Highlights from SEC Speaks 2018: Litigation and Enforcement Trends

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The U.S. Securities and Exchange Commission (“SEC” or the “Commission”) held its annual SEC Speaks conference in Washington, DC on February 23 and 24, 2018 and provided remarks from the Chairman and commissioners, discussions regarding current enforcement initiatives and enforcement priorities for the upcoming year and an update on litigation, judicial and legislative developments.

Highlights from this year’s conference included the opportunity to hear from all five SEC commissioners, after over two years of vacancies at the SEC’s highest level of leadership, as well as discussions concerning new initiatives, including a self-reporting program for share class selection disclosure issues through the Share Class Selection Disclosure Initiative, a Cyber Unit focusing on cyber-based misconduct and a Retail Strategy Task Force aiming to identify misconduct affecting retail investors. Additionally, staff from the SEC’s Division of Enforcement (the “Division”) emphasized a focus on protecting retail investors and reiterated the SEC’s commitment to utilizing technology in initiating and pursuing investigations, incentivizing and protecting whistleblowers, targeting recidivist offenders and rewarding meaningful cooperation.

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Chairman's Speech and Commissioners' Remarks

Chairman Clayton

Chairman Jay Clayton delivered opening remarks and reflected on his first year leading the SEC. Chairman Clayton first provided what he described as a "practitioner's analysis of the Commission," and then he answered questions in a Q&A session with former SEC Chairman Harvey Pitt.

In providing a "practitioner's analysis" of the SEC, Chairman Clayton examined the Commission from the lens of a private practitioner performing due diligence in order to evaluate an organization. As part of this analysis, Chairman Clayton described the SEC as having "a foundation of exceptional design and resilience" but one with limited resources, particularly "in comparison to companies that operate in the financial markets." In keeping with his "practitioner's analysis," Chairman Clayton described the SEC's staff as being the Commission's "goodwill." In concluding his analysis, Chairman Clayton expressed his vision for the SEC as an organization that should be "nimble and forward-looking" and whose "special sauce," or differentiator, is its adaptability.

During the Q&A session with former Chairman Pitt, Chairman Clayton addressed his enforcement priorities, which he described as "hav[ing] maximum impact on returning dollars to 'main street' investors, or preventing money from being taken from them." He referenced a need to focus on financial institutions as a means of protecting the long-term interests of "main street" investors. In keeping with the "main street" investors theme, Bill Hinman, Director of the SEC's Division of Corporate Finance, noted in his introduction of Chairman Clayton that the terms "Mr. and Ms. 401(k)" and "main street investor" are becoming key terms within the SEC under Chairman Clayton's tenure.

Chairman Clayton also expressed the view that having more public companies would benefit both retail investors (as they would have more investment options without the barriers associated with private investments), as well as companies themselves (as they complete the initial public offering process and become stronger companies with better financial reporting). He believes that an increase in the number of public U.S. companies can be accomplished without eliminating protections for investors.

Finally, Chairman Clayton expressed a desire to establish a single, meaningful standard of conduct for all investment professionals. He noted that a retail investor's relationship with his or her investment adviser and/or broker-dealer are governed by many different regulators and that "having that many people with different standards and lenses leaves room for us to bring regulatory harmony."

Commissioner Stein

Commissioner Kara M. Stein's remarks focused on the evolution of financial products and what she feels is at stake with the increasing complexity of the options available to investors. Commissioner Stein expressed her view that, in this "era of the possible," the advances in financial innovation and engineering have facilitated the development of new and even more complex financial products and have also allowed the rapid proliferation of these products into the hands of retail investors. Commissioner Stein noted that now, when investors literally have more investments at their fingertips than ever before, the question ought not to be "*can* we develop and sell new and more complex products to investors," but rather "*should* we?"

Using an analogy to Steven Spielberg's movie *Jurassic Park*, Commissioner Stein compared retail investors to the park guests. From the guests' viewpoint, the dinosaurs were majestic, at least from afar. When guests experienced the dinosaurs up close, however, the creatures became unpredictable, if not outright terrifying. Commissioner Stein further noted that, in the movie, the scientists that engineered the dinosaurs did not fully understand their capabilities, the unintended effects of their creations or the collateral damage that would inevitably follow. Commissioner Stein indicated that, through her analogy, she was not intending to suggest "that every complex financial product is equivalent to a tyrannosaurus rex or velociraptor—that is, something scary, dangerous, and unpredictable." Commissioner Stein noted that all investments bear at least some degree of risk, and she recognized that there is a sliding scale of complexity. But she expressed her view that the questions really should be whether certain products are appropriate for all investors; how these products are being sold, particularly to retail customers; and whether, even if the disclosure is perfectly clear, it appropriately informs investors' decision-making.

Commissioner Stein addressed the range of derivative products and strategies available to investors now, noting the range of complexity from covered call strategies on the "simpler side" to far more exotic and complex products like "straddles, strangles, iron condors, iron butterflies, twin-win notes, worst of notes, and buffered super track notes." While recognizing that there are differing views as to whether derivatives can be risk-moderators, Commissioner Stein noted that the question ought to be “should certain complex and esoteric products or strategies be targeted to retail investors?”

