ANTI-MONEY LAUNDERING FOR REGISTERED BROKER-DEALERS

A continuing priority for SEC enforcement and examination

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The U.S. Securities and Exchange Commission (SEC) recently resolved a case against broker-dealer Wilson-Davis & Co. Inc. for its alleged failure to comply with its responsibilities. The SEC's Order Instituting Proceeding alleging Wilson-Davis' violations of the Bank Secrecy Act (BSA), and 31 C.F.R. § 1023.320(a)(2) (the SAR Rule), arose out when Wilson failed to file Suspicious Activity Reports (SARs) when necessary. Wilson admitted to the allegations in a cease-and-desist order with the SEC. (See the SEC filing.)

In the Wilson order, the SEC found that Wilson failed to file SARs when it knew, suspected or had reason to suspect that penny-stock transactions executed by Wilson facilitated fraudulent activity. The SEC also highlighted that Wilson allegedly didn't take steps outlined in Wilson's own anti-money laundering (AML) compliance policy.

Under the May 15, 2019, pact, Wilson agreed with the SEC to pay a civil money penalty of $300,000. In the cease-and-desist order, Wilson agreed to hire an AML compliance consultant at its own cost to independently review and suggest updates to Wilson's AML compliance program. The consultant will submit a report to the SEC describing the review performed, and Wilson must adopt all recommendations contained in the report.

The SEC has filed dozens of enforcement actions against broker-dealers through the years. The Wilson cease-and-desist order is the latest in a line of similar cases involving firms that failed to file SARs when faced with red flag activity.

The SEC requires firms registered as a broker or dealer with FINRA (broker-dealers) to comply with the BSA as enforced by the Financial Crimes Enforcement Network (FinCEN). FinCEN, in turn, requires brokers to establish written programs to identify their customers, perform customer due diligence and monitor accounts for suspicious activity. If there's any suspicious activity, the SEC requires brokers to file SARs.

The SEC first announced its focus on these provisions (Section 17 of the SEC Act and Rule 17a-8) in 2013 when the enforcement division formed a broker-dealer task force, making it a priority to hold brokers to their anti-money laundering (AML) obligations. Since then, the SEC has continued to signal its intense interest and seriousness in pursuing this objective with its approach to exams, investigations, and most recently, in litigation. This article details the key points of the SEC's approach to AML to date and highlights key takeaways.

CONTINUING PRIORITY FOR EXAM

The SEC has made AML compliance a continuing priority in the Office of Compliance Inspection and Examinations' (OCIE) examination program. Since 2014, it's been specifically listed as a priority in OCIE's examination priorities in all six years.

This annual OCIE guidance provides a road map to an exam team's minimum expectations and gives some signal for what the exam teams will be looking for during the course of an exam. This published guidance makes clear that the SEC isn't satisfied with an off-the-shelf program that goes through the motions of compliance.

The OCIE has consistently emphasized the importance of customer-specific diligence and tailoring a program to the unique compliance risks presented by broker-dealers' customers. In 2017, for example, the OCIE noted that it would examine whether the AML program was tailored and appropriated "in light of the risks presented" by broker-dealers' activities.

The 2018 guidance similarly signaled the OCIE's intention to ensure that broker-dealers are "taking reasonable steps to understand the nature and purpose of customer relationships and to properly address risks."

Once an effective program is down on paper, the SEC will make sure that it's actually used and works in practice. The 2017 guidance noted that it would examine the "effectiveness of independent testing," and the guidance for 2018 and 2019 both noted that the OCIE would conduct reviews to ensure that broker-dealer firms had robust, timely and independent tests of its broker-dealers.

It's not enough to just file a SAR before the SEC exam team arrives. The 2017 guidance, for example, noted that the OCIE would review "the timeliness and completeness of SARs filed," and the 2018 guidance noted that there would be an assessment of whether broker-dealer-filed SARS are "timely, complete, and accurate."

