was believed to be controlled by a South American criminal organisation.
According to its website, the Caribbean securities company appeared to be operating worldwide; however information on the management, contact persons, names or phone numbers, and type of services offered, were not provided.

Case description

According to information provided by law enforcement to the FIU:

- intelligence sources suspected that the South American criminal organisation had set up securities companies in the Caribbean and in Canada, and used nominees to run the operations;
- money generated by cocaine trafficking worldwide on behalf of the criminal organisation was deposited in bank accounts in Western Europe in a country known for its bank secrecy as well as in the Caribbean.

In Canada, all methods used to launder the proceeds of cocaine trafficking for the organisation were not known, but one channel used to introduce the drug trafficking money into the system was the purchase of drafts at MSBs payable to the securities company in the Caribbean.
Once in the system (in the Caribbean or in Europe), the drug money was transferred to securities companies in Canada.
Eight securities companies were found to be the beneficiaries of wire transfers totalling approximately US$30,000,000.00 over a period of two years. These EFTs were ordered by the company in the Caribbean from accounts held in Western Europe and the Caribbean. The eight companies were sharing the same address and administered by the same person, who was listed as a lawyer. The suspicious movement of funds between the Caribbean company and the eight securities companies were reported by a number of financial institutions in Canada; examples of suspicious transactions or behaviours include:

- the lawyer did not want to explain the relationship between the two companies and the purposes of the financial transactions from one entity to another;
- a securities company was the beneficiary of an EFT and the lawyer withdrew the full amount in cash and

claimed that the money would be used to pay dividends to investors; and

- after receiving funds from the Caribbean, the eight companies issued cheques, bank drafts or ordered wire transfers payable to entities and other established securities companies in Canada but also in the United States and Asia: after receipt of a wire transfer, one securities company ordered a wire transfer (same amount) to the benefit of an oil and gas company that was operating in South East Asia. According to a database maintained by a non-governmental entity, the beneficiary did not have any assets or liabilities, changed name three times, was a medical equipment supplier, a music video producer and games wholesale distributor, and there was no movement in the share price for five years.

Enforcement actions

The case was referred to law enforcement for investigation.

3.6 Clients and Account Types

Trust, Nominee, and Omnibus Accounts

125. Trust and nominee accounts present ML/TF vulnerabilities in the layering and integration stages. A particular risk involves jurisdictions where the formation of a trust or nominee account does not require the collection of beneficial ownership information for individuals. Moreover, while some jurisdictions may require beneficial ownership information, the information required can be limited to information regarding non-natural persons. As with shell companies, a lack of beneficial ownership information regarding the individuals who benefit from the account may mask an individual's identity such that he or she would gain access to a financial system when such access would otherwise be restricted or forbidden.

126. An omnibus account is an account established for an entity that is acting as an intermediary on behalf of multiple individuals or entities. For example, a bank in jurisdiction X could open an omnibus account with a securities intermediary in jurisdiction Y through which the bank in jurisdiction X manages a portfolio for its clients. In this scenario, the ML/TF vulnerability is that the securities intermediary may not know who the beneficial owners of the investment portfolio are.

127. One jurisdiction reported that "hub and spoke" arrangements involving jointly held accounts posed a particular vulnerability. In these arrangements, the primary accountholder opens accounts with numerous others (secondary accountholders), who in turn open accounts with others (tertiary accountholders). This can give the primary accountholder access to dozens or hundreds of accounts, decreasing transparency and making it difficult for a financial institution to determine exactly who is originating a transaction.

Charitable and Other Non-Profit Organisations

128. Whilst most charitable and non-profit organisations are reputable and provide legitimate services or funding for their causes, some organisations have been and can be used for ML/TF. Although not unique to the securities industry, a particular vulnerability involves organisations that may be used as a front for transferring funds to suspect beneficiaries located in high-risk areas/jurisdictions or conflict zones deemed to harbour or support terrorists. For example, legitimate funds may be used to purchase securities that are donated to a charitable organisation. The charity, in turn, could liquidate the securities or use the income generated by the securities to transfer funds to, or to purchase material for, individuals who further terrorists' activities.

Shell Companies

129. The term "shell company" often refers to a non-publicly traded corporation or limited liability company that might have no physical presence and generates little or no independent economic value. These companies are commonly organised in a way that makes their ownership and transaction information easier to conceal. Thus, transactions involving shell companies present a high ML/TF vulnerability.

130. Whilst publicly traded shell companies can be used for illicit purposes, ML/TF vulnerabilities associated with shell companies are heightened when the company is privately held, such that beneficial ownership can be more readily obscured.

131. For example, a domestic or international shell company securities account can be used to evade CDD/KYC investigations regarding the beneficial owners of certain assets. In particular, individuals or entities in high-risk areas/jurisdictions or conflict zones can disguise their true identities through a series of shell companies located in various jurisdictions to participate in a financial system that they otherwise would not be able to access.

132. Shell companies can also be used to introduce illicit funds into a financial system and/or generate illicit funds through manipulative or fraudulent securities activities. For example, a brokerage account can be opened in the name of shell companies and used to engage in fraudulent conduct with regard to low priced, illiquid, low volume or privately placed securities. In addition, a shell company can be established to accept payments from criminal organisations for non-existent services. These payments, which appear legitimate, can be deposited into depository or brokerage accounts and either wire transferred out of a jurisdiction or used to purchase securities products that are easily transferable or redeemable.

Unregulated Investment Funds and Pools (i.e. Hedge Funds)

133. Generally, hedge funds are vehicles established to hold and manage investment assets. Because of the way they are structured, they may not be subject to regulatory oversight. Hedge funds may receive funds domestically or internationally, and some (feeder funds) are established to invest into other hedge funds. A hedge fund will often utilise the services of a regulated securities intermediary.

134. Hedge funds present an ML/TF vulnerability because the regulated entity that the hedge fund is using to effect transactions (e.g**.** a broker-dealer) may not know the identity of the underlying hedge fund investors. Typically, hedge fund investors are of higher net worth than other retail investors. This anonymity of ownership can also result from the opacity associated with some feeder funds.

135. In addition, some hedge funds may be used to perpetuate a securities fraud, such as a Ponzi scheme. Securities fraud is discussed in Chapter 4.

Suspicious Indicators Associated with Trust, Nominee, and Omnibus Accounts, Charitable Organisations, Shell Companies and Hedge Funds

136. The questionnaire responses did not specifically identify any suspicious indicators associated with trust, nominee, and omnibus accounts, charitable organisations, shell companies and hedge funds. However, the following general suspicious indicators (also appearing in Annex B) may be useful when evaluating risks posed by these types of accounts, organisations and entities:[25]

[25] In addition, the FATF typology entitled "The misuse of corporate vehicles, including trust and company service providers" published in 2006 contains relevant background information.

- During the account opening process, the person opening the account refuses to provide information to complete CDD/KYC (e.g. occupation, prior financial relationships, etc.), in particular with respect to beneficial ownership;

- The person opening the account is reluctant to provide complete information about the nature and purpose of the customer's business, prior financial relationships, anticipated account activity, the entities' officers and directors or business location; and

- The trust or beneficial owner of a nominee account is located in a high-risk area/jurisdiction or conflict zone.

Case study 13: Fictitious transactions involving publicly-traded shell company

Offence:	Money laundering
Securities Related Predicate Offence (if any):	N/A
Jurisdiction:	Israel
Subject:	Individuals, companies
Instruments, methods and techniques:	Shell company, third parties

Suspicious transaction/activity report information

The STR indicated that there may have been a violation of the jurisdiction's money laundering law in relation to identifying the beneficial owner of a company.

Case description

The FIU detected a connection between D, a young businessman, and an organised crime group. Person A was active in local politics and owned several businesses. Together with another very wealthy businessman whose source of wealth is unknown, he purchased a public shell company X that traded on the local stock exchange for a small fraction of its true worth. D used a shell bank account managed by the wife of someone related to D. The shares of company X were transferred to several entities, none of which constituted a "party of interest" according to the stock exchange's reporting threshold. Some of the shares were transferred on the same day they were credited to different accounts managed by related parties in what appears to be a fictitious transaction, since the debited account did not receive any funds in return. The owner of the account debited declared there were no beneficiaries. This public company later attempted indirectly to win a government bid regarding a natural resource.

Case study 14: Securities intermediary failed to identify beneficial owners of offshore trust accounts

Offence:	Regulatory violation
Securities Related Designated Offence (if any):	N/A
Jurisdiction:	United States
Subject:	Broker-dealer
Instruments, methods and techniques:	Offshore trusts; wire transfers
Indicators:	• Offshore Trusts; and • Wire Transfers.

Suspicious transaction/activity report information

None

Case description

An SRO found that an introducing broker-dealer failed to obtain beneficial ownership information relating to accounts for high risk offshore trusts, as required by the firm's AML/CFT procedures. The accounts were used in millions of dollars of international wire transfers. In addition, even though the introducing broker-dealer's clearing broker-dealer made repeated requests for information regarding the beneficial ownership of the accounts, the introducing broker-dealer did not obtain this information. It was also unable to analyse the transactions identified by the clearing broker-dealer for suspicious activity because it did not have information identifying the beneficial owners of the accounts.
In addition, the introducing broker-dealer did not have sufficient procedures in place to ensure that there was adequate communication between the firm and its parent corporation, a bank, as to whether, in general, STRs should be filed and whether a particular STR had in fact been filed. Consequently, the firm's processes did not make certain that its independent obligations regarding the filing of an STR were met. The firm was also unable to reliably

incorporate the information that STRs had been filed into an ongoing risk assessment of its customers and to evaluate account activity going forward.

Enforcement actions

The firm was censured and fined US$3 million.

Case study 15: Purchase and sale of shares of a public shell company

Offence:	Money laundering
Securities Related Predicate Offence (if any):	N/A
Jurisdiction:	Israel
Subject:	Individual; private company
Instruments, methods and techniques:	Cash deposits, shell company, use of a nominee
Indicators:	• Buying the shares of a shell public company using a bank cheque purchased with cash by a third party; • Reluctance to expose buyers of the shares to the bank; • Shares bought using a straw man (i.e. a front for the true purchaser); • Shares resold after a very short period of time; and • Withdrawing funds from the shell company by means of loans or deals with interested parties, sometimes via MSBs.

Case description

Natural Person N is suspected of buying a public shell company (company A) traded on the stock exchange and hiding his involvement in the company for the purpose of money laundering.

The FIU received an STR regarding N who previously held shares through a “straw man” in two public companies, "B" and "C”. N was suspected by the securities regulator of manipulating the share price in order to artificially push it upwards, and of transferring funds for no apparent legitimate purpose by crediting the accounts of companies B and C by transfers from related private companies and shortly afterwards withdrawing money from the accounts of B and C for no apparent legitimate purpose. Some of the funds were drawn as loans and transferred to MSBs.

In order to purchase company A, N purchased two bank cheques using large amounts of cash: one written to the order of a law firm that was dealing with the acquisition and one written to the order of the public shell company A. N informed the bank that he represented the potential buyers and received the cash from them. He was reluctant to provide any information regarding the "investors".

A week after N purchased the bank cheques, 81% of company A shares were purchased by person M, who is believed to be a "straw man" for person N. Also, 50% of the shares were purchased by person M on behalf of unidentified third parties, none of whom were actually related to the transaction. Three weeks after the acquisition, N's wife was named Secretary of company A. Two months later, the remaining shares were again sold to person O and to another family member of N.

