

Monarch Bay Securities, LLC

# Anti-Money Laundering Independent Test 2016

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## Introduction

Firm Name: Monarch Bay Securities, LLC

AML CO: Keith Moore, since 11/2014

AML CO (Alternate): None named as of 11/6/2016

Examiner: Lisa Roth, President, Monahan & Roth, LLC

Date: Remotely performed field work from September 28, 2016 through 11/6/2016

## AML Compliance Program

Section 352 of the US Patriot Act required all financial institutions to develop and implement AML compliance programs on or before April 24, 2002. Section 352 requires the compliance programs, at a minimum, to establish (1) the development of internal policies, procedures, and controls, (2) the designation of a compliance officer with responsibility for a firm's anti-money laundering program, (3) an ongoing employee training program, and (4) an independent audit function to test the effectiveness of the anti-money laundering compliance program. Subsequently to the effective date of the rules, FINRA has issued guidance to broker-dealers to reinforce their compliance programs. The following report summarizes the results of an independent test performed to assess the compliance of the Firm's AML program with the governing laws, rules, regulations and guidance.

For ease of review the examiner's notes are identified as OBSERVATIONS, FINDINGS, or RECOMMENDATIONS.

### AML Compliance Program Review Summary

Monarch has in place written policies and procedures, and the AML CO demonstrates that periodic amendments, enhancements and additions have been made to the policies and procedures to best ensure compliance among its sales and operations personnel.

Monarch's anti-money laundering policies and procedures are incorporated into its overall Written Supervisory Procedures manual as Chapter 10. Monarch's CEO/AML CO Keith Moore has approved and implemented the procedures.

## AML Compliance Program Review Table

The following table reports certain observations made in connection with the review of the WSP Chapter 10. Note that recommended edits from the prior year inspection report have been provided in as an attachment to this report.

Page	Chapter or Category	Description	Observation, Recommendation or Finding
1	AML Contacts	All personnel will be provided with a “point of contact” sheet with AML primary and alternate contact persons.	2016 Observation: Satisfactory
3	Receipt and Review of Stock Certificates	Stock Deposit Questionnaire  Recommended in 2015: Add a statement in the written procedures to reference the red flags section later in the manual.	2016 Observation: The recommendation made in 2015 (additional red flags) has not been implemented.
8	Red Flags	Transactions Involving Penny Stock Companies:  Recommended in 2015: Add Low Priced Stock including specific recommendations made in FINRA examination.	2016 Observation: The recommendation made in 2015 (additional red flags) has not been implemented.
9	Suspicious Activity Reporting Requirements	Dollar threshold for reporting, standard, time requirements, scope	2016 Observation: Satisfactory
11	Minimum Reporting Requirements	Description of filing requirements: Recommended in 2015 Include the BSA E-filing web link to the procedures.	2016 Observation: The recommendation made in 2015 (update to e-filing) has not been implemented.
14	Risk-Based Assessment of Customer Accounts	The company has recently undergone a transaction that includes the transfer of all retail customer business away from the company. The	2016 Observation: the company should take steps to clarify that it no longer conducts a retail business in its AML procedures, and to focus on the particular steps it will take to ensure

Page	Chapter or Category	Description	Observation, Recommendation or Finding
		company has ceased engaging in retail/customer activity.	money-laundering compliance related to its investment banking activities.
15	General Due Diligence When Opening an Account	Periodic credit history and criminal background checks through vendor databases at the time of hire and monthly thereafter	2015 Observation: Satisfactory through use of USA Info
20	Notices to Customers	The Firm's CIP will provide its customers with adequate notice that it is requesting information to verify their identities. The notice will briefly describe the identification requirements of this section in a manner reasonably designed to ensure that a customer is able to view the notice, or is otherwise given notice, before opening an account.	2016 Observation: The company does not appear to notify its clients of its CIP practices. Note, this is a repeat observation. If the practice is no longer relevant, due to its business audience, the company should amend its procedures accordingly.
25	Training on AML Procedures	Annual training, focus, description	2016 Observation: Satisfactory
27	Books and Records Requirements	Maintenance in accordance with 17a-3 and 17a-4	2016 Observation: Satisfactory

## Risk Assessment

FINRA guidance recommends a “risk-based” approach in establishing and implementing a firm’s AML program. That means that the program’s AML policies, procedures and internal controls should be designed to address the risk of money laundering specific to the firm. Under the leadership of the AML Compliance Officer (AML CO), the firm can identify risk by looking at the type of customers it serves, where its customers are located, and the types of services it offers. FINRA suggests that is a good practice to develop a written analysis of the firm’s money laundering and terrorist financing risk and how the firm’s AML procedures manage that risk, to ensure that the AML program is properly tailored.

