SECURITIES AND EXCHANGE COMMISSION BRINGS FIRST EVER ENFORCEMENT ACTION UNDER THE USA PATRIOT ACT

On May 22, 2006, the Securities and Exchange Commission brought its first ever enforcement action under the USA PATRIOT Act. See Securities Exchange Act Release No. 53847 (May 22, 2006). The USA PATRIOT Act, which amended the Bank Secrecy Act (the "BSA"), requires broker-dealers to establish, document and maintain procedures, including certain recordkeeping requirements, for verifying the identities of customers opening new accounts. Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-8 thereunder require broker-dealers to comply with these reporting, recordkeeping and record retention requirements of the BSA. Acting under this authority, the SEC sanctioned Crowell, Weedon & Co., a registered broker-dealer operating in California, for violating Section 17(a) and Rule 17a-8.

In this action, the SEC alleged that Crowell had failed to comply with the requirements of the Customer Identification Program ("CIP") Rule under the BSA, 31 C.F.R. § 103.122. Under that Rule, broker-dealers are required to establish, document, and maintain written CIPs as part of their anti-money laundering compliance programs. The provisions of any particular broker-dealer's CIP should be appropriate to the broker-dealer's size and business, but must include procedures for: (1) verifying the identity of each customer; (2) collecting and maintaining customer identification information; and (3) determining whether a particular customer appears on any government-published list of known or suspected terrorists or terrorist organizations.

The SEC alleged that although Crowell had instituted a CIP by the October 1, 2003 effective date, Crowell had failed to follow the verification and documentation procedures outlined in its written CIP, and instead used procedures that were "materially different and weaker" than those mandated in the policy. Crowell's written policy required Crowell's registered representatives' opening new accounts to verify the identities of new customers using both documentary and nondocumentary methods. According to the SEC, however, between October 1, 2003 and late April 2004, Crowell opened approximately 2,900 new accounts without following those procedures, and instead relied on its registered representatives' personal knowledge of a customer's identity, without documenting this process. In sum, Crowell both failed to follow its written CIP and failed to document the actual procedures it was following.

The SEC also alleged that although Crowell had contracted with an unnamed "business partner" to verify the identities of new customers by comparing the identifying information collected from the customer with a database, the business partner was never able to perform this service due to technical difficulties. According to the SEC, it was not until April 2004 that Crowell retained a new vendor to perform this service. At that time, Crowell asked the new vendor also to verify the identities of the previously unverified 2,900 customers.

Without admitting or denying the SEC's findings, Crowell consented to the entry of an Administrative Order requiring Crowell to cease and desist from committing any violations or causing any future violations of Section 17(a) and Rule 17a-8. The SEC did not impose any fines or other penalties on Crowell.

This enforcement action is notable for a number of reasons. First, it puts financial services institutions, such as mutual fund families and broker-dealers, on notice that the SEC will be scrutinizing their anti-money laundering compliance programs and will not hesitate to commence enforcement actions even in the absence of any clear harm. Second, it illustrates that the establishment of appropriate compliance standards and procedures is only the first step in the creation of an effective compliance program. Additional critical components should include, among other things, effective training and dissemination of information regarding compliance standards and procedures and periodic monitoring and auditing to evaluate the program's effectiveness.

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If you have any questions concerning the foregoing or would like additional information, please contact Barry Barbash (bbarbash@willkie.com, 202-303-1201) or Larry Bergmann (lbergmann@willkie.com, 202-303-1103) of our Investment Management group, Robert Meyer (rmeyer@willkie.com, 202-303-1123) of our Compliance and Enforcement group, or the attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our website is located at www.willkie.com.

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