

The SEC and SARs

The Commission periodically has filed enforcement actions against broker-dealers for failing to file SARs – suspicious activity reports -- typically centered on a failure to file reports regarding microcap issuers. Those actions are based on Exchange Act Section 17(a) and Rule 17a-8. SARs on the other hand trace to the Bank Secrecy Act and FinCEN.

The question of broker-dealer compliance with SARs and the Commission's authority under the Exchange Act Section and Rule typically cited by the agency was raised in an action recently decided by the Second Circuit Court of Appeals. *SEC v. Alpine Securities Corporation*, No. 19-3272 (Decided Dec. 4, 2020).

The Case

Alpine, a registered broker-dealer, was named as a defendant in an enforcement action by the Commission. The complaint alleged that the firm, which specializes in microcap securities, had failed over a period of time to properly file thousands of SARs either by not filing or by not properly furnishing the required information. The Commission's complaint alleged violations of Exchange Act Section 17(a) and Rule 17a-8.

Defendant responded by claiming that the Commission did not have the authority to enforce what are Bank Secrecy Act and FinCEN regulations. Specifically, Alpine asserted that the SEC does not have authority to bring an enforcement action based on a failure to file SARs under Section 17(a), that Rule 17a-8 is not valid and that the enactment of the Rule violated the Administrative Procedure Act. The District Court granted summary judgment in favor of the Commission. The Second Circuit affirmed.

The Decision

The Court began with a brief review of the statutory authority for SARs. It traces to the Foreign Transactions Reporting Act of 1970, known as the Bank Secrecy Act, as amended by the PATRIOT Act in 2001. That Act requires broker-dealers to file SARs

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after Treasury consulted with the SEC, the Board of Governors of the Federal Reserve and the Securities and Exchange Commission. The Treasury delegated authority to the Financial Crimes Enforcement Network within the Treasury or FinCEN. In 2002 FinCEN promulgated regulations that require broker-dealers to file SARs with regard to certain transactions involving at least \$5,000.

In 1981 the Commission adopted Rule 17a-8 under Exchange Act Section 17(a). It incorporated the initial rules applicable to broker-dealers under the Bank Secrecy Act. That Rule was updated in 2011. It incorporates the requirements of the rules regarding SARs enacted by Treasury and FinCEN. Based on this history the Court concluded that the challenges raised by the broker-dealer defendant lacked merit.

First, the Court quickly concluded that the Commission had the authority to initiate this enforcement action. The complaint was based solely on Exchange Act Section 17(a) and Rule 17a-8. Accordingly, the “suit falls within the SEC’s independent authority as the primary federal regulator of broker-dealers to ensure that they comply with reporting and recordkeeping requirements . . .” the Court found.

Second, the fact that Rule 17a-8 requires compliance with the Bank Secrecy requirements does not change this conclusion the Circuit Court stated. This question is governed by the analytical framework of *Chevron v. Nat. Res. Def. Council*, 467 U.S. 837 (1984). Under that decision if Congress has not specifically addressed the point and the statute is ambiguous, a reviewing court must respect the determination of the agency if it is permissible.

The determination of the agency in this action is tied to an express delegation by Congress of authority to determine “which reports from covered entities, including brokers and dealers are necessary and appropriate to further the goals of the Exchange Act. The Commission’s actions were undertaken in accord with the dictates of the statute. When enacting Rule 17a-8 the SEC concluded that the rule would protect national securities markets and exchanges. SARs, which assist the Treasury in targeting illegal securities transactions, also serve the aims of the Exchange Act by protecting investors and helping guard against market manipulation.

The fact that Congress directed Treasury to regulate recordkeeping and reporting requirements by broker-dealers does not mean that the Commission is precluded from acting in the area as Defendant claims. To the contrary, as the Supreme Court held in *FDA v. Brown & Williamson*, 529 U.S. (2000) that result obtains only if there is a conflict. Here there is none. When Rule 17a-8 was first enacted the Commission noted in soliciting comments during the rule making process that Treasury had delegated the responsibility to the Commission. No comments were filed. This is consistent with the fact that Congress did not silo SARs authority with Treasury, implying the SEC also has authority.

Finally, the Rule does not violate the APA as claimed by Defendant. Alpine’s argument is based on the fact that the Rule permits the automatic incorporation in the future of Bank Secrecy Act requirements in violation of the APA notice and comment rule making

requirements.

To the contrary, the public was afforded comment opportunities, the Court found. One occurred when the Commission published Rule 17a-8. There the agency expressly stated that it did “not specify the required reports and records so as to allow for any revisions the Treasury may adopt in the future.” When the Rule was formally adopted, the release reiterated this statement. When FinCEN later adopted its SARs rules, they were again subject to notice and comment by the public. There was thus “ample notice and comment opportunities in compliance with the APA,” the Court concluded.

In its most recent amendment to the Rule the Commission made it clear that it was consulting with FinCEN. The agency also made clear that the Rule was consistent with the requirements of the Exchange Act. Based on this point, and the history of the Rule, the Court found that the requirements of the APA had been met.

Comment

Chevron, the Supreme Court’s seminal decision on rule writing, makes it clear that if Congress delegated authority to an agency to write rules, the provisions written must be within the ambit of the authority granted. This means that to the extent Rule 17a-8 comports with the text of the Exchange Act under which it was created, it is likely within the authority granted.

That does not mean that incorporating yet to be written rules by FinCEN are within the text of the Exchange Act rule writing authority granted to the SEC. Yet that is the question here: Did the Exchange Act grant the SEC authority to write rules directing broker-dealers to comply with whatever SAR rules FinCEN writes in the future? A reading of the plain text of the Exchange Act – the test used by the new conservative Supreme Court – answers the question. No; the text of the statute says nothing.

Finally, just how an Exchange Act Rule incorporating “to-be-written-in-the-future” rules authored by FinCEN complies with the APA is unclear. To be sure each version of the Exchange Act Rule was subjected to the notice and comment requirement of the APA. Equally clear is the fact that FinCEN’s rules were subjected to the same APA process. But nothing in the APA says that the notice and comment process used by one agency under one statute – here FinCEN – can be tacked together with a rule written by another agency under another statute in a different time period. Neither the text of the APA nor the text of the Exchange Act specifies that such a procedure can be created by an agency. Equally clear is the fact that there cannot be an APA notice and comment procedure for the public of yet to be written rules, an issue the Court implicitly acknowledged but side stepped. While the process adopted may be efficient it is a shortcut not authorized by Congress or the statute. It is invalid.