*2016 OBSERVATION: Monarch describes its risk-based customer review program in its AML policies and procedures. The firm's high risk areas include its processing of low-priced securities certificates, which appear to be addressed in detail in its procedures.*

*Notably, the company has divested its interests in customer-related accounts, including the processing of certificates. As such, its risk profile is substantially reduced.*

*Nonetheless, its procedures have not yet been amended to reflect its new focus on investment banking and related consultations.*

## Account Opening and Maintenance

Broker-dealers are required to implement reasonable procedures for identifying customers and verifying their information. The information required under NASD and FINRA Rules regarding suitability is the starting point for AML customer identification procedures, and the Money Laundering Abatement Act imposes additional customer identification requirements on broker-dealers.

### Customer Identification Programs (CIP)

The firm must establish, document, and maintain a written CIP. This program must be appropriate for the firm's size and business, be part of the firm's anti-money laundering compliance program, and, at a minimum, must contain procedures for the following: identity verification, recordkeeping, comparison with government lists, and providing customer notice.

#### Required Customer Information

A broker-dealer's CIP must contain procedures for opening an account that specifies the identifying information that will be obtained from each customer. The minimum identifying information that must be obtained from each customer prior to opening an account is:

- A name;
- A date of birth, for an individual;
- An address:
- For an individual, a residential or business street address;

- For an individual who does not have a residential or business street address, an Army Post Office (APO) or Fleet Post Office (FPO) box number, or the residential or business street address of a next of kin or another contact individual; or
- For a person other than an individual (such as a corporation, partnership, or trust), a principal place of business, local office, or other physical location; and
  - An identification number, which will be:
    - For a U.S. person, a taxpayer identification number; or
    - For a non-U.S. person, one or more of the following:
      - a taxpayer identification number;
      - a passport number and country of issuance;
      - an alien identification card number; or
      - the number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.

Importantly, whatever identifying information the firm does accept must enable it to form a reasonable belief that it knows the true identity of a customer.

*2016 OBSERVATION: As noted above, the company no longer opens retail accounts.*

*In place of its customer-based procedures, the consultant encourages the company to draft and implement procedures targeted to its new institutional business audience.*

### Identity Verification Procedures

A CIP must include risk-based procedures for verifying the identity of each customer to the extent reasonable and practicable. The procedures must enable the firm to form a reasonable belief that it knows the true identity of each customer. The procedures must be based on the broker-dealer's assessment of the relevant risks, including those presented by the:

- types of accounts maintained by the broker-dealer;
- methods of opening accounts provided by the broker-dealer;
- types of identifying information available; and
- broker-dealer's size, location, and customer base.

*2016 OBSERVATION: As noted above, the company no longer opens retail accounts.*

*In place of its customer-based procedures, the consultant encourages the company to draft and implement procedures targeted to its new institutional business audience.*

### **Customer Verification**

A CIP must contain procedures for verifying the identity of each customer within a reasonable time before or after the customer's account is opened.

A broker-dealer's CIP is required to include procedures that describe when the broker-dealer will use documentary methods, non-documentary methods, or a combination of both methods to verify customers' identities. For example, depending on the type of customer, the method of opening an account, and the type of identifying information available, it may be more appropriate to use either documentary or non-documentary methods, and in some cases it may be appropriate to use both methods. These procedures should be based on the firm's assessment of the relevant risk factors.

*2016 OBSERVATION: As noted above, the company no longer opens retail accounts.*

*In place of its customer-based procedures, the consultant encourages the company to draft and implement procedures targeted to its new institutional business audience.*

### **Verification through Documents**

A CIP must contain procedures that describe the documents the broker-dealer will use for verification, based on its own risk-based analysis of the types of documents that it believes will enable it to verify the true identities of customers. Examples of documents that firms may use for verification include the following, which are generally accepted as reliable:

- For an individual, an unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard, such as a driver's license or passport; and
- For a person other than an individual (such as a corporation, partnership, or trust), documents showing the existence of the entity, such as certified articles of incorporation,
- A government-issued business license, a partnership agreement, or a trust instrument.



*2016 OBSERVATION: Because the company no longer has customer accounts, no customer files for the time frame of this report were reviewed. Monarch's CIP requires documentary evidence at the time of account opening. Its procedures in this regard are adequate to meet the requirements, and should be applied to its institutional client base with particular instructions for the type of evidence collected and the scope of individual (authorized persons, beneficial owners, etc. who may be pertinent for CIP review.*

*The company uses MIS (McDonald Information Systems) and performs and OFAC review for principals. For each officer of the issuer and any shareholder with 10% or more of the issuer equity the company performs SEC review, Google review, and checks FINRA and FINCEN for available disclosures. The company performs a similar review for each investor.*

### **Verification through Non-Documentary Methods**

A CIP must contain procedures that describe the non-documentary methods the broker-dealer will use for verification. Due to the prevalence of identity theft and because identification documents may be obtained illegally and be fraudulent, firms are encouraged by regulators and government agencies to use non-documentary methods even when a customer has provided identification documents.

Examples of non-documentary methods of verification include:

- Contacting a customer;
- Independently verifying the customer's identity through the comparison of information provided by the customer with information obtained from a consumer reporting agency, public database, or other source;
- Checking references with other financial institutions; or
- Obtaining a financial statement.