During the first months after the acquisition of the company, several cash deposits (amounting to approximately one million dollars) were made. This was unusual for a company that was a public shell and was not performing any activity until the acquisition. Another pattern followed by firm A was the acquisition of shares of a foreign company whose activity was not related to the alleged activity of company A. Company A lent funds to the foreign company by means of an international transfer and the loan was repaid from an account abroad managed by the foreign company after a short period of time.

Several months after the acquisition, the funds were drawn from the account by different means: Loans to related parties, transfers to MSBs (company A's financial reports showed as an asset on the balance sheet large amounts of money to be paid by factors other than clients).

The company also reported the loss of millions of Israeli Shekels due to an investment in derivatives.

Case Study 16: Use of Omnibus accounts and fictitious account names to facilitate sanctions evasion

Offence:	Money laundering
Securities Related Predicate Offence (if any):	N/A
Jurisdiction:	United States
Subject:	Entity
Instruments, methods and techniques:	Omnibus account/fictitious account names
Indicators:	

Suspicious transaction/activity report information

References to “code names” in transactions processed through an omnibus account of a third country broker maintained at a securities firm in the United States.

Case description

An entity subject to an asset freezing order established an account with a securities firm in a third country. The third country firm agreed to use a fictitious name for the sanctioned party when processing stock trades on its behalf through its omnibus account held with a U.S. broker, thus disguising the identity of the beneficial owner of the stock held in the omnibus account.

Enforcement actions

The case is still being investigated.

Margin Trading

137. One of the unique characteristics of the securities industry is that it can be used to both disguise the proceeds of criminal activity and to generate further profits. The use of margin account trading involves the investor borrowing funds to carry out trading. The securities themselves are used as collateral for the loan. By influencing the timing and value of trades (and leverage), a launderer can potentially use the proceeds of a scheme to generate more funds.

Case study 17: Margin accounts

Offence:	Money laundering
Securities Related Predicate Offence (if any):	N/A
Jurisdiction:	Malaysia
Subject:	Individual
Instruments, methods and techniques:	Multiple trading and margin accounts, offsetting trades

Case description

Mr. W opened five trading accounts and two margin accounts at five broker-dealers in various names. These accounts were opened under his name, his mother's name, Mrs. F, his girlfriend's name, Ms. V, and company XYZ, which was owned by Mr. W and Mrs. F. The scheme was carried out on four separate occasions, involving two cycles where the proceeds from the first cycle were used to facilitate the scheme carried out during the second cycle. During the first cycle, Mr. W placed odd lot buy orders using his trading account and Mrs. F's trading account and simultaneously placed odd lot sell orders through another broker-dealer to match the trades, but at exorbitant prices. Mr. W controlled both the selling and the buying parties.
Mr. W then took out the proceeds at the selling brokers and defaulted on the buying brokers' side. This allowed him to raise huge amount of sales proceeds that were used to increase his margin and facilitate his scheme during the second cycle. During the second cycle, the same scheme was used but involved different broker-dealers, where he had used trading accounts of Ms. V and company XYZ.

3.7 Determination of Value

138. Securities traded on exchanges tend to have a reasonable degree of price transparency. However, both on and off-market trades can be used to disguise value, especially where there are no traditional pricing mechanisms, and such trades can be used to transfer value in circumstances which are attractive to a money launderer. For example, a difficult to price instrument can be transferred at a pre-arranged, excessive price in order to transfer value from one person or entity to another.

Transfer Pricing

139. Large capitalisation stocks are subject to a high degree of transparency and, subject to general market forces, generally fluctuate within an established price band. It is noted, however, that the market price on small capitalisation stocks, which may be rarely traded, can be subject to more extreme price movements. In addition, the price of such an illiquid stock may be substantially affected by relatively

small transactions. This mechanism has been exploited for money laundering purposes where block trades of illiquid stocks are transacted at a pre-agreed price between two parties. In such transactions, parties agree to the initial purchase of an illiquid security at an artificially low price with the same security being bought back some time later by the original seller or an associate at a significantly higher price.

140. A variation on this occurs in the derivatives market where OTC derivatives can be structured to meet the requirements of a specific customer. Such transactions may be highly leveraged or arranged so that only a small movement in the value of the underlying securities can trigger disproportionately large payments. Furthermore, the pricing model on a bespoke or custom built derivative may be extremely difficult for anyone, other than a market expert, to understand. Such transactions have frequently been used to transfer profits from high-tax to low-tax jurisdictions and for the purposes of avoiding exchange control regulations.

Case study 18: Money laundering through transfer pricing

Offence:	Money Laundering/Tax evasion
Securities Related Predicate Offence (if any):	N/A
Jurisdiction:	U.K.
Subject:	Banking/securities corporation
Instruments, methods and techniques:	Off-market prices on derivative contracts
Indicators	• Unnatural diminution in profits; • Unnecessarily complex transaction structure; and • Subsidiary companies established for no viable economic purpose in a low-tax jurisdiction.

Suspicious transaction/activity report information

No reports were filed at the time but subsequent investigations were undertaken by revenue authorities.

Case description

The investment banking arm of a global investment bank had made substantial profits on its derivative trading book. In order to transfer profits to a low-tax jurisdiction, a special purpose subsidiary company was established in that jurisdiction. A number of complex over-the-counter derivative contracts were entered into between the investment bank and the subsidiary. During the course of the contracts, variation margin payments were made to the subsidiary on each "revaluation" of the contract and a substantial loss was realised on liquidation of the contract.

Enforcement actions

Investigations by revenue authorities proved inconclusive due to the complexity of the transactions.

Short selling

141. In the securities industry short selling generally involves the practice of selling securities that are not actually owned by the seller, or that will be borrowed for delivery. In a "naked" short sale, the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard settlement period. The investment strategy behind short selling is the hope that a profit will be made from the difference in price of the assets sold and those purchased (at a lower price) for return to the borrower.

142. Short selling is a trading vehicle that can be linked to market manipulation or insider trading, which are both predicate offences that could be the basis for ML/TF. One example cited involves "PIPES", or private investment in public equities. A financial institution may solicit indications of interest from potential purchasers before committing to the deal. While potential investors are forbidden from trading on the information about the transaction, some disregard the prohibition and sell the associated public equity short, anticipating a price decline.

3.8 Rogue Employees

143. While most AML/CFT regimes are designed to detect and report suspicion surrounding customer interactions, these programs are only as reliable as the people who implement them. To this extent, employees who assist customers in money laundering, terrorist finance may, and/or in predicate offences, pose a serious vulnerability to a financial institution.

Suspicious Indicators Associated with Rogue Employees

144. A number of jurisdictions identified the following as suspicious indicators that may be associated with employees vulnerable to assisting money launderers or terrorist financiers. These indicators are not necessarily unique to the securities industry or indicative of employee misconduct, but rather should be taken into account with other indicators:

- The employee appears to be enjoying a lavish lifestyle inconsistent with his or her salary or position;
- The employee is reluctant to take a holiday or vacation;
- The employee is subject to intense job-related demands, such as sales or production goals, that may make him more willing to engage in or overlook behaviour that poses ML/TF risks;
- The employee puts a high level of activity into one customer account even though the customer's account is relatively unimportant to the organisation;
- The employee is known to be experiencing a difficult personal situation, financial or other;
- The employee has the authority to arrange and process customer affairs without supervision or involvement of colleagues;
- The management/reporting structure of the financial institution allows an employee to have a large amount of autonomy without direct control over his activities;
- The employee is located in a different country than his direct line of management, and supervision is only carried out remotely;
- A management culture within the financial institution focuses on financial reward over compliance with regulatory requirements;
- The employee's supporting documentation for customers' accounts or orders is incomplete or missing; and
- Business is experiencing a period of high staff turnover or is going through significant structural changes.

Case study 19: Employee of a securities intermediary assisting a politically exposed person (PEP) launder money

Offence:	Drug Trafficking, Bribery
Securities Related Designated Offence (if any):	N/A
Jurisdiction:	United States
Subject:	Individuals
Instruments, methods and techniques:	Stock brokerage accounts, wire transfers, foreign shell companies
Indicators:	• PEP • Widespread news accounts regarding investigation of the PEP; • Foreign wire transfers; and • Shell companies.

Suspicious transaction/activity report information

None Indicated.

Case description

D, an investment representative at a large broker-dealer, helped a PEP from a foreign jurisdiction launder over US$10 million that the PEP received from drug traffickers. The PEP received these illicit assets as payment for allowing drug shipments to safely pass through his jurisdiction. D helped the PEP establish numerous brokerage accounts at her firm in the name of various foreign shell companies and then deposited the illicit assets into these accounts. Weeks before the PEP was to lose prosecution immunity, D assisted the PEP in wire transferring the illicit assets out of the brokerage account and into a foreign account. D then set up a fictitious account for the PEP and wire transferred all of the assets back to her firm.

Enforcement actions

D was criminally indicted.

Case study 20: Use of "friendly" broker to deposit funds and conduct stock market transactions

Offence:	Money laundering
Securities Related Predicate Offence (if any):	
Jurisdiction:	Brazil
Subject:	Individual
Instruments, methods and techniques:	Use of multiple accounts
Indicators:	N/A

Suspicious transaction/activity report information

None indicated.

Case description

A businessman, M, wishes to "pay" another businessman J for "rendered services" without any apparent business relationship between them. M is a friend of N and a broker with "Stocks & Co". M continuously deposits money of unknown origin into N's current account with the broker.
N keeps these deposits of money segregated from his own. These deposits are used in transactions carried out on the stock exchange without regard to profit or loss. In time, N made deposits of small amounts of money of unknown origin into several bank accounts belonging to J.
M, N, and J apparently believed that this procedure would minimise the possibility of detecting a link between the origin of the amounts "paid" by M to J. The jurisdiction observes that the securities account was being used to hide the origin of the money that was deposited in J´s bank accounts.

Enforcement actions

The two brokers involved were subject to an administrative penalty by the securities commission, as were the directors of the brokers, for failing to file STRs.

Case study 21: Employee of a securities intermediary assisting in market manipulation

Offence:	N/A
Securities Related Designated Offence (if any):	Market manipulation; securities fraud
Jurisdiction:	United States
Subject:	Individuals
Instruments, methods and techniques:	Stock brokerage accounts; penny stocks; wash trades, shell companies
Indicators:	• Accumulation of stock in small increments throughout trading day to increase price; • Marking the closing price; • Unauthorised buying of stock through customer accounts; • Account activity not consistent with customer profile; and • Trading between numerous accounts controlled by the same people.

Suspicious transaction/activity report information

No STRs were filed. Securities intermediary faced liability for ignoring red flags and suspicious indicators and for failing to supervise a problem employee despite warning from compliance officers.

Case description

RR1, a customer and RR2 from another firm participated in scheme to manipulate the stock of a thinly traded security. They artificially inflated and maintained the price for the stock, marked the closing price, engaged in matched and wash trades, attempted to artificially create "downbids" to suppress short sales, and engaged in unauthorised and unsuitable trading in customer accounts. Certain senior executives allowed RR to operate with greater freedom than other RRs. The securities intermediary that RR2 worked for was aware of numerous red flags and suspicious indicators regarding the market manipulation but did not file an STR.

Enforcement actions

A cease and desist order was filed against the firm and the firms was required to pay disgorgement.

3.9 Terrorist Financing

145. The replies to the questionnaire and the case studies gathered suggest that there is relatively little evidence of the securities industry being used to finance terrorism.