In May 2019, Peter Driscoll, the director of the OCIE, spoke at the Securities Industry and Financial Markets Association (SIFMA) Operations Conference about how financial institutions are required to comply with their AML operations. Driscoll noted that broker-dealers and mutual funds must implement and maintain robust AML programs, take reasonable steps to follow up on red flags identified through these monitoring programs and file SARs, if necessary.

Driscoll also told the audience at SIFMA that his team won't "second-guess decisions firms have made regarding implementation of their AML compliance programs or whether to file Suspicious Activity Reports, provided those decisions appear reasonable." The remarks echo prior statements made by SEC Commissioner Hester M. Peirce. On Oct. 30, 2018, Peirce noted that "the SEC should . . . avoid second-guessing good faith decisions through enforcement actions." And on May 11, 2018, he said that "it is not the job of the SEC to second-guess the good faith decisions of CCOs."

Finally, in a public statement on Dec. 11, 2017, the chairman of the SEC also emphasized that broker-dealers that allow customers to use cryptocurrencies "should exercise particular caution, including ensuring that their cryptocurrency activities are not undermining their anti-money laundering and know-your-customer obligations."

SUCCESSFUL LITIGATION

The SEC's efforts to enforce registrants to abide by the SEC's view of their AML obligations hasn't been litigated extensively. Of the cases filed to date, the vast majority have settled. Recently, however, the SEC has pursued litigation against Alpine Securities Corporation in United States Sec. & Exch. Comm'n v. Alpine Sec. Corp., where it's prevailed on summary judgment and has now filed a motion seeking over $22 million in penalties. These efforts have put the new effort to the test, and yet again, shows how seriously the SEC takes these issues.

THE SEC'S ALLEGATIONS

Alpine is a broker-dealer that offers clearing services for microcap securities (U.S. public-company stocks with a market capitalization of $50 million to $300 million). In a 47-paragraph complaint, the SEC alleged that Alpine violated FinCEN requirements regarding the filing and record keeping of SARs. The SEC alleged that Alpine had a BSA compliance program, but that Alpine systematically omitted material red-flag information from almost 2,000 SARs and failed to file hundreds of SARs within the required time frame.

DECISION ON SUMMARY JUDGMENT

Alpine argued that the SEC lacked the authority to enforce BSA regulations and that the SEC's effort was an unfair attempt to second-guess its business judgment after the fact. The court granted partial summary judgment to the SEC on the question of whether Alpine violated the Securities Exchange Act by "filing fatally deficient SARs or by failing to file any SAR when [Alpine Securities] had a duty to do so."

The court held that the SEC "has enforcement authority to pursue violations of the Exchange Act" and that the SEC has "discretion to determine which reports are necessary or appropriate to further the goals of the Exchange act." Id. at 796.

MOTION ON PENALTIES

On May 3, 2019, the SEC filed a motion for penalties against Alpine. The SEC sought a permanent injunction against further violations of the BSA as well as civil penalties of almost $23 million. The SEC argued that Alpine recklessly disregarded its legal obligations under the BSA pertaining to the filing of SARs, is likely to allow for future violations and continues to refuse to admit wrongdoing.

The motion is currently pending, and the court's ultimate decision on this issue will be an important data point for firms in assessing their enforcement risk.

TAKEAWAYS

- To date, the SEC appears to have kept its enforcement and litigation involving AML to cases where there were clear signs of a microcap manipulation or plainly supported that a SAR should've been filed. In the orders examined here, the SEC has identified SAR-related behavior that appears to fail the reasonableness test either because of content deficiencies or because the firm in question failed to file a SAR when necessary.

- However, tensions between what some consider the SEC's second-guessing and appropriate use of enforcement resources could increase again when reasonable minds differ on whether firms in new SEC cases were responsible to file SARs. Tension might also arise if the SEC uses AML rules to address problematic conduct involving cryptocurrency.

- In the meantime, the fact that the SEC continues to pursue these violations, and in one instance sought a $23 million penalty, emphasizes that broker-dealers have a continuing incentive to comply with AML obligations. ■ FM

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