Regulators and government agencies have recommended that firms analyze whether there is a logical consistency between the identify information provided, such as the customer's name, street address, zip code, telephone number (if provided), date of birth, and Social Security number (e.g., zip code and city/state are consistent).

The final rule requires that a broker-dealer's CIP address the following circumstances where non-documentary procedures must be used:

- An individual is unable to present an unexpired government-issued identification document that bears a photograph or similar safeguard;
- The broker-dealer is not familiar with the documents presented;

- The account is opened without obtaining documents;
- The customer opens the account without appearing in person at the broker-dealer; and
- Where the broker-dealer is otherwise presented with circumstances that increase the risk that the broker-dealer will be unable to verify the true identity of a customer through documents.

*2016 OBSERVATION: Because the company no longer has customer accounts, no customer files for the time frame of this report were reviewed. Monarch's CIP requires documentary evidence at the time of account opening. Its procedures in this regard are adequate to meet the requirements, and should be applied to its institutional client base with particular instructions for the type of evidence collected and the scope of individual (authorized persons, beneficial owners, etc. who may be pertinent for CIP review. (SEE COMMENTS ABOVE)*

#### *Additional Verification for Certain Customers*

The risk that a firm may not know the customer's true identity may be heightened for certain types of accounts, such as an account opened in the name of a corporation, partnership, or trust that is created or conducts substantial business in a jurisdiction that has been designated by the U.S. as a primary money laundering concern or has been designated as non-cooperative by an international body. Regulators and government agencies emphasize that a firm must take further steps to identify customers that pose a heightened risk of not being properly identified. A firm's CIP must prescribe additional measures that may be used to obtain information about the identity of the individuals associated with the customer when standard documentary methods prove to be insufficient.

The CIP must address situations where, based on the broker-dealer's risk assessment of a new account opened by a customer that is not an individual, the broker-dealer will obtain information about individuals with authority or control over such account. This verification method applies only when the broker-dealer cannot verify the customer's true identity using documentary and non-documentary verification method.

*2016 OBSERVATION: Because the company no longer has customer accounts, no customer files for the time frame of this report were reviewed. Its procedures in this regard are adequate to meet the requirements, and should be applied to its institutional client base with particular instructions for the type of evidence collected and the scope of individual (authorized persons, beneficial owners, etc. who may be pertinent for CIP review.*

### *Lack of Verification*

A CIP must include procedures for responding to circumstances in which the broker-dealer cannot form a reasonable belief that it knows the true identity of a customer. These procedures should describe:

- When the broker-dealer should not open an account;
- The terms under which a customer may conduct transactions while the broker-dealer attempts to verify the customer's identity;
- When the broker-dealer should close an account after attempts to verify a customer's identity fail; and
- When the broker-dealer should file a Suspicious Activity Report (Form SAR-SF) in accordance with applicable law and regulation.

*2016 OBSERVATION: The company appears to have a consistent and adequate routine in place for addressing lack of verification regarding its institutional/investment banking client base.*

*2016 RECOMMENDATION: The consultant recommends that the company update its written policies to include the policies in place for performing verification.*

### *Record Keeping*

Firms must develop procedures designed to ensure the confidentiality of the SAR filings, and must maintain copies of SARs for a five-year period. Firms are prohibited from notifying any person involved in a reported transaction that the transaction has been reported on a SAR. In addition, firms may not disclose SARs or the fact that a SAR was filed other than to law enforcement agencies or securities regulators. Firms must also have procedures in place to ensure the denial of any subpoena requests for SARs or information in SARs, and for informing FinCEN of any subpoena received. FINRA guidance suggests that firms should segregate SAR filings and supporting documentation from other books and records of the firm to avoid violating the prohibitions on disclosure of these records, and that the broker-dealer establish procedures and identify a contact person to handle requests for a subpoena or other requests that call for disclosure of a SAR.

*2016 OBSERVATION: Monarch has filed 4 SARs in the most recent 12 months. The Consultant was able to (but did not) open and review the materials in each SAR Folder.*

*2016 RECOMMENDATION: The AML CO is advised that precautions must be taken to ensure the confidentiality of SARs such that unauthorized persons are*

*not able to access the information. Reasonable protections might include password protection on relevant file folders.*

### **Required records**

A CIP must include procedures for making and maintaining a record of all information obtained to verify a customer's identity. At a minimum, the record must include all identifying information about a customer obtained to verify a customer's identity.

With regard to verification, a firm's records must contain a description of any document that was relied on to verify the customer's identity, noting the type of document, any identification number contained in the document, the place of issuance, and, if any, the date of issuance and expiration date.

With respect to non-documentary verification, firms are required to retain records containing a description of the methods and the results of any measures undertaken to verify the identity of a customer.

With respect to any method of verification chosen, firms must retain a description of the resolution of each substantive discrepancy discovered when verifying the identifying information obtained.

