Published on *The National Law Review* https://natlawreview.com

A Compilation of Enforcement and Non-Enforcement Actions

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Non-Enforcement

Whistleblowing Compliance Officer Awarded Over $1 Million By SEC; SEC Announces First Retaliation Award

The SEC announced that a compliance professional has been awarded $1.4 million to $1.6 million for reporting misconduct inside his firm to the SEC. The SEC recently noted that it has paid $50 million to 17 whistleblowers, out of fines collected by the SEC. The previous award to a compliance officer whistleblower was $300,000. In both instances, the compliance officer made a report to management, concluded that no appropriate action was taken, and then took the matter up with the SEC.

The SEC's whistleblower program rewards high-quality, original information that results in an SEC enforcement action with sanctions exceeding $1 million. In addition, the SEC has vigorously responded in connection with a retaliation case – awarding $600,00 to a whistleblower victim of employer retaliation. The whistleblower award stemmed from a June 2014 enforcement action with $2.2 million in fines.

In the matter of Paradigm Capital Management, the SEC found that a hedge fund portfolio manager caused a hedge fund to trade with a broker-dealer (acting as principal) that was under common control with the hedge fund by virtue of the fact that the portfolio manager was a control person of both the fund and the broker-dealer absent the requisite client disclosure and consent mandated by Section 206(3) of the Investment Advisers Act. The SEC also found the adviser's Form ADV to be misleading, for failure to disclose the improper principal transactions. (The Paradigm case is interesting not only as a whistleblower case, but as an example of the difficulty of obtaining consent from an un-conflicted person, in the context of a hedge fund with an general partner under common control with the broker-dealer on the other side of the principal trade.) The then head trader of the adviser who placed the inappropriate trades on the portfolio manager's instructions reported the adviser's misconduct to the SEC and then informed his employer of his whistleblowing, setting in motion a series of retaliatory actions by the employer. The SEC found that the employer's retaliation violated Section 21(F) of the Exchange Act, which prohibits any form of discrimination against a whistleblower, as well as Advisers Act Sections 206(3)(principal trades without valid client consent) and 207 (misleading Form ADV disclosure).

By way of reminder, the SEC operates an Office of the Whistleblower. Under the SEC's whistleblower policies, compliance and internal audit professionals are seen to be on the front lines of addressing compliance matters, but can and (evidently) do become whistleblowers if management's response proves inadequate. Equally, officers and directors of firms that have engaged in misconduct are generally not considered eligible for whistleblower awards. However, if a corporate officer (such as the head trader) or director reports information to the SEC 120 days after other responsible officers (particularly compliance officers) fail to take appropriate action, then the SEC is prepared to reward officer/director whistleblowers. Whistleblower awards can range from 10 percent to 30 percent of the money collected in a case. By law, the SEC must protect the confidentiality of whistleblowers and cannot disclose any information that might directly or indirectly reveal a whistleblower's identity.

New Head of SEC's OCIE Appointed

The U.S. Securities and Exchange Commission on April 9 tapped the second-in-command of its examination office to take the place of its departing director, promoting to "top cop" a former hedge fund manager who helped form the SEC unit that oversees private funds, the office's Private Fund Examination Unit.

Marc Wyatt will become acting director of the agency's Office of Compliance Inspections and Examinations once current director Andrew Bowden leaves at the end of April. Bowden, who only recently announced his departure, said he will rejoin the private sector, but did not specify where he will end up. Wyatt is the OCIE's current deputy director, leading the office's technology controls program.

By way of reminder, OCIE is the head examination office within the SEC. It conducts exams for investment advisers and companies, broker-dealers, market oversight, and clearance and settlement. Wyatt, who specializes in the workings of private equity and hedge funds, joined the OCIE in 2012 as a senior specialized examiner. Before coming to the SEC, Wyatt was a principal and senior portfolio manager at Stark Investments where he served as chief executive of Stark Investments U.K. Ltd. and was responsible for the fund's European activities.

