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Second Circuit Affirms SEC's Bank Secrecy Act Powers

The Second Circuit's recent decision gives the SEC the green light to continue enforcing broker-dealer compliance with the Bank Secrecy Act.

Key Points:

- In *US Securities and Exchange Commission v. Alpine Securities Corp.,* the Second Circuit affirmed the SEC's authority to require SEC-registered broker-dealers to comply with the BSA's reporting and recordkeeping requirements, under Section 17(a) and Rule 17a-8 of the Securities Exchange Act of 1934 (Exchange Act).
- The *Alpine* decision validates the SEC's focus on broker-dealer AML programs. In anticipation of such scrutiny, broker-dealers and Chief Compliance Officers should evaluate whether their compliance programs satisfy existing anti-money laundering obligations, and particularly BSA reporting obligations.

On December 4, 2020, the US Court of Appeals for the Second Circuit affirmed the decision of the US District Court for the Southern District of New York in *US Securities and Exchange Commission v. Alpine Securities Corp.*[1] The case primarily dealt with the issue of whether the US Securities and Exchange Commission (SEC) possesses the authority to enforce broker-dealer compliance with Suspicious Activity Report (SAR) reporting as required by the Bank Secrecy Act (BSA), but under Section 17(a) and Rule 17a-8 of the Exchange Act.[2]

Alpine, the defendant, was an SEC-registered broker-dealer specializing in clearing and settlement services for penny stocks and micro-cap securities. Alpine had previously been the subject of an examination conducted by the Financial Industry Regulatory Authority, Inc. (FINRA), and FINRA had issued a report in September 2012 containing its findings. FINRA found that Alpine had not filed SARs for extensive periods, was not in compliance with SAR reporting rules, had filed late when discovering that SARs should have been filed, and had provided substantively deficient SAR narratives.[3] The report ultimately concluded that Alpine's anti-money laundering (AML) procedures were inadequate to detect and report suspicious activity. Subsequently, in July 2014, the SEC Office of Compliance Inspections and Examinations (OCIE) conducted a one-week on-site review of Alpine and issued its own report, similarly criticizing Alpine's deficient SAR reporting practices.[4]

The SEC thereafter named Alpine in an enforcement action alleging that it had failed to properly file several thousands of SARs, in violation of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. Alpine argued that the SEC lacked authority to enforce SAR reporting under this Section and Rule

because the requirement derived from the BSA and not the Exchange Act. The district court had granted summary judgment in favor of the SEC on the following grounds:

- The SEC correctly applied its enforcement authority under Section 17(a) and Rule 17a-8 on the basis of deficient SAR reporting.
- Alpine's deficient SAR reporting violated these sections.
- Rule 17a-8 was valid and did not violate the Administrative Procedures Act.

The Second Circuit affirmed.

Evolving Anti Money Laundering and Bank Secrecy Act Enforcement

1. In the last few years, the SEC has increasingly focused on AML and BSA compliance, and in particular, whether SARs are filed appropriately by broker-dealers and whether required disclosures are included in SARs filed.

The SEC, like FINRA and the Commodity Futures Trading Commission (CFTC), began actively pursuing AML and BSA cases only in recent years. Historically, AML and BSA enforcement had fallen under the purview of the Department of Justice (DOJ), Financial Crimes Enforcement Network (FinCEN), banking regulators, and the Internal Revenue Service (IRS). Similarly, BSA obligations of futures commission merchants (FCMs) and introducing brokers (IBs) were historically the subject of National Futures Association (NFA) examinations, and only recently became a subject of CFTC enforcement actions.[5]

Both the SEC and CFTC have recently demonstrated an increased commitment to BSA enforcement. The SEC, for example, has highlighted its reliance upon SAR-reporting data in identifying broker-dealers for closer scrutiny — insofar as the data have pointed the SEC in the direction of particular broker-dealers with "disturbingly low" or otherwise deficient SAR reporting figures.[6] The SEC OCIE examines broker-dealer compliance with AML obligations, including assessing whether a broker-dealer has met SAR-filing obligations, has implemented a robust AML program, and conducts independent testing of its AML program.[7] Furthermore, the SEC's Office of Market Intelligence (OMI) contains a Broker-Dealer Task Force, as well as a Bank Secrecy Act Review Group dedicated to annually reviewing tens of thousands of SARs filed by broker-dealers and financial institutions. Similarly, the CFTC now operates a task force devoted to BSA enforcement, noting that SARs and other reports required by the BSA "significantly contribute to the [Enforcement] Division's ability to detect and prosecute the sort of misconduct that may flow through intermediaries like FCMs or IBs."[8]

2. A recent settlement involving the SEC, FINRA, and CFTC demonstrated an ongoing, multi-agency commitment to enforcing AML compliance by brokerage firms, specifically in relation to SAR reporting.