Commissioner Stein discussed ways in which the Commission could address the problems that arise from these new and complex products. First, she noted that the Commission, FINRA and the exchanges need to be able to understand the full impact these products have on the markets and investors. According to Commissioner Stein, part of that includes finalizing the consolidated audit trail (the “CAT”). The CAT is critical to overseeing the capital markets and will help the Commission and the self-regulatory organizations catch up with the industry’s technological evolution. Second, Commissioner Stein stated that the exchanges listing these complex products must be able to effectively surveil for problems. Without the ability to monitor for problems, Commissioner Stein questioned whether the exchanges should even be listing the products to begin with. She further commented that, if there is a problem, the Commission should require the exchanges to have protective mechanisms in place to address them. Finally, Commissioner Stein noted that part of the solution must come from industry professionals and gatekeepers, including lawyers, accountants, investment advisers and broker-dealers.

Commissioners Piwowar, Peirce and Jackson

Commissioner Michael Piwowar held a round table discussion with newly appointed SEC Commissioners Hester Peirce and Robert Jackson Jr., who were both sworn in on January 11, 2018. This marked the first time in 837 days, according to Commissioner Piwowar, that the SEC has had a full five-person commission. Commissioner Piwowar commented that Commissioners Jackson and Peirce started attending meetings 30 minutes after being sworn in and “haven’t stopped running since.”

Commissioner Peirce, a “well-known scholar on the regulation of financial markets,” as Commissioner Piwowar introduced her, placed a strong emphasis on the importance of economic analysis. She stated that there is a tendency in government to move forward with regulation without really thinking about the underlying problem that needs to be solved. Economic analysis and data allows the agency to take a step back, clearly define the problem and consider all of the solutions. Commissioner Peirce stated that her experience on Capitol Hill, and especially during the financial crisis, showed her the importance of regulator accountability to Congress. She looked at what led to the financial crisis, and the role played by regulations makes her “cautious” about the unintended consequences of well-intended regulations.

Commissioner Jackson, who was previously a law professor at Columbia University, stated that the SEC is where law and finance come together and emphasized that the melding of the two disciplines is essential to prevent another financial crisis. He believes that empirical research allows everyone to start with the same premises for a particular action where politics can often get in the way. He spoke about his previous position at the Treasury Department during President Obama’s administration, and he thinks that the SEC creates the same “family feel.”

Both new Commissioners expressed their passion for public service and their motivation to make a difference in the lives of the ordinary investor. They both see a new energy at the SEC, which they attribute largely to Chairman Clayton, “who has really come in with an outsider’s view and has asked us how we can make things work better,” Commissioner Peirce stated. Commissioner Jackson echoed her sentiment, stating that Chairman Clayton “comes to the job wanting to get things done.” Although the two Commissioners have sharply divergent views on Dodd-Frank (Commissioner Peirce is a well-known critic, while Commissioner Jackson is a strong supporter of the legislation), they do see eye-to-eye on the Commission’s three-part mission: protect investors; maintain fair, orderly and efficient markets; and facilitate capital formation. Both Commissioners believe that each part of the tripartite mission is interconnected and that their role as Commissioners is to find a solution that achieves all of the goals and balances the competing considerations.

Enforcement

Speakers from the Division discussed recent cases, as well as the Division's priority areas for 2018, which include cybersecurity, cryptocurrency offerings, protection of retail investors and a continued focus on use of technology and data analysis to generate and support investigations.

Overview and Observations

Stephanie Avakian, Co-Director of the Division, noted that the cases brought under the tenure of her and Steven Peikin (Co-Director of the Division) over the past nine months demonstrate that the Division's overall priorities have not changed and that the Division continues to cover a broad landscape. However, the Division has devoted more resources to the areas of cybersecurity, cryptocurrencies and retail investor matters. Specifically, the Division announced the creation of a Cyber Unit and a Retail Strategy Task Force on September 25, 2017. Ms. Avakian and Mr. Peikin stated that they continue to focus on how to most effectively and efficiently focus their resources in a variety of areas, but particularly in the cybersecurity/cryptocurrency and retail investor areas.

Mr. Peikin discussed the recently created Share Class Selection Disclosure Initiative program, which the SEC just recently announced on February 12, 2018, noting that it is an effort to deal with a recurring and widespread problem—namely investment advisers who put their clients into higher-fee mutual fund share classes when lower- or no-fee classes are available. The goal of this new program, which is being run by the SEC's Asset Management Unit, is to get as much money returned to harmed investors as soon as possible and, to that end, the program incentivizes self-reporting by offering standardized settlement terms resulting in disgorgement or return of money to impacted investors with no penalties assessed against the self-reporting firm.