The outgoing Bowden made waves last year when he warned of mass compliance failures within the private equity sector. Bowden told a gathering of private equity industry compliance officers that a recent SEC exam initiative had found more than half of private equity firms appeared to be violating laws or had material weaknesses around how they were assessing fees and expenses on investors and others. The speech has been seen as indicating the intention of OCIE to focus on fees and expenses in the private equity sector, large swaths of which came under the SEC's watch with the passage of the Dodd-Frank Act. Wyatt's appointment as overall head of OCIE seems destined to ensure that the SEC's close focus on private funds under Andrew Bowden is not likely to abate.

Form D's Eligible for Electronic Filing with the States

SEC Form D is used by issuers of securities to file with the SEC the intention to rely on an exemption from securities registration under Regulation D of the Securities Act of 1933. The Form D is filed electronically with the SEC typically within 15 days of the first sale of securities in connection with the exempt offering.

Previous to this year, comparable filings with the states to notice file the issuer's intention to rely on the federal Regulation D exemption required a paper filing with each state securities regulator in which the offering would be conducted along with a filing fee. Issuers who conducted its Reg. D offering in multiple states were required to incur the time and expense of filing with each state.

Now, since early this year, the North America Securities Administrators Association (NASAA), an organization consisting of the state securities regulators of all 50 states and the District of Columbia, has made available an electronic system for filing the Form D's in almost every state via NASAA's Electronic Filing Depository (EFD). The EFD is currently only available to issuers who are relying upon the Rule 506 exemption under Regulation D. It is expected that the EFD will be expanded in the future to accommodate filings for additional exemptions with the state securities regulators.

The EFD not only allows the issuer to make all of its required Rule 506 state exemption filings but also results in a uniform filing system among the various states. Previously, the paper filings with the states could include on a state-by-state basis, additional supplemental filings in addition to Form D.

The EFD is available 24/7 for filers and collects filing fees as well as a one-time $150 system use fee for each offering utilizing the system. Some states have already made it mandatory for Rule 506 issuers to file electronically. Others have made it optional so that the issuer can still make a paper filing with such states and some states have not yet adopted the EFD for use by issuers in their state. One such state is New York, although the New York securities administrator is apparently considering its adoption. New York has been a problematic state for issuers in terms of the timing of its filing requirement (i.e., the filing is required prior to an offer to any person in the State) and the New York Form 99's requirement for the issuer and its officers and directors to list their participation in prior distributions.

It is hoped that if New York adopts the use of the EFD system for issuers offering securities under Rule 506 in the State of New York that the New York requirement to file will be uniform with all other states (i.e., within 15 days of the first sale in the state).

State Regulators Ask for Comments About Model Rule for Broker-Dealer Registration Exemption for Certain M&A Brokers

Since the SEC issued its "no-action" letter in January 2014 regarding merger and acquisition (M&A) brokers who did not register with the SEC as a broker and complied with certain conditions, observers wondered if state securities regulators would step-to-the-plate and provide similar regulatory relief for M&A brokers.

Further, since the SEC no-action letter, legislation has been introduced in Congress to exempt M&A brokers from SEC broker-dealer registration that would go even further, if made into law, in providing regulatory relief for such unregistered brokers.

NASAA has drafted a model rule to be implemented by the 50 state securities regulators and of the District of Columbia that would exempt an M&A broker from state broker-dealer licensing or registration to work side-by-side with the SEC's no-action letter and possibly federal legislation that may be enacted. Even if this model rule is adopted by NASAA, it would still be up to each state to determine whether or not to adopt the rule by rule or order under its state securities law.