*2016 OBSERVATION: Monarch's procedures state that the AML CO will ensure all records, reports, working papers and other applicable documents required will be maintained in accordance with the Bank Secrecy Act and SEC Rule 17a-8.*

*The consultant has drafted and recommends the implementation of amendments to the procedures to incorporate the electronic filing requirements under the amended Bank Secrecy Act.*

### **Retention of records**

A broker-dealer must retain records of all of the identification information obtained from the customer for five years after the account is closed. SARs must be retained for 5 years. In addition, records made about information that verifies a customer's identity only have to be retained for five years after the record is made. In all other respects, the records must be maintained pursuant to the provisions of SEC Rule 17a-4.

*2016 OBSERVATION: As required, Monarch's policies include requirements for retaining information obtained from the customer for five years. In addition, the procedures include a 5-year retention requirement for other related records, such as records of any rejected transaction.*

### *Notifying Federal Law Enforcement*

In the course of performing due diligence or during the opening of an account, firms should immediately contact Federal law enforcement by telephone in appropriate emergency situations as described below:

- a customer is listed on the OFAC List;
- a customer's legal or beneficial account owner is listed on the OFAC List;
- a customer attempts to use bribery, coercion, undue influence, or other inappropriate means to induce a broker-dealer to open an account or proceed with a suspicious or unlawful activity or transaction; and
- any other situation that a firm reasonably determines requires immediate government intervention.

*2016 OBSERVATION: Monarch's procedures for notifying law enforcement include current provisions for immediate notification of the AML CO so that he or she can file appropriate reports. Monarch has in fact timely contacted law enforcement under the direction of the AML CO/CCO as appropriate.*

### **Client Account Test Table**

Because the company has transferred out its retail customer business line, retail customer accounts were not reviewed.

In their place the consultant reviewed two representative sample due diligence files for

- BlackGold Capital Management LP: this file folder contained a DDQ but did not contain evidence of background checks on the principals as noted in an earlier section of this report.
- uBid IPO: for this investment, the company maintains a robust DD folder including banking, account reconciliations, informational decks, legal reviews and general information. Notwithstanding the thorough business assessment of the offering, it does not appear that the company undertook a background check adequate to vet the principals from a perspective of money laundering compliance.

## **Account Maintenance and Monitoring**

### **“Correspondent Accounts”**

Broker-dealers are prohibited from establishing, maintaining, administering, or managing a “correspondent account” for an unregulated foreign shell bank. Firms must have procedures in place to ensure that this does not occur and should immediately terminate such accounts if they have any. The broker-dealer's AML compliance personnel should be notified upon discovery or suspicion that the firm

may be maintaining or establishing a “correspondent account” in the United States for a foreign shell bank.

Monarch’s policies and procedures adequately address these requirements. As of the date of the AML Independent Test, the firm had no such accounts.

The Money Laundering Abatement Act requires broker-dealers to maintain records identifying the owners of foreign banks that maintain “correspondent accounts” in the United States and the name and address of an agent residing in the United States authorized to accept service of legal process for such banks. Broker-dealers must require their foreign bank account holders to complete model certifications issued by Treasury to the extent possible. U.S. depository institutions and broker-dealers can send the certification forms to their foreign bank account holders for completion. The certification forms generally ask the foreign banks to confirm that they are not shell banks and to provide the necessary ownership and agent information. Use of the certification forms enables compliance with requirements concerning “correspondent accounts” with foreign banks and can provide a safe harbor for purposes of complying with such requirements. Firms are required to recertify (if relying on the certification forms) or otherwise verify any information provided by each foreign bank, or otherwise relied upon, at least every two years or at any time the firm has reason to believe that the information is no longer accurate.

*2016 OBSERVATION: Monarch has no accounts requiring certification. Its policies and procedures are adequate to detect any attempt to open such an account. Based on a review of client records, it appears that Monarch complies with its policies and procedures regarding accounts requiring certification (no such accounts were observed). Notably, all retail accounts have been transferred out and the company will not be engaging in customer-related activities going forward.*

Broker-dealers are required under Section 312 of the Money Laundering Abatement Act to establish appropriate, specific, and, where necessary, enhanced due diligence policies, procedures, and controls that are reasonably designed to detect and report instances of money laundering for any “correspondent account” established, maintained, administered, or managed for a foreign bank. *At a minimum*, in the case of foreign banks licensed by certain high-risk jurisdictions or operating under an offshore banking license, broker-dealers are required to take reasonable steps:

- to determine the ownership of the foreign bank;
- to conduct enhanced scrutiny of the account to detect and report suspicious activity; and
- to determine whether the foreign bank maintains “correspondent accounts” for any other bank, and if so, the identity of those banks.

