SULLIVAN & CROMWELL LLP

S&C memo

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Alpine Securities Corporation v. *Securities and Exchange Commission*

SCOTUS Denies Cert in Challenge to SEC's Suspicious Activity Reporting Regime

SUMMARY

On November 8, 2021, the Supreme Court denied a petition for a writ of certiorari filed by registered broker-dealer Alpine Securities Corporation, which sought to overturn a civil enforcement action brought against the company by the Securities and Exchange Commission under Section 17(a) of the Securities Exchange Act of 1934 and Exchange Act Rule 17a-8 for failing to file certain Suspicious Activity Reports and omitting information from other SARs. Section 17(a) requires issuers to "make and keep . . . such records" and "make and disseminate such reports" as the SEC determines are necessary, and Rule 17a-8 incorporates the reporting and retention requirements of the Bank Secrecy Act by mandating that every registered broker or dealer subject to the requirements of the Bank Secrecy Act comply with the applicable reporting, recordkeeping and record retention requirements set forth in FinCEN's regulations. Alpine argued in its petition that the SEC did not have independent authority to enforce provisions of the Bank Secrecy Act, which granted enforcement authority to the Department of the Treasury. As a result of the Supreme Court's denial of certiorari, the Second Circuit's decision affirming the district court's ruling that the SEC lawfully exercised its authority stands. By maintaining the status quo, the Court leaves in place a system of multiple SAR regimes, including the SEC's more stringent filing requirements and harsher penalties.

BACKGROUND

Originally enacted in 1970, the Currency and Foreign Transactions Reporting Act, more commonly known as the Bank Secrecy Act, imposed a series of reporting requirements on financial institutions designed to combat money laundering and other illegal activity. The BSA also authorized the Secretary of the Treasury to "delegate duties and powers" to "an appropriate supervising agency" in order to enforce the provisions

of the statute.[1] Since 1990, that enforcement authority has resided with FinCEN.[2] Amendments to the BSA in 1992 required financial institutions to "report any suspicious transaction relevant to a possible violation of law or regulation."[3] In 2001, the USA PATRIOT Act directed the Treasury Secretary, "after consulting with the [SEC]" to issue new regulations requiring broker-dealers to file SARs with FinCEN.[4]

Pursuant to Section 17(a) of the Exchange Act, the SEC is authorized to require broker-dealers to "make and keep for prescribed periods such records . . . and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate" for purposes such as the public interest or investor protection.[5] In 1981 the SEC enacted Rule 17a-8 under its Section 17(a) authority, which required broker-dealers subject to the BSA to comply with the reporting, recordkeeping, and record retention provisions of Treasury's BSA regulations.[6] The SEC has long issued enforcement actions under 15 U.S.C. § 78(u) for violations of its Section 17(a) and Rule 17a-8 recordkeeping requirements and in recent years has issued a number of significant penalties, including an $11.5 million penalty on Interactive Brokers LLC in 2020.[7]

SEC BEGINS ENFORCEMENT ACTION PROCEEDINGS AGAINST ALPINE

Alpine is a registered broker-dealer that provides brokerage clearing services for microcap securities. In 2012, the Financial Industry Regulatory Authority issued an Examination Disposition Letter finding that Alpine had failed to file a number of required SARs and many of the SARs that it did file were inadequate.[8] In 2015, the SEC's Office of Compliance Inspections and Examinations found that Alpine "failed to disclose in the SAR narrative . . . material information that was contained in [Alpine's] investigative files." [9] On June 5, 2017, the SEC filed a civil enforcement action alleging violations of Section 17(a) of the Exchange Act and Rule 17a-8.[10] In its complaint, the SEC alleged that Alpine "systematically" omitted material red-flag information from SARs, filed SARs on the deposit of stock but failed to file SARs on related transactions, and filed SARs after the 30-day reporting period.[11] The district court rejected Alpine's challenge to the enforcement action, granted summary judgement to the SEC, and ordered Alpine to pay a $12 million monetary penalty. The Second Circuit affirmed the lower court's ruling. Alpine then filed a petition for a writ of certiorari on July 19, 2021.[12]

ARGUMENTS

In its petition,[13] Alpine put forward three main arguments against the SEC's administration and enforcement of the BSA under its Section 17(a) authority:

- First, Alpine contended that Congress never intended for the SEC to have independent authority to enforce the BSA. Alpine argued that permitting the SEC to have enforcement authority gave rise to risks that the SEC could interpret, apply or enforce the BSA reporting rules differently than FinCEN, which would frustrate congressional intent that the Treasury Department have sole enforcement authority over the BSA.[14] Alpine also claimed that the SEC's rules governing broker-dealer compliance with the BSA were inconsistent with FinCEN's own regulations and frustrated Congress's intentions in enacting the BSA and subsequent AML statutes. Alpine contrasted the SEC with the federal banking regulators, whose authority to enforce the BSA derives from a

Congressional mandate to the Treasury Secretary and occurs pursuant to Treasury regulations "establishing the terms and conditions which shall apply to any [such] delegation [of enforcement authority]."[15]

- Second, Alpine argued that the SEC's enforcement action was *ultra vires* because enforcement authority for the BSA resides with FinCEN as prescribed by Congress.[16] Alpine also claimed that Rule 17a-8 violates the Administrative Procedure Act because the SEC failed to submit a SAR enforcement rule for notice and comment.[17]
- Third, Alpine made a prudential argument that the SEC's creation of a BSA enforcement regime operating in parallel to FinCEN's would undermine Treasury's ability to oversee the SAR reporting regime and would negatively impact regulated entities' ability to understand and comply with their BSA obligations. According to Alpine, it faced a maximum civil penalty of over $200 million under the SEC's standards, compared with a maximum penalty of approximately $1.5 million under FinCEN's standards. The company also noted that the SEC has taken positions regarding what constitutes an actionable SAR violation that are inconsistent with FinCEN guidance.[18]

In its response, the SEC maintained that the Alpine penalty represented an appropriate exercise of its enforcement authority under Section 17(a) of the Exchange Act and Rule 17a-8, which was independent from the BSA. Because the SEC's authority is independent from the BSA, the failure of Treasury to delegate authority is immaterial.[19] The SEC further argued that requiring broker-dealers to report suspicious transactions is consistent with the goals of the Exchange Act, and that the SEC minimizes regulatory costs by incorporating the BSA's reporting obligations, rather than promulgating detailed, overlapping regulations.[20]

IMPLICATIONS

By denying certiorari, the Supreme Court left in place the Second Circuit's ruling affirming the authority of the SEC to enforce the BSA SAR-filing requirements through its books and records authority under the Exchange Act.[21] As a result of the denial, the SEC can continue its enforcement of BSA and SAR-related violations of Rule 17a-8 and broker-dealers will remain subject to separate enforcement regimes with differing scienter standards and penalty amounts.

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ENDNOTES

1 31 U.S.C. § 5318(a)(1).

2 31 C.F.R. § 1010.810.

3 Pub. L. No. 102-550, § 1517, 106 Stat. 3672, 4060 (1992) (codified at 31 U.S.C. § 5318(g)).

4 Pub. L. No 107-56, § 356, 115 Stat. 272, 324 (2001) (codified at 31 U.S.C. § 5318). Broker-dealers are required to file SARs if a transaction "is conducted or attempted by, at, or through a broker-dealer, it involves or aggregates funds or other assets of at least $5,000, and the broker-dealer knows, suspects, or has reason to suspect that the transaction . . . (i) [i]nvolves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity. . . as part of a plan to violate or evade any Federal law or regulation or to avoid any transaction reporting requirement under Federal law or regulation; (ii) [i]s designed, whether through structuring or other means, to evade any requirements of this chapter or of any other regulations promulgated under the Bank Secrecy Act; (iii) [h]as no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, 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; or (iv) [i]nvolves use of the broker-dealer to facilitate criminal activity. 31 C.F.R. § 1023.320(a)(2)

5 Securities and Exchange Act of 1934, ch. 404, 47 Stat. 881 (codified at 15 U.S.C. § 78a *et seq*.).

6 Rule 17a-8, 46 Fed. Reg. 61,454, 61,455 (Dec. 17, 1981).

7 *See* Report to the Chairman, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate, Anti-Money Laundering Efforts in the Securities Industry, GAO– 02–111, October 2001, at 22; Lori A. Richards, Director, Office of Compliance Inspections and Examinations, SEC, remarks at the Conference on Anti-Money Laundering Compliance for Broker Dealers – Securities Industry Association (May 8, 2001), *available at* https://www.sec.gov/news/speech/spch486.htm ("In the 1980's, the SEC conducted a number of special examination sweeps that focused on broker-dealer compliance with the BSA. Following those sweeps, and again in the early 1990s, the SEC brought a series of enforcement actions against securities firms and their employees for violations of the BSA's currency transaction reporting requirements."); Press Release, SEC, SEC Charges Interactive Brokers with Repeatedly Failing to File Suspicious Activity Reports (Aug. 10, 2020), *available at* https://www.sec.gov/news/press-release/2020-178.