In August 2020, the SEC required a broker-dealer to pay a multimillion-dollar penalty to settle charges for repeated failures to file SARs. In parallel actions, FINRA and the CFTC announced settlements with the same company related to anti-money laundering failures resulting in additional agreements to pay multimillion-dollar penalties to both agencies. The case notably marked the first CFTC enforcement action that charged a violation of Regulation 42.2, which requires certain categories of registrants to comply with the BSA.[9]

3. DOJ continues to prosecute BSA violations, pursuing criminal charges for ineffective AML compliance programs and non-compliance with SAR reporting obligations.

BSA compliance by banks and other financial firms has been, and remains, one of DOJ's top enforcement priorities. The prioritization of BSA enforcement is facilitated (within DOJ) by the Criminal Division's Money Laundering and Asset Recovery Section (MLARS), which occupies a central, coordinating role for federal law enforcement. In the past several years, DOJ has pursued criminal charges against a number of major banks for BSA violations, based on willfully failing to maintain effective AML compliance programs and/or willfully failing to file SARs. In a number of these cases, DOJ and banks have entered into deferred prosecution agreements (DPAs), under which the banks were required to admit violating the BSA, pay large penalties (several of which have ranged between US$300 million and more than US$1.5 billion), and implement enhancements to BSA/AML compliance programs.

4. Parallel DOJ-SEC proceedings in December 2018 marked the first-ever criminal charges against a US broker-dealer under the BSA.

In December 2018, the US Attorney's Office for the Southern District of New York (Southern District) announced first-of-its-kind criminal charges against Central States Capital Markets, LLC (CSCM), a Kansas-based broker-dealer. CSCM was charged with a felony violation of the BSA for its willful failure to file a SAR regarding a customer's illicit activities.[10] Simultaneous with the filing of criminal charges, the Southern District announced a DPA with CSCM, under which CSCM agreed to accept responsibility for its conduct, pay a US$400,000 forfeiture penalty, and enhance its BSA/AML compliance program. The same day, the SEC announced the resolution of parallel proceedings against CSCM, instituting a cease and desist order outlining non-compliance with BSA reporting and recordkeeping requirements, and charging violations of Exchange Act Section 17(a) and Rule 17a-8 thereunder.[11] The SEC settlement included a censure for CSCM, and CSCM agreed to hire an independent AML consultant to evaluate and monitor its AML compliance program for a two-year period.[12]

5. While the Second Circuit decision addressed SEC authority over broker-dealers, SEC-registered investment advisers — including managers of private funds — should be alert to the potential for SEC AML scrutiny.

While SEC-registered investment advisers themselves are not subject to the BSA, many advisers have broker-dealer affiliates that are subject to Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. Further, registered investment advisers are subject to broad SEC oversight. As part of its regular compliance examinations of investment advisers, the SEC's examination staff reviews the adviser's books and records for information suggesting that a violation of the federal securities laws may have occurred. If potential money laundering by the firm's advisory clients is detected, the examination staff may refer the matter to the Enforcement Division or to DOJ for further investigation. Further, if asset managers represent to clients or fund investors that they have voluntarily adopted AML procedures, the SEC may also review those representations for accuracy against the actual procedures the managers have implemented.[13]

Conclusion

The *Alpine* decision cements the SEC's authority to enforce broker-dealers' compliance with SAR reporting and recordkeeping obligations going forward. The court invoked the analytical framework of *Chevron, USA Inc. v. Nat. Res. Def. Council, Inc.*, which requires a reviewing court to observe deference to an agency's construction of a statute absent express Congressional intent otherwise.

The court noted, "Congress has never indicated its disapproval of joint SAR reporting enforcement." By contrast, the Exchange Act unequivocally granted the SEC authority to promulgate rules to pursue its statutory aims, such as the enactment of Rule 17a-8. Using Alpine as an example, the court added,

"SARs facilitate the SEC's effective enforcement with regard to market abuses associated with penny stock trading."[14]

Short of future Congressional action or SEC rulemaking to restrict the scope of the SEC's enforcement authority — both of which appear unlikely — the SEC's authority to enforce broker-dealers' BSA compliance appears here to stay.