*2016 OBSERVATION: Monarch prohibits establishing, maintaining, administering, or managing a “correspondent account” in the United States for an unregulated foreign shell bank. Based on a review of client records, it appears that Monarch complies with its prohibition.*

The Money Laundering Abatement Act requires broker-dealers to take reasonable steps to determine the identity of the nominal and beneficial account holders of, and the source of funds deposited into, a private banking account maintained by or on behalf of a non-U.S. citizen, and to conduct enhanced scrutiny of accounts requested or maintained by, or on behalf of, a senior foreign political figure, or any immediate family member or close associate of a senior foreign political figure. A private bank account is an account (or combination of accounts) that requires an aggregate deposit of funds or other assets of more than \$1,000,000 established on behalf of one or more individuals who have a direct or beneficial ownership interest in the account, and is assigned to, or administered by, in whole or in part, an officer.

*2016 OBSERVATION: Monarch does not accept private banking accounts held by or on behalf of non-U.S. citizens. Based on a review of client records, it appears that Monarch complies with its prohibition.*

### Monitoring Account Activity

The Money Laundering Abatement Act requires BDs to monitor account activities, including but not limited to, trading and the flow of money into and out of the account, the types, amount, and frequency of different financial instruments deposited into and withdrawn from the account, and the origin of such deposits and the destination of withdrawals.

*2015 OBSERVATION: Monarch’s policies include steps for monitoring ongoing activity, including wire requests, account opening and transactions in general. Reports generated by its clearing firm demonstrate that the overwhelming majority of incoming and all outgoing wires in the review sampling were first party wires. It appears that Monarch diligently performed related daily, weekly, monthly and quarterly reviews up until August 2016 when it transferred its retail customers to an unaffiliated broker-dealer.*

*Its procedures related to account transaction activity appear to be adequate to detect potential suspicious activity. Before funds or securities are transferred, its procedures require the review and confirmation of the wire transfer instructions to insure the following:*

- *The customer's identification and instructions are verified through personal contact with the customer (company will not accept wire instructions through email or fax without personal verification)*
- *The AML CO or supervisor requires the completion of a Letter of Authorization for 3<sup>rd</sup> Party Wires*
- *For standing wires, the company requires a notary seal.*

### Wire Review Summary

In connection with transaction reviews, the firm's wire reports for months April through August 2016, representative sample exception report log sheets and year-to-date client revenue records were reviewed.

The company provided evidence of oversight in the form of logs that include record of a supervising principal's review of various Daily, Weekly, Monthly and Quarterly reports. The nature of the reports is broad, including such reports as Restricted Trades, Delinquent Documents, Daily Fails, Inventory and numerous other reports. It is noted that many of the reports address business lines that will no longer be pursued by the company. Nonetheless the logs demonstrate the company's methodical approach to oversight.

As recorded in the wire logs, the company appears to exert diligence in ensuring consistency between the sender and recipient of the wire transfers. Notably, the company no longer processes wire transactions on behalf of customers.

11.7.2016: Keith will send a copy of the CORE Wire form.

This was the case (sender and recipient were the same) in:

10 of 12 wires sent in March 2016 (1<sup>st</sup> half of March not reviewed)

12 of 16 wires sent in April 2016 (2<sup>nd</sup> half of April not reviewed)

13 of 19 wires sent in May 2016

17 of 20 wires sent in June 2016

8 of 8 wires sent in July 2016

7 of 7 wires sent in August 2016

Exceptions noted in March were addressed as follows:

- Wire on March 22, 2016 from Darren Goodrich Inc. 104k PST to TD Ameritrade Clearing Inc.: The account beneficiary is the same in both accounts, based on information retained internally at the company in the form of a written record.
- Wire on March 30, 2016 from Christopher Castaldo to Wall Street Buy Sell Hold: Instructions from the customer were verified by a principal of the company, according to records retained internally at the company in the form of a written wire request.

Exceptions noted in April were addressed as follows:

- Wire on April 1, 2016 from Christopher Castaldo to Wall Street Buy Sell Hold:



Instructions from the customer were verified by a principal of the company, according to records retained internally at the company in the form of a written wire request.

- Wire on April 4, 2016 from Darren Goodrich Inc. 104k PST to TD Ameritrade Clearing Inc.: The account beneficiary is the same in both accounts, based on information retained internally at the company in the form of a written record.
- Wire on April 6, 2016 from Kerry Stewart to TD Ameritrade Inc.: The account beneficiary is the same in both accounts, based on information retained internally at the company in the form of a written record (standing instructions, notarized)
- Wire on April 8, 2016 from Howdy S. Kabrins to Advance Medical Isotope Corp: Instructions from the customer were remitted in writing but were not apparently verified by a principal of the company, according to records retained internally at the company in the form of a written wire request.

