

**Insights**

## **CONTINUING AML REGULATORY ISSUE FOCUS:**

A LOOK AT A RECENT SEC ENFORCEMENT CASE, THE SEC'S RESPONSE TO PETITION FOR CERTIORARI, AND A FINRA REGULATORY NOTICE REGARDING FINCEN'S INITIATIVES

Oct 20, 2021

### **1. Garcia Case Highlights Necessity of Knowing Your Customer and Listening to Internal Fraud Watchdogs.**

The SEC's recent [Order](#) against a broker-dealer (the "Firm") imposed a \$750,000 financial penalty for the Firm's failure to comply with its Customer Identification Program ("CIP") procedures and appropriately respond to other "red flags" of malfeasance, all in violation of Section 17(a) of the Exchange Act and 17a-8 thereunder. The financial penalty was on top of the \$3.3 million plus interest the Firm had already paid in restitution.

The underlying conduct, as outlined in the Order, related to an alleged fraud perpetrated by an unlicensed investment adviser against a municipal entity (all of which is discussed below).<sup>1</sup> The Order outlines how different departments within the Firm possessed relevant information of wrongdoing, yet this information was not shared adequately across departmental lines. The SEC's Order reminds firms of the importance of preventing information silos and ensuring critical know your customer ("KYC") information is appropriately bubbled up to management. This Order also demonstrates that anti-money laundering ("AML") issues continue to be a hot target for regulators in 2021, consistent with our [prior client alert](#) this year.

At the heart of the SEC's Order was the conduct of Garcia, who the Order found essentially acted as an unregistered investment adviser.<sup>2</sup> In particular, Garcia provided investment advice to a municipal corporation in Puerto Rico known as Mayaguez Economic Development, Inc. ("MEDI"). Garcia first opened an investment account at a brokerage firm (which the SEC did not name in its Order) with over \$9 million of MEDI's funds, and purchased U.S. Treasuries notes. Garcia subsequently successfully wired out \$4.1 million from that account.

Garcia then attempted to open an account for MEDI at the Firm. The Order found that the Firm had fallen short in its CIP requirements in two respects. First, the Firm's registered representative who handled Garcia's account application failed to verify that Garcia matched the photo ID he presented.

Second, the Firm failed to notice that the address in Puerto Rico that Garcia provided for MEDI did not match the address in MEDI's corporate documents.

Further, Garcia attempted to transfer to the Firm a margin balance of \$4.1 million, which drew the attention of the Firm's Financial Intelligence Unit ("FIU"). The FIU, after conducting an investigation, recommended that the Firm reject Garcia's effort to open the account, in part because it appeared that Garcia's prior brokerage firm had terminated its relationship with him. The Firm nevertheless decided to move forward with the account, but requested that Garcia provide additional information about the beneficial ownership of MEDI and the source of funds for the account. In response, Garcia provided documents showing (falsely) that he was the beneficial owner of MEDI. Based on the conflict between MEDI's corporate documents and Garcia's answers, FIU again recommended rejection of Garcia's application. Garcia then responded by changing the account application to show that it was being opened for Mayaguez Economic Development Financial Strategies, Inc. ("MEDI FS"), a different entity for which Garcia was the sole officer and director. Because MEDI FS's documents appeared in order, the Firm agreed to open the account, according to the SEC's Order.

Within days of the Firm's receipt of the assets for the investment account, Garcia began requesting large wire transfers out of the account (\$500,000 to \$2 million each). Out of eight requested wire transfers, the Firm permitted three to go forward. Garcia withdrew two of the wire requests after the Firm sought more information about the purpose of the wires. Because of this development, FIU opened another investigation into Garcia and MEDI FS. FIU expressed concern about the mismatch between the stated conservative investment strategy for MEDI FS's account and the large wire transfers sought almost immediately after the account was opened. FIU also discovered further discrepancies in the addresses that Garcia had provided during account opening. As a result, the Firm froze the account and terminated its relationship with MEDI FS, less than two months after the account was funded.

Of particular concern to the SEC in its Order was its finding that "various different [Firm] departments and personnel were in possession of the contradictory information Garcia had provided... However, this collection of information was not reasonably channeled through any central reporting function." (Order, at ¶ 20.) Unfortunately, the SEC did not explain what information should have been shared with whom, and when, and thus it is unclear what level of information sharing the SEC believes was lacking. The Order noted that the Firm had made significant improvements to its customer due diligence procedures and to its AML and fraud surveillance and investigation functions since 2016.

