NO. 21-82

In the

Supreme Court of the United States

ALPINE SECURITIES CORPORATION,

Petitioner,

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE CATO INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Does the SEC's assertion of independent authority to interpret and enforce the Bank Secrecy Act contravene Congress's decision to entrust enforcement of the Act's comprehensive anti-money-laundering regime to the Treasury Department, a politically accountable executive agency?

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INTEREST OF *AMICUS CURIAE*[1]

The Cato Institute ("Cato") was established in 1977 as a nonpartisan public policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Center for Monetary and Financial Alternatives reveals the shortcomings of today's monetary and financial regulatory systems and identifies and promotes alternatives more conducive to a stable, flourishing, and free society. Cato's Robert A. Levy Center for Constitutional Studies promotes the principles of limited constitutional government that are the foundation of liberty. Cato publishes books and studies, conducts conferences, issues the annual *Cato Supreme Court Review*, and files *amicus* briefs with courts.

Cato supports the petition because it has a strong interest in ensuring that the Securities and Exchange Commission and other unelected administrative agencies wield their vast regulatory and law enforcement powers only as authorized by Congress. Cato also has a strong interest in promoting the virtues of transparency, integrity, and accountability in agency decision-making.

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[1] All parties consented to the filing of this brief after receiving timely notice pursuant to Supreme Court Rule 37.2. Pursuant to Supreme Court Rule 37.6, *amicus curiae* states that no counsel for any party authored this brief in whole or in part and that no entity or person, aside from *amicus curiae*, its members, and its counsel, made any monetary contribution toward the preparation or submission of this brief.

SUMMARY OF ARGUMENT

The petition correctly describes this case as another "power grab" by the Securities and Exchange Commission ("SEC"). *Cf. Liu v. SEC*, 140 S. Ct. 451 (2019); *Lucia v. SEC*, 138 S. Ct. 2044 (2018); *Kokesh v. SEC*, 137 S. Ct. 1635 (2017); *Gabelli v. SEC*, 568 U.S. 442 (2013). The SEC is flexing its ever-expanding prosecutorial muscle to enforce what are, in substance, the rules of another agency—the Financial Crimes Enforcement Network ("FinCEN"), a bureau within the Treasury Department to which primary enforcement discretion under the Bank Secrecy Act has been granted directly by the Department and indirectly by Congress.

In 1981, the SEC placed its rulemaking process on autopilot by incorporating by reference into its own rules both the existing *and future* rules that FinCEN promulgates under the Bank Secrecy Act. Two decades later, FinCEN amended its rules to impose substantive new regulatory requirements on securities broker-dealers concerning the reporting of suspicious transactions. The SEC now contends that those rules automatically became part of the SEC's own rules—and are enforceable under the SEC's lower evidentiary standards and harsher penalties—without the need for the SEC to provide any further notice or opportunity for public comment.

This kind of evergreen incorporation by reference is deeply troubling. Among other concerns, the SEC has abdicated the administrative responsibilities that Congress delegated to the agency back in 1934, by effectively subdelegating those responsibilities to FinCEN. In taking that approach, the SEC has evaded

the transparency and accountability that accompanies proper notice-and-comment rulemaking, blurring the lines of accountability and "undermining an important democratic check on government decision-making." *U.S. Telecom Ass'n v. FCC*, 359 F.3d 554, 565–66 (D.C. Cir. 2004) (subdelegation to outside entities "aggravates the risk of policy drift inherent in any principal-agent relationship"); Emily S. Bremer, *Incorporation by Reference in an Open-Government Age*, 36 Harv. J.L. & Pub. Pol'y 131, 133 (2013) ("The time has come to reevaluate incorporation by reference, a little known but frequently used regulatory practice with profound public policy implications."). The public and regulated parties are entitled to provide input before the SEC imposes substantive requirements subject to its own evidentiary standards and penalties. Moreover, that exercise of authority must represent the considered judgment and expertise of the SEC itself, and not the judgments of a politically controlled agency like FinCEN.

Cato respectfully urges the Court to grant the petition and provide guidance in this important area of administrative law. It is bad enough when Congress delegates its own Article I legislative responsibility to administrative agencies with only the vaguest instructions to legislate rules that are "necessary or appropriate in the public interest" or "for the protection of investors," as it did with the SEC. *See* 15 U.S.C. §§ 78q(a)(1), 78w(a)(1); *see also Gundy v. United States*, 139 S. Ct. 2116 (2019). Whatever scraps of political accountability may remain after that delegation are thrown to the wind if agencies are then free to construct their own daisy chains of successive

subdelegations and re-delegations across the vast administrative state.

