

I. MONEY LAUNDERING AND TERRORIST FINANCING IN THE SECURITIES SECTOR¹

RED FLAGS FOR SECURITIES SECTOR

Insider Trading

- a) 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.
- b) The customer is known to have friends or family who work for the securities issuer
- c) A customer's trading patterns suggest that he or she may have inside information.
- d) 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.
- e) A customer trades in selective scrip just after opening the account and makes sizeable profit in each trade.
- f) A customer trading in small amount of shares suddenly takes a sizable position in a specific scrip and makes a considerable profit on it.
- g) A Customer earns a sizable profit by generating a considerable portion of market volume in illiquid scrip.

Market Manipulation

- a) A customer engages in prearranged or other non-competitive securities trading, including wash or cross trades of illiquid or low priced securities.
- b) 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.
- c) 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.
- d) Securities or funds transfers between parties without an apparent relationship.
- e) Securities transactions occur across many jurisdictions, and in particular high risk jurisdictions.
- f) Two or more unrelated accounts at the brokerage house trade an illiquid or low priced security suddenly and simultaneously.
- g) Transactions between the same or related parties structured solely so that one side incurs a loss while the other incurs a gain.
- h) The customer deposits a large number of physical securities at the brokerage house.
- i) The physical securities are titled differently to the name on the account.
- j) The company at issue has no apparent business, revenues or products.

¹ (Source: FATF ML/FT Report, October 2009)

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- k) 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.
- l) The officers or insiders of the company at issue are associated with other low priced, illiquid or low volume companies.
- m) The low priced, illiquid or low volume company at issue has failed to make required regulatory disclosures/ history of regulatory violations.

Securities Offering Fraud

- a) The customer opens numerous accounts for different legal entities that the customer controls.
- b) The customer receives many incoming cheques or wire transfers from unrelated third parties.
- c) The customer allocates incoming third-party deposits among numerous accounts.
- d) The customer's profile does not suggest a legitimate business reason for receiving many third party deposits.
- e) The cheques or wire transfers note that the funds are for an investment.

Customer Due Diligence

- a) The customer provides the brokerage house 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.
- b) The customer, whether a person or entity, is reluctant to provide the brokerage house 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.
- c) 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).
- d) The customer refuses to identify a legitimate source for funds or provides the brokerage house with information that is false, misleading, or substantially incorrect.
- e) The customer engages in frequent transactions with money services businesses.
- f) The customer does not provide his mailing address or gives broker's address as his mailing address or requests that all correspondence will be collected from the brokerage house.
- g) Accounts where authorization to operate the account and issue payment instructions are given to a third party and who has never/rarely visited or contacted the brokerage house.
- h) The customer is reluctant to meet personnel from the brokerage house in person, is very secretive and/or evasive or becomes defensive when asked to provide more information.
- i) During the account opening process, the customer refuses to provide information to complete CDD/KYC (e.g. identification documents, beneficial ownership, etc.)
- j) The customer exhibits unusual concern with the Brokerage House's compliance with regulatory reporting requirements and/or the firm's AML/CFT policies.
- k) The customer withdraws funds/profits from his account only in cash.

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- l) A customer is a trust, Shell Company, or Private Investment Company that is reluctant to provide information on controlling parties and underlying beneficiaries. Beneficial owners may hire nominee incorporation services to establish shell companies and open bank accounts for those shell companies while shielding the owner's identity.
- m) A customer or group tries to persuade an employee not to file required reports or maintain required records.
- n) A business or customer asks to be exempted from reporting or recordkeeping requirements.
- o) The customer has commercial or other types of relationships with risky persons or institutions.
- p) 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.
- q) The customer's address is associated with multiple other accounts that do not appear to be related.
- r) 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.
- s) The customer is, or is associated with, a PEP or senior political figure.
- t) The customer refuses to invest in more appropriate securities when those securities would require a more enhanced CDD/KYC procedure.
- u) The customer with a significant history with the brokerage house abruptly liquidates all of his or her assets in order to remove wealth from the jurisdiction.
- v) 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.
- w) 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.
- x) 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.
- y) The customer opens an account or purchases a product without any regard to loss, commissions or other costs associated with that account or product.
- z) The customer acts through intermediaries, such as money managers or advisers, in order not to have his or her identity registered.
- aa) The customer is interested in paying higher charges to the brokerage house in order to keep some of his or her information secret.
- bb) 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.