Exceptions noted in May were addressed as follows:

- Wire on May 2, 2016 from EDJ Limited to Goldman Sachs: Instructions from the customer were verified by [named principal] of the company, according to records retained internally at the company in the form of a written wire request.
- Wire on May 10, 2016 from Charles F. Paulson TTEE to the Paulson Liquidating Trust: The account beneficiary is the same, based on information retained internally at the company in the form of a trust certificate.
- Wires on May 12, 13 and 16, 2016 from Christopher Castaldo to Wall Street Buy Sell Hold: Instructions from the customer were verified by a principal of the company, according to records retained internally at the company in the form of a written wire request.
- Wire on May 31, 2016 from New Paradigm Ventures Inc. to RBC Bank: Instructions are found in the form of an internal memo, but do not conform to the company's customary process of attaining signature and principal approval.

Exceptions noted in June were addressed as follows:

- Wires on June 1 and June 6, 2016 from "The Estate of" to "David Sinclair Death Estate:" Although distinct names appear on the blotter, the recipient and the sender were the same beneficial owners subject to the demise of the original account holder.
- Wire on June 13, 2016 from "Tanveer Ahmed" to "Kwaja Tanveer Ahmed:" The individual beneficiary of the account is the same, despite the omission of the proper name in the account title.

*2016 OBSERVATION: It is noted that the company no longer engages in customer wire activity. Nonetheless, because there were two exceptions noted above, the company is encouraged to implement a consistent process subject to principal oversight if it determines it will re-engage in this type of activity in the future.*

## Procedures for Filing Reports in Response to Certain Activity

### *Suspicious Activity Report (SAR)*

Treasury rules require broker-dealers to file SARs in response to any transaction conducted or attempted by, at or through a broker-dealer involving (separately or in the aggregate) funds or assets of \$5,000 or more for which:

- the broker-dealer detects any known or suspected federal criminal violation involving the broker-dealer, or
- the broker-dealer knows, suspects, or has reason to suspect that the transaction:
- involves funds related to illegal activity,<sup>33</sup> is designed to evade the regulations, or
- has no business or apparent lawful purpose and the broker-dealer knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.

Although the reporting threshold begins at \$5,000, FINRA and other guidance suggests that broker-dealer should focus on a risk-based approach to developing compliance procedures that can be reasonably expected to promote the detection and reporting of suspicious activity. Specifically, a compliance program that allows for the review of only those transactions that are above a set threshold, regardless of whether transactions at a lower dollar threshold may involve money laundering or other risks, is not a satisfactory program. Therefore, broker-dealers should file a SAR and in some circumstances notify law enforcement authorities of all transactions that arouse articulable suspicion that proceeds of criminal, terrorist, or corrupt activities may be involved.

*2016 OBSERVATION: Monarch AML CCO confirmed that SARS have been filed and/or considered during the period in question. Please note an earlier observation by the Consultant regarding password protection or other means recommended to ensure confidentiality of the SAR information.*

### *Currency Transaction Report (CTR)*

Broker-dealers are required to file CTRs with FinCEN for transactions involving currency that exceed \$10,000. Because structuring is prohibited, multiple transactions are treated as a single transaction if they total more than \$10,000 during any single business day.

### *Currency and Monetary Instrument Transportation Report (CMIR)*

Any person who physically transports, mails, or ships currency or other monetary instruments into or out of the United States, in aggregated amounts exceeding \$10,000 at one time, must report the event on a CMIR with the Commissioner of Customs. Any person who receives any transport, mail, or shipment of currency, or other monetary instrument from outside the United States in an aggregate amount exceeding \$10,000 at one time also must report the receipt.

### ***Report of Foreign Bank and Financial Accounts (FBAR)***

Any person having a financial interest in, or signature or other authority over, financial accounts in a foreign country is required to report the relationship if the aggregate value of the accounts exceeds \$10,000 by filing a FBAR with FinCEN.

### ***Funds Transfers and Transmittals***

Broker-dealers effecting transmittals or transfers of funds, including wire fund transfers, of \$3,000 or more must collect, retain and record on the transmittal order certain information regarding the transfer, including the name and address of the transmitter and recipient, the amount of the transmittal order, the identity of the recipient's financial institution, and the account number of the recipient. Broker-dealers also must verify the identity of transmitters and recipients that are not established customers.

*2016 OBSERVATION: Monarch's AML CO reported that no relevant filings have occurred in 2016. The company's procedures adequately address the relevant electronic filings that are required should a triggering instance occur.*

### **Monitoring for, Detecting, and Responding to "Red Flags"**

FINRA guidance suggests that broker-dealers should develop administrative procedures concerning SARs. The procedures should address the process for filing SARs and reviewing SAR filings and the frequency of filings for continuous suspicious activity. Further, FINRA advises that a broker-dealer should consider requiring that all of its SAR filings be reported periodically to its Board of Directors and/or to senior management. In the event of a high-risk situation, broker-dealers should require that a report be made immediately to the Board of Directors and/or senior management.

### **Comparison with Government Lists**

A CIP must include procedures for determining whether a customer appears on any list of known or suspected terrorists or terrorist organizations issued by any Federal government agency and designated as such by Treasury in consultation with the Federal functional regulators. The procedures must require that the broker-dealer make such a determination within a reasonable period of time after the account is opened, or earlier if required by another Federal law or regulation or Federal directive issued in connection with the applicable list. The procedures also must require that the broker-dealer follow all Federal directives issued in connection with such lists.