ARGUMENT

I. The Petition Raises Important Questions Involving Delegation of Legislative Power, Administrative Accountability, and Rulemaking Transparency.

Section 17(a)(1) of the Securities Exchange Act of 1934 authorizes "the Commission" to prescribe the recordkeeping and reporting obligations of broker-dealers. 15 U.S.C. § 78q(a)(1). In delegating this task to the SEC, Congress chose a bipartisan, Senate-confirmed, multi-member independent agency, rather than a politically controlled executive agency (such as FinCEN). *Id.* § 78d(a).

The relevant enabling statute provides the SEC with little in the way of "intelligible principle[s]," *see Gundy*, 139 S. Ct. at 2123, allowing the agency to promulgate any rules it deems "necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this chapter." 15 U.S.C. § 78q(a)(1). Exercising that authority, the SEC has been prolific in prescribing a bevy of books, records, and reports that broker-dealers must make and preserve in connection with their business affairs. *See* 17 C.F.R. §§ 240.17a-1 through 240.17a-25.

There is one notable exception: recordkeeping related to the Bank Secrecy Act. Congress granted the Treasury Department "[g]eneral powers" to administer and enforce that statute. 31 U.S.C. §§ 5318–5321. Congress also granted the Department

permission to subdelegate those responsibilities to other agencies. *Id.* § 5318(a)(1). In keeping with the traditional role of the SEC, the Department subdelegated to the SEC responsibility for examining broker-dealers for statutory compliance. 31 C.F.R. § 1010.810(b)(6).

In 1981, when the SEC imposed on broker-dealers the obligation to make and preserve records relating to compliance with the Bank Secrecy Act, it did so in an unconventional way. Rather than apply its own subject-matter expertise to determine which records and reports were "necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of [the Exchange Act]," 15 U.S.C. § 78q(a)(1), the SEC adopted Rule 17a-8, which purports to incorporate by reference all existing *and future* rules promulgated by FinCEN in this area. 17 C.F.R. § 240.17a-8 (affected broker-dealers "shall comply with the reporting, recordkeeping and record retention requirements [promulgated by FinCEN]").

That kind of circular redelegation—where the Treasury Department subdelegates part of its Bank Secrecy Act authority to the SEC, which, in turn, incorporates by reference the rules of a bureau within the Treasury Department—raises obvious accountability problems.

When it adopted Rule 17a-8, the SEC particularly extolled the ingenuity and convenience of its prospective, automatic incorporation of FinCEN's *future* rules. *See* Recordkeeping by Brokers and Dealers, 46 Fed. Reg. 61,454, 61,455 (Dec. 17, 1981) (the rule imposes no burdens beyond "identical Treasury regulations" and "does not specify the

required reports and records so as to allow for any revisions the Treasury may adopt in the future"). At the time, however, no one could have predicted the vast expansion of SEC prosecutorial power that followed. In 1981, the SEC had no penal law enforcement powers. It could only impose remedial administrative sanctions against rulebreakers, or it could ask a federal court to enjoin violative conduct. *See, e.g.*, Paul S. Atkins and Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 Fordham J. Corp. & Fin. L. 367 (2008). It is therefore unsurprising that no one commented on the rule. With no punitive enforcement sanctions available to the SEC, the rule imposed no new substantive regulatory requirements and added no new legal risk beyond what FinCEN had already put in place. *See INS v. Chadha*, 462 U.S. 919, 986 n.19 (1983) (White, J., dissenting) (noting that legislative rules have the "force and effect of law" and may be promulgated only after public notice and comment) (quoting *Batterton v. Francis*, 432 U.S. 416, 425 n.9 (1977)).

Today's world of securities enforcement is vastly different. In the decades since the SEC adopted Rule 17a-8, Congress has empowered the SEC with an array of harsh quasi-criminal law enforcement tools and sanctions, and the agency has transformed itself into an aggressive quasi-criminal prosecutorial office. Atkins and Bondi, 13 Fordham J. Corp. & Fin. L. at 383–94. For example, in the Insider Trading Sanctions Act of 1984, Congress empowered the SEC to seek civil monetary penalties for insider trading in amounts up to three times the profits realized. *See* 15 U.S.C. § 78u-

1. Congress expanded the SEC's penalty authority in the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, which also empowered the agency to impose those penalties unilaterally, through in-house administrative proceedings, against SEC-regulated broker-dealers and their personnel. *See id.* §§ 78u(d)(3), 78u-2(a)(1). And with the Dodd-Frank Act of 2010, the SEC's prosecutorial power was again vastly expanded when Congress authorized the agency to penalize *any* person—whether SEC-regulated or not—through its own administrative adjudication process. *See id.* § 78u-2(a)(2).

