

## Select Securities and Exchange Commission and FINRA Cases and Developments: 2012 Year in Review

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In 2012, the SEC and FINRA continued their vigorous enforcement of the securities laws, rules, and regulations—with cases against broker-dealers, investment advisers, and investment companies accounting for 38% of the SEC enforcement docket and FINRA bringing a record number of enforcement actions against its member firms and associated persons.

The Morgan Lewis Securities Litigation and Enforcement and Investment Management Practices have published an outline highlighting key U.S. Securities and Exchange Commission (the SEC or the Commission) and **Financial Industry Regulatory Authority (FINRA)** enforcement developments and cases regarding broker-dealers, investment advisers, and investment companies during 2012.<sup>[1]</sup>

This LawFlash describes important developments in the enforcement programs of the SEC and FINRA, sets forth the metrics used to measure enforcement activity, and summarizes key cases brought by regulators. The full 2012 Year in Review is available [here](#).

### The SEC

The SEC again brought a high number of enforcement actions in FY 2012.<sup>[2]</sup> Down just one case from FY 2011's record, the Commission filed 734 enforcement actions last year. Senior SEC officials credit the reorganization of and reforms in the Division of Enforcement over the last few years for the near record, while noting that the actions represent increasingly complex and diverse cases.<sup>[3]</sup> In FY 2012, the SEC also obtained orders requiring the payment of \$3 billion in penalties and disgorgement, an 11% increase from the amounts ordered in FY 2011. In sum, the metrics used to measure the SEC's enforcement activity clearly demonstrate that the Commission continues to aggressively enforce the securities laws. At the same time, several members of the Commission, as well as some of its critics, called for even more aggressive measures and legislative changes to enhance the SEC's penalty authority.

Some of the key statistics from FY 2012 are set forth below:

- The Commission brought 734 enforcement actions, just one case fewer than the 735 initiated in FY 2011.
- The SEC designated 150 actions as National Priority cases, an increase of approximately 30% from FY 2011.
- The Commission brought 58 insider trading cases, one more than the prior year.
- The SEC filed 29 actions related to the financial crisis, up six from the 23 filed in FY 2011, representing a 26% increase from the prior year.
- Continuing the trend in one of the Commission's principal areas—regulation of broker-dealers, investment advisers, and investment companies—the SEC brought more actions against such regulated entities last year than it did in FY 2011. The Commission initiated 134 actions against broker-dealers, compared to 113 in FY 2011. This represents an approximately 19% increase year-over-year. The SEC also topped the number of actions filed against investment advisers and investment companies, bringing 147 such cases in FY 2012, one more than the record number filed in the previous year. Combined, cases against broker-dealers, investment advisers, and investment companies accounted for 38% of the Commission's FY 2012 enforcement docket.
- The Commission's Office of the Whistleblower was fully up and running in FY 2012 and received 3,001 tips, complaints, and referrals from whistleblowers in all 50 states and 49 foreign countries. The SEC also made its first award to a whistleblower who helped the Commission stop a fraudulent investment scheme.

In addition to the high number of cases brought last year, the other big headline at the SEC was the significant personnel departures after the reelection of President Barack Obama. Chairman Mary Schapiro announced that she was leaving the agency in November, and then-Commissioner Elisse Walter was appointed the new Chair. Ms. Schapiro's leaving was promptly followed by announcements that the Directors of the Division of Corporation Finance and the Division of Trading and Markets, the SEC's General Counsel, and the SEC's Chief of Staff were all departing the Commission. In early January 2013, the Director of the Division of Enforcement also announced his departure from the agency. Late last month, President Obama nominated Mary Jo White, a former U.S. Attorney for the Southern District of New York, to become the agency's next Chair, which some view as a signal that the SEC will continue to aggressively enforce the securities laws. This year will be a year of change at the Commission, with a new Chair and senior staff appointed to fill these vacancies.

Turning to other key developments, late last year, the U.S. Supreme Court granted certiorari in *Gabelli v. Securities and Exchange Commission*, which will determine when, in civil SEC enforcement cases, an action "accrues" for statute of limitations purposes. Oral argument was heard in January 2013, and a decision is expected by June.

The SEC's "no admit or deny" settlement policy continued to be a source of controversy. The U.S. Court of Appeals for the Second Circuit began its review of the opinion by Judge Jed Rakoff of the U.S. District Court for the Southern District of New York in which he refused to approve a Commission settlement; a ruling should be forthcoming this year. Other judges have also raised concerns about certain SEC settlements.