146. However, this lack of evidence specific to the securities industry does not rule out the potential for terrorist financing in this sector.

147. Following the 9/11 attacks in the United States, various agencies worldwide engaged in studies to ascertain which sectors of the financial services industry had been used to finance the attacks. No empirical evidence was revealed to suggest that securities had been used either to finance the attacks or to generate funding from them (for example, through short selling of airline or hotel stocks).

148. The lack of information on terrorist financing in this sector might, in part, be explained by the relative newness of the provisions on terrorist financing compared with those relating to money laundering. The 8 (now 9) FATF Special Recommendations came into effect in October 2001, and the effect of them in an industry which, in itself, is expanding quickly, may not have been fully felt.

149. The information provided in Section 3.6, above, dealing with clients and account types details some of the TF threats in this and other sectors.

150. Specific indicators relating to the securities industry were not cited, but more common ones which are potentially relevant to this industry are found in the FATF typology on Terrorist Financing. [26]

[26] http://www.fatf-gafi.org/dataoecd/28/43/40285899.pdf

CHAPTER 4:
PREDICATE OFFENCES FOR MONEY LAUNDERING LINKED TO SECURITIES

4.1 Introduction

151. As previously mentioned, the securities industry is not only a vehicle through which illicit assets can be laundered; it is also vehicle for generating illicit assets that would eventually have to be laundered. Indeed, the FATF's definition of the "designated offences" that lead to money laundering include three securities-specific offences: insider trading, market manipulation, and fraud.

152. This section addresses these three securities-specific designated offences because: (1) a significant number of jurisdictions included these designated offences in their questionnaire responses; (2) the relatively low level of securities related STRs may be the result of the non-reporting of these offences;[27] and (3) in identifying and reporting these types of offences, jurisdictions may be in a position to better prevent money laundering.

153. This chapter is organised into topical sections that address each of the three designated offences that implicate the securities industry. Suspicious indicators and case studies are also included.

4.2 Insider trading

154. Although insider trading is illegal conduct, this does not mean that company insiders, such as officers, directors and employees, can never trade shares of the company's securities. In some jurisdictions, certain circumstances require such transactions to be reported to regulators and the public. Insider trading, however, involves situations where the person who buys and sells securities, whether a company insider or not, does so in violation of a fiduciary duty or other relationship of trust and confidence, while in possession of material, non-public information about the security. In some jurisdictions, this includes situations where a person in possession of material, non-public information provides this information to someone else for trading where, depending on the circumstances, the recipient of the information can violate insider trading laws as well.

155. Insider trading is unique to the securities industry and generates illicit assets. As a predicate offence for money laundering, and an offence in its own right, this type of misconduct is reportable on STRs and has proven useful in assisting law enforcement and regulators prosecute such misconduct.

156. The illicit assets generated by insider trading can be laundered through the securities industry itself or through other parts of the financial sector. The most common example of laundering would be the simple transfer of illicit proceeds to a bank account.

Suspicious Indicators Associated with Insider Trading

157. The following were identified as suspicious indicators that could implicate insider trading:

- The customer makes a large purchase or sale of a security, or option on a security, shortly before news is issued that affects the price of the security;

[27] This may also result from a perception that these securities-specific designated offences are not money laundering per se.

- The customer is known to have friends or family who work at or for the securities issuer;
- The customer lives in the locality where the issuer is located;
- The customer's purchase does not correspond to his or her investment profile. For example, the customer may never have invested in equity securities, but does so at an opportune time;
- The customer's account is opened or significantly funded shortly before a purchase; and
- The customer sells his or her position in a security in conjunction with a significant announcement about the security.

Case study 22: Insider trading and money laundering

Offence:	Money laundering
Securities Related Predicate Offence (if any):	Insider trading
Jurisdiction:	Belgium
Subject:	Individual, companies
Instruments, methods and techniques:	Shares, affiliated companies
Indicators:	• Unusual important transactions; • Suspicion of insider trading; and • Securities sold a few months later.

Suspicious transaction/activity report information

In 2004, a Belgian bank reported several unusual important purchases of shares of two Belgian quoted companies, belonging to the same group, by company Y represented by Mr. X and a third party also in relation with company Y. Mr. X was manager in the two Belgian quoted companies, but also managed company Y.

Case description

Mr. X, manager of an important group of companies, knew that a reorganisation of the group was going to be publicly announced. This could have a favourable effect on the share price of two companies of this group after the reorganisation was announced.
Mr. X used this knowledge to purchase securities of these two companies through another company he managed and through a third party before the reorganisation was announced.
Once the reorganisation was announced, the share price of these two companies rose sharply. The shares were sold at a high profit.
The profit made by Mr. X was then invested in other securities and part of the money was transferred to other bank accounts held by him. As such, the money obtained illegally (thanks to the insider trading) was laundered.

Enforcement actions

The case was disclosed in 2005 to the public prosecutor for ML for insider trading.

Case study 23: Insider trading and money laundering

Offence:	Money laundering
Securities Related Predicate Offence (if any):	Insider trading
Jurisdiction:	Belgium
Subject:	Individuals
Instruments, methods and techniques:	Shares, use of a nominee
Indicators:	• Unusual transaction; and • Purchases do not correspond to the customer's investment profile.

Suspicious transaction/activity report information

A Belgian bank reported that a significant purchase of shares of company M was carried out through the bank account of Mr. Y's wife. The transaction was unusual.

Case description

Mr. Y had insider information on company M, quoted on the stock exchange. Through relatives, he knew that company M would soon be acquired.
To avoid attracting attention, he transferred his assets to his wife's account over which he had power of attorney, and purchased shares of company M prior to the announcement of the takeover. The bank knew that Mr. Y's spouse did not usually perform stock exchange transactions and was surprised to find out that funds were transferred from her husband's account. It is believed that Mr. Y's wife carried out the transactions on his behalf and tried to conceal the transactions by using her account.
After the takeover, his wife's account was credited with the proceeds of the securities sold.
Mr. Y then laundered the money by having the funds transferred to his personal account.

Enforcement actions

The case was disclosed in 2006 to the public prosecutor for ML for insider trading.

4.3 Market Manipulation

158. Market manipulation generally refers to conduct that is intended to deceive investors by controlling or artificially affecting the market for a security. In particular, the manipulator's purpose is to drive the price of a security up or down in order to profit from price differentials. There are a number of methods that manipulators use to achieve these results.

159. The most pervasive market manipulation method involves what is colloquially referred to as a "pump-and-dump" scheme. This scheme involves touting a company's stock with false or misleading statements, often in conjunction with securities trades that raise the price of the security or make it appear as if the securities trading volume is higher than it actually is. Therefore the security price is artificially raised ("pumped"); the security is then sold ("dumped") for a profit. Often the underlying security is low priced, illiquid, and trades with little volume.

Penny Stock Manipulations

160. Penny stocks may represent equity interests in companies that are about to become public or that are already public. The issuers of these shares often, but not always, have legitimate business operations and revenue streams. Shares in these issuers may take the form of physical securities that can be deposited with a securities intermediary. Penny stocks are not likely to be traded on traditional exchanges, but in OTC markets or on bulletin boards. Penny stocks typically have very low trading volumes but, unlike bearer securities, ownership of these shares will often be registered with the issuer or a transfer agent.

161. Illicit actors can acquire penny stocks in several ways. They can purchase already issued penny stocks in the OTC markets, acquire large blocks of shares as compensation for bringing a company public e.g. through a reverse merger into a private shell company, or issue the shares. These shares, which usually have little or no value, can then be deposited into brokerage accounts. Fraudulent promotion

methods and wash trades may then be used to inflate the price of the security. After the manipulators exit the market, investors are often left with worthless securities. Penny stock pump-and-dump schemes have increasingly been conducted through internet-based accounts and through trading accounts held in the name of private shell companies.

Suspicious Indicators for Market Manipulation

162. The following have been identified as suspicious indicators involving market manipulation in general and penny stock pump-and-dump schemes in particular:

- The customer engages in large or repeated trading in securities that are illiquid, low priced or difficult to price;
- The issuing company has no apparent business, revenues or products;
- The issuing company has experienced frequent or continuous changes in its business structure and/or undergoes frequent material changes in its business strategy or line of business;
- The officers or insiders of the issuing company are associated with other low priced, illiquid or low volume companies;
- The officers or insiders of the issuing company have a history of regulatory violations;
- The issuing company has failed to make required regulatory disclosures;
- The issuing company has been the subject of a prior trading suspension;
- A customer's transactions show a pattern of receiving physical securities or receiving incoming shares transfers that are then sold, with the proceeds wired out of the account;
- The customer deposits physical securities together with a request to journal the shares into multiple accounts that do not appear to be related, or to sell or otherwise transfer ownership of the shares;
- One party purchases securities at a high price and then sells them at a considerable loss to another party;
- A customer journals securities between unrelated accounts for no apparent business reason; and
- A customer engages in prearranged or other non-competitive securities trading, including wash or cross trades of illiquid or low priced securities.

Case study 24: Stock price manipulation

Securities Related Predicate Offence (if any):	Embezzlement Market manipulation
Jurisdiction:	Korea
Subject:	Individuals
Instruments, methods and techniques:	Shares, funds transfers, multiple securities accounts
Indicators:	• Unusually large transactions; and • Repeated purchase and sale of shares.

Suspicious transaction/activity report information

According to an STR, person A had frequent large fund transactions with unspecified persons, including B and C, and securities accounts at three brokers. In light of repeated selling and buying of shares of U Co. Ltd in large volumes through a certain computer IP, it was suspected that A was manipulating the market price using embezzled money and a borrowed bank account using an assumed name.

Case description

Analysis revealed that B, a company director of U Co. Ltd, embezzled corporate funds deposited as payment for shares and was manipulating the market price using a securities account in the name of unspecified persons with the embezzled funds.
The executives, including the former representative director and the present representative director of U Co. Ltd and a former branch manager of the broker, conspired to manipulate the share price more than 10 times through false stock trading orders and wash sales with embezzled money and gained illegal proceeds worth 35 billion won. As a result, private investors were severely damaged. It is of significance that relevant crimes were detected and further damage was prevented because an STR was sent to law enforcement authorities.

Enforcement actions

B was prosecuted for violation of the Securities Exchange Act and bribery (sentenced to 2 years of imprisonment, stay of execution for 4 years at the first trial). C was prosecuted for violation of the Act on the Aggravated Punishment, Etc. of Specific Economic Crimes (Embezzlement and Breach of Trust) and the Act on External Audit of Stock Companies (sentenced to 5 years imprisonment and a fine of 2 billion won). Other related persons were also prosecuted.

Case study 25: Market manipulation involving the use of private shell companies

Offence:	Money laundering
Securities Related Predicate Offence (if any):	Market manipulation
Jurisdiction:	United States
Subject:	Individuals
Instruments, methods and techniques:	Stock brokerage accounts; penny stocks; wash trades, false promotional methods; foreign accounts
Indicators:	• Individuals subject to previous securities related injunctions; • False and misleading disclosure documents; and • Brokerage accounts opened using private shell companies.

Suspicious transaction/activity report information

N/A

Case description

Individuals, some of whom were previously subject to securities misconduct injunctions, conspired to acquire controlling interests in a public company trading on the OTC markets. In perpetuating the conspiracy, the individuals acquired restricted stock of the companies and used fabricated and backdated corporate records that made it appear as if the restricted stock certificates had satisfied minimum holdings periods. The individuals then used false attorney opinion letters to get the transfer agents to issue freely tradable shares. Thereafter, the individuals prepared and distributed false and misleading disclosure documents for the companies and engaged in promotional campaigns to create demand. The individuals used brokerage accounts opened through private shell companies to sell shares of the companies in conjunction with the promotional campaigns.