Certainly no one could have predicted in 1981 that the SEC would one day wield its current prosecutorial arsenal against broker-dealers for failing to file FinCEN-compliant Suspicious Activity Reports, which did not even exist until 1996, and were not required to be filed by broker-dealers until 2001. *See* USA Patriot Act of 2001, Pub. Law No. 107-56, § 356, 115 Stat. 272, 324–25; Amendment to the Bank Secrecy Act Regulations–Requirement that Brokers or Dealers in Securities Report Suspicious Transactions, 67 Fed. Reg. 44,048 (July 1, 2002).

Moreover, FinCEN and the SEC have radically different enforcement authorities. When FinCEN enforces the Bank Secrecy Act, it must show that a defendant acted at least negligently and, even then, the maximum penalty for negligent conduct is only $1,180 per violation. *See* 31 U.S.C. § 1321(a); Financial Crimes Enforcement Network; Inflation Adjustment of Civil Monetary Penalties, 86 Fed. Reg. 7348 (Jan. 28, 2021). In sharp contrast, the SEC contends that, under its enforcement regime, it need

not prove negligence to penalize violations of its recordkeeping and reporting requirements, and the maximum SEC penalties—even without proof of negligence—can be as high as $97,523 per violation. 15 U.S.C. § 78u(d)(3)(B)(i), adjusted for inflation at 17 C.F.R. § 201.1001.

The civil enforcement tools available to the SEC dwarf those available to FinCEN or the Treasury Department under the Bank Secrecy Act. That disparity can lead to wildly inconsistent positions enforcing the same legal requirement, as well as wildly inconsistent sanctions being imposed depending on which agency takes enforcement action. Here, for example, it does not appear that FinCEN took *any* enforcement action against petitioner, while the SEC sought draconian sanctions. As the petition explains, these parallel enforcement regimes are a recipe for arbitrary law enforcement outcomes. They are particularly disturbing given that Congress specifically assigned responsibility to the Treasury Department and FinCEN—not the SEC—to enforce the Bank Secrecy Act and the rules thereunder. 31 U.S.C. §§ 5320, 5321.

The SEC's approach also defies both the letter and spirit of the statute under which the SEC sought its penalties in this case. That statute empowers the SEC to seek penalties only for violations of "this chapter [i.e., Title 15 of the United States Code], the rules and regulations thereunder, or a cease-and-desist order entered by the Commission . . . ." 15 U.S.C. § 78u(d)(3)(A). If the SEC can unilaterally expand that limited mandate through the mere stroke of an incorporation-by-reference pen, it is hard to fathom

any principled limit on the agency's ability to expand its power by incorporating other titles of the U.S. Code and the Code of Federal Regulations into its own rules.

II. The SEC's Approach Violates the Administrative Procedure Act.

Rule 17a-8 impermissibly allows the SEC to circumvent its notice-and-comment rulemaking obligations. As the petition explains, the SEC's current use of the rule purports to allow the agency to exert additional enforcement power under lower evidentiary requirements using another agency's rules without providing the public with notice and the opportunity to comment. That rule-of-law violation subverts transparency and accountability, and it would allow the SEC to impose substantive obligations on parties without subjecting its rule to proper judicial review.

Congress delegated the responsibility for writing broker-dealer recordkeeping and reporting rules to the SEC, in the same legislation through which it created the agency as an independent one largely insulated from political pressure and influence. Section 4A(a) of the Exchange Act explicitly specifies to whom the SEC may delegate its assigned regulatory functions: "[T]o a division of the Commission, an individual Commissioner, an administrative law judge, or an employee or employee board." 15 U.S.C. § 78d-1(a). Neither the Treasury Department, FinCEN, nor any other agency or person outside of the SEC's control is mentioned in this grant of limited permission to subdelegate. That is in stark contrast to the much broader subdelegation power that Congress has given,

for example, the Treasury Department in the Bank Secrecy Act. 31 U.S.C. § 5318(a)(1) (authorizing Treasury Secretary to "delegate duties and powers under this subchapter to an appropriate supervising agency and the United States Postal Service").

