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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Will SEC Be Told To Butt Out Of AML Reporting Enforcement?

By **Jon Hill**

Law360 (July 25, 2021, 4:24 PM EDT) -- A penny stock broker wants the U.S. Supreme Court to reject authority that the U.S. Securities and Exchange Commission has used to obtain millions of dollars in fines for anti-money laundering-related lapses, but some observers see it as a big ask that faces long odds.

Alpine Securities Corp., a broker-dealer based in Utah, **filed a petition** with the Supreme Court this past week that challenges the SEC's ability to go after brokers for shoddy reporting of suspicious activity, a variety of enforcement action that has been an emerging priority for the agency.

If the justices agree to hear Alpine's case, it will be the fifth time in roughly as many years that the SEC's enforcement practices have gone under the high court's microscope. But several observers who spoke to Law360 said they are doubtful the case will get that far.

"The difficulty here is that this case is about compliance with a recordkeeping rule," said Daniel Hawke, a former head of the SEC's Market Abuse Unit who is now a partner at Arnold & Porter Kaye Scholer LLP. "Of the many weighty issues the court has on its plate, this does not seem like the type of pressing issue the court is likely to consider as warranting its consideration."

Alpine's case sits at the intersection of the federal securities laws administered by the SEC and federal anti-money laundering laws administered by the U.S. Treasury Department's Financial Crimes Enforcement Network, or FinCEN.

FinCEN rules issued under the Bank Secrecy Act, the chief federal AML law, broadly require financial institutions like banks and brokers to file so-called suspicious activity reports, or SARs, when they see signs of possible financial crimes so that the government can investigate and follow up if necessary.

These reports are considered a crucial tool in the fight against money laundering, fraud and other forms of illicit financial activity, and there's a welter of FinCEN rules and guidance about when a SAR should be filed and what information it should contain.

Deficient SARs filing practices can land a financial institution in hot water for violating the BSA. In the past, for example, some major banks have faced big-dollar enforcement actions from FinCEN, the U.S. Department of Justice and the federal banking agencies that have alleged such lapses.

But the SEC has stepped up lately as an enforcer of SARs requirements at broker-dealers. The agency has said they violate the Exchange Act and its Rule 17a-8 when they don't file SARs as mandated by FinCEN and the BSA.

That's because the Exchange Act's Section 17(a) provides that broker-dealers must comply with whatever recordkeeping requirements the SEC "prescribes as necessary or appropriate," while Rule 17a-8 directs broker-dealers to comply with the gamut of BSA reporting requirements, including filing SARs.

"It's a very important rule to the SEC," Hawke said. "The commission's message to broker dealers in the Alpine case is that if you identify activity that's required under the BSA to be reported in a SAR, you have an obligation to report it and provide a certain level of information to make the SAR useful

to regulators. And if you don't, that's a violation of your recordkeeping requirements under the Exchange Act."

The SEC has alleged such violations in a number of settled enforcement actions against broker-dealers in recent years, collecting some hefty fines in the process.

Interactive Brokers LLC, for example, agreed last year to pay a $11.5 million penalty to the SEC to resolve allegations that it failed to file more than 150 SARs for certain penny stock trades on its platform. And this year, GWFS Equities Inc. was fined $1.5 million as part of an SEC settlement over alleged SARs lapses tied to hacking-related incidents involving customer accounts.

In Alpine's case, the SEC alleged in a **2017 enforcement action** that the firm had failed to file more than 200 SARs and omitted important information from more than 1,900 other SARs, resulting in what the agency said were "thousands" of Section 17(a) and Rule 17a-8 violations.

But Alpine, notably, did not settle. It fought back aggressively after the SEC sued it in New York federal court, questioning the very premise of the agency's case.

In Alpine's view, what the SEC is really doing in cases like these is stepping into FinCEN's shoes and enforcing the BSA, even though the SEC has never been given jurisdiction to do so. Although the agency does have authority to examine for BSA compliance, it has invented this additional enforcement role for itself by hyperextending its Exchange Act authority, according to Alpine.

"There's really no question the SEC is enforcing the BSA and the FinCEN rules, and doing so independently," said Robert Loeb of Orrick Herrington & Sutcliffe LLP, counsel for Alpine. "The SEC thinks it can decide what a violation is and bring these enforcement actions, but it doesn't have that authority. It was never delegated by Congress or FinCEN."

"The Exchange Act doesn't grant the SEC authority to substantively enforce the statutes and regulations of other agencies," Loeb added.

So far, however, Alpine hasn't had much luck persuading other courts to take its side. After ultimately being stuck with a **$12 million fine** at the district court level in 2018, the firm lost an appeal **last year at the Second Circuit**, where a three-judge panel ruled the SEC wasn't sticking its nose where it didn't belong.

