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Highlights from Securities and Exchange Commission (SEC) Speaks 2014

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The United States Securities and Exchange Commission (the SEC or the Commission) held its annual SEC Speaks conference in Washington, DC on February 21–22, 2014, recapping the prior year and emphasizing SEC priorities for the coming year.

Chairman's Remarks

Chairman Mary Jo White stated that the Division of Enforcement continues to aggressively pursue cases and, to date, has charged 169 individuals or entities with wrongdoing stemming from the financial crisis, 70 of whom were CEOs, CFOs, or other senior executives. She further remarked that the Commission has "brought landmark insider trading cases and created specialized units that pursued complex cases against investment advisers, broker dealers and exchanges, as well as cases involving **Foreign Corrupt Practices Act (FCPA)** violations, municipal bonds, and state pension funds." In 2013, the Division of Enforcement obtained orders to return $3.4 billion in disgorgement and civil penalties, which is the highest amount in the agency's history. Chairman White also highlighted the fact that the Commission modified its longstanding no admit/no deny settlement protocol in 2013 to require admissions in a broader range of cases. Chairman White stressed the importance of admissions in order to "achieve a greater measure of public accountability, which, in turn, can bolster the public's confidence in the strength and credibility of law enforcement, and the safety of our markets." Chairman White indicated that the Commission expects to bring more such cases in 2014, particularly in cases of egregious conduct, "where a large number of investors were harmed, where the markets or investors were placed at significant risk, where the conduct undermines or obstructs our investigative processes, where an admission can send a particularly important message to the markets or where the wrongdoer poses a particular future threat to investors or the markets."

Division of Enforcement: Aggressively Pursuing Cases Armed with New Tools

Speakers from the Division of Enforcement, including Andrew Ceresney, Director of the Division of Enforcement, emphasized the Commission's aggressive pursuit of a wide variety of cases and an increasing requirement of admissions of fault in settled actions.

Joseph Brenner, Chief Counsel, discussed the SEC's focus on applying long-standing but infrequently or never utilized statutes and rules in bringing enforcement actions. Specifically, Mr. Brenner referenced the SEC's first action brought under Rule 10A of the Securities Exchange Act of 1934 (the Exchange Act) (requiring audit partner rotation every five years) and recent actions brought using Section 20(d) of the Exchange Act (banning trading options based on insider trading), and Section 26 of the Exchange Act (prohibiting representations that the SEC approved of a particular transaction). Mr. Brenner also indicated that the SEC is focusing on Section 20(b) of the Exchange Act as a means to hold individuals and firms liable for violating the federal securities laws through the actions of another person or entity. He noted that this statute is unlike secondary liability in that it does not require proof of an underlying violation. Mr. Brenner indicated that the SEC is exploring use of Section 20(b) in false statement cases in order to better protect investors by targeting those who put false information in the hands of someone else who then distributes such false information to investors through public statements or filings.

Charlotte Buford, Assistant Chief Counsel, spoke about the SEC's intention to use the administrative proceeding forum more frequently and in a wider variety of upcoming enforcement actions. Ms. Buford stated that in choosing the forum, the SEC considers factors such as speed and efficiency, the nature of the case, litigation considerations such as the amount of discovery needed, and settlement considerations. Ms. Buford noted that, although certain types of actions such as insider trading cases were historically brought in district court, two insider trading cases were recently brought as administrative actions. She also referenced the SEC's recent action against Alcoa, Inc. involving FCPA violations, which was filed as a settled administrative proceeding. Ms. Buford indicated that the SEC will continue to increase its use of administrative proceedings in the coming years.

David Woodcock, Regional Director, Fort Worth Regional Office, and Chair of the Financial Reporting and Audit Task Force, discussed the Commission's renewed focus on financial reporting fraud and the creation of a task force to deter, detect, investigate and prosecute audit failures. Mr. Woodcock stated that the task force seeks to (1) understand the state of financial fraud (*i.e.*, how and where is it happening); (2) focus on third parties who report fraud; (3) review work of those in academia for best practices/detection abilities; (4) collaborate with federal regulators and law enforcement partners; and (5) meet with whistleblowers and/or their respective counsel and advisors. The task force looks to identify certain trends and red flags, such as multiple revisions of financial statements over a short period of time, to indicate possible weaknesses in a company's internal controls that may tend to indicate possible larger issues present at the company. It is also reviewing the actions of auditors who may not be fulfilling their gatekeeping role in public companies.