Allowing administrative agencies to abdicate their congressionally delegated rulemaking responsibilities through dynamic incorporation of both existing *and future* rules of other agencies makes a mockery of the APA's notice-and-comment requirements. Those requirements are designed to ensure that an agency purposefully entrusted by Congress to legislate rules in a given area will undertake a careful and transparent public rulemaking process rather than evade that step by automatically accepting the judgment and processes of another agency, which may lack expertise in or appreciation for the legislative interests and purposes behind the subdelegating agency's congressional mandate. *See U.S. Telecom Ass'n v. FCC*, 359 F.3d 554, 565 (D.C. Cir. 2004) ("[W]hen an agency delegates power to outside parties, lines of accountability may blur, undermining an important democratic check on government decision-making"); *see also* Matthew C. Stephenson, *When and Why Agencies Must Decide for Themselves: Judge Williams's Restrictive Approach to Administrative Subdelegation,* 38 Yale J. on Reg. 752, 765 (2021) ("[T]he core value of requiring the agencies in which Congress has vested authority to take responsibility for making the hard choices trumps whatever policy benefits might be associated with devolution of federal power to [other] actors."); Jessica Bergman Asbridge, *Whose Job Is It Anyway? The Department of Labor's Authority to Make Labor*

Market Determinations Under the H-2B Program, 64 Drake L. Rev. 273, 295 (2016) ("Permitting an agency that Congress selected to administer a statute to redelegate its discretionary authority to another agency would ignore Congress's decisions as to important policy issues."); Bremer, 36 Harv. J.L. Pub. Pol'y at 186 ("By permitting automatic modifications to administrative regulations without the agency conducting a rulemaking, dynamic incorporation robs the public of the opportunity to examine and comment on changes to the incorporated material."). The SEC's automatic incorporation by reference of yet-to-be-promulgated FinCEN rules evades its own notice-and-comment rulemaking obligations.

It is inappropriate to assume, as the court of appeals did below, that FinCEN will undertake its own notice-and-comment process whenever it amends its own rules and brush off the need for the SEC to perform its separate rulemaking responsibilities. The legal consequences of a new rule include not only the specific requirements it imposes, but also the penalties for violations. Regulated parties may be comfortable with FinCEN rules, knowing that non-negligent violations will not give rise to penalties, and that even negligent violations will result in only modest penalties. Before those rules are automatically adopted by the SEC and effectively repurposed to include strict-liability obligations and harsher penalties, regulated parties are entitled to object and seek judicial review.

Nor is there any obvious limiting principle. If the decision below is correct, nothing prevents the SEC from incorporating by reference the current and future

rules of countless other federal agencies in addition to those of FinCEN. For example, the SEC could adopt rules requiring broker-dealers to comply with all tax filing and reporting obligations imposed by the Internal Revenue Service—and then seek harsh penalties and other law-enforcement sanctions whenever it believed a broker-dealer had filed an incomplete or misleading tax return. Or, when promulgating recently promised new rules requiring public companies to disclose detailed information concerning environmental, social, and governance ("ESG") risks, the SEC could dynamically incorporate by reference current and future rules and definitions promulgated by a range of other agencies—or even those adopted by non-governmental advocacy organizations.

These scenarios are not far-fetched. Currently pending in Congress, and already passed by the House, is an ESG disclosure bill that is chock full of dynamic incorporations by reference of lists and definitions from external statutes, agency rules, and international standards. *See* Corporate Governance Improvement and Investor Protection Act, H.R. 1187, 117th Cong. (2021) The same bill also expressly invites the SEC, when adopting new ESG disclosure rules, to "incorporate any internationally recognized, independent, multi-stakeholder environmental, social, and governance disclosure standards." *Id*. § 103(b)(4). Apart from undermining essential notice-and-comment requirements, automatic incorporation of other agencies' current and future rules invariably increases the burden and complexity of complying with ever-expanding matrices of cross-referenced rules and regulations.

There is no evidence that Congress intended to allow the SEC to enforce substantive obligations from FinCEN's rules on broker-dealers without subjecting those obligations to proper rulemaking review, nor did it intend for the SEC to subdelegate to another agency its assigned responsibility to regulate (by notice-and-comment rulemaking) broker-dealer recordkeeping and reporting requirements. These abdications of congressionally delegated responsibility, through dynamic incorporation by reference of FinCEN's rules, are inconsistent with Congress's directives and should not be permitted.

CONCLUSION

The Court should grant the petition for certiorari.

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