That inauspicious track record is one reason that attorneys like Jodi Avergun, chair of Cadwalader Wickersham & Taft LLP's white collar defense and investigations group, told Law360 that they see Alpine's path to the high court as a steep uphill climb.

"I don't think it has much chance," Avergun said. "You saw summary judgment in the district court and a very quick Second Circuit affirmance, and the Second Circuit is really the right court to be interpreting both the Exchange Act and the BSA."

Hawke added that under the Exchange Act, the SEC has a lot of latitude to "promulgate rules governing and enforcing the recordkeeping requirements applicable to broker-dealers, whether those rules apply to BSA reporting and recordkeeping or any other aspect of a broker's business."

But while Alpine has been something of a lone wolf in fighting the SEC on this, some attorneys agree that the agency has been overreaching. Kenneth Herzinger of Paul Hastings LLP told Law360 that the agency turned heads in the defense bar when it began bringing these SAR-related cases within the past decade, inching in behind FinCEN.

"You've now got two different federal regulators applying the rules, and applying them differently," said Herzinger, a former SEC enforcement attorney who is now a partner in Paul Hastings' white collar defense practice. "And the rules that the SEC is applying aren't even their own rules and guidance. It's FinCEN's rules and guidance."

Herzinger said the SEC has been more willing to second-guess firms' SAR filing decisions and has an easier path to establishing liability than FinCEN. The Exchange Act also provides for higher potential penalties, meaning the SEC can expect to score bigger fines than FinCEN and has more leverage in

negotiating settlements.

What that adds up to is "two competing and inconsistent regulatory regimes," Herzinger said.

And while the SEC has much more resources than FinCEN and arguably has more expertise in overseeing broker-dealers specifically, that doesn't entitle it to stray into FinCEN's territory, according to Herzinger.

"Before the Alpine decision [at the Second Circuit], there were a lot of defense lawyers arguing in unfiled cases that the SEC lacked authority," Herzinger said. "But I think the Second Circuit's affirmance in particular ... emboldened the agency to be more aggressive."

Fortunately for Alpine, aggressive regulators aren't exactly in vogue these days at the Supreme Court.

Even before conservative justices gained a 6-3 majority last term, the SEC has had to make a string of trips to the high court to defend its enforcement practices in cases like Kokesh v. SEC, Lucia v. SEC, Lorenzo v. SEC and, most recently, Liu v. SEC.

Although the justices haven't always ended up ruling against the agency, they have shown a clear willingness to scrutinize it, and that may work in Alpine's favor as it seeks to appeal.

"There is some thought that this court might not be friendly to administrative agencies being either creative or expansive in their exercise of authority," Avergun said. "A company ... may feel this is the right atmosphere politically to bring this case."

But Avergun said the Alpine case is also coming at a time of heightened concern in government about market integrity and misuse of the financial system by fraudsters, cybercriminals and other bad actors. Against that backdrop, the justices could be more inclined to give the SEC a wide berth when anti-money laundering enforcement is at stake.

"Money laundering is such a huge risk in the United States, and FinCEN can't do it alone," Avergun said. "I just don't think there's a realistic hope of the justices taking the case as a practical, pragmatic matter."

Hawke of Arnold & Porter agreed that it would "create consternation" among regulators if the Supreme Court were to rule for Alpine that the SEC can't police SARs filings by broker-dealers.

And it wouldn't really come as a relief to many of Alpine's peers, either, since they could find Congress or Treasury eager to move in with a more onerous enforcement regime if the SEC is sidelined, according to Hawke.

Other attorneys who spoke to Law360 cited additional factors that could further tilt the justices against granting an appeal, including the lack of a circuit split.

Alpine, however, argued in its petition that it would be "inadvisable" for the Supreme Court to wait for a split because it could take a long time for one to emerge, particularly if the SEC just keeps bringing contested SAR actions in the Second Circuit, where it now has precedent on its side. The firm also noted that the justices have agreed to hear some cases, like Liu v. SEC, "even without a circuit split."

"This court hasn't hesitated in the past to rein in the SEC when it exercises powers that Congress never granted it," Alpine wrote in its petition.

Hawke added that he gives Alpine credit for its resolve and acknowledged that the firm has advanced arguments that "could find a home in certain corners of the court."

That's why if the justices decide to take the firm's case, Hawke and other attorneys said it will be a bad omen for the SEC's future in anti-money laundering enforcement.

"I think it's more likely than not that this cert petition will be denied, but if it's not, then all bets are

off and 17a-8 is likely in trouble," Hawke said.

--Editing by Marygrace Murphy.