Enforcement actions

N/A

Case study 26: Securities intermediary expelled for inadequate AML/CFT policies and procedures

Offence:	Regulatory violation
Securities Related Predicate Offence (if any):	N/A
Jurisdiction:	United States
Subject:	Broker-dealer
Instruments, methods and techniques:	Penny stocks; wire transfers; journaling
Indicators:	• Stock Promoters; • Penny Stocks; • Customers with money laundering convictions and regulatory actions against them; • Wire transfers to well known tax havens; and • Journaling of securities between accounts followed by immediate liquidation.

Suspicious transaction/activity report information

N/A

Case description

A broker-dealer agreed to an expulsion from SRO membership for systematic and repeated violations of AML/CFT rules and regulations, including failure to investigate and report numerous suspicious transactions.
The SRO found that, at various times from February 2004 to September 2006, the broker-dealer's customers included notorious stock promoters and others who had been barred by the SRO, disciplined by the country's primary securities regulator, or had criminal histories, including one customer who had been convicted for the sale of an illegal controlled substance and money laundering. The same individual had been previously convicted for his role in a "smurfing" scheme, a commonly-used money laundering technique involving the splitting of a large financial transaction into smaller transactions to avoid scrutiny by regulators and law enforcement.
The SRO further found that in at least a dozen instances, the broker-dealer's customers sold large blocks of penny stocks that were linked to allegedly fraudulent schemes. The country's securities regulator had filed at least two enforcement actions charging federal securities law violations involving penny stocks that were later sold through the broker-dealer and other firms. In one instance, an individual who had previously been barred by the SRO delivered over 1.8 billion shares of a penny stock issued by a company that was contemporaneously the subject of a pending, and publicly released, complaint by the securities regulator alleging manipulation and other securities laws violations. In the following 10-month period, this customer sold the shares for approximately US$8 million in 155 separate sales, wiring the proceeds out of his account after each sale.

Enforcement actions

The broker-dealer agreed to an expulsion from SRO membership.

4.4 Securities Fraud

163. Securities fraud broadly refers to deceptive practices in connection with the offer and sale of securities. In this regard, securities fraud encompasses insider trading and market manipulation.

164. For example, illicit actors can engage in confidence or boiler room schemes the structure of which would make the scheme a "security" for the purposes of a jurisdiction's securities laws. However, the actual sellers of these (mostly worthless) shares are often based in a separate country from the purchaser, making access to perpetrators of the fraud difficult.

165. In a Ponzi scheme, a fraudster lures investors with the promise of high returns that are to be generated through the investment or business efforts of the fraudster. Instead of generating actual profits, the fraudster creates the illusion of profits by paying investors returns from their original investment or paying returns from the money that new investors contribute to the fraud. This type of scheme tends to collapse when the number of new investments into the scheme do not satisfy the payment obligations for previous investors.

166. Although many Ponzi schemes do not necessarily involve the direct use of securities intermediaries or markets, the way these schemes are marketed often causes sales of interests in the scheme to be classified as securities, and thus subject to the jurisdiction of securities regulators.

Securities Offering Fraud Indicators

167. The following have been identified as suspicious indicators associated with a securities offering fraud:

- The customer opens numerous accounts for different legal entities that the customer controls;
- The customer receives many incoming cheques or wire transfers from unrelated third parties;
- The customer allocates incoming third-party deposits among numerous accounts;
- The customer makes numerous outgoing payments to third parties close in time to when the customer receives many incoming third-party cheques or wire transfers;
- The customer's profile does not suggest a legitimate business reason for receiving many third party deposits; and
- The cheques or wire transfers note that the funds are for an investment.

Case Study 27: Securities fraud

Offence:	Money laundering
Securities Related Predicate Offence (if any):	Securities fraud
Jurisdiction:	United States
Subject:	Individual
Instruments, methods and techniques:	Cheques, wire transfers, monetary transactions
Indicators:	• D established various businesses and bank accounts under his name; • Monetary transfers between various bank accounts controlled by D (or D's businesses); • Authorities had imposed cease and desist order against D and D's business; • D promised substantial guaranteed returns and secure principal investment; and • Deposited investment monies into bank account controlled by D.

Case description

The individual generated illicit assets within the securities industry by operating two Ponzi schemes. Under the first scheme, D told investors that their money would be used to purchase equipment that would be leased and resold. Under the second scheme, D sold promissory notes that were purportedly secured by stock in D's associated legal entity and by precious metal production contracts. Both schemes promised investors high rates of return and guaranteed the principal investment. In actuality, the defendant used investor funds for his personal expenses.
Investors would either wire, hand deliver or mail their investments (via cheques) to D or one of his businesses (legal entities) and the funds were deposited into bank accounts controlled by D. D would then transfer the funds among various bank accounts that he controlled in order to disguise the origin of the proceeds and to further perpetuate the fraud. After receiving the funds, D would use them to pay for personal expenses, promote another business, and to make periodic payments to investors. The periodic payments to investors were made to legitimise and disguise the underlying schemes and to avoid reporting to and detection by law enforcement.

Enforcement actions

A U.S. state investigated the investments offered by D under the first program, and issued an order against D and his related business to cease and refrain from further offer or sale of such investments in the state.
A federal action has been filed against D alleging violations of federal laws related to mail fraud, securities fraud, and money laundering.

CHAPTER 5: SUSPICIOUS TRANSACTION REPORTING AND ENFORCEMENT ACTIONS

5.1 Suspicious Transaction Reports

168. A review of the published STR reporting figures from some of the Third Round Mutual Evaluation Reports suggests that STR reporting in the securities industry is relatively low, compared with the banking industry. A selection of comparative statistics is set out below:

Country A

Financial Institution	2001	2002	2003	2004
Banks	911	1 128	1212	1 698
Money Exchange	21	28	199	330
Securities	**24**	**4**	**3**	**3**

Country B

Financial Institution	2002	2003	2004	2005
Banks	680	549	685	921
Money Exchange	102	106	39	20
Securities	**10**	**12**	**3**	**5**

Country C

Financial Institution	2002	2003	2004	2005
Banks	193	177	288	349
Money Exchange	0	0	0	0
Securities	**0**	**0**	**1**	**1**

Country D

Financial Institution	2002	2003	2004	2005
Banks	272 823	288 343	381 671	522 655
Money Exchange	5 723	209 512	269 284	383 567
Securities	**0**	**4 267**	**5 705**	**6 936**

169. The STR reporting disparity between the banking and securities industries is not surprising in light of the relative size of the banking industry in most countries compared to the securities industry. In addition, in some countries STR reporting in the securities industry is a newer legal requirement than that for submitting STRs in relation to banking activities. Nevertheless, the figures might be indicative of under-reporting in the industry, and it is suggested that the issue be examined further.

170. It is also worth nothing that some jurisdiction's reporting requirements are narrower than others', which results in the inconsistent capture of data for the same event or activity.

171. The securities typology questionnaire (see Annex D) requested information on the amount and nature of the STRs received in the securities sector. Of the 40 questionnaire responses received, 31 provided responsive data.

172. In contrast, a number of jurisdictions reported that their STR tracking and/or reporting mechanisms were not conducive to quantitative breakdowns regarding the number of securities related

STRs filed. This appears to be a reporting gap, in that data is simply not available in certain jurisdictions to enable an assessment of the potential risks in the sector.

173. One FIU reported that STRs were categorised based on the institution making the filing. Accordingly, figures for the securities business of larger banking groups are potentially being categorised as banking STRs.

Number of Securities Related STRs

174. Questionnaire responses represent the number of securities related STRs filed between 2005 and 2008 (see the summary at Annex C, Table 1). Of significance, most jurisdictions evidenced yearly increases in securities related STRs between 2005 and 2008, with a particular increase in 2007. It should be noted that most questionnaires were submitted in late 2008, making final 2008 figures unavailable for some respondents.

Breakdown of STRs Based on Type of Security

175. Fourteen of the forty questionnaire responses provided a breakdown of STRs filed by securities type. The most common type of securities product subject to an STR filing were equities, mutual funds, money market mutual funds, bonds and similar debt instruments, foreign exchange contracts, and certificates of deposit. It should be noted that not all jurisdictions consider certificates of deposit and foreign exchange contracts to be securities. Furthermore, with reference to the type of product referenced in an STR, some jurisdictions permit the designation of "any other." This may mean that the suspicious activity was related to the securities markets, even though the STR did not explicitly identify it as such.

STRs Filed By Type of Institution

176. The overall trend for STR reporting was upwards in all areas, with broker-dealers submitting the most. It is not clear if there is any incidence of double reporting amongst institutions.

Emerging Issues

177. Discussions with representatives of FIUs, law enforcement and the private sector suggest that there is a need for greater understanding of the expectations of all parties who file STRs. Reports of poor quality are often thought to hamper enforcement action. This phenomenon is not peculiar to the securities industry, and is one which greater dialogue between the competent authorities and the private sector might help to resolve. Guidance and feedback to those required to report suspicious transactions is part of the package of measures that competent authorities should provide under the FATF Recommendations.

178. Conversely, there is often a perception that the products and methodologies used in the securities industry are extremely complex. This, in turn requires specialist knowledge, which relatively few FIUs and law enforcement agencies currently have.

179. The complexity of the products and methodologies, coupled with the ability to move funds/value internationally also gives rise to practical considerations as to how best to bring actions to seize and freeze criminal assets. Again, mechanisms to share expertise between agencies and jurisdictions are to be encouraged.

180. In some jurisdictions a separate reporting regime exists for suspicions of money laundering and those of the predicate offences where the securities market can be used, such as insider trading and market manipulation. Under these circumstances, it is not always clear that the reporting institution is aware of the possibility that there might also be a requirement to report a suspicion of money laundering. This is a

potential gap in the system, and might partially explain the relatively low levels of ML/TF STR reporting in the securities sector. Again, greater awareness between competent authorities and amongst the industry is to be encouraged.

STR Referrals to Law Enforcement

181. The questionnaire responses did not give uniform results, and thus the trends, rather than the figures, are reported here.

182. The number of reported STR referrals to law enforcement, and subsequent criminal prosecutions remain relatively low. Due to the dual nature of STR reporting for ML/TF cases and predicate offences, such as insider trading and market manipulation in some jurisdictions, conclusion trends on numbers are difficult to determine.

5.2 Enforcement actions

Referrals from the FIU made to Law Enforcement

183. Out of 31 countries that reported receiving STRs involving securities, 18 reported referrals to law enforcement based on these STRs. The number of referrals in specific countries generally represents a small fraction of the number of STRs (less than 10%). Only 7 countries reported money laundering prosecutions in respect to these referrals and 3 reported convictions. It should be noted however, that a number of countries reported that statistics associating prosecutions and convictions to specific STRs or sectors were not available.

184. Eighteen countries reported no enforcement action from 2005 to 2008, either because none were taken in the securities sector or because data was unavailable.

185. Among the 21 countries that reported at least one action in that period, the large majority reported regulatory actions (i.e. actions against financial institutions or intermediaries that failed to comply with their AML obligations, including AML program requirements, CDD and reporting); five countries reported at least one criminal enforcement action (i.e. actions for criminal violations using the securities sector), and one reported joint regulatory/criminal enforcement actions.