Notably, as set forth in the SEC's announcement of the Share Class Selection Disclosure Initiative, the program "covers only eligible advisers" and the SEC "provides no assurance that individuals associated with these entities will be offered similar terms if they have engaged in violations of the federal securities laws." Accordingly, with respect to individual liability, there are no assurances from the SEC that individual executives will not be charged personally in connection with any settlements achieved through this new self-reporting initiative. Anthony Kelly, Co-Chief of the Asset Management Unit, noted that failure to self-report under the Share Class Selection Disclosure Initiative program can result in the SEC imposing greater-than-ordinary penalties if such conduct is later uncovered by the SEC. In the wake of this new Share Class Selection Disclosure Initiative, investment advisers will likely need to assess facts and issues quickly in determining whether it makes sense to self-report to the SEC through this program.

Mr. Peikin also noted that the Division's FY 2017 Annual Report, released on November 15, 2017, identified five broad principles that are indicative of how the SEC views enforcement: (1) "Focus On The Main Street Investor"; (2) "Focus On Individual Accountability"; (3) "Keep Pace With Technological Change"; (4) "Impose Sanctions That Most Effectively Further Enforcement Goals"; and (5) "Constantly Assess The Allocation Of Our Resources."

Collaboration with Office of Compliance Inspections and Examinations ("OCIE")

Jeffrey Boujoukos, Regional Director of the Philadelphia Office, highlighted how collaboration between the Division and OCIE leads to enforcement recommendations. He stated that the Division works closely with OCIE, using its examination findings, and that OCIE guidance may highlight key enforcement areas of the future. With respect to referrals from OCIE to the Division, Mr. Boujoukos noted that OCIE considers the Division's priorities as a whole, and notes areas of interest during an exam that overlap with such priorities. The Division also relies upon OCIE to provide knowledge on retail investor matters and, through exams, provide insights and information that assist in carrying out enforcement priorities.

Mr. Boujoukos concluded by suggesting that examined entities and individuals should take responses to deficiency letters seriously, should make efforts to respond promptly and should take advantage of opportunities to resolve problems at the examination stage.

Cyber Matters

Robert A. Cohen, Chief of the SEC's Cyber Unit, noted that this new unit includes 30 staff members located in Chicago, New York, Philadelphia, San Francisco and Washington, DC. Mr. Cohen noted that the unit will focus on cyber-related misconduct, including (1) market manipulation schemes involving false information spread through electronic and social media and falsified EDGAR filings; (2) hacking to obtain material nonpublic information; (3) misconduct perpetrated using the dark web; (4) intrusion into retail brokerage accounts; and (5) other cyber-related threats to trading platforms and other critical market infrastructure.

Mr. Cohen also focused on violations related to distributed ledger technology (i.e., blockchain technology) and Initial Coin Offerings ("ICOs"), including three specific types of cases. The first type of case involves garden variety fraud and/or Ponzi schemes in which companies mislead investors by putting "blockchain" or "crypto" on the name of a fund without holding any securities related to blockchain or cryptocurrencies. This is done to increase the likelihood of attracting investors who see these key cyber-related buzzwords. The second type of case deals with material misrepresentations made to investors as part of an ICO or other types of fraud relating to ICOs. The third type of case involves non-fraud registration concerns, such as where a company preparing for an ICO failed to determine whether the digital token was a security, such that the offering of the token should have been registered with the SEC. The Commission released an investigative report in 2017 relating to DAO tokens and explained that digital tokens can be considered securities and that ICOs must thus be registered or qualify for an exemption. Later in 2017, the SEC shut down the ICO of Munchee Inc. for registration failures. In the SEC's view, the DAO report and the Munchee Inc. action put the market on notice, and the Commission may now seek greater remedies in these cases than it has in the past. The SEC views the fact that companies are now hiring competent law firms to conduct registration analyses surrounding ICOs as a sign of progress in this area.

Mr. Cohen highlighted cases that exemplify the recent work of the Cyber Unit. The Unit's first enforcement action was *SEC v. PlexCorps*, in which the SEC obtained an emergency asset freeze to halt an ICO fraud that raised approximately $15 million from thousands of investors by falsely promising a 13-fold return in less than a month. In *PlexCorps*, the Commission also brought charges against Dominic Lacroix, an alleged recidivist securities law violator, and PlexCorps itself for violating the registration provision of the federal securities laws. Mr. Cohen also commented on *SEC v. AriseBank*, in which the Cyber Unit halted an allegedly fraudulent ICO that targeted retail investors to fund what it claimed to be the world's first "decentralized bank." According to the SEC, AriseBank and its co-founders allegedly offered and sold unregistered investments in their token. Lastly, Mr.

Cohen highlighted the SEC's case against Jon Montroll and BitFunder, in which the SEC alleged that Montroll and BitFunder operated as an unregistered securities exchange and defrauded users by making false and misleading statements in connection with an unregistered offering of securities. Furthermore, the SEC's complaint alleged that Montroll misappropriated investors' bitcoins and failed to disclose a cyberattack on the exchange's system and resulting bitcoin theft.