In addition, broker-dealers have obligations under other laws to screen their customer against government lists. For example, compliance with the OFAC rules prohibit transactions with certain foreign countries and nationals. Firms must check the OFAC List to ensure that potential customers and existing customers, on an ongoing basis, are not prohibited persons or entities and are not from embargoed countries or regions before transacting any business with them. Because the lists change, firms must be alert to directives, and must respond with effective account reviews.

*2016 OBSERVATION: Monarch participates in the Treasury's 314(a) program. The AML CO has adequate knowledge of the program, and retains evidence in the form of reviewed FINCEN Lists including all names required in the search, and Secure Information Sharing System (SISS) Activity Reports verifying the AML CO's review.*

### Customer Notice

A broker-dealer's AML compliance program must include requirements for providing customers with adequate notice that the broker-dealer is requesting information to verify their identities. Notice must occur before the account is opened. Notice is adequate if the broker-dealer generally describes the identification requirements of the final rule and provides such notice in a manner reasonably designed to ensure that a customer is able to view the notice, or otherwise given notice, before opening an account. For example, depending upon the manner in which the account is opened, a broker-dealer may post a notice in the lobby or on its Web site, include the notice on its account applications, or use any other form of oral or written notice.

*2016 FINDING: Up to and including the time that it ceased conducting retail business, Monarch's customer welcome letter did not include adequate notice of the company's background checks and related identification procedures. Because it does not perform customer-related investment services, it is no longer subject to this requirement. Nonetheless, the company is advised to expand its CIP to its investment banking client base to vet control persons, certain beneficial owners, and others as deemed appropriate by the AML CO. The consultant recommends that when it implements CIP for its investment banking clients, it implement a relevant notice as well.*

### Reliance on Another Financial Institution

A broker-dealer's AML compliance program may include procedures specifying when the broker-dealer will rely on the performance by another financial institution (including an affiliate) of any procedures of the broker-dealer's CIP, with respect to any customer of the broker-dealer that is opening an account or has established an account or similar business relationship with the other financial institution to provide or engage in services, dealings, or other financial transactions.

In order for a broker-dealer to rely on another financial institution, the following requirements must be met:

- Reliance must be reasonable under the circumstances;
- The other financial institution must be subject to a rule implementing the anti-money laundering compliance program requirements of the PATRIOT Act and be regulated by a Federal functional regulator; and

- The other financial institution must enter into a contract requiring it to certify annually to the broker-dealer that it has implemented its anti-money laundering program, and that it will perform (or its agent will perform) specified requirements of the broker-dealer's CIP.

*2016 OBSERVATION: In the course of its business, Monarch may rely on federally regulated third parties for purposes of verification and possibly other AML requirements.*

*The consultant recommends that the company amend its written procedures to clarify when, if and to what extent it will delegate authority to third parties.*

### Responding to Regulatory Requests for AML Information

FINRA requires broker-dealers to provide contact information for the individual or individuals responsible for implementing the day-to-day operations and internal controls of the member's anti-money laundering program.

*2016 OBSERVATION: Monarch's Firm Notification is current and up to date including the name of the AML CO. The company does not currently have in place an AML Alternate.*

Under authority granted in Section 314 of the USA Patriot Act, the Treasury established a process through which law enforcement can communicate with financial institutions, including broker-dealers, in order to request information regarding those suspected of engaging in money laundering or terrorist activities so that any accounts and transactions involving these individuals or entities can be promptly located. Although participation in the mechanism is voluntary, firms that opt in to the program are required to annually certify to their participation and comply with the reporting requirements.

*2016 OBSERVATION: Monarch is a voluntary participant in the 314(a) program. The AML CO demonstrated compliance with the program requirements as noted above.*

## Qualifications and Responsibilities of Officers, Employees

### AML Compliance Officer

Every broker-dealer compliance program must designate an AML Compliance Officer to help administer the firm's AML compliance program efforts. Broker-dealers must vest this person with full responsibility

and authority to make and enforce the firm's policies and procedures related to money laundering. Whomever the firm designates as its AML Compliance Officer must have the authority, knowledge, and training to carry out the duties and responsibilities of his or her position.

The AML Compliance Officer should monitor compliance with the firm's AML program and help to develop communication and training tools for employees. The AML Compliance Officer should also regularly assist in helping to resolve or address heightened due diligence and "red flag" issues.

To the extent applicable, the AML Compliance Officer should report to a member of the Board of Directors (or other high level executive officer) on AML compliance issues. This senior officer or director should communicate with firm employees on AML issues to further demonstrate the firm's commitment to AML compliance. The firm's senior management should work with the AML Compliance Officer to help ensure that the firm's AML policies, procedures, and programs meet all applicable government standards and that they are effective in detecting, deterring, and punishing or correcting AML misconduct. The firm's senior management also should work with the AML Compliance Officer to ensure that the AML compliance policies, procedures, and programs are updated and reflect current requirements.