## **2. Alpine Securities Seeks U.S. Supreme Court Certiorari On Its Challenge to SEC's Authority To Enforce SAR Filing Requirements.**

Alpine Securities recently filed a [Petition on a Writ of Certiorari](#) to the U.S. Supreme Court, which challenges whether the SEC, in enforcing its own books and records requirements under Section 17(a) of the Securities Exchange Act and Rule 17a-8, has the authority to enforce the proper filing of

SARs. The requirement to file SARs when firms suspect illicit financial transactions is imposed by the regulations of the Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN"), at 31 C.F.R. 1023.320, enforcing the Bank Security Act ("BSA"), 31 U.S.C. 5311. Alpine Securities seeks review of the Second Circuit Court of Appeals' affirmation of the Southern District of New York's grant of summary judgment in SEC's favor, after the District Court imposed civil penalties in the amount of \$12 million for Alpine Securities' failure to appropriately file about 2,700 suspicious activity reports ("SARs") regarding microcap stock trading at its firm. (*U.S. Sec. and Exchg. Comm'n. v. Alpine Sec. Corp.*, 413 F.Supp. 3d 235 (S.D. N.Y. 2019); *U.S. Sec. and Exchg. Comm'n. v. Alpine Sec. Corp.*, 982 F.3d 68 (2<sup>nd</sup> Cir. 2020).) **If Alpine Securities prevails before the U.S. Supreme Court, the SEC will no longer have the authority to bring SAR enforcement cases.**

Alpine Securities argues that the SEC has usurped FinCEN's ability to enforce its own SAR regulations, and that SEC imposes harsher penalties than FinCEN would for the same conduct. (Alpine Securities' brief, p. i.) Importantly, Alpine Securities secured the support of two former FinCEN officials in its quest to restrain the SEC's enforcement practices concerning SARs. ([Read Law360 article here.](#))

The SEC responded to Alpine Securities' Petition for Certiorari by arguing that the Supreme Court should deny cert because 1) Congress has signaled its intention for the filing of SARs to be regulated by multiple authorities; 2) the SEC's enforcement of FinCEN's SAR regulation falls within the SEC's investor protection function; and 3) there is no circuit split for the Supreme Court to resolve. ([Read the SEC's brief opposing Alpine Securities' request for certiorari here](#), at p. 16, 26, 28.) Alpine Securities' reply in support of its request for cert argues that because the BSA was enacted later and is more specific than the Exchange Act, only the Treasury Department has the authority to enforce the BSA. ([Read Alpine Securities' brief in support of its cert request here](#), at p. 6-7.)

The Supreme Court is expected to issue an Order on Alpine Securities' Petition for Certiorari within the next 30 days.

### **3. FINRA Regulatory Notice Regarding FinCEN's Statement of National Priorities Encourages Firms To Incorporate FinCEN's Initiatives Into Their Risk-Based AML Programs.**

In a cross-agency move to enforce AML priorities, FINRA recently released [Regulatory Notice \("RN"\) 21-36](#), which discussed application of FinCEN's [Statement of National Priorities](#) (the "Priorities") in the broker-dealer context. ([Read FinCEN's press release regarding its Priorities here.](#))

**FINRA notes that neither RN 21-36 nor FinCEN's AML Priorities create new regulations for firms to follow.** (RN, p. 2.) **However**, in the RN, FINRA urges firms to review FinCEN's Priorities and begin thinking about the steps they would need to take to incorporate the Priorities into their risk-based AML programs, including possible changes to their documentation, red flags, and surveillance technologies. In light of the Priorities, FINRA also urges firms to consider re-evaluating AML risks

created by their business activities, customer base, account types, and the types of transactions that they and their customers conduct.

The Anti-Money Laundering Act of 2020 requires that FinCEN promulgate any appropriate regulations regarding the Priorities within 180 days of their establishment. Since FinCEN issued the Priorities in late June 2021, firms should expect releases from FinCEN regarding their proposed regulations in the near future.

We will continue to update you on these important issues as they unfold. Please contact us if you have questions about how these developments may impact your compliance, regulatory risk or other business functions.

1. The SEC has filed a separate Complaint in the District of Puerto Rico against the unregistered investment adviser, Eugenio Garcia Jimenez, Jr. (“Garcia”). ([Read the SEC’s complaint against Garcia here.](#)) Garcia reportedly also is facing U.S. federal criminal charges of conspiracy to commit wire fraud, wire fraud, and money laundering in the District of Puerto Rico. (Case No. 3:21-cr-00082.) In addition, he is facing a civil suit in Puerto Rico arising out of the same conduct. (See Case No. SJ2019CV06533.) All the alleged facts and conclusions discussed in this Alert are taken from the Order.

2. Garcia has no CRD number because, according to FINRA BrokerCheck and SEC’s IARD database, he has never been registered as a broker or investment advisor.

## **RELATED PRACTICE AREAS**

- Financial Regulation Compliance & Investigations
- Securities Litigation and Enforcement

## MEET THE TEAM



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