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SEC Speaks 2015: Enforcement Trends and Priorities for the Year Ahead

On February 20 and 21, 2015, the US Securities and Exchange Commission held its annual "SEC Speaks" conference in Washington, DC, where Commissioners and Commission staff reported on developments in securities regulation in the previous year and discussed the Commission's priorities in the coming year. Below are summaries of selected speakers' remarks at this year's conference. The summaries focus primarily on enforcement-related concerns regarding insider trading, financial reporting, accounting, and auditors and the priorities of the Division of Enforcement's FCPA, Asset Management, Market Abuse, and Complex Financial Instruments Units. We also report on Commissioners' remarks regarding statutory disqualification waivers.

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Andrew J. Ceresney, Director, Division of Enforcement

Mr. Ceresney began the panel by stating that 2014 was a record year for the Enforcement Division. According to Mr. Ceresney, the number and quality of actions brought were high, and the Division leveraged technology to file impactful actions.

Stephanie Avakian, Deputy Director, Division of Enforcement (addressing insider trading, financial reporting and accounting, and auditor matters)

Ms. Avakian indicated that investigating insider trading continues to be a priority. The Division of Enforcement is focusing on new tactics and leveraging technology and data to detect misconduct and streamline investigations. This approach includes in-house tools the Commission has developed to analyze large volumes of data to identify suspicious trading patterns not only in single accounts but also across multiple accounts and securities.

Ms. Avakian acknowledged that the Second Circuit's recent decision in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), could have an impact on a subset of the Commission's insider trading cases if not reversed. She noted that the Commission has filed an *amicus* brief urging that the decision be modified on rehearing. She stated, however, that the Commission's enforcement program will remain strong even if the decision is not modified.

The first point Ms. Avakian made in an effort to distinguish the effect of *Newman* was to observe that its holding – that a tippee must "know" that the tipper obtained a personal benefit from tipping – arose in a criminal case. She stated that the "knowing" requirement did not apply to the Commission, which, under *Dirks v. SEC*, 463 U.S. 646 (1983), must satisfy a negligence standard of "knew or should have known." Second, Ms. Avakian indicated that *Newman*'s conclusion – that mere friendship between the tipper and tippee is insufficient to establish the tipper obtained a benefit – conflicts with *Dirks*, with Second Circuit precedent such as *SEC v. Obus*, 693 F.3d 276 (2d Cir. 2012), and with every other circuit that has examined the issue. Ms. Avakian added that the *Newman* decision applies only in one circuit and will not affect administrative proceedings. However, it bears noting that an SEC administrative law judge recently ruled that he would apply *Newman*'s holding and reasoning to an insider trading case currently before him.[1]

[1] *See* Stephanie Russell-Kraft, *SEC Admin Judge Will Apply Newman To Insider Trading Case*, Law360 (Feb. 11, 2015).

Ms. Avakian also addressed the Enforcement Division's continued focus on accounting and financial reporting cases. She stated that the Division created the Financial Reporting and Audit Task Force in 2013 to identify cases the Division would not otherwise find and to develop methodologies to proactively detect misconduct. In terms of accounting issues, Ms. Avakian mentioned that the Enforcement Division is investigating cases involving revenue recognition, expense recognition, faulty valuations, missing or insufficient related party disclosures, and faulty asset impairment. In addition, Ms. Avakian mentioned that the Enforcement Division is focused on bringing cases where there are missing and/or insufficient internal controls, and will continue to focus on financial reporting gatekeepers. This will include evaluating the conduct of auditors and their accounting procedures to determine if the auditors followed GAAS.

Ms. Avakian closed her remarks by stating that the Commission had recently brought actions against auditors for deficient audits and that, in the last fiscal year, the Division of Enforcement filed substantially more financial reporting and disclosure cases than in the previous year. However, some commentators have pointed out that this claim is questionable given that the Division included in these numbers 27 Securities Act Section 8(d) "stop order" cases and 5 delinquent filing cases, which arguably should have been categorized differently. If these matters were removed from the issuer reporting and disclosure classification, the Commission's FY2013 and FY2014 financial reporting cases would have produced relatively similar numbers.[2]

David R. Woodcock, Regional Director, Fort Worth Regional Office and Chair of the Financial Reporting and Audit Task Force, and Margaret S. McGuire, Senior Counsel to the Director of the Division of Enforcement and Vice-Chair of the Financial Reporting and Audit Task Force

Mr. Woodcock noted that the Commission continues to be focused on financial fraud, disclosure, and audit matters. Like Ms. Avakian, he too cited a more than 40% increase in such matters from FY2013 to FY2014. Financial fraud continues to be a priority for the Commission and his list of current investigations mirrored the list Ms. Avakian had provided.