*2016 OBSERVATION: Monarch's AML CO is Keith Moore. Mr. Moore continues to be adequately qualified to perform the duties and responsibilities of the position. Mr. Moore continuously enhances his knowledge and training through participation in industry trade association meetings, and through ongoing communications with his peers. Mr. Moore demonstrates his qualifications, in part, through delivery of employee training, among other means.*

## Monitoring Employee Activity

FINRA has advised that firms:

- establish controls and monitor employees' trading and financial activity
- ensure that AML compliance programs contain a mechanism or process for the firm's employees to report suspected violations of the firm's AML compliance program procedures and policies to management confidentially, and without fear of retaliation
- separate the duties of employees where feasible to ensure a system of checks and balances (for example, firms may want to ensure that persons who handle cash do not open accounts or file CTRs);

*2016 OBSERVATION: Consistent with its established practices, Monarch requires all employees to request duplicate copies of personal brokerage statements be provided to the Compliance department. This includes outside accounts for which RR's have a financial interest or direct the trading as well as accounts owned by immediate family members. Prior approval by the CCO is*

*required for all accounts held outside Monarch. The CCO reviews these accounts for money-laundering in the same manner as for customer accounts. Further, employees are vetted at the time of hiring using a background check program and OFAC screening.*

## AML Training Program

The Money Laundering Abatement Act requires firms to develop ongoing employee training programs on AML issues. The AML employee training should be developed under the leadership of the AML Compliance Officer or senior management. Educational pamphlets, videos, intranet systems, in-person lectures, and explanatory memos are all appropriate training vehicles for AML training. The training may vary based on the type of firm and its size, its customer base, and its resources. FINRA urges its members to instruct their employees about the following topics, at a minimum:

- how to identify “red flags” and possible signs of money laundering that could arise during the course of their duties;
- what to do once the risk is identified;
- what their roles are in the firm’s compliance efforts;
- how to perform their roles;
- the firm’s record retention policy; and
- disciplinary consequences, including civil and criminal penalties for non-compliance with the Money Laundering Abatement Act.

FINRA has advised, *at a minimum*, that broker-dealers should implement AML training on an annual basis, and that firms should update their training materials, as necessary, to reflect new developments in the law. The regulator has suggested that money laundering compliance training be incorporated into continuing education programs for both registered representatives and supervisors.

A broker-dealer should scrutinize its operations to determine if there are certain employees who may need additional or specialized training due to their duties and responsibilities. For example, employees in Compliance, Margin, and Corporate Security may need more comprehensive training. The firm should train these employees or have these employees receive the appropriate instruction to ensure compliance with the Money Laundering Abatement Act.

*2016 OBSERVATION: Monarch has implemented AML training that meets the requirements noted above. An adequate portion of the company’s firm element*

*training program in 2016 was dedicated to AML training, including identification of red flags and other relevant information.*

*The 2016 training covered general AML information, description of different types of risk (clients, business, geographic), CIP and KYC requirements relevant to detection of suspicious activity, red flags, prohibited clients, and emergency notification procedures, among other relevant material.*

*Recommendations made in the prior year AML Independent Test were incorporated into the 2016 training.*

*The AML CO's records confirm that operational personnel, including persons with operations, compliance, legal and/or trading responsibilities (among others) are required to complete AML training.*

## AML Independent Test

Requirements for testing of Monarch's AML-Compliance program include, at a minimum: (1) evaluating the overall integrity and effectiveness of a broker-dealer's AML-Compliance program; (2) evaluating its procedures for BSA reporting and recordkeeping requirements; (3) evaluating the implementation and maintenance of its CIP; (4) evaluating the broker-dealer's customer due diligence requirements; (5) evaluating its transactions, with an emphasis on high-risk areas; (6) evaluating the adequacy of its staff training program; (7) evaluating its systems, whether automated or manual, for identifying suspicious activity; (8) evaluating its policies and procedures for reporting suspicious activity; and (9) evaluating a broker-dealer's response to previously identified deficiencies.

### **OBSERVATION:**

*The 2016 AML Independent Test was performed by Lisa Roth of Monahan & Roth, LLC who:*

- \* is not the AML-CO,*
- \* has a solid working knowledge of the Bank Secrecy Act and related rules, regulations and policies,*
- \* does not perform any of the functions being tested,*
- \* does not report to any persons whose job performance, role, responsibility and/or function is being tested*



## Conclusions

Observations and findings not withstanding, the results of the 2016 AML Independent Test reported herein can be interpreted to conclude that Monarch has in place adequate policies and procedures to address its responsibilities under the US Patriot Act, and relevant regulatory requirements.

The consultant recommends that the report be presented to members of Senior Management for review and consideration. The consultant further advises that a record be retained of steps taken in response to the report.

Keith Moore, AML CO: \_\_\_\_\_ Date: \_\_\_\_\_