Mr. Cohen also noted that while the Cyber Unit's work is mostly reflected through enforcement actions, it has also been able to induce approximately twelve ICOs to be voluntarily put on hold pending review of whether the underlying token is a security such that the offering of the token must be registered with the Commission.

Asset Management and Retail Investor Matters

Anthony Kelly, Co-Chief of the Asset Management Unit, noted that his unit spends substantial time focusing on the various incentives that can cause advisers to "drift away" from their fiduciary duties and that the unit continues to dedicate a significant amount of time and resources to issues involving wrap fee programs, separately managed accounts, mutual funds and exchange-traded funds ("ETFs"). In particular, the unit looks at full and fair disclosure of conflicts, utilization of products for the primary purpose of generating fees, charging fees for services not provided (e.g., where an investment adviser representative assigned to provide advisery services to a customer account leaves his or her firm and no new representative is assigned to that customer account, yet advisery fees continue to be charged), arrangements with third-party service providers, cherry picking, trade allocation, misappropriation of investor assets, and use of investor proceeds for payments in violation of Rule 12b-1 under the Investment Company Act. While the Division recently formed the Retail Strategy Task Force, consistent with a focus by the Asset Management Unit on retail issues, according to Mr. Kelly the unit has not walked away from other areas, such as the private fund space, which accounted for 10 new cases in 2017. The Asset Management Unit is also focused on issues surrounding proprietary and affiliated products, such as inadequate disclosures regarding the sale of proprietary vs. non-proprietary products, product fees and an adviser's preference for proprietary products.

Finally, Mr. Kelly touched on the issue of cooperation credit, criticizing investigation subjects (and their counsel) who seek cooperation credit for timely producing documents and giving testimony—tasks that Mr. Kelly pointed out are legal obligations and do not warrant cooperation credit. Rather, according to Mr. Kelly, the SEC looks for a "plus" factor when assessing cooperation. Specifically, the SEC looks for something that an investigation subject has done that allowed for resolution of the matter in a shorter amount of time or with use of fewer resources than otherwise would have been necessary. Additionally, the SEC considers the voluntary return of assets to harmed investors to be cooperation. The SEC continues to encourage cooperation and seeks to recognize and reward such actions. Ms. Avakian, Co-Director of the Division, stated that the SEC's *Seaboard*factors are still the standard in assessing cooperation.

Retail Strategy Task Force

Charu Chandrasekhar, Chief of the Retail Strategy Task Force that was announced in September 2017, discussed the Division's focus on developing means of proactively identifying misconduct that impacts retail investors. In particular, the task force utilizes data analysis and technological resources to sort voluminous trading data by product, investor type, investor location, sales or trading practices, and by fees. Misconduct that the task force seeks to identify ranges from the sale of unsuitable structured products to cybersecurity fraud. Ms. Chandrasekhar noted that, while the task force remains focused on boiler room fraud, Ponzi schemes, and microcap fraud, the task force considers the term “retail” to be much broader than that. For example, misconduct in the “retail” context encompasses any conduct by professionals that impacts retail investors, including inadequate fee disclosures and unsuitable investment recommendations.

Problems the task force sees in this space include offerings or recommendations of mutual fund share classes with higher fees when classes with lower fees are available, fee disclosure issues, unsuitability issues with regard to ETF products, and churning and excessive trading. Additionally, retail fraud has developed a significant overlap with cyber fraud, and the task force is now seeing retail investor fraud in tandem with ICOs.

FCPA

Charles E. Cain, Chief, FCPA Unit, recapped FCPA activity from 2017. Per Mr. Cain, after a “blockbuster year” in 2016, the unit’s enforcement activity continued to be strong in 2017 but was more in line with recent averages prior to 2016. Mr. Cain noted that the unit brought significant cases against individuals and entities across many sectors, including the financial services, health science and extractive industries. Key priorities for 2018 include combating recidivism and individual accountability, which presents unique challenges stemming from the fact that many culpable individuals are foreign nationals residing overseas.

International cooperation continued to be an important theme for the FCPA Unit. Last year, it worked with Dutch authorities to obtain a $965 million joint resolution with Telia, a Swedish-based telecommunications provider, related to misconduct in Uzbekistan. The unit seeks to continue to build strong relationships with its foreign counterparts, and Mr. Cain noted that the SEC hosted a weeklong foreign bribery training program with the FBI, DOJ and prosecutors from around the world in October 2016 and expects to do another similar program within the next year.

Financial Fraud and Audit

Margaret S. McGuire, Chief, Financial Reporting and Audit Group, discussed key cases from 2017. The SEC brought 95 enforcement actions relating to financial reporting and audit-related matters in FY 2017, which constituted 25% of all actions brought by the Division during that period. These cases included issues relating to capitalization, fictitious revenue and impairment. The group is currently seeing issues in the areas of revenue recognition in new or emerging business models, related-party transactions where disclosures are misleading or completely absent, and internal controls over financial reporting. In investigating these issues, the group focuses on both required and voluntary disclosures made to the investing public. Ms. McGuire also noted that the group continues to keep a critical eye on audits and auditors.