Mr. Woodcock noted a number of significant cases that were brought in this area over the last several months. For example, the Commission brought a case against CVS Caremark Corp., charging the company with misleading investors about significant financial setbacks and using improper accounting to artificially boost its financial performance. CVS agreed to pay $20 million to settle the charges. In Diamond Foods, the Commission charged the snack foods company in an accounting scheme to falsify expenses in order to boost earnings and meet estimates by stock analysts. Diamond Foods agreed to pay $5 million to settle the matter. In AgFeed Industries, the Commission charged the company with repeatedly reporting fake revenues from its China operations in order to meet financial targets and prop up AgFeed's stock price. The company, in turn, obtained illicit gains in stock offerings to investors at the inflated prices resulting from the accounting scheme. The company agreed to pay back $18 million in illicit profits. Finally, in Saba Software, the Commission charged a company with an accounting fraud in which improper time-reporting practices enabled the company to achieve its quarterly revenue and margin targets by improperly accelerating and misstating virtually all of its professional services revenue during a four-year period as well as a substantial portion of its license revenue. Saba Software agreed to pay $1.75 million to settle the SEC's charges.

Mr. Woodcock noted that the Commission has brought the first case emanating from the Financial Reporting and Audit Task Force, which he explained was not set up to bring cases on its own. In this litigated matter involving the CYIOS Corporation, the Department of Defense IT contractor was charged with continuing to employ a contract CFO even after being informed that she had been suspended by the PCAOB. In addition, the contractor, a public company, was charged with failing to make required filings prior to terminating its common stock's registration, and its sole officer and director was charged with failing to assess internal controls over financial reporting, as required by Exchange Act Rule 13a-15.

[2] *See* Jason S. Flemmons & Martin S. Wilczynski, *SEC Enforcement's Accounting Statistics for Fiscal 2014 – Up or Down?*, Securities Docket (Jan. 21, 2015).

Ms. McGuire's remarks focused more on the activities and processes of the task force. She explained that the purpose of the task force is early identification of potential financial fraud matters. To do that, the Division of Enforcement has brought on experts to assist in identifying financial fraud and relied on academics, whistleblowers, and market participants and observers to help identify potential misconduct.

The task force also has developed two initiatives, the Issuer Monitoring and Review Initiative (IMRI) and the Internal Controls and Financial Reporting Initiative (ICFR). IMRI is an effort to identify potentially problematic issuers. The Division of Enforcement has developed a methodology and tools using internal and external data to review such issuers. Ms. McGuire said the task force has already identified over 200 issuers of interest and has started investigations that span industries and financial accounting metrics. One of three outcomes typically results from these reviews. On one end of the spectrum, investigators might review an issuer and determine that no further investigation is warranted. On the other end of the spectrum, the review might result in the decision to refer the matter out for an investigation. For those issuers who do not clearly fall at either end of the spectrum, the task force might incubate the matter to obtain additional information; this may entail reaching out to the issuer or auditor and inviting them in for a meeting. A minority of the matters the task force reviews are referred out for investigation of issues outside of the task force's mandate (*e.g.*, insider trading or manipulation).

With respect to the ICFR initiative, Ms. McGuire said that she could not overstate the importance of a robust controls environment. Strong, effective controls limit the potential for improper accounting and financial fraud to occur. The task force is looking for companies that may have weak internal controls environments. To do that, they are focusing on issuers that have filed multiple revisions of their financial statements over a short period of time, or whose multiple revisions impact the same financial metric or business segment. Through these efforts, the task force can identify matters before they may become full-blown fraud.

Mr. Woodcock and Ms. McGuire closed by stating that a number of cases concerning internal controls would be announced in the coming weeks and that the task force looks at the auditor's audit and conduct from the beginning of every matter it handles.[3]

Remarks by the SEC's Office of Chief Accountant (OCA) and Michael Maloney, Chief Accountant, Division of Enforcement

Mr. Maloney stated that the Division of Enforcement has approximately 100 accountants and that accountants are present in all the Commission's Offices and Divisions. Enforcement has a very diverse and experienced team of accountants who play an integral role in forensic analysis and in investigative testimony and witness interviews. Enforcement Division accountants also monitor the marketplace to help the Division identify new issues and areas of concern.

Mr. Maloney commented that there has been a renewed interest in identifying and investigating financial reporting matters. The Division of Enforcement has a very robust pipeline of accounting cases, with active investigations in every office. Typical sources of Enforcement's investigations include the SEC's whistleblower program, company restatements, and referrals.