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Endnotes

1 *US Securities and Exchange Commission v. Alpine Securities Corp. No. 19-3272, 2020 U.S. App. LEXIS 37842 (2d Cir. Dec. 4, 2020).*

2 A SAR is a report made by a financial institution about a suspicious transaction relevant to a possible violation of law or regulation. *See generally* 31 U.S.C. § 5318(g)(1); 31 C.F.R. § 1023.320.

3 *See SEC v. Alpine Sec. Corp.,* 354 F. Supp. 3d 396, 408-409 (S.D.N.Y. 2018).

4 *See id.* at 410.

5 *See* Nat'l Futures Ass'n, *Compliance Rules: Rules Governing the Business Conduct of Members Registered with the Commission*, Rule 2-9(c), https://www.nfa.futures.org/rulebook/rules.aspx?RuleID=RULE%202-9&Section=4 (last visited Dec. 21, 2020); *see also* Nat'l Futures Ass'n, Interpretive Notice 9045, *NFA Compliance Rule 2-9: FCM and IB Anti-Money Laundering Program* (rev. Jun. 16, 2020), https://www.nfa.futures.org/rulebook/rules.aspx?Section=9&RuleID=9045.

6 Andrew Ceresney*, Remarks at SIFMA's 2015 Anti-Money Laundering & Financial Crimes Conference,* US Securities and Exchange Commission (Feb. 25, 2015), https://www.sec.gov/news/speech/022515-spchc.html.

7 *See* US Securities and Exchange Commission: Office of Compliance Inspections and Examinations, *2020 Examination Priorities 17* (2020), https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2020.pdf; *see also* US Securities and Exchange Commission, *Leaders of CFTC, FinCEN, and SEC Issue Joint Statement on Activities Involving Digital Assets* (Oct. 11, 2019), https://www.sec.gov/news/public-statement/cftc-fincen-secjointstatementdigitalassets.

8 Commodity Futures Trading Comm'n, Annual Report on the Division of Enforcement: 2018 Annual Report 6, (Nov. 2018), https://www.cftc.gov/sites/default/files/2018-11/ENFAnnualReport111418_0.pdf.

9 *See* Commodity Futures Trading Commission, *CFTC Orders Interactive Brokers LLC to Pay More Than $12 Million for Anti-Money Laundering and Supervision Violations*, (Aug. 10, 2020), https://www.cftc.gov/PressRoom/PressReleases/8218-20; *see also* Commodity Futures Trading Commission, *CFTC Orders Chicago Broker to Pay Over $495,000 for Supervision Failures and Failure to Report Suspicious Activity*, (Sep. 30, 2020), https://www.cftc.gov/PressRoom/PressReleases/8268-20.

10 Press Release, Dep't of Just., Manhattan US Attorney Announces Bank Secrecy Act Charges Against Kansas Broker Dealer (Dec. 19, 2018), https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-bank-secrecy-act-charges-against-kansas-broker-dealer.

11 *See* Press Release, Dep't of Just., Manhattan US Attorney Announces Bank Secrecy Act Charges Against Kansas Broker Dealer (Dec. 19, 2018), https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-bank-secrecy-act-charges-against-kansas-broker-dealer; *see also* Order Instituting Administrative and Cease-And-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Act of 1934 and Section 203(e) of the Investment Advisors Act of 1940 Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, *In re Central States Capital Markets, LLC* (SEC File No. 3-18940), https://www.sec.gov/litigation/admin/2018/34-84851.pdf.

12 *See* Dep't of Just., Deferred Prosecution Agreement (Dec. 10, 2018), https://www.justice.gov/file/1121126/download; *see also* Order Instituting Administrative and Cease-And-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Act of 1934 and Section 203(e) of the Investment Advisors Act of 1940 Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, *In re Central States Capital Markets, LLC* (SEC File No. 3-18940), https://www.sec.gov/litigation/admin/2018/34-84851.pdf.

13 *Cf*. FBI Criminal Investigative Division & FBI New York Field Office, *Federal Bureau of Investigation Intelligence Bulletin: Threat Actors Likely Use Private Investment Funds To Launder Money, Circumventing Regulatory Tripwires* (May 1, 2020), https://blueleaks.io/jric/files/DDF/200501%20LES%20FBI%20Intelligence%20Bulletin%20-%20Threat%20Actors%20Likely%20Use%20Private%20Investment%20Funds%20to%20Launder%20Money,%20Circumventing%20Regulatory%20Tripwires.pdf.

14 *US Securities and Exchange Commission v. Alpine Securities Corp*. No. 19-3272, 2020 U.S. App. LEXIS 37842, at *13 (2d Cir. Dec. 4, 2020).