The model rule which is being considered by NASAA and for which it is asking for public comments until May 17, 2015, would serve to exempt from state broker-dealer licensing or registration, an M&A broker under the following conditions:

1. Excluded Activities.
a. The exemption would not be available if the M&A broker directly or indirectly takes custody of funds or securities of issuers involved in the M&A transaction; or

b. Engages on behalf of an issuer in a IPO or that is already a reporting company under Section 12 of the Securities Exchange Act of 1934; or engages on behalf of any party in a transaction involving a public shell company. In addition, the private company involved in the M&A transaction would need to meet either one or both of the following in the fiscal year ending immediately before the M&A transaction:

i. The earnings of the company before interest, taxes, depreciation, and amortization is less than $25,000,000;

ii. The gross revenues of the company are less than $250,000,000.

2. Disqualifications. The exemption would not be available if the M&A broker is subject to certain “bad-boy” provisions as specified.

Enforcement

Recent SEC Enforcement Actions Target False Reporting by Investment Advisers Regarding Assets Under Management

In three separate matters since the start of 2015, the SEC has reported enforcement actions against SEC registered investment advisers and certain of their principals for, among other things, falsely reporting to the SEC and the public the amount of their assets under management (AUM).

In the matter of Logical Wealth Management, Inc. and Daniel J. Gopen (SEC IA Release No. 4027, February 19, 2015), in the matter of Acamar Global Investments, LLC and Rudolph A. Martin (SEC IA Release No. 4050, March 18, 2015) and the in the matter of Aegis Capital, LLC, Circle One Wealth Management, LLC, Diane W. Lamm, Strategic Consulting Advisors, LLC and David I. Osienboro (SEC IA Release No. 74608, March 30, 2015), the SEC alleged violations under the Investment Advisers Act of 1940, for, among other things, filing a false statement with the SEC with respect to the registrant’s amount of AUM at the time of filing its Form ADV with the SEC. The information included in the Form ADV filing is available to the public and is required to be provided by the investment adviser to clients and prospective clients.

In the case of the Logic Wealth Management matter, the adviser and its president and chief compliance officer (CCO) agreed to the issuance of an SEC cease and desist order, revocation of the adviser’s SEC registration and the CCO’s bar from association with an investment adviser, among others, and serving or acting as an employee, officer, director or member of an advisory board of an investment adviser. In addition, the CCO was ordered to pay a $25,000 civil penalty. In the Logical Wealth Management matter, the adviser never qualified for SEC registration by having the required AUM (i.e., at least $100 million in AUM), although it repeatedly reported on its Form ADV that it did.

In the Acamar Global Investments matter, the adviser reported on Form ADV that it had in excess of $180 million of AUM when in fact, it never had more than $200,000 of AUM. In order to settle the matter, the adviser and its principal agreed to the issuance of a cease and desist order and a bar for Mr. Martin from being associated with, among other entities, an investment adviser or serving as an employee, officer, director, or member of an advisory board of an investment adviser. A civil penalty was not imposed by the SEC after the respondents filed a notice of an inability to pay a civil penalty.

In the matter of Aegis Capital, et al., the adviser had outsourced the adviser's CCO responsibilities to an outside compliance firm, Strategic Consulting Advisors. David Osienboro an attorney and principal of the outside compliance firm was designated on the adviser's Form ADV as its CCO. Aegis had falsely claimed on its Form ADV to have nearly $165 million of AUM and over 1,500 clients when in fact, it never had that much of AUM or number of clients. With respect to such conduct, according to the SEC, the adviser and the outside CCO by filing an inaccurate Form ADV with the SEC, violated Section 207 under the Advisers Act which makes it unlawful for a person to make an untrue statement of a material fact in a report filed with the SEC. The SEC issued a cease and desist order against the various respondents and will determine at a later date, what, if any, other penalties will be issued in the matter.

All three of these matters, announced in the first three months of 2015, demonstrate the gravity of making a false filing with the SEC. Although each of the matters described above had allegations of violations of certain other provisions under the Advisers Act, the common thread is the false reporting by the advisers of AUM within the Form ADV.

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National Law Review, Volume V, Number 120

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