186. Most countries noted that the enforcement actions provided no information on areas of high risk or vulnerability in the securities sector, since the action related to deficiencies in AML procedures. However, the following vulnerabilities were noted:

- Fictitious companies;
- Off market trading under conditions that were not “at arms length”;
- Trading in penny stocks;
- Trading in thinly-traded or illiquid shares; and
- Wire transfers.

CHAPTER 6:
CONCLUSION AND RECOMMENDATIONS FOR FURTHER WORK

6.1 General

187. The primary goal of this study was to consider and raise awareness of the vulnerability of the securities industry to money laundering and terrorist financing. With the help of the jurisdictions and international organisations that participated in the typology, a comprehensive set of red flags and indicators and relevant case studies have been gathered for the first time in a global study.

188. Such a study is, by its very nature, limited by the number of practical examples that have been experienced by the participants, and some threats remain theoretical rather than actual. However, in an industry which, by its very nature, facilitates the movement and investment of funds worldwide into an ever-changing array of products, often very rapidly, knowledge of the threats goes some way to raising awareness of the potential issues.

189. In a dynamic environment, the risks will evolve, and the project team hopes that this study will form the catalyst for further work on this topic by industry organisations, supervisory bodies and law enforcement. In particular, further cooperation in endeavouring to understand the risks and methodologies involved in a complex and fast-moving environment would enhance the effectiveness of the global effort to fight ML/TF.

190. In countries with less developed securities markets, some of the typologies and indicators might not currently be readily recognisable. However, given the rapid expansion of the securities industry globally in the past 25 years, it is hoped that the information provided will be of use as markets in developing economies expand.

6.2 Terrorist Financing

191. Although the literature review and the responses to the questionnaire do not readily suggest that the securities industry lends itself to terrorist financing, it remains a serious risk. In particular, the possibility that the use of opaque corporate structures and/or charities, combined with the transfer of value via securities and transactions at securities firms is a potential vulnerability. In addition, the FATF Special Recommendations relating to terrorist financing are newer than those for money laundering, and thus further trends may become apparent as suspicious transaction reporting regimes mature.

6.3 Money Laundering

192. Case studies and other intelligence gathered for this report show that the use of the securities industry to launder money constitutes an actual threat. The industry itself can be uniquely used to generate illicit proceeds from proceeds which might have had a legitimate origin. These illicit proceeds lead to almost "automatic" laundering when they are realised. This phenomenon can be contrasted with the more traditional use of the securities sector to disguise the origin of illicit funds derived from outside the sector.

193. As defences in areas more traditionally associated with ML/TF, such as banking, are tightened, the use of the securities industry may become a greater temptation to those seeking to disguise illicit proceeds, or indeed to generate them.

194. The use of cash in the securities industry does not appear to be widespread, and funds are very often introduced via other regulated sectors. Whilst reliance on other parts of the financial sector to

conduct certain aspects of CDD can be a perfectly acceptable way to facilitate transactions in the global financial system, it is important that the industry and its regulators take appropriate steps to ensure that reliance is only placed on third parties with adequate AML/CFT systems and controls. CDD itself is more than just customer identification, and ascertaining the purpose and intended nature of a transaction with funds from another part of the financial sector remains an important consideration.

6.4 STRs, Law Enforcement and Co-operation

195. The recorded figures for STRs in the securities industry suggest that reporting in this area remains relatively low. Comparisons with the banking sector do not provide much in the way of conclusive findings, given the difference in size between the relative sectors in most countries.

196. There is no one factor behind the relatively low figures for STR reporting, but the following appear to play a part:

- The reporting requirement for securities has only been relatively recently introduced in some jurisdictions;
- The separate reporting requirements for insider trading, market manipulation and securities fraud in some jurisdictions might mean that ML STRs are not being submitted to the FIU;
- Most securities intermediaries do not accept cash;
- The definition of "security" is not consistent;
- Securities in some jurisdictions can be sold by participants in other industries, such as banking and insurance companies;
- Because the securities markets are fast paced and transaction times are of critical importance, intermediaries are required to act quickly on a client's behalf, thus potentially affecting an intermediary's ability (and perhaps inclination) to scrutinise and submit STRs;
- Some in the industry may not understand STR requirements; and
- There may be a perception that the securities industry is not attractive to those wanting to launder money/finance terrorism.

197. The relative lack of referrals of STRs to law enforcement and the corresponding figures for securities-related criminal money laundering cases globally raises several issues.

198. Law enforcement in some jurisdictions report that STRs received from the securities sector do not contain a sufficient level of detail to enable them to take further action. Conversely, the products and schemes used within the industry are often complex and require specialist expertise to understand the full nature of the flows of funds. In addition, the global nature of the securities industry makes the ability to trace and seize assets more complex than more tangible domestically based assets.

199. Several of the case studies presented in this report suggest that the indicators of predicate offences such as securities fraud or market manipulations are similar to those for money laundering and that the transactions involved in both categories are closely linked, if not the same.

200. Liaison between law enforcement, regulators, FIUs, and the industry is to be encouraged, as each has relevant experience which can increase awareness of the vulnerabilities in this sector. In particular, obtaining direct private sector input and feedback in developing case studies is essential to ensure they are useful tools to the industry.

6.5 Definitions

201. This study has not attempted to produce a global standard definition of "security". It is, however, clear from the questionnaire responses that a variety of terms are used worldwide to match the financial activities specified in the FATF glossary. This might give rise to some overlap or even gaps where different regulatory authorities have responsibility for traditional activities thought to fall within the banking or securities sectors.

202. In addition, several jurisdictions note that securities products are traded by participants in other markets, such as banking, and products traditionally seen as insurance-related are in turn traded by those in the banking or securities markets, because they contain an investment element. Co-operation between the competent authorities responsible for each core sector is to be encouraged to address any potential vulnerabilities.

6.6 Issues for consideration

Securities and the "financial institution" category

203. The definition of the financial institutions in the FATF standards is broad and encompasses a variety of financial sectors, including banks, credit unions, insurance, and securities broker-dealers. Given the overlap among these sectors, it may be impractical to effectively establish mutually exclusive categories applicable to each sector in the 40+9 Recommendations and the Methodology. Nonetheless, representatives of the securities industry consulted during the development of this report have noted that they do not fully recognised themselves in the term "financial institution", which they tend to associate with the banking sector. In the future, consideration could therefore be given, when practical, to producing securities-specific material or sections in FATF documents (e.g., best practices paper or interpretative notes).

Scope of "financial institution" definition

204. This report refers to a broad range of products and intermediaries that may not be fully captured under the FATF standards. The recent financial crisis has brought the world's attention to certain products and areas where a lack of regulation has been cited as one of the causes of the turmoil. It is suggested that the FATF keep the definition of "financial institution" under review, to ensure that all products and intermediaries are captured.

RBA Guidance

205. Unlike DNFBPs, MSBs and life insurers, the securities sector has not been the object of a risk-based approach (RBA) guidance document by the FATF. Given the particular complexity of securities products, and continuing difficulties for the sector in identifying money laundering, they may be merit for the FATF in producing such guidance.

CDD/reliance

206. There are a number of synergies between the securities industry and other parts of the financial services industry. In particular, this report notes a trend to rely on customer due diligence information

gathered from the banking sector which is then relied upon to fulfilling the CDD/KYC obligations of the securities industry. This is an area which would benefit from further investigation, possibly in the context of more general work being undertaken in relation to FATF Recommendation 9.

Sector/product specific vulnerabilities

207. Whilst foreign exchange trading is an activity covered by the FATF definition of activities conducted by a "financial institution", it remains somewhat unclear what the ML/TF risks are, and there appears to be scope for some cross-over between the securities and banking sectors. Further work to clarify the risks and identify any potential gaps in supervisory responsibility would be beneficial.

208. Similarly, some securities products, most notably those with insurance elements, involve synergies within the insurance industry. It is recommended that further work (possibly work looking at the insurance industry) be undertaken to look at any potential specific risks in this sector.

209. Whilst several ML/TF vulnerabilities associated with derivatives were identified in this report, further work, perhaps involving the private sector, could address this issue in greater depth.

Suspicious transaction reporting

210. The categorisation of suspicious transaction reports by some FIUs means that some STRs relating to the securities industry are being categorised in a way that may not fully capture the full picture of the risks in this area. It is recommended that thought be given to further work to improve the categorisation of STRs, where this is necessary.

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ANNEX A:

GLOSSARY OF TERMS[28]

Annuities: Form of contract sold by life insurance companies that guarantees a fixed or variable payment to the annuitant at some future time, usually retirement.

Bearer form: Securities that are not registered with the issuer and payable to the person who is in possession. Bearer bonds have coupon attachments that the holder can present on the interest date for payment. Bearer securities are negotiable without endorsement, can be transferred by delivery and can pay dividends upon presentation of a coupon.

Bearer bonds: Bond issued with detachable coupons that must be presented to a paying agent or the issuer for interest payment.

Bearer securities: Securities that are completely negotiable and entitle the holder to the rights under the security (e.g. to payment if it is a debt security, and voting if it is an equity security). They are transferred by delivering the instrument from person to person. In some cases, transfer is by endorsement, or signing the back of the instrument, and delivery.

Beneficial owner: the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.

Bills of exchange: An unconditional order in writing, addressed by one person (the drawer) to another person (the drawee) and signed by the person giving it, requiring the drawee to pay, on demand or at a fixed or determinable future time, a specified sum or money to, or to the order of a specified person (the payee) or to the bearer.

Boiler rooms: Refers to dishonest broker-dealers who set up a group of high-pressure salespeople who use banks of telephones to make cold calls to as many potential investors as possible. These salespeople urge investors to buy "house stocks"; stocks that the firm buys or sells as a market maker or has in its inventory. Boiler room operators typically sell penny stocks.

Bonds: An IOU issued by a borrower to a lender. Bonds often take the form of fixed interested securities issued by governments, municipalities, or companies. A bond typically obligates the issuer to pay the bondholder a specified sum of money, usually at specific intervals, and to re-pay the principal amount at maturity.

Broker: A person who acts as an intermediary between a buyer and seller of securities, usually for a commission.

[28] To reflect their common usage, the terms in this glossary were derived, in part, from: (1) Barron's Dictionary of Finance and Investment Terms (6th Ed. 2003); (2) Oxford's Dictionary of Finance and Banking (3rd Ed. 2005); and from the FATF Glossary.

Block trade: Refers to a large trade that is usually at least 10,000 shares of a stock or $200,000 of bonds. It can also refer specifically to large trades that occur between institutional parties at a fixed or pre-determined price.

Bulletin boards: Electronic inter-dealer quotation system that displays real-time quotes, last-sale prices, and volume information for many over-the-counter securities that are not listed on a national securities exchange.

Call options: Call options give the buyer the right, but not the obligation, to buy the underlying currency or a security at a particular price by a particular date.

Cashier's cheque: A cheque that draws directly on a customer's account, making the bank the primary obligor. Customers requiring a cashier's check must pay the amount of the cheque to the bank. The bank will then issue a cheque to a third party named by the customer.

Certificates of participation: Certificates showing the level of participation in a business.

Certificate of deposit (CDs): A negotiable certificate that usually pays interests and is issued by a bank in return for a term deposit (ranging from months to years).

Cheques: A bill of exchange, or draft on a bank drawn against deposited funds to pay a specified sum of money to a specified person on demand.