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Fund Transfers and/or Deposits

- a) 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.
- b) 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.
- c) Incoming payments made by third-party cheques or cheques with multiple endorsements
- d) Deposit of large amount of small-denomination currency to fund account or exchanges of small notes for bigger notes.
- e) Multiple personal and business accounts or the accounts of nonprofit organizations or charities are used to collect and funnel funds to a small number of foreign beneficiaries.
- f) Foreign exchange transactions are performed on behalf of a customer by a third party, followed by funds transfers to locations having no apparent business connection with the customer or to higher-risk countries.
- g) 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
- h) Wire transfer activity that is unexplained, repetitive, unusually large or shows unusual patterns or with no apparent business purpose.
- i) 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).
- j) 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 authorized signatory.
- k) Transfer of funds to financial or banking institutions other than those from where the funds were initially directed, specifically when different countries are involved.
- l) Transfers/journals between different accounts owned by the customer with no apparent business purpose.
- m) 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.

Lending Activity

- a) Loans secured by pledged assets held by third parties unrelated to the borrower.
- b) Loan secured by deposits or other readily marketable assets, such as securities, particularly when owned by apparently unrelated third parties.
- c) Borrower defaults on a cash-secured loan or any loan that is secured by assets which are readily convertible into currency.
- d) Loans are made for, or are paid on behalf of, a third party with no reasonable explanation.

Bearer Securities

- a) The customer deposits a large number of bearer securities at the brokerage house and quickly redeems the securities.

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- b) The customer requests cashing bearer securities without first depositing them into an account or frequently deposits bearer securities into an account.
- c) The customer's explanation regarding the method of acquiring the bearer securities does not make sense or changes.

Unusual Securities Transactions and Account Activity

- a) 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.
- b) 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.
- c) A customer's transactions have no apparent economic purpose.
- d) Use of shell companies to purchase public company shares, in particular if the public company is involved in a cash intensive business.
- e) A dormant account that suddenly becomes active without a plausible explanation (e.g. large cash deposits that are suddenly wired out).
- f) Transactions that show the customer is acting on behalf of third parties.
- g) The purchase of long term investments followed by a liquidation of the accounts shortly thereafter, regardless of fees or penalties.
- h) Large sum cash purchases of financial instruments and mutual funds holdings followed by instant redemption.

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

- a) The customer's account is not used for its intended purpose (i.e. used as a depository account).
- b) The customer engaged in extremely complex transactions where his or her profile would indicate otherwise.
- c) 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.
- d) The customer exhibits a lack of concern about higher than normal transaction costs.
- e) There are unusual transfers of funds or journaling (i.e. book entries) among accounts without any apparent business purpose or among apparently unrelated accounts.
- f) The customer enters into a financial commitment that appears beyond his or her means.
- g) 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

Rogue Employees

- a) The employee appears to be enjoying a lavish lifestyle that inconsistent with his or her salary or position.
- b) The employee is reluctant to take vacation.

- c) The employee inputs a high level of activity into one customer account even though the customer's account is relatively unimportant to the organization.
- d) The employee's supporting documentation for customers' accounts or orders is incomplete or missing.
- e) The employee has the authority to arrange and process customer affairs without supervision or involvement of colleagues.
- f) The management/reporting structure of the financial institution allow an employee to have a large amount of autonomy without direct control over his activities.
- g) The employee is located in a different country to his direct line of management, and supervision is only carried out remotely.
- h) A management culture within the financial institution focuses on financial reward over compliance with regulatory requirements.
- i) Business is experiencing a period of high staff turnover or is going through significant structural changes.