8 Complaint and Demand for Jury Trial, *SEC* v. *Alpine Sec. Corp.*, No. 1:17-cv-014179-DLC (S.D.N.Y 2015), ECF No. 1.

9 *Id.* at 11.

10 *Id.*

11 *Id.* at 3.

12 Brief for the Petitioner, *Alpine Sec. Corp.* v. *SEC* (2021) (No. 19-3272), *cert. denied* 595 U.S __ (2021).

13 Alpine's petition was supported by *amicus* briefs filed by two former directors of FinCEN, James H. Freis, Jr. and Charles M. Steele, as well as the Cato Institute. Brief of Former FinCEN Officials James H. Freis, Jr. and Charles M. Steele as Amici Curiae Supporting Certiorari, *Alpine Sec. Corp. v. SEC* (2021) (No. 19-3272), *cert. denied* 595 U.S __ (2021); Brief of the Cato Institute as Amicus Curiae in Support of Petitioner, *Alpine Sec. Corp.* v. *SEC* (2021) (No. 19-3272), *cert. denied* 595 U.S __ (2021).

14 For instance, civil penalties for violations of the BSA are (1) $1,180 for a negligent violation; (2) up to $91,816 for a "pattern of negligent violations"; and up to $236,071 for a willful violation. 31 U.S.C. §§ 5321(a)(1), 5321(a)(6)(A)–(B). On the other hand, penalties levied by the SEC for violations of

ENDNOTES CONTINUED

Rule 17a-8 can be enforced on a strict-liability basis, with the amount totaling the greater of $97,523 or the "gross amount of [the defendant's] pecuniary gain" for each violation. 15 U.S.C. § 78(u)(d)(3)(B)(i). The penalty for a deliberate or reckless violation is the greater of $487,616 or "the gross amount of the defendant's pecuniary gain. *Id.* § 78(u)(d)(3)(B)(ii).

15 31 U.S.C. § 5321(e).

16 Brief for the Petitioner, *Alpine Sec. Corp.* v. *SEC*. at 19.

17 While Rule 17a-8 went through notice and comment rulemaking in 1981(prior to the imposition of the SAR filing requirement on broker-dealers), FinCEN's SAR regulation did not go through the process until 20 years later. Because Rule 17a-8 incorporates by reference FinCEN's recordkeeping and reporting requirements under 31 U.S.C. ch. X, Alpine argued that the this facet of Rule 17a-8 was not subject to notice and comment rulemaking.

18 Brief for the Petitioner, *Alpine Sec. Corp.* v. *SEC*. at 28. For instance, Alpine noted that the SEC asserts that a broker-dealer is obligated to file a SAR whenever it discovers a red-flag in a low-priced securities transactions above the size threshold, whereas FinCEN guidance states that "[t]he presence or absence of a red flag in any given transaction is not by itself determinative of whether a transaction is suspicious."

19 Brief for the Respondent, *Alpine Sec. Corp.* v. *SEC* (2021) (No. 19-3272), *cert. denied* 595 U.S __ (2021).

20 The SEC also noted that Congress was well apprised of the SEC's use of Rule 17a-8 to impose SAR reporting obligations on broker-dealers following the passage of the PATRIOT Act and could have stepped in to address the issue. *Id*. at 17 (citing a number of Government Accountability Office reports addressing, in part, the SEC's use of Rule 17a-8 to enforce the SAR filing requirement).

21 The Second Circuit is the highest court to have considered the SEC's enforcement authority regarding BSA compliance by broker-dealers, and thus, there is no split among the federal circuit courts of appeal. Alpine argued in its petition as a reason in favor of granting certiorari that a circuit split was unlikely to occur because of the SEC's ability to choose the venue to bring an enforcement action, and the significant incentives that companies have to settle with the agency when faced with an enforcement action.

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