Closed-end companies (Units in Collective Investment Schemes (UCIS)): A fund set up by an investment trust that issues a fixed number of shares to its investors.

Commercial paper: Short-term debt obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers to investors with temporarily idle cash.

Contracts for difference (CFD): A type of derivative where an agreement is made to exchange the difference in value of a particular security (or other financial instrument) between the time at which a contract is opened and the time at which it is closed. The CFD allows a trader to buy and sell in any market and make profit from rising and falling prices, and to establish a deposit or margin to gain exposure to markets without tying up capital.

Correspondent account: An account whereby one financial institution regularly performs services for another financial institution in markets that may be inaccessible to the latter. Many correspondent relationships involve the wire transfer of money.

Credit-default swaps (CDS): Financial contract whose value is based on underlying debt obligations. A CDS can be tied to the performance of the debt obligations of a single entity or security, or, with more complex CDS, an index of several such entities or securities.

Dealer: A person who acts as a principal in a financial transaction rather than as a broker or agent.

Debenture: General debt obligation backed only by the integrity of the borrower and documented by an agreement called an indenture (e.g. an unsecured bond).

Dematerialisation of securities: The transfer of physical, hard-copy security certificates to book entry credits of a security holder's interest.

Depository institutions: Financial institutions that take deposits and extend loans. This definition includes banks and credit unions.

Derivatives: A financial instrument whose price is related to an underlying commodity, currency, economic variable, financial instrument or security. The different types of derivatives include futures contracts, forwards, swaps, and options. They can be traded on exchanges or over-the-counter (OTC). Market traded derivatives are standard, while OTC trades are specific and customised.

Downbid: Generally refers to a current bid less than a previous bid.

Electronic communications networks (ECN): Electronic trading systems that automatically match buy and sell orders at specified prices. Subscribers, which are typically institutional investors, broker-dealers, and market-makers; they can place trades directly with an ECN.

Equities: Ownership interest possessed by shareholders in a corporation. Often called stocks.

Exchanges: Any organisation, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such an exchange.

Foreign exchange contracts: Futures and options contracts based on foreign currencies. The buyer of a currency futures contract acquires the right to buy a particular amount of that currency by a specific date at a fixed rate of exchange and the seller agrees to sell that currency at the same fixed price.

Forward rate agreements: Purchase or sale of a specific quantity of a commodity, government security, foreign currency, or other financial instrument at the current or spot price, with delivery and settlement at a specified future date.

Fraud: Intentional misrepresentation, concealment, or omission of the truth for the purpose of deception or manipulation to the detriment of a person or organisation.

Free look period: A contractual provision that provides the contract owner the right to return the contract within a specified period for a refund.

Futures contract: An agreement to buy or sell a fixed quantity of a particular commodity, currency, or security for delivery at a fixed date in the future at a fixed price. Unlike an option, a futures contract involves a definite purchase or sale and not an option to buy or sell.

Hedge funds: Hedge funds pool investors' money and invest those funds in financial instruments in an effort to make a positive return. Many hedge funds seek to profit in all kinds of markets by pursuing leveraging and other speculative investment practices that may increase the risk of investment loss. Hedge funds typically issue securities in "private offerings" that are usually not required to be registered with a securities or financial regulator.

Insider trading: Buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, non public information about the security. Insider trading violations may also include "tipping" such information, securities trading by the person "tipped," and securities trading by those who misappropriate such information.

Investment adviser: Any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.

Investment trusts: Refers to firms that, for a management fee, invest the pooled funds of small investors in securities appropriate for its stated investment objectives. See also **Unit Trusts**.

Journaling: A book entry system where assets are debited from one account and credited to another.

Margin: Arrangement whereby an investor pays for part of a securities purchase and borrow the rest from a securities intermediary. For example, an investor may buy $5,000 worth of stock in a margin account by paying for $2,500 and borrowing $2,500 from the securities intermediary.

Money manager: See **Portfolio manager**.

Market manipulation: A deliberate attempt to interfere with the free and fair operation of the market and create artificial, false or misleading appearances with respect to the price of, or market for, a security, commodity or currency.

Money orders: A financial instrument that can be easily converted into cash by the payee named on the money order. The money order lists both the payee and the person who bought the instrument, known as the payor. Money orders are issued by a variety of entities to people presenting cash or other forms of payment.

Mortgage bonds: Bond issue secured by a mortgage on the issuer's property, such as the lien on which is conveyed to the bondholders by a deed of trust.

Mutual funds (Open-end investment company): See definition of **unit investment trust.**

Nominee accounts: An account under which a person, a nominee named by another, acts on his or her behalf often to conceal the identity of the nominator.

Nostro: Account established by a domestic banking institution to receive deposits from, make payments on behalf of, or handle other financial transactions for a foreign financial institution, usually in the foreign financial institution's currency. See also **correspondent account**.

Note: A written promise to pay a specified amount to a certain entity on demand or on a specified date.

Omnibus accounts: Account opened in the name of one financial institution at another financial institution comprised of multiple individual accounts whose names are not disclosed to the former.

Options: The right to buy or sell a fixed quantity of a commodity, currency, or security at a particular date at a particular price (the exercise price). Unlike futures, the purchaser of an option is not obligated to buy or sell at the exercise price. If the option lapses, the purchaser only loses the initial purchase price of the option.

Over-the-counter (OTC) markets: A market in which securities are bought and sold outside of established securities markets.

Penny stocks: Securities with very low market price, volume and/or liquidity that are traded on a securities exchange or on the OTC markets. These shares are usually issued by companies with a short or erratic history of revenues and earnings, and therefore such stocks are more volatile than those of well established companies trading on major securities exchanges.

Pink sheets: an electronic quotation system that displays quotes of many securities traded over the counter.

Politically exposed person (PEP): Individuals who are or have been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, and important political party officials. Business relationships with family members or close associates of PEPs involve reputational risks similar to those with PEPs themselves. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories.

Ponzi scheme: A type of fraud names after Charles Ponzi, who operated such a scheme in the U.S. in the 1920s. Under the scheme, investors are offered unsustainably high rates of interest and are initially paid their interest from a fund consisting of new deposits. When the deposits dry up, the scheme collapses. Also referred to as **pyramid schemes**.

Portfolio manager: A professional responsible for the securities portfolio of an individual or institutional investor. In return for a fee, the manager has the responsibility of choosing and managing assets.

Pump-and-dump: "Pump and dump" schemes, also known as "hype and dump manipulation," involve the touting of a company's stock (typically **penny stocks**) through false and misleading statements to the marketplace. After pumping the stock, fraudsters profit by selling their cheap stock into the market.

Put options: Put options give the buyer the right to sell underlying currencies or securities at a specific price and date.

Reverse merger: A method through which a private company can go public without an initial public offering (IPO). This occurs when a private company acquires or merges with a public shell company that is listed on a stock exchange or traded on the OTC markets.

Shell bank: a bank incorporated in a jurisdiction in which it has no physical presence and which is unaffiliated with a regulated financial group.

Shell companies: Company that often has no physical presence and generates little or no independent economic value. These companies are commonly organised in a way that makes ownership and transactions information of the company easier to conceal, particularly when the shell company is private.

Short sale: Generally, the sale of a stock that an investor does not own. Investors who sell short believe the price of the stock will fall. If the price drops, the investor can buy the stock at the lower price and make a profit. If the price of the stock rises and the investor buys it back later at the higher price, he or she will incur a loss. When an investor sells short, a securities intermediary loans the investor the stock. The stock the investor borrows comes from either the intermediary's own inventory, the margin account of another of the intermediary's clients, or another securities intermediary.

Subscription rights: A privilege granted to existing shareholders of a corporation to subscribe to shares of a new issue of common stock before it is offered to the public; better known simply as a right. Such a right normally lasts two or three weeks, are freely transferable and entitles the holder to buy the new public stock below the public offering price.

Transfer agents: Companies that have publicly traded securities typically use transfer agents to keep track of the individuals and entities that own their stocks and bonds. Many transfer agents are banks or trust companies, but sometimes a company acts as its own transfer agent. Transfer agents perform three main functions: issue and cancel certificates to reflect changes in ownership; act as an intermediary for the company; and handle lost, destroyed, or stolen certificates.

Traveller's cheques: A preprinted, fixed-amount cheque designed to allow the person signing it to make an unconditional payment to someone else as a result of having paid the issuer for that privilege.

Trust accounts: An arrangement enabling property to be held by a person or persons (the trustees) for the benefit of some other person or persons (the beneficiaries). The trustee is the legal owner of the property but the beneficiary has an equitable interest in it.

Underwriting: The process of agreeing to purchase a new issue of securities from an issuer and distribute it to investors. The underwriter makes a profit between the price paid to the issuer and the public offering price.

Unit investment trusts or unit trusts: An investment trust formed to manage a portfolio, in which investors can buy units. Open-end investment companies are often organised as unit investment trusts.

Variable annuity: A contract issued by an insurance company under which an investor provides the insurer with a lump-sum payment or series of payments. In return, the insurer agrees to make periodic payments to the investor beginning immediately or at some future date. The investor is usually permitted to invest the purchase payments in a range of investment options. The value of the account in a variable annuity will vary depending on the performance of the investment options that have been chosen.

Warrants: A security that offers the owner the rights to subscribe for ordinary shares of a company at a fixed date, usually at a fixed price. Warrants can themselves be bought and sold on stock exchanges and are equivalent to stock options.

Wealth managers: See **Investment adviser** and **Portfolio manager**.

ANNEX B:

SUSPICIOUS INDICATORS

Introduction

211. This annex is divided into two sections. Section I lists suspicious indicators that have been identified in the questionnaire responses as indicating possible ML/TF in the securities industry. Section II lists suspicious indicators and red flags that are pertinent for evaluating whether a customer may be engaged in activities that would come under the FATF's list of "designated categories of offences" that are: (i) predicate offences to money laundering and (ii) offences that are unique to the securities industry, namely insider trading, market manipulation, and other forms of securities fraud.

1. The suspicious indicators listed in these two sections are being provided here to give law enforcement, regulators and the private sector an overview of the types of activities that can be suspicious. We caution however, that this list is non-exhaustive and that some of these ML/TF suspicious indicators and red flags may be not be applicable in all jurisdictions. Furthermore, some of the suspicious indicators and red flags with respect to the designated offences may be more useful for banks in identifying securities specific illicit activities that may not necessarily require the use of a securities intermediary or markets per se (i.e. securities offering fraud).

2. We also note that the occurrence of one or more of these indicators/red flags may be a warning sign of unusual activity that may be indicative of ML/TF and/or the occurrence of a securities specific designated offence. However, this does not necessarily mean that money laundering, terrorist financing or any other illicit activity is occurring. Further investigation should be conducted if any of these indicators/red flags are present during the course of a transaction or customer interaction.

Section I:
Suspicious Indicators for Money Laundering and Terrorist Financing in the Securities Industry

Customer Due Diligence

- The customer provides the securities firm with unusual or suspicious identification documents that cannot be readily verified or are inconsistent with other statements or documents that the customer has provided. This indicator may apply to account openings and to interaction subsequent to account opening, such as wire transfers.

- During the account opening process, the customer refuses to provide information to complete CDD/KYC (e.g. occupation, prior financial relationships, etc.).

- The customer, whether a person or entity, is reluctant to provide the securities firm with complete information about the nature and purpose of the customer's business, prior financial relationships, anticipated account activity, the entity's officers and directors or business location.