Mr. Maloney identified certain characteristics that tend to minimize Enforcement's interest in issuers. For large issuers, these characteristics include having stronger controls in place, being more aware of the

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[3] At an earlier conference, Mr. Woodcock identified a number of risk indicators that may prompt an investigation by the task force. These include:

- Use of an accounting policy resulting in relatively high reported book earnings while the firm is simultaneously using a different method for tax treatment that minimizes taxable income;
- A high proportion of transactions structured as off-balance-sheet; and
- Instances where issuers have multiple revisions over a short period.

Mr. Ceresney stated that the task force would focus on decision-making with respect to reserves, revenue recognition issues, independence violations, audit committees, companies with substantial foreign operations, audit quality, and red flags that have been missed or ignored.

Boards of Accountancy, and having a depth of resources in accounting. For smaller issuers, less complex issues and business structures tend to lead to less Enforcement interest. On the other hand, characteristics that enhance the Division of Enforcement's interest in larger issuers are: 1) more complex businesses; 2) related party transactions; 3) oversight issues related to foreign operations; 4) extreme loyalty of employees that may lead to accounting lapses-in-judgment; and 5) an over-reliance on existing processes in place. For smaller issuers, factors that attract Enforcement interest are less established controls, particularly for high-growth companies that outpace their accounting infrastructure, and more dominant management.

Mr. Maloney mentioned that there are several recurring issues that Division of Enforcement accountants review. Revenue recognition is of particular interest as well as the deferral of expenses and valuation issues based on faulty assumptions. Auditor independence also remains an area where enforcement concerns are high. OCA observed that there is a concern that as audit firms grow their consulting practices, there is a higher risk that they are not maintaining their independence. A failure to maintain independence may occur both at the time of engagement and as "scope creep" after an engagement. Other independence-related Enforcement priorities include broker-dealer audits, issuers who loan staff to assist clients with audit work, and independence concerns related to advocacy and lobbying.

Mr. Maloney stated that with regard to auditing firms, characteristics that minimize the Division of Enforcement's interest in larger firms are issuers that have strong audit committees and a depth of resources. For smaller firms, issuers with less complex disclosure issues minimize the Division's enforcement interest. Characteristics that enhance Enforcement interest in larger firms are "jewel client" relationships that incentivize compromise, and an over-reliance on specialists, controls, or management representations. For smaller firms, the corresponding factors are fewer available resources, acquiescence to opinion shopping, and price cutting to gain market share.

OCA also discussed Rule 102(e) proceedings involving accountants. OCA said that it works closely with the Division of Enforcement on cases seeking to censure or deny the privilege for accountants to appear or practice before the Commission. Accountant suspensions outpace attorney suspensions, and there have been more than 1,000 such suspensions in the last 40 years. The majority of cases are against internal, company accountants. The Commission is confident that accountants will comply with these orders, but federal courts have also ordered individuals to comply with the suspensions where necessary. Recent matters have included: 1) an injunction granted against further violations of Rule 102(e) where an individual attempted to practice as an accountant before the SEC despite a previous accounting bar (SEC v. Prince, No. 09-1423 (D.D.C. May 2, 2013)); 2) an administrative proceeding against an accountant previously barred by the PCAOB who continued to associate with a registered public accounting firm (In Re Traci J. Anderson, SEC Release 33-9725); and 3) an action against an individual who remained associated in a financial management or accounting capacity with an issuer despite receiving a PCAOB suspension (In Re James T. Crane, SEC Release 34-74039).

With respect to enforcement actions against issuers, OCA said that it was focused on fraud. They are not interested in second-guessing judgments on complex issues, but if there are poor procedures in place that lead to misstatements, OCA is very concerned. Representative matters include: 1) the sanctioning of a software company for having inadequate internal accounting controls over its financial reporting which resulted in misstated revenues in public filings (In Re JDA Software Group, Inc., SEC Release 34-73209) and 2) an action for improperly accounting for a deferred tax asset that was not fully realizable due to the company's deteriorating loan portfolio and financial condition (In Re Hampton Roads Bankshares, Inc., SEC Release 34-73750).

Kara N. Brockmeyer, Chief, FCPA Unit

Ms. Brockmeyer stated that 2014 was a busy year for the FCPA Unit. Although the Unit brought relatively few cases, it exacted large penalties. For instance, in the Alcoa matter, in which the aluminum producer's subsidiaries paid over $110 million in bribes to Bahraini officials to influence negotiations with a government-operated aluminum plant, the company settled with the Commission and the DOJ for a total of $384 million. And, late last year, Avon agreed to pay $135 million to settle charges that it had failed to put controls in place to detect and prevent $8 million worth of payments and gifts from a subsidiary's employees and consultants to Chinese government officials.