Ms. McGuire provided insight into how her group operates, noting that it utilizes liaisons—teams of attorneys and accountants in each regional office and the home office—that work closely with the group to help identify new matters earlier and more efficiently. The group also continues to rely on both internal and external technologies in support of its mission, and it even creates its own technology where it does not yet exist. These tools allow the group to look at more issuers more quickly and more efficiently, and to see more of the transactions that are going on with these companies. One such tool is the Corporate Issuer Risk Assessment Tool, which provides a full view of an issuer’s reporting environment and allows the group to compare an issuer to itself (comparing period-over-period disclosures) and its peers. Ms. McGuire also noted that the group coordinates with the Division of Economic and Risk Analysis (“DERA”) to utilize DERA’s tools in reviewing voluminous data from issuers. DERA's tools allow for side-by-side comparisons of financial statements, including having redline capabilities to compare various footnotes and other information. The group is also able to identify any issuers that have used a particular term or a unique XBRL tag in their public filings.

Complex Financial Instruments

Daniel Michael, Chief, Complex Financial Instruments Unit, discussed the unit's priorities for the year. One substantive area that the unit has recently focused on is cross-trades, specifically the concern that managers who move securities from one client account to another may be improperly providing an advantage to one client over the other. The unit has found the use of data analytics to be particularly helpful in identifying potential improper cross-trading activity that is worthy of follow-up and review by the SEC. Another area of concern is mismarking, due to the stark consequences and steep losses that can be triggered by such activity. While this area is fraught with subjectivity and issues with opacity, the unit looks for collusion among traders or traders who incentivize third-parties to provide marks that do not truly reflect the fair value of securities.

Mr. Michael stated that the sale of complex products to unsuitable investors continues to be an issue and noted that the unit brought several cases against broker-dealers who offered structured notes to retail investors. When examining such activity, the unit asks three questions: (1) is the broker-dealer discharging its obligation to recommend suitable products; (2) did the offering materials ensure that investors received adequate disclosures regarding fees and costs; and (3) are broker-dealers recommending trading strategies without adequate bases?

As an illustration of the unit's commitment to protecting investors who trade in opaque markets, Mr. Michael highlighted a case the SEC settled several weeks ago with Deutsche Bank, who agreed to repay approximately $3.7 million to customers. The SEC found that several of the bank's traders made misrepresentations to customers regarding prices while negotiating sales of commercial mortgage-backed securities. Mr. Michael noted that, despite the fact that the parties in transactions such as these are often sophisticated and institutional, it does not remove broker-dealers' obligations to provide accurate information.

This year, the unit seeks to continue to identify fraudulent practices in opaque markets, maximize its use of data analytics and prevent the offering or sale of complex products to unsuitable investors. While the unit has historically focused on structured notes, Mr. Michael expects that its focus will extend beyond that to other products in the market, such as complex ETFs.

Broker-Dealers

Antonia Chion, Chief, Broker Dealer Task Force, and Associate Director, Home Office, discussed the key cases and areas of focus for the task force. Ms. Chion stated that the task force is focused not only on primary violators (especially repeat offenders), but also on gatekeepers, including broker-dealers, lawyers, auditors and transfer agents. She noted that there are often parallel criminal proceedings in cases of microcap fraud, including regarding gatekeepers. Ms. Chion stated that the task force is working closely with many foreign regulators to pursue targets located outside of the United States who operate off-shore or through foreign entities.

Ms. Chion highlighted two exemplary cases from 2017. In the first case, the Division brought an injunction action against various individuals and entities alleged to have engaged in a complex shell operation. The Commission alleged that the defendants created the shell companies, issued stock to nominee officers and directors, created fake business plans and had audits conducted. Thereafter, the defendants sought to have the securities registered for sale, conducted a sham IPO, and purported to sell shares to investors but continued to maintain control over the shares. They also brought a case against the lawyer for the companies for aiding and abetting the fraud. The lawyer had assisted in drafting false and misleading registration statements and signed false opinion letters. In the second case, filed last year against Colorado-based broker-dealer Alpine Securities, the Commission alleged that there was a failure to file suspicious activity reports ("SARs") in certain instances but also alleged that, in instances where SARs were filed, they contained so little information that there was no way to understand why the activity was suspicious. This second case is indicative of the task force's focus on the intersection of broker-dealers and anti-money laundering ("AML") obligations in the microcap area. Ms. Chion noted that the task force was seeing cases where there was an outright failure to file any SARs where the broker-dealer had reason to know of suspicious activity. She noted the importance of effective AML programs, which is also an OCIE priority. OCIE will focus on whether firms are appropriately adapting their AML programs to address various regulations.