- The customer, whether a person or entity, is located in a jurisdiction that is known as a bank secrecy haven, a tax shelter, or high-risk geographic locations (e.g. narcotics producing jurisdiction).

- The customer is reluctant to meet personnel from the securities firm in person, is very secretive and/or evasive or becomes defensive when asked to provide more information.
- The customer refuses to identify a legitimate source for funds or provides the securities firm with information that is false, misleading, or substantially incorrect.
- The customer engages in frequent transactions with money services businesses.
- The customer's background, whether a person or entity, is questionable or does not meet expectations based on business activities.
- The customer has no discernable reason for using the firm's service or the firm's location (e.g. customer lacks roots to the local community or has come out of his or her way to use the firm).
- The customer refuses to provide information regarding the beneficial owners of an account opened for an entity, or provides information that is false, misleading or substantially incorrect.
- The customer's address is associated with multiple other accounts that do not appear to be related.
- The customer has a history of changing financial advisors and/or using multiple firms or banks. This indicator is heightened when the customer uses firms located in numerous jurisdictions.
- The customer is known to be experiencing extreme financial difficulties.
- The customer is, or is associated with, a PEP or senior political figure.
- The customer refuses to invest in more appropriate securities when those securities would require a more enhanced CDD/KYC procedure.
- The customer with a significant history with the securities firm abruptly liquidates all of his or her assets in order to remove wealth from the jurisdiction.
- The customer appears to be acting as a fiduciary for someone else but is reluctant to provide more information regarding for whom he or she may be acting.
- The customer is publicly known to have criminal, civil or regulatory proceedings against him or her for crime, corruption or misuse of public funds or is known to associate with such persons. Sources for this information include news items or Internet searches.
- The customer inquires as to how quickly he or she can liquidate accounts or earnings without explaining why or provides suspicious reasons for doing so.
- The customer opens an account or purchases a product without any regard to loss, commissions or other costs associated with that account or product.
- The customer has commercial or other types of relationships with risky persons or institutions.
- The customer acts through intermediaries, such as money managers or advisers, in order not to have his or her identity registered.

- The customer exhibits unusual concern with the securities firm's compliance with government reporting requirements and/or the firm's AML/CFT policies.

- The customer is reluctant to provide the securities firm with information needed to file reports or fails to proceed with a transaction once asked for documentation or learns of any recordkeeping requirements.

- The customer is interested in paying higher charges to the securities firm in order to keep some of his or her information secret.

- The customer tries to persuade an employee of the securities firm not to file a required report or not to maintain required records.

- The customer funds deposits, withdraws or purchases financial or monetary instruments below a threshold amount in order to avoid any reporting or recordkeeping requirements imposed by the jurisdiction.

- The customer requests that account openings and closings in his or her name or in the name of family members be done without producing a paper trail.

- Law enforcement has issued subpoenas regarding a customer and/or account at the securities firm.

Fund Transfers and/or Deposits

- Wire transfers are sent to, or originate from, financial secrecy havens, tax shelters or high-risk geographic locations (e.g. jurisdictions known to produce narcotics/psychotropic drugs or to be related to terrorism) without an apparent business reason or connection to a securities transaction.

- Wire transfers or payments to or from unrelated third parties (foreign or domestic) or where the name or account number of the beneficiary or remitter has not been supplied.

- Many small, incoming wire transfers or deposits are made, either by the customer or third parties, using cheques, money orders or cash that are almost immediately withdrawn or wired out in a manner inconsistent with customer's business or history.

- Incoming payments made by third-party cheques or cheques with multiple endorsements.

- Deposit of large amount of small-denomination currency to fund account or exchanges of small notes for bigger notes.

- Wire transfer activity that is unexplained, repetitive, unusually large or shows unusual patterns or with no apparent business purpose.

- The securities account is used for payments or outgoing wire transfers with little or no securities activities (e.g. account appears to be used as a depository account or a conduit for transfers).

- The controlling owner or officer of a public company transfers funds into his personal account or into the account of a private company that he or she owns or that is listed as an authorised signatory.

- Quick withdrawal of funds after a very short period in the account.
- Transfer of funds to financial or banking institutions other than those from where the funds were initially directed, specifically when different countries are involved.
- Transfers/journals between different accounts owned by the customer with no apparent business purpose.
- Customer requests that certain payments be routed through nostro or correspondent accounts held by the financial intermediary or sundry accounts instead of its own account.

Bearer Securities

- The customer requests cashing bearer securities without first depositing them into an account or frequently deposits bearer securities into an account.
- The customer's explanation regarding the method of acquiring the bearer securities does not make sense or changes.
- The customer deposits bearer securities together with a request to journal the shares into multiple accounts that do not appear to be related, or to sell or otherwise transfer ownership of the shares.

Unusual Securities Transactions and Account Activity

- Transaction where one party purchases securities at a high price and then sells them at a considerable loss to another party. This may be indicative of transferring value from one party to another.
- A customer's transactions include a pattern of sustained losses. This may be indicative of transferring value from one party to another.
- The purchase and sale of non-listed securities with a large price differential within a short period of time. This may be indicative of transferring value from one party to another.
- Payments effected by administrators and asset managers in cash, bearer cheques or other transferable instruments without indentifying who they are for or providing very little information regarding the underlying account holder or beneficiary.
- A company uses cash to pay dividends to investors.
- Use of shell companies to purchase public company shares, in particular if the public company is involved in a cash intensive business.
- Transfer of assets without a corresponding movement of funds, such as through journaling or effecting a change in beneficial ownership.
- A dormant account that suddenly becomes active without a plausible explanation (e.g. large cash deposits that are suddenly wired out).
- A customer's transactions have no apparent economic purpose.

- A customer who is unfamiliar with a financial product's performance and specifications but wants to invest in it nonetheless.

- Transactions that show the customer is acting on behalf of third parties.

- The purchase of long term investments followed by a liquidation of the accounts shortly thereafter, regardless of fees or penalties.

- Transactions involving an unknown counterparty.

- Large sum cash purchases of financial instruments and mutual funds holdings followed by instant redemption.

Insurance Products (applicable to jurisdictions where some insurance products can be considered securities)

- The customer cancels an insurance contract and directs that the funds be sent to a third party.

- The customer deposits an insurance annuity check from a cancelled policy and immediately requests a withdrawal or transfer of the funds.

- The customer cancels an annuity product within the free-look period. Although this could be legitimate, it could also signal a method of laundering funds if accompanied with other suspicious indicators, such as purchasing the annuity with several sequentially numbered money orders and/or having a history of cancelling annuity products during the free look period.

- The customer opens and closes accounts with an insurance company only to reopen a new account shortly thereafter with the same insurance company, but with new ownership information.

- The customer purchases an insurance product with no concern for investment objective or performance.

- The customer purchases an insurance product with unknown or unverifiable sources of funds, such as cash, official cheques or sequentially numbered money orders.

- Securing a policy loan against the cash value soon after the policy is issued and repaying the loan with various monetary instruments or cash.

Activity that is Inconsistent with the Customer's Business Objective or Profile

- The customer's transaction patterns suddenly change in a manner that is inconsistent with the customer's normal activities or inconsistent with the customer's profile.

- There are unusual transfers of funds or journaling (i.e. book entries) among accounts without any apparent business purpose or among apparently unrelated accounts.

- The customer maintains multiple accounts, or maintains accounts in the names of family members or corporate entities with no apparent business or other purpose.

- The customer's account is not used for its intended purpose (i.e. used as a depository account).

- The customer enters into a financial commitment that appears beyond his or her means.
- The customer begins to use cash extensively.
- The customer engaged in extremely complex transactions where his or her profile would indicate otherwise.
- Customer's credit usage is in extreme amounts that do not correspond to his or her financial status or collateral, which is provided by an unrelated third-party.
- The time zone in customer's location is not consistent with the times that the trades were executed, with no apparent business or other purpose, or there is a sudden change inconsistent with the customer's typical business activity.
- A foreign based customer that uses domestic accounts to trade on foreign exchanges.
- The customer exhibits a lack of concern about higher than normal transaction costs.

Rogue Employees

- The employee appears to be enjoying a lavish lifestyle that inconsistent with his or her salary or position.
- The employee is reluctant to take annual leave.
- The employee is subject to intense job-related demands, such as sales or production goals that may make him more willing to engage in or overlook behaviour that poses ML/TF risks.
- The employee inputs a high level of activity into one customer account even though the customer's account is relatively unimportant to the organisation.
- The employee is known to be experiencing a difficult personal situation, financial or other.
- The employee has the authority to arrange and process customer affairs without supervision or involvement of colleagues.
- The management/reporting structure of the financial institution allow an employee to have a large amount of autonomy without direct control over his activities.
- The employee is located in a different country to his direct line of management, and supervision is only carried out remotely.
- A management culture within the financial institution focuses on financial reward over compliance with regulatory requirements.
- The employee's supporting documentation for customers' accounts or orders is incomplete or missing.
- Business is experiencing a period of high staff turnover or is going through significant structural changes.

Section II:
Suspicious Indicators for Predicate Offences To Money Laundering Linked to Securities

Insider Trading

- The customer makes a large purchase or sale of a security, or option on a security, shortly before news is issued that affects the price of the security.
- The customer is known to have friends or family who work for the securities issuer.
- A customer's trading patterns suggest that he or she may have inside information.

Market Manipulation, including Penny Stocks

- A customer engages in prearranged or other non-competitive securities trading, including wash or cross trades of illiquid or low priced securities.
- Securities or funds transfers between parties without an apparent relationship.
- Securities transactions occur across many jurisdictions, and in particular high risk jurisdictions.
- Two or more unrelated accounts at the securities firm trade an illiquid or low priced security suddenly and simultaneously.
- A customer journals securities between unrelated accounts for no apparent business reason.
- A customer has opened multiple accounts with the same beneficial owners or controlling parties for no apparent business reason.
- Transactions between the same or related parties structured solely so that one side incurs a loss while the other incurs a gain.
- Transaction where one party purchases securities at a high price and then sells them at a considerable loss to another party.
- The customer deposits a large number of physical securities at the securities firm.
- The physical securities are titled differently to the name on the account.
- The physical security does not bear a restrictive legend even though the history of the stock and/or the volume of shares being traded suggest that it should have such a legend.
- The customer's explanation regarding the method of acquiring the physical securities does not make sense or changes.
- The customer deposits physical securities together with a request to journal the shares into multiple accounts that do not appear to be related, or to sell or otherwise transfer ownership of the shares.
- Large or repeated trading in securities that are illiquid, low priced or difficult to price.

- The company at issue has no apparent business, revenues or products.
- The company at issue has experienced frequent or continuous changes in its business structure and/or undergoes frequent material changes in business strategy or its line of business.
- The officers or insiders of the company at issue are associated with other low priced, illiquid or low volume companies.
- The officers or insiders of the low priced, illiquid or low volume company have a history of regulatory violations.
- The low priced, illiquid or low volume company at issue has failed to make required regulatory disclosures.
- The low priced, illiquid or low volume company at issue has been the subject of a prior trading suspension.
- A customer's transactions include a pattern of receiving physical securities or receiving incoming shares transfers that are sold with the proceeds wire transferred out of the account.
- The purchase and sale of non-listed securities with a large price differential within a short period of time.

Securities Offering Fraud

- The customer opens numerous accounts for different legal entities that the customer controls.
- The customer receives many incoming cheques or wire transfers from unrelated third parties.
- The customer allocates incoming third party deposits among numerous accounts.
- The customer makes numerous outgoing payments to third parties close in time to when the customer receives many incoming third party cheques or wire transfers.
- The customer's profile does not suggest a legitimate business reason for receiving many third party deposits.
- The cheques or wire transfers note that the funds are for an investment.