Matthew Solomon, Chief Litigation Counsel, spoke about new litigation developments and the Commission's active trial docket. He noted that the Commission employs 115 dedicated litigators—32 in Washington and 83 spread out among the regional offices—as well as a large number of litigation support staff and investigators. Mr. Solomon cited a number of recent cases brought against investment professionals that each involved misstatements to investors, a complicated set of facts, major investor losses and bad conduct that was exposed at trial. Mr. Solomon also discussed the Commission's increased use of administrative proceedings to bring cases and noted that such proceedings have involved actions against entities and individuals for failure to prevent fraud, failure to properly supervise and failure to comply with the requirement of regulated entities to provide information to the SEC upon request, among others. Mr. Solomon stated that the SEC will continue to be aggressive in its pursuit of insider trading claims despite the fact that such cases are often circumstantial and challenging, noting that "deterrence demands a strong SEC presence."

Jina Choi, Regional Director, San Francisco Regional Office, spoke about the importance of technology and cooperation tools in investigations and enforcement actions. Noting the document-intensive nature of investigations and the ever-expanding amount of market data, Ms. Choi commended the Commission's use of link-analysis software to detect patterns in data. She noted the importance of forensic analysis, such as examinations of devices to detect whether they were wiped clean, which can provide evidence to assist the SEC in demonstrating scienter. Ms. Choi spoke about the SEC's increased use of cooperation agreements, citing its execution of 60 cooperation agreements since 2010. Ms. Choi noted that the first deferred prosecution agreement with an individual was entered into in November 2013 with a former hedge fund administrator in a case against a hedge fund manager. Ms. Choi stated that the SEC continues to give credit to those who cooperate, particularly those who self-police and self-report violations. Ms. Choi said that the whistleblower program continues to contribute to the Commission's ability to detect and prosecute cases, noting the SEC paid $14 million to a whistleblower in 2013 for information that led to an enforcement action that recovered substantial investor funds.

Marshall Sprung, Co-Chief of the Asset Management Unit (AMU), stated that the AMU was focusing on three areas: registered funds, private funds, and separately managed accounts. Mr. Sprung discussed the Northern Lights settled action, which involved the trustees of two registered series trusts, whom the SEC charged with causing the trusts to violate Section 34(b) of the Investment Company Act based on 15(c) disclosures contained in the trusts' shareholder reports and board minutes. Mr. Sprung highlighted that this action reinforces that trustees and directors must give accurate information to shareholders regarding the process for fee approval. Mr. Sprung noted that the hedge fund arena has been active and that the Commission has been focusing on valuation and using risk analytics to identify hedge funds with suspicious results. Finally, Mr. Sprung remarked that the SEC has been looking closely at compliance issues involving separately managed accounts and has sought civil penalties against firms and chief compliance officers, including for failure to conduct annual reviews.

Michael Osnato, Chief of the Complex Financial Instruments Unit (formerly known as the Structured and New Products Unit), stated that the new mandate for the Complex Financial Instruments Unit is to pursue cases involving the most complicated products in the most complicated parts of the market. Mr. Osnato said this will involve exploring the over-the-counter market to find fraud in areas where there is little price transparency. According to Mr. Osnato, another priority for the coming year is to learn how complex products are used and misused, which will require examining the role of public companies and banks in the use of such products. Lastly, Mr. Osnato highlighted that the SEC will use experts and technology to investigate the use of complex products in the retail market.

Kara Brockmeyer, Chief of the FCPA Unit, noted that her unit brought a variety of cases in 2013, which included "old school" bribery cases funneling money, improper travel and entertainment, and improper charitable donations. Ms. Brockmeyer stated that the SEC continues to see issues with third-party intermediaries, as many companies enter into arrangements with third parties without adequately explaining the roles of the third parties. Ms. Brockmeyer lauded companies for "putting more thought" into compliance programs and internal controls, as well as for their decisions to self-report. She also discussed the Cross-border working group, which has brought 21 fraud actions involving 90 individuals or entities and has revoked the registrations of 63 companies since this initiative started three years ago.