Market Abuse and Market Structures

Joseph Sansone, Chief, Market Abuse Unit, highlighted three areas of emphasis for the unit. First, the unit had success in identifying insider trading. In 2017, the SEC brought 41 actions against 100 defendants. In one case, *SEC v. Rivas*, the unit identified insider trading committed by an IT employee of a large bank, who ultimately used inside information from the bank to tip friends and downstream tippees. Mr. Sansone noted that data analytics played a key role in detecting these illicit trades, which resulted in the individuals making millions of dollars over a period of two-and-a-half years. The individuals attempted to conceal their activity through the use of a complicated set of encrypted messages and shell companies, but the unit was able to analyze the historical patterns of trading and detect the connections that the individuals sought to hide.

The unit also had success in attacking market manipulation schemes. In *SEC v. Avalon*, the SEC filed charges against a Ukraine-based firm that perpetuated a $30 million manipulation scheme and the New York-based broker-dealer that assisted with the scheme. The unit was able to analyze millions of rows of trade data to decipher the fraudulent activity and the SEC was ultimately able to obtain an asset freeze and order requiring the trading firm to repatriate assets to the United States. The SEC prevailed against a motion to dismiss filed by the defendant broker-dealer, and that case is still being litigated.

The final area that Mr. Sansone discussed was algorithmic trading, which is an area where the unit also heavily relies on data analytics. Mr. Sansone described a recent case against Citadel Securities, where Citadel made misleading statements to other brokers who sent retail customer trades to its firm, regarding two algorithms it employed. The unit obtained a $22.6 million settlement from the firm.

Public Finance

LeeAnn G. Gaunt, Chief, Public Finance Abuse Unit, talked about her unit's focus on misconduct in the municipal bond market and public pension funds. In particular, because municipal bonds are largely held by retail investors, this area of focus is well-aligned with Chairman Clayton's prioritization of protecting "main street" investors. Within the municipal bond market, the unit continues to focus on offering and disclosure frauds and broker-dealer fraud in initial offerings. In 2016, the Unit concluded its Municipalities Continuing Disclosure Cooperation ("MCDC") Initiative, pursuant to which it had recommended favorable settlement terms for issuers and other individuals involved in the offer or sale of municipal securities—as well as underwriters of such offerings—if they self-reported to the Division possible violations involving materially inaccurate statements involving Rule 15c2-12 under the Securities Exchange Act of 1934. Issuers and underwriters who did not participate in the MCDC Initiative did not benefit from the same leniencies and were subject to more severe disgorgement and penalties, highlighting—according to Ms. Gaunt—that there are real, tangible benefits to cooperation and self-reporting.

Ms. Gaunt discussed the unit's increased focus on public corruption. While these cases typically involve bribes or kickbacks in connection with public pension funds, the unit has also recently seen instances of corruption in the municipal securities space. Ms. Gaunt highlighted charges that were brought against Oyster Bay, New York and a former town supervisor in connection with defrauding municipal bond investors by concealing side deals with a local restaurateur as well as a recent case brought against the former mayor of Markham, Illinois for his alleged involvement in a pay-to-play scheme in connection with a 2012 bond offering by the city.

Other Priorities and Initiatives

Richard Best, Regional Director of the SEC's Atlanta Office, noted that the Division is also focused on its efforts to combat recidivism and on maintaining its whistleblower program. Regarding issues of recidivism, Mr. Best referenced the SEC's case against Nicholas Genovese and Willow Creek Advisers, and the success of the SEC's Miami Office's Recidivist Initiative that resulted in enforcement actions against 23 individuals (nine of whom also have been charged by criminal authorities). Regarding the whistleblower program, Mr. Best noted that in 2017 the SEC received over 4,484 tips across the U.S. and 72 countries worldwide, amounting to approximately 12 tips per calendar day. To date, the SEC has paid out over $179 million to whistleblowers, and collected over $1 billion in remedies and $671 million in disgorgement from whistleblower tips. For FY 2017, the SEC paid more than $50 million to 12 whistleblowers, including four of the ten highest-ever SEC whistleblower awards.

Legal and Policy Developments

Joseph K. Brenner, Chief Counsel for the Division, discussed arguments typically raised by defendants against the SEC related to "scheme liability" under Rules 10b-5(a) and (c) under the Securities Exchange Act of 1934 and Sections 17(a)(1) and (3) of the Securities Act of 1933. He noted that defendants who make broad "scheme liability" arguments in response to the above rules and statutory provisions are disregarding nuanced but important distinctions between these rules and statutory provisions. For example, Rule 10b-5(a) prohibits "employ[ing] any*device*, scheme, or *artifice* to defraud . . . in connection with the purchase or sale of any security" and, similarly, Sections 17(a)(1) and (3) each prohibit "any *device*, scheme, or *artifice* to defraud." Mr. Brenner explained that the texts of these statutes and rules—and the differences between them—matter and that, for example, the words "device" and artifice" are just as important as "scheme." Similarly, while Rule 10b-5(c) pertains to an "*act*, practice, or course of business," Section 17(a)(3) pertains to "any *transaction*, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." According to Mr. Brenner, the distinction between "acts" and "transactions" is important.