ANNEX C:
SUSPICIOUS TRANSACTION REPORTS

Table 1: Securities Related STRs – 2005-2008[29]

2005	2006	2007	2008 (to extent available)	Total
10,852	13 241	20 350	13 357	**57 800**

Table 2: STR Breakdown Based on Type of Security

Type of securities activity/product	2005	2006	2007	2008 (to extent available)	Totals
Transferable Securities					
Equities	1 255	1 549	3 021	1 818	**7 643**
Bonds and Similar Instruments	194	252	334	271	**1 051**
Certificates of Deposit	48	105	88	114	**355**
Commercial Paper	11	23	42	17	**93**
Other	19	22	27	30	**98**
Units in Collective Investment Trusts					
Mutual Funds	366	392	754	441	**1 953**
Money Market Mutual Funds	196	257	373	231	**1 057**
Derivatives					
Options		1		1	**2**
Securities Futures Products	13	23	8	11	**55**
Commodity Derivatives Contracts (including futures)	14	17	40	12	**83**
Foreign Exchange Contracts	30	59	163	100	**352**
OTC Derivatives	16	15	35	14	**80**
Others	10	26	39	14	**178**
Other					
Warrants	7	10	21	6	**44**
Other securities	84	78	104	83	**349**
Any other	1 818	1 834	2 272	1 281	**7 205**

[29] Two jurisdictions provided figures that appear large with respect to their securities markets. Jurisdiction one indicated that 303,054 STRs were filed between 2005 and 2008. In particular, jurisdiction one indicated that 70,405 STRs were filed in 2005, 78,705 in 2006, 86,607 in 2007 and 67,337 in 2008. It is unclear whether this figure is representative of all STRs filed in the jurisdiction or only those related to securities. Jurisdiction two indicated that 34,700 STRs were filed in 2007, but did not provide yearly figures or specify whether figures were inclusive of all STRs filed. Because of this ambiguity, Table 2 adjusts the securities related STRs figures by deducting the figures provided by jurisdictions one and two. Inclusion of these figures would bring the total numbers of securities related to 81,257 for 2005, 91,946 for 2006, 141,657 for 2007, 80,964 for 2008 for a total of 395,824 securities related STRs filed for that period.

Table 3: STR Breakdown by type of institution

Type of Institution	2005	2006	2007	2008 (to extent available)	Total
Securities Broker or Dealer[30]	8 284	8 486	13 224	7 765	**37 759**
Commodities Futures Merchant, Broker, Dealer, Pool Operator[31]	196	258	446	206	**1 106**
Fund Manager	54	15	892	351	**1 312**
Bank or Affiliate[32]	947	1 395	1 231	1 044	**4 617**
Financial Adviser	262	698	1 299	918	**3 177**
Collective Investment Scheme[33]	623	646	1 404	423	**3 096**
Other, Foreign FIU, Self-Regulatory Organisation[34]	1 170	1 933	3 550	1 973	**8 626**

30 This figure includes market makers, municipal or local government securities dealers, introducing and clearing brokers, securities dealers, securities floor traders, securities options brokers and dealers, specialists, and federal or national government broker-dealers.

31 This figure includes agricultural trade option merchants, commodity pool operators, commodity trading advisors, futures commission's merchants, and futures floor brokers and dealers.

32 This figure includes banks, bank holding companies and bank subsidiaries.

33 This figure includes mutual funds.

34 This figure includes STRs filed by direct participation programs, FIUs and self-regulatory organisations, and those did not indicate what type of institution was filing, if any.

ANNEX D: QUESTIONNAIRE AND RESPONDING JURISDICTIONS AND ORGANISATIONS

The following jurisdictions submitted a response to the questionnaire that is re-produced below.

Andorra	Argentina	Australia	Austria
Belgium	Brazil	British Virgin Islands	Canada
Cayman Islands	China	Denmark	European Commission
France	Hong Kong	Israel	Japan
Jordan	Lithuania	Luxembourg	Malta
Mauritius	Mexico	Moldova	Monaco
Norway	Panama	Poland	Portugal
Qatar	Romania	Singapore	Slovakia
Spain	Sweden	Switzerland	The Netherlands
Turkey	Ukraine	United Kingdom	United States

2008 FATF Securities Typology Questionnaire

I. BACKGROUND

1. The objectives of the FATF Securities Typology Questionnaire are to collect information about: (i) the range of products classified as "securities" in various jurisdictions; (ii) how jurisdictions supervise compliance with anti-money laundering/combating terrorist financing ("AML/CTF") requirements for these products; (iii) potential areas of AML/CTF vulnerabilities in the securities industry; (iv) suspicious transaction reports (STRs) in the securities industry; and (v) enforcement actions in the securities industry.

2. The results of this survey will be used to develop a securities typology report to provide insight into the how money laundering and terrorist financing ("ML/TF") may operate in the securities industry. The securities typology project team will use the responses along with information from other sources to prepare the securities typologies report.

II. INSTRUCTIONS FOR COMPLETING THE SURVEY

3. All FATF members and FSRBs are invited to submit completed questionnaires to support the securities typologies report initiative. Contributions should be submitted to the FATF Secretariat (secretariat@fatf-gafi.org) **by 19 December 2008**. All questionnaire participants are encouraged to seek input from private sector representatives operating within their respective jurisdictions, as appropriate, in developing responses to the questions contained in this questionnaire. Responses should be complete yet concise and clearly address the questions asked. Any additional information which may be relevant for the securities typologies report may be submitted along with the questionnaire response. The typology is looking at the use of the securities industry/securities products for money laundering and terrorist financing, and questionnaire responses should concentrate on this, rather than examining the predicate offence (e.g. fraud).

1. Jurisdiction/Organisation

Name of Jurisdiction or Organisation completing questionnaire

2. Contact details

Contact details for any queries arising from this response

3. Range of products classified as "securities"

Using the definition of "financial institution" in the FATF glossary as a point of reference, please use the following chart to identify: (1) products that are traded as "securities" in your country; (2) the type of financial institutions involved in selling, recommending or distributing securities (e.g. broker-dealers, banks, etc.); and (3) the supervisory authority(ies) responsible for AML/CFT supervision of that product/financial institution.

Product	**FATF definition of activity (see Glossary - below)**	**Is this treated as a security in your jurisdiction? (YES or NO)**	**If product is a security, type(s) of institutions involved in sale, advice, or distribution** (e.g. broker-dealer/fund manager/bank)	**Name of supervisory authority(ies) responsible for regulating AML/CFT compliance of applicable institution**
1. Transferable Securities				
Equities	7(a), 9, 10, 11			
Bonds and similar debt instruments	7(a), 9, 10, 11			
Certificates of deposit	7(a), 9, 10, 11			
Bills of exchange	7(a), 9, 10, 11			
Other (please specify)				
2. Units in collective investment schemes				
Unit trusts	7(d), 9, 10, 11			
Investment trusts	7(d), 9, 10, 11			
Mutual funds	7(d), 9, 10, 11			
OEICs (open-ended investment companies)	7(d), 9, 10, 11			
SICAV/Fs (an open-ended collective	7(d), 9, 10, 11			

investment scheme)				
Closed-end company	7(d), 9, 10, 11			
3. Derivatives				
Options	7(a), 7(b), 7(c), 7(e), 9, 10, 11.			
Future	7(a), 7(b), 7(c), 7(e), 9, 10, 11.			
Swaps	7(a), 7(b), 7(c), 7(e), 9, 10, 11.			
Forward rate agreements	7(a), 7(b), 7(c), 7(e), 9, 10, 11.			
Commodity derivatives contracts	7(a), 7(e), 9, 10, 11.			
Foreign exchange contracts	7(a), 7(b), 7(c), 9, 10, 11.			
Other				
4. Other				
Please detail any other product which is classified as a "security" in your jurisdiction (e.g., insurance products such as variable annuities).				

4. AML/CTF vulnerabilities in the securities industry

4.1 Please describe the types of transactions, products and/or activities in the securities industry that are considered to present high risk factors for ML/TF, if any.

4.1.2. Are any of the above designated as high risk by law/regulation/other measures in the jurisdiction?

4.2 Please describe the payment methods in the jurisdiction (e.g., cash, wire transfer, cheque, online systems, mobile phone systems, etc.) associated with higher risks for ML/TF, if any.

4.3 Please describe the delivery methods used in the jurisdiction (e.g. physical securities, book-entry, etc.) associated with higher risks for ML/TF, if any.

4.4 Please provide examples of any specific suspicious transaction triggers/indicators/red flags for the securities industry.

5. Typologies/methods/trends

Please attach or provide hyperlinks to any ML/TF typologies for the securities industry developed within your jurisdiction (such as documents that detail high risk securities products or method of distribution, as well as what caused initial suspicions in the securities industry, how assets were traced, and the outcome of investigations/prosecutions). Where relevant, please indicate at which stage of the transaction(s) you consider that money laundering/terrorist financing took place.

6. Enforcement actions for violations of AML/CFT requirements

6.1 How many criminal/regulatory enforcement actions concerning AML/CFT requirements applicable to the securities firms have been brought in the past 3 years?

Year	Number – regulatory only	Number – criminal only	Number – joint regulatory/criminal
2005			
2006			
2007			
2008 (if available)			

6.2 Do any of these enforcement actions reveal areas of high risk or vulnerability in the securities industry? If so, provide brief summaries of key enforcement actions.

7. Suspicious transaction reports

7.1 How many STRs relating to securities transactions has the FIU received in the past 3 years?

Year	Number
2005	
2006	
2007	
2008 (if available)	

7.2 Please specify the number of STRs filed in the past 3 years relating to securities transactions for each type of securities activity/product and/or relating to the each type of filing institution (if this information is maintained by the FIU).

For example, possible types of products and institutions are given below.

Type of securities activity/product	2005	2006	2007	2008 (if available)
A. Transferable Securities				
Equities				
Bonds and similar debt instruments				
Certificates of deposit				
Bills of exchange				
Other (please specify)				
Other (please specify)				
B. Units in collective investment schemes				
Unit trusts				
Investment trusts				
Mutual funds				
OEICs				
SICAV/Fs				
Other (please specify)				
Other (please specify)				
C. Derivatives				
Options				
Futures				
Swaps				
Forward rate agreements				
Commodity derivatives contracts				
Foreign exchange contracts				
Other (please specify)				
Other (please specify)				
D. Other				

Please detail any other product which is classified as a "security" in your jurisdiction.				

Type of filing institution	2005	2006	2007	2008 (if available)
Broker/dealer				
Fund manager				
Bank				
Financial advisor				
Collective Investment Scheme provider				
Other (please specify)				

7.3 Do any of these STRs reveal areas of high risk or vulnerability in the securities industry? If so, please discuss any tends or areas of risk/vulnerabilities demonstrated by STRs.

7.4 Based on STRs related to the securities industry or as a result of other information concerning the securities industry: how many referrals has the FIU made to law enforcement, how many ML/TF prosecutions have been commenced, and how many convictions have resulted?

Year	Number of Referrals	Number of Prosecutions	Number of Convictions
2005			
2006			
2007			
2008 (if available)			

8. Other proceedings

Please give details of any ancillary proceedings/tracing/freezing of assets/regulatory proceedings/criminal proceedings that revealed the use of securities.



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