Securities Regulation Daily Wrap Up, TOP STORY—S.D.N.Y.: Ruling in SEC's favor on SARs regulation violations by Alpine, (Apr. 2, 2018)

Securities Regulation Daily Wrap Up

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By Joseph Arshawsky, J.D.

In a closely watched case, the SEC obtained partial summary judgment on an exemplary series of suspicious activity reports (SARs) filed by Alpine Securities Corporation, finding all of the SARs presented to be deficient as the SEC claimed, a federal court has ruled. The court only denied the SEC summary judgment on a recordkeeping issue. The court also summarily denied Alpine's motions for summary judgment and judgment on the pleadings (*SEC v. Alpine Securities Corporation*, March 30, 2018, Cote, D.).

Alpine is a broker-dealer that primarily provides clearing services for microcap securities in the OTC market. Most of the SARs at issue were originated by a brokerage owned by the same principals. The SEC alleged in this case that Alpine violated Exchange Act Rule 17a-8 by filing fatally deficient SARs or by failing to file any SAR when it had a duty to do so. Rule 17a-8 requires compliance with Bank Secrecy Act (BSA) regulations that govern the filing of SARs by broker-dealers.

At the court's invitation, the SEC moved for partial summary judgment using exemplar SARs in each of four categories. The SEC alleged that Alpine: (1) failed to include pertinent information in approximately 1,950 SARs; (2) failed to file additional or continuing SARs for certain suspicious patterns of transactions in approximately 1,900 instances; (3) filed at least 250 SARs after the 30-day period for filing had elapsed; and (4) failed to maintain supporting information for approximately 1,000 SARs as it was required to do for five years after filing. Alpine submitted its own motions arguing that the SEC was without authority to enforce BSA regulations.

Alpine's motions. In Alpine's motion for summary judgment, it argued that "because the gravamen of the SEC's complaint is Alpine's alleged failure to comply with the BSA SAR regulation," the suit was not actually brought under Rule 17a-8, despite the complaint. The court disagreed, however, ruling that the Commission's suit was brought under the Exchange Act.

Next, Alpine argued that the rule itself is not a reasonable interpretation of the Exchange Act, and the failure to update the regulation or engage in notice-and-comment for the 2002 revisions precludes enforcement. The court found, however, that Congress' express delegation to the SEC of rulemaking authority was proper and that Rule 17a-8 was a reasonable interpretation of Exchange Act Section 17(a). The court had no problem with the rule's incorporation of Treasury regulations under the BSA. "It is reasonable to conclude that the same reports that help the Treasury target illegal securities transactions for its purposes also help protect investors by providing information to the SEC that may be relevant to whether a stock or a market is being manipulated in violation of the nation's securities laws," the court stated. Finally, the text of the regulation itself, as well as the SEC's 1981 notice of final rule, unambiguously demonstrated the SEC's intent for the nature of the Rule 17a-8 reporting obligation to evolve over time through the Treasury's regulations. Accordingly, Alpine's motion for summary judgment was denied.

Alpine's motion for judgment on the pleadings argued that the SEC failed to allege that Alpine negligently or willfully violated Rule 17a-8. Although Alpine's intent is relevant to the remedy, Rule 17a-8 has no scienter requirement.

SEC's motion for summary judgment. The great bulk of the opinion sets forth each of the SARs in detail and analyzes their insufficiencies against the SEC's four categories. In all but one case, record-keeping, the court granted the SEC partial summary judgment. The largest category involved fourteen SARs whose narrative section, the SEC alleged, lacked certain required information. Within this category are seven subcategories.

Basic customer and suspiciousness information. The SEC argued correctly that Alpine omitted some of the "five essential elements" (Who? What? Where? When? Why?) from some narratives. For example, none of the narratives described who the client is by describing the nature of its business. The narratives also failed to explain why the underlying transactions were suspicious. Alpine argued that the SEC failed to prove that Alpine knew or suspected that the transaction at issue was criminal. But there is no scienter requirement, only an objective test that a SAR must be filed when the broker-dealer has "reason to suspect" that the transaction requires the filing.

Next, while Alpine could rely on the SARs filed by the introducing broker, Alpine carried the burden of showingthat the introducing broker filed a complete SAR, which Alpine failed to do. Finally, none of the SARs indicated that it was being filed voluntarily and not because of a legal duty, and therefore "it would have been unreasonable for Alpine to assume that FinCEN and the SEC would know the SAR was simply a 'voluntary' filing." The SEC's motion assumed without resolving the issue that Alpine had a duty to file each of the SARs at issue. Because the SARs at issue lacked a "who" or a "why," the SEC carried its burden of showing that each SAR was deficient as a matter of law.