Daniel Hawke, Chief of the Market Abuse Unit, said that his unit will continue to treat large-scale organized insider trading as a high priority area. With the assistance of technology, which helps establish relationships and patterns of trading, Mr. Hawke emphasized that the Market Abuse Unit

has a large and robust pipeline of insider trading investigations in the works. Mr. Hawke also highlighted that his unit is frequently coordinating with criminal authorities so that parallel proceedings are often occurring. Mr. Hawke noted that the Commission will continue to assert enforcement interest in the conduct of exchanges in which they are engaging in for-profit or commercial business activities. Mr. Hawke also discussed the SEC's $12 million settlement with Knight Capital Americas LLC, which was the Commission's first enforcement action under the market access rule, Rule 15c3-5.

Elisha Frank, Assistant Director, Miami Regional Office, and Co-Chair of the Microcap Fraud Task Force, and Michael Paley, Assistant Director, New York Regional Office and Co-Chair of the Microcap Fraud Task Force, spoke about the Commission's new task force on microcap fraud that became operational in October 2013. Ms. Frank stated that the task force's goal was to approach fraud in the microcap fraud area in a more targeted, concentrated manner. Ms. Frank further noted that the task force is focusing on the role of gatekeepers in fraud actions, as well as on the role of repeat players, as identified through FINRA referrals and other tips or information sources. Mr. Paley highlighted the growing effort between the Division of Enforcement and the Division of Corporation Finance to identify patterns and phony registrations.

LeeAnn Gaunt, Chief of the Municipal Securities and Public Pensions Unit, announced that her unit will be focusing on the following three areas: municipal bond underwriting, government board standards and municipal bond trading. Ms. Gaunt further noted that the Commission will generally be pursuing claims involving offering/disclosure violations, tax/arbitrage, pay-to-pay and public corruption, public pension and related disclosing violations, and valuation/pricing in the secondary market. Ms. Gaunt ended her remarks by noting that 2013 was a year filled with many "firsts" for the Municipal Securities and Public Pensions Unit, which included the first enforcement action that resulted in a penalty against a municipal issuer, the first enforcement action that involved material misstatements outside of offering documents in the secondary market, and the first enforcement action alleging further misconduct against a city after a prior cease-and-desist order involving the same conduct.

As highlighted by several speakers, 2014 looks to be another year of aggressive enforcement activity by the SEC across a wide variety of areas, which will include a renewed emphasis on financial reporting fraud and other potential actions, such as insider trading, FCPA violations, asset management, audit failures and compliance deficiencies.

Key Commissioners' Remarks

Commissioner Luis Aguilar noted the achievements of the Commission since he was first appointed in 2009, including the consideration of more than 230 rule-making releases, as well as 15,000 enforcement recommendations. Commissioner Aguilar highlighted the need to address growing cyber threats and discussed a 2012 global survey of market participants, which reflected that 89 percent of participants identified cyber threats as a significant systematic risk, and 53 percent reported to have personally experienced a cyber attack. Commissioner Aguilar also stated that the Commission should focus on more stringent requirements for transfer agents as a means to protect small investors, especially in the wake of ongoing rule-making (i.e., the Dodd-Frank Act and the JOBS Act, including crowd-funding and the loosening of registration requirements).

Commissioner Daniel Gallagher spoke critically of the "monstrous" **Dodd-Frank Act**, including how the many rule-makings were "irrelevant" to the Commission's mandate. Commissioner Gallagher also pushed back against the criticisms of the Commission following the financial crisis, which he claimed

placed inordinate blame on the Commission (rather than also on other regulators and the legislature). Commissioner Gallagher noted the absence of any real debate on the Commission's role in the financial crisis.

Commissioner Kara Stein, in contrast, suggested that the Commission embrace the rule-making responsibilities of the Dodd-Frank Act and the JOBS Act and encouraged the Commission to work with other financial regulators to leverage the relationships for the betterment of the economy and investors.

Commissioner Michael Piwower addressed three surprises in his short tenure at the Commission, which included the Staff's heavy workload (including in connection with rule-making for the Dodd-Frank Act and the JOBS Act), the amount of collaboration between divisions within the Commission, and the enhanced role of economic analysis. Commissioner Piwower highlighted the advantages of economic analysis beyond simply a cost-benefit analysis. He also stressed the nonpartisan nature of economic analysis and noted the enhanced integration of economic analysis in the regulatory framework. Commissioner Piwower emphasized that economic analysis is relevant to not simply rulemaking, but also to supporting compliance, litigation and research.

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