To illustrate his point, Mr. Brenner discussed the SEC's litigation against Francis Lorenzo ("Lorenzo"), who was charged with violating Section 17(a)(1), Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5. In response, Lorenzo broadly argued that he was not liable because he was not a "maker" of the alleged misrepresentations. Lorenzo did not tailor his arguments to the specific verbiage of each statute and rule under which he was charged. The DC Circuit specifically noted this shortcoming in rejecting Lorenzo's argument. Mr. Brenner further expressed his belief that the DC Circuit's opinion should make practitioners and defendants consider whether they still want to make the argument that the Commission must prove deceptive conduct to find a defendant liable under Rules 10b-5(a) and (c) and Sections 17(a)(1) and (3). Furthermore, he noted that even if a defendant were to convince a court that proof of deceptive conduct is required, courts have found a broad range of conduct to be considered "deceptive," and the SEC is typically able to point to something in the record that falls within this broad category.

Litigation and Judicial Developments

Bridget Fitzpatrick, Chief Litigation Counsel; Robert B. Stebbins, General Counsel of the SEC; Michael A. Conley, SEC Solicitor; and various members of the SEC's Office of the General Counsel discussed recent litigation and judicial developments.

Pre-trial Asset Recovery

Ms. Fitzpatrick highlighted the SEC's recent success in obtaining pre-trial recovery of assets, including via emergency relief, by identifying three cases that had key developments in 2017. In *SEC v. Shapiro*, an alleged Ponzi scheme case, the SEC obtained an asset freeze and receivership, resulting in the target company's operations being turned over to a board of fiduciaries to manage and liquidate assets. In *SEC v. Jammin Java Corp.*, an alleged pump-and-dump case, the SEC obtained $58 million in pre-trial remedies including via summary judgment on scienter-based fraud charges. In *SEC v. Liu*, the SEC stopped an alleged EB-5 offering fraud and obtained $35 million in pre-trial remedies, including via a temporary receivership and on summary judgment.

Disgorgement Post-Kokesh

Ms. Fitzpatrick discussed *Kokesh v. SEC*, in which the United States Supreme Court ruled that disgorgement is a penalty and is governed by the five-year statute of limitations set forth in 28 U.S.C. § 2462. She indicated that this ruling is playing out on three fronts. First, there have been defendants from prior SEC cases, previously resolved via settlement, who have petitioned to challenge their settlement agreements based on the issues raised by *Kokesh*. The SEC stated that courts have consistently rejected these arguments and refused to set aside settlement deals that were previously negotiated. Second, the SEC is seeing cases where the alleged misconduct resulted in ill-gotten gains received both within and outside of the limitations period. The SEC and courts have reopened such cases to determine how to calculate the damages that occurred within the five-year limitations period. Third, the SEC is seeing cases where defendants attempt to expand *Kokesh* by arguing that disgorgement is no longer a remedy or that *Kokesh*applies to other relief, such as injunctions. In these cases, according to Ms. Fitzpatrick, courts have largely held that *Kokesh* is a limited ruling that looks at disgorgement within a specific statutory context—28 U.S.C. § 2462—and does not apply to other remedies.

Sarah R. Prins, Senior Counsel, highlighted that *Kokesh*left open the question of whether disgorgement constitutes an equitable remedy and was silent on the authority of courts to order disgorgement. Mr. Conley, SEC Solicitor, stated that the SEC is continuing to seek disgorgement and that it is the SEC's position that disgorgement is an inherently equitable remedy.

Steven Peikin, Co-Director of the Division of Enforcement, added that *Kokesh* has impacted the SEC's investigative procedures. When the SEC seeks to investigate conduct that is "aged," it now moves swiftly to obtain a tolling agreement. The ruling in *Kokesh* has also impacted case selection, as the SEC is being more judicious about whether to start an investigation into conduct that occurred years prior.

Administrative Law Judges

There have been a host of cases in the past year challenging the constitutionality of SEC administrative law judges ("ALJs"), notably with the DC Circuit Court of Appeals and Tenth Circuit Court of Appeals creating a circuit split that the United States Supreme Court is expected to resolve in the coming months. In each case—*Bandimere v. SEC* (10th Circuit) and *Lucia v. SEC*(D.C. Circuit)—the plaintiffs contended that SEC ALJs are subject to the Appointments Clause of the U.S. Constitution, such that appointment by anyone other than the president is unconstitutional. In an *en banc*decision, the DC Circuit held that SEC ALJs are employees and thus not subject to the Appointments Clause, whereas the Tenth Circuit held that SEC ALJs are inferior officers subject to the Appointments Clause. The Supreme Court granted certiorari in *Lucia*, which is currently being briefed and will be argued in April 2018.

Ms. Fitzpatrick, Chief Litigation Counsel, noted that the SEC expects the Supreme Court's ruling in *Lucia* to be handed down this summer and that while awaiting the ruling, the SEC has proceeded to appoint its ALJs but has strategically considered its choice of venue in enforcement actions. For example, in most contested cases where relief sought by the SEC is available both administratively and in federal court, the SEC has proceeded in district court. However, where the primary remedy sought by the SEC is available only in an administrative forum, it continues to bring those cases as administrative proceedings. By way of example, where the SEC seeks relief against auditors under Rule 102(e) of the Commission's Rules of Practice, such cases will continue to be brought before ALJs.