Criminal or regulatory history. The SEC successfully argued that certain SARs were deficient as a matter of law because Alpine failed to include the relevant regulatory or criminal history of the customer, contained in Alpine's back-up files, in the narratives of the SARs. The SEC easily carried its burden of showing that each of them was deficient as a matter of law for its omission of the criminal or regulatory history of a related party, which was a violation of Section 1023.320(a)(2) of the BSA regulations. Alpine argued unsuccessfully that the regulatory and criminal history was a matter of public record. However, there is no exception to the duty to file a SAR based on a determination that the government may also know "through other sources the very information that Alpine was required to report." Accordingly, the SEC was entitled to summary judgment on this category as well.

Shell company involvement. The SEC successfully argued that certain SARs were deficient because their narratives did not state that a shell company was involved in the transaction. The SARs narratives did not disclose the involvement of a shell company that would help a regulator understand either the customer or the transaction at issue. Alpine's argument that the shell companies were not suspicious did not save Alpine from summary judgment because once the transaction was otherwise required to be reported on a SAR, Alpine was required to disclose the use of a shell corporation to the regulators. In another case, Alpine failed to report that an issuer had no website and there was a stop in place for trading shares of that issuer. Accordingly, the court granted the SEC summary judgment.

Stock promotion. The court agreed with the SEC that certain SARs were deficient for their failure to describe the evidence of stock promotion activity (a possible "red flag" for "pump-and-dump" penny stock schemes) that appeared in Alpine's files for these SARs.

Unverified issuers. The court also agreed with the SEC that Alpine was required by law to include in its SARs the fact that it could not locate information regarding proper registration of an issuer, such as the failure to renew its incorporation, or the lack of a website. The SEC was granted summary judgment with respect to the omissions regarding the issuers.

Low trading volume. The court also agreed with the SEC that Alpine should have disclosed the large size of their transactions relative to much smaller daily trading volumes. A transaction is suspicious if it is a "substantial deposit, transfer or journal of very low-priced and thinly traded securities." None of the SARs included the information about the low trading volume that was in Alpine's file. Whether the government is aware or not of criminality, the court noted, the duty to report suspicious activity exists. The SEC was entitled to summary judgment on this category as well.

Foreign involvement. Finally, the court agreed with the SEC that certain SARs were defective because they failed to disclose the involvement of a foreign individual or entity in the transaction. Alpine "was required to include in the narrative sections for the SARs the information about the foreign connections to the transactions that it had in its files." Reporting a foreign address in a "subject information" box does not excuse the

requirement of identifying why a transaction is suspicious in the narrative section of the SARs. Observing that "Alpine's SARs were woefully inadequate," the court granted summary judgment as to all seven categories of missing information in the SARs.

Deposit-and-liquidate patterns. In another category, the SEC argued successfully that Alpine violated Rule 17a-8 and Section 1023.320(a)(2) when it failed to file new or continuing SARs in connection with the liquidation of share positions. Alpine filed SARs to report large deposits, but no additional SARs when they sold off a large proportion of those deposits within a month or so of the deposit. FinCEN has identified as suspicious a "substantial deposit of very low-priced and thinly traded securities," followed by the "systematic sale of those low-priced securities shortly after being deposited." That pattern of transactions requires supplemental reporting as a matter of law, and the SEC was entitled to summary judgment to the extent that it proved that such a pattern occurred and that Alpine failed to file SARs reflecting that trading.

Late-filed SARs. The court agreed with the SEC that Alpine violated the law by filing five SARs between 189 and 211 days late. The court was loathe to grant Alpine its argument for an indefinite delay during deliberations. Alpine generally had 30 days from the transaction to file a SAR. Accordingly, the SEC was entitled to summary judgment on the late-filed SARs.

Missing supporting documents. The SEC argued that Alpine had not produced the supporting documentation for five SARs, which the law required it to maintain and produce upon request. Here, the court denied the SEC's motion for summary judgment as premature given that the SEC did not produce evidence that it reviewed the 2016 document production and failed to locate the supporting documents.

The case is No. 1:17-cv-04179-DLC.

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Companies: Alpine Securities Corp.

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