Client Update

Regulators Keep the Focus on Firms' SAR Obligations

If there was any question whether the Securities and Exchange Commission planned to continue emphasizing the importance of filing suspicious activity reports ("SARs"), several recent developments have answered that question with a resounding "yes." Since June 2016, when the SEC brought its first "SAR-only" case, the SEC has fined five firms for failing to file SARs, including recent cases against Merrill Lynch and Wells Fargo. In each case, the only charge brought against the firm was a failure to comply with the rule requiring broker-dealers to file SARs. Ten days ago, the SEC upped the ante, requiring admissions of violations from broker-dealer Aegis Capital Corporation, and also charging the firm's CEO and two former AML compliance officers. The same week, the SEC obtained partial summary judgment in a rare court decision involving the SAR rule, in a case that sheds light on the type of information that must be included in SAR filings.

The *Aegis* action continues the SEC's recent trend of fining firms solely for failing to file SARs. It is also the second time the SEC has brought SAR-only charges against individuals, and the first time that a CEO has been charged. Coupled with recent SEC and Financial Industry Regulatory Authority ("FINRA") announcements that AML compliance will be an exam priority in 2018, these recent cases suggest that now is a good time for firms to ensure that their SAR compliance programs are operating effectively.

BACKGROUND

The Bank Secrecy Act ("BSA") requires broker-dealers to file SARs to report suspicious transactions that occur through their firms. Failing to file a SAR is a violation of Section 17(a) of the Exchange Act and SEC Rule 17a-8.

Prior to June 2016, the SEC charged firms with failing to file SARs only when charging other violations, such as fraud or "know your customer" AML violations. In June 2016, the SEC brought its first SAR-only case, *In re Albert Fried & Company*. In that case, a small broker-dealer was fined $300,000 for failing to file SARs for over five years, despite red flags related to its customers' trading of penny stocks. Since that time, the agency has fined five firms solely for

failing to file SARs. The cases have involved both large and small firms; late last fall, the SEC sued both Wells Fargo and Merrill Lynch for failure to file SARs. Wells Fargo paid $3.5 million in November for failing to file SARs after new management told employees that they were filing too many SARs; a month later, Merrill Lynch paid $26 million to settle SEC and FINRA charges that it failed to file SARS during a four-year period.

AEGIS CAPITAL CORPORATION

On March 28, the SEC and FINRA fined New York-based brokerage firm Aegis for failing to file SARs on hundreds of transactions that raised potential market manipulation red flags, such as high trading volume in companies with little or no business activity. Aegis failed to file SARs even where its clearing firm had flagged the transactions as AML concerns. The firm paid $1.25 million in fines to the SEC and FINRA, and was required to admit to the violations and retain a compliance expert for a two-year period.

With *Aegis*, the SEC has shown itself willing to charge individuals—not just firms—with failing to file SARs, even in the absence of other violations. The SEC charged the Aegis CEO with causing the firm's violations because, among other things, he received a letter from the SEC's Office of Compliance Inspections and Examinations identifying serious deficiencies in the firm's practices and failed to take adequate steps to address the concerns. The SEC also charged two former AML compliance officers, alleging that they aided and abetted the violations by failing to file SARs even after being alerted to the red flags by the clearing firm.

The CEO and one of the former compliance officers settled, paying fines of $40,000 and $20,000, respectively. The former compliance officer also agreed to be barred from serving in a compliance capacity in the securities industry for an 18-month period. The other former compliance officer refused to settle, resulting in the SEC's Division of Enforcement bringing a contested action against him before an SEC administrative law judge.

ALPINE SECURITIES CORPORATION

The same week that the *Aegis* case was announced, the Southern District of New York sided with the SEC in a rare litigated case. On June 5, 2017, the SEC sued Alpine, alleging several thousand incidents of either failing to file SARs or filing deficient SARs in violation of Rule 17a-8. The parties cross-moved for partial summary judgment, with the firm arguing, among other things, that the SEC lacked the authority to enforce the BSA via Rule 17a-8. Ultimately, the court rejected Alpine's arguments and granted the SEC's motion for partial summary judgment, ruling that the exemplar SARs identified by the SEC were deficient. In particular, the court made the following findings regarding the information required to be included in a SAR:

- *Basic customer and suspiciousness information*—a SAR must describe the client, the nature of its business and why the transaction is unusual for the customer's business or otherwise convey why the firm thought the transaction was suspicious.

- *Criminal or regulatory history*—public availability of regulatory and criminal history does not absolve firms from including the information in the SAR; the court stated that"[t]he law does not recognize any 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 [the firm] was required to report."
- *Unverified issuers*—failing to include "critical information" about the issuers that existed in the firm's supporting files, such as the lack of a company website or the lapsing of corporate registration, rendered the SARs deficient.
- *Low trading volumes*—the duty to report suspicious activity exists even where the SEC cannot show manipulative trading is occurring.
- *Foreign involvement*—where there was involvement of a foreign individual or entity in the transaction, that information must be included in the narrative section of the SAR.

KEY TAKEAWAYS

Broker-dealers need to remain vigilant in maintaining and enforcing their SAR procedures, especially when engaging in high-risk activity, such as small cap stock trades or operating branches in high-risk areas. Broker-dealer executives should take special note that the SEC is willing to bring charges against executive officers, including CEOs, in order to clamp down on Rule 17a-8 violations.

The *Alpine* case provides a reminder that policies and procedures should be in place to ensure SARs are filed in a timely manner and are complete and accurate, and that SAR narratives provide sufficient detail regarding the suspicious actor, the activity reported and the basis for filing. Broker-dealers should take this time to consider bolstering their compliance with Rule 17a-8, particularly in light of the new Customer Due Diligence Rule, which makes express the need to understand the nature and purpose of a customer relationship so that customer activity can be assessed for the purpose of SAR filings.

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Please do not hesitate to contact us with any questions.

WASHINGTON, D.C.

Kara N. Brockmeyer
kbrockmeyer@debevoise.com

Satish M. Kini
smkini@debevoise.com

Julie M. Riewe
jriewe@debevoise.com

Arian M. June
ajune@debevoise.com

Ajani B. Husbands
ahusband@debevoise.com

NEW YORK

Matthew L. Biben
mlbiben@debevoise.com

Andrew J. Ceresney
aceresney@debevoise.com

Mary Jo White
mjwhite@debevoise.com