Senior Commission officials and some members of Congress sought to increase the SEC's penalty authority last year. The Stronger Enforcement of Civil Penalties Act of 2012, which would substantially increase the amount of penalties the SEC could levy on wrongdoers, was proposed in Congress but has not yet been acted upon.

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A long-running but important supervisory case involving a broker-dealer's General Counsel came to a conclusion in early 2012, without offering any guidance concerning the definition of a "supervisor." Later in the year, Commissioner Daniel Gallagher expressed a desire for the Commission to more realistically define the contours of what it means to be a supervisor.

Last year, the SEC brought broker-dealer cases in matters arising out of the financial crisis, including actions involving mortgage-backed securities and the marketing and sales of collateralized debt obligations. As it has traditionally done, the Commission was also active in the fraud, insider trading, and short-selling areas. In the asset management space, it continued to focus on misrepresentations in the marketing and sales of advisory services, failure to disclose conflicts of interest, mutual fund fee arrangements, and valuation of assets. Finally, the SEC continued to show interest in cases against securities exchanges and alternative trading systems.

## **FINRA**

Last year, FINRA reported two records in its enforcement program: it brought more disciplinary actions (1,541) and ordered more restitution to investors (\$34 million) than ever before. In fact, many of the traditional metrics used to measure FINRA's enforcement activity showed increases from 2011.<sup>[4]</sup> Highlights from the 2012 statistics<sup>[5]</sup> are described below:

- FINRA filed 1,541 new disciplinary actions against firms and individuals, up from 1,488 cases from the prior year—an increase of 3.6% and, as noted, a record since FINRA was established in 2007.
- FINRA resolved 1,370 formal actions last year; in 2011, it had concluded 1,287 such cases.
- FINRA expelled 30 firms from its membership (compared to 21 in the prior year), barred 294 people (versus 329 in 2011), and suspended 549 individuals (an increase over the 475 such actions in the prior year).
- FINRA reported that it had imposed fines of more than \$68 million versus almost \$63million in the prior year.
- FINRA ordered firms and individuals to provide more than \$34 million in restitution to customers; in 2011, such orders totaled \$19million. Again, the 2012 restitution figure was a record and represents an almost 79% increase year-over-year.

In other 2012 developments, FINRA continued its focus on referring potential instances of fraud that fell outside of its jurisdiction to the appropriate regulatory agency. As part of this effort, the Office of Fraud Detection and Market Intelligence referred 692 matters concerning potential fraudulent conduct to the SEC and other law enforcement agencies.

Although we have not undertaken an empirical analysis of all of FINRA's settlements, anecdotally, it appears that the staff is willing to include references to firm-initiated actions in its settlements and to note the fact that such steps had been taken into account by FINRA in resolving the matter. For example, at least eight cases described in the summaries in our outline contain such information.

In 2012, FINRA posted five Targeted Examination Letters on its website. These sweeps involve conflicts of interest, Alternative Trading Systems, communications relating to nontraded REITs, the prohibition against trading ahead of customer orders, and business continuity plans put into use as a result of Hurricane Sandy. Such inquiries show the breadth of concerns at FINRA last year.

As in the past, last year, FINRA actively investigated matters involving anti-money laundering, structured products, mutual fund sales practices, record retention, regulatory reporting, and research

report disclosures and supervision and concluded cases against firms in each of these areas. It also returned to previous areas of interest, including advertised trade volume and mortgage-backed securities. FINRA opened new fronts in the customer arbitration agreement and options order-marking areas.

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[1]. This LawFlash and its accompanying outline were prepared by partners Ben A. Indek, Ivan P. Harris, Jennifer L. Klass, and Richard F. Morris; senior counsel Anne C. Flannery; of counsel Mary M. Dunbar; and senior associates Joshua R. Blackman and Julia N. Miller, with substantial assistance from

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[2]. The SEC's fiscal year begins on October 1. References to FY 2012 are to the year that commenced on October 1, 2011, and ended on September 30, 2012.

[3]. See Press Release, Sec. & Exch. Comm'n, SEC's Enforcement Program Continues to Show Strong Results in Safeguarding Investors and Markets (Nov. 14, 2012), *available here*. The statistics in this LawFlash were drawn from this press release or other SEC publications cited in our outline.

[4]. In contrast to the SEC, FINRA's fiscal year follows the calendar year; statistics for FINRA reflect the period of January 1, 2012, through December 31, 2012.

[5]. See, Press Release, Fin. Indus. Regulatory Auth., 2012: FINRA Year in Review (Jan. 8, 2013), *available here*. Unless otherwise noted, FINRA's 2012 statistics are taken from its press release or other materials on its website cited in our outline.

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