Limits on Absolute Immunity

At the request of the Second Circuit, the SEC filed an amicus brief in *City of Providence v. Bats Global Markets, Inc.*, which was a class action brought by institutional investors against various U.S. stock exchanges. Plaintiffs alleged that the defendant stock exchanges had engaged in market manipulation in violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder by providing customers that engaged in "high frequency trading" with proprietary information that allowed those particular customers to utilize market data faster than other investors. The Second Circuit asked the SEC to set forth its view as to whether the court had subject matter jurisdiction over the case and whether the defendants enjoyed absolute immunity from suit for the alleged misconduct.

The SEC took the position that the defendant stock exchanges were not absolutely immune from the lawsuit and distinguished between activities where the exchanges were acting as regulators of its members—where they should be immune from suit—and activities where the exchanges were instead acting as regulated entities, which, in the SEC's view, was the case in this lawsuit. The Second Circuit largely agreed with the SEC in holding that the exchanges were not immune from suit because the claims did not involve regulatory conduct. However, the court did not fully embrace the SEC's position that immunity only applies when the exchanges are regulating members. Defendants sought a rehearing, and the petition is still pending.

Mr. Conley, the SEC's Solicitor, stated that he anticipates that there will be further legal developments concerning the limits and scope of immunity in the future. He noted that there are open questions about the potential intersection of the immunity principle with preclusion and other doctrines, where the SEC regulates a particular space and private actions may not be appropriate as a result.

MD&A Disclosure Liability

The SEC filed an amicus brief in the U.S. Supreme Court in support of the respondents in *Leidos, Inc. v. Indiana Public Retirement System*. The U.S. Supreme Court granted certiorari to resolve an ongoing circuit split on the question of whether an issuer's Form 10-K that discloses only some of the trends, events or uncertainties that it is required to disclose under Item 303 of SEC Regulation S-K ("Item 303") is categorically exempt from liability under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.

Jeffrey Berger, Senior Litigation Counsel, explained that the SEC took the position in its amicus brief that a "Management's Discussion and Analysis" ("MD&A") section in an issuer's filing that omits some of the information required to be disclosed by Item 303 can be a predicate for a Section 10(b) violation. According to Mr. Berger, in the SEC's view, disclosure liability in this context should be possible because failing to disclose all of the information required to be disclosed under Item 303 fits into the "half-truth rubric." Mr. Berger further stated that it was the SEC's view that a reasonable investor would expect all information to be disclosed in an MD&A, such that a failure to do so may mislead investors. However, because *Leidos* settled before oral argument, the scope of potential liability under Item 303 premised on Section 10(b) remains unclear for the time being.

Insider Trading

Members of the SEC's Office of the General Counsel also discussed recent developments in insider trading liability, particularly in the aftermath of the U.S. Supreme Court's decision in *Salman v. United States* back in December 2016. Mr. Conley, the SEC's Solicitor, indicated that many of the ongoing judicial developments in insider trading liability turn on one of the following two legal issues: (1) whether a tipper obtained a personal benefit related to the breach of a duty owed and (2) what the tippee knew about the tipper's personal benefit.

Members of the SEC's Office of the General Counsel highlighted two recent decisions from Second Circuit Court of Appeals. First, the SEC attorneys explained that in *U.S. v. Martoma*, a divided Second Circuit held that the *Salman* decision essentially abolished the requirement from *U.S. v. Newman* that a "close personal relationship" exist between the tipper and tippee. As a result, the Second Circuit affirmed the defendant's conviction for insider trading. The defendant filed a petition for rehearing *en banc*, which has not yet been ruled on.

Second, in *SEC v. Payton*, the Second Circuit recently affirmed a judgment finding remote tippees civilly liable for insider trading, as well as a post-judgment order of the district court denying the defendants' motion for a judgment as a matter of law or for a new trial. Notably, U.S. District Court Judge Jed Rakoff, in denying the defendants' post-trial motions, had found that the jury had sufficient evidence to conclude that the tipper received a personal benefit and that the remote tippees had "generally understood, but had consciously avoided learning, the means by which the confidential . . . information had been obtained." 219 F. Supp. 3d 485, 492 (S.D.N.Y. 2016). According to Mr. Conley, the *Payton* decision, in particular, demonstrates that the SEC can continue to pursue tippee liability.

Whistleblower Retaliation

The panel addressed the U.S. Supreme Court’s ruling last week in *Digital Realty Trust Inc. v. Somers*, wherein a unanimous Court held that employees who bring securities law complaints against their companies must first take their allegations to the SEC in order to be protected by the anti-retaliation measures set forth under Dodd-Frank. In reaching this decision, the U.S. Supreme Court declined to defer to the SEC’s contrary, broader interpretation of what constitutes a whistleblower under Dodd-Frank. The panel indicated the SEC was considering its options in light of this recent rules.?????????

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