Ms. Brockmeyer outlined the evolving scope of the Unit's focus. In addition to traditional FCPA hot spots, such as China, Russia, and Africa, some of the Unit's cases are emanating from the Middle East, Southeast Asia, Europe, and Latin America, including countries not normally thought of as being high-risk. And although the Unit will continue to focus on large, multinational firms, it will also pay attention to medium-sized companies which, as they grow larger, do not consider the compliance risks they might face and the internal controls needed to address those risks. The Unit will also scrutinize industries that may not have focused on their FCPA risks because the Commission has yet to bring cases against firms in those industries.

The Unit has sought to give meaningful credit to cooperators. This January in the PBSJ Corporation matter, it concluded its second deferred prosecution agreement, offering what Ms. Brockmeyer characterized as significantly reduced penalty. She also outlined how a company can obtain credit for cooperation:

- Real-time reporting of the company's investigative findings, which allows the Unit to leverage these findings in its own investigation and interview witnesses contemporaneously;
- Translating witness interviews into English;
- Bringing foreign employees to the US;
- When the wrongdoer is or was an employee, letting the Unit know that the employee has already left or will be terminated;
- Helping the Unit interview witnesses; and
- Thinking creatively to provide necessary documents to the Unit rather than using foreign data protection laws to block their production.

Ms. Brockmeyer noted an uptick in self-reporting, and in particular, observed that companies now report potential misconduct when it is nascent or recent. In these circumstances, the Unit might never conduct an investigation, which suggests that the Unit is willing to credit companies that are demonstrably serious about addressing FCPA risk and imposing effective internal controls. In 2014, the Unit had only two cases with monitorship; in many more, a self-reporting period was imposed instead.

Ms. Brockmeyer has also noticed increasing levels of international cooperation, including cases where the Unit is working in tandem with foreign regulators and prosecutors. In addition, the Unit has collaborated with the SEC's Office of International Affairs to train non-US law enforcement agents in detecting and prosecuting bribery and corruption.

Julie M. Riewe, Co-Chief, Asset Management Unit

Ms. Riewe noted that five years after its formation, the AMU has 75 professionals in all 12 of the Commission's offices. The Unit focuses on registered investment companies, private funds (hedge funds and private equity) and retail accounts. The Unit has seven former industry professionals, including one former FBI agent. These specialists help the Unit target misconduct, sharpen document requests, question sophisticated witnesses during testimony, develop theories and investigative theses, and assist the Division of Investment Management when it is considering new rules or issuing staff guidance. Ms. Riewe noted that coordination with the Office of Compliance Inspections and Examinations and the Division of Investment Management has been critical to the Unit's success. She indicated that the staffs regularly confer about priorities and potentially problematic conduct.

Ms. Riewe stated that 2015 priorities for registered investment companies include conflicts of interest, valuation, compliance and controls, performance and performance advertising, best execution, fund governance, the "15c process," fund distribution, and deviating from investment guidelines. She cited a number of actions in this space, including an action against Manarin Investment Counsel Ltd. for failing its "best execution" obligations when investing in mutual fund shares by consistently selecting higher cost mutual fund shares for the three fund clients even though cheaper shares in the same mutual funds were available, and passing the higher, avoidable fees through to an affiliated brokerage firm. She also referred to Chariot Advisors LLC, a registered investment advisor accused of misrepresenting to a fund client's board its readiness and ability to implement an investment strategy based on algorithmic trading, thus preventing the board from carrying out its duty to evaluate advisory agreements under Section 15(c) of the Investment Company Act. Finally, she noted the action against F-Squared, an investment management firm charged with fraudulently advertising a successful seven-year track record for an algorithm-based investment strategy when the subject algorithm did not even exist during the seven years in question.

In the private funds space, Ms. Riewe said the priorities are on conflicts of interest, valuation, compliance controls, undisclosed and misallocated fees and expenses, and the use of friendly broker marks. Here, Ms. Riewe cited actions against 1) Paradigm Capital Management, a hedge fund advisor charged with failing to adequately disclose transactions with an affiliated broker-dealer and establishing a conflicts committee to oversee these transactions that was itself conflicted; 2) Clean Energy Capital LLC, an investment advisory firm accused of failing to disclose that it was using assets from private equity funds to cover the firm's expenses and then, when they could no longer pay the firm's expenses, loaning money to the funds at unfavorable interest rates; and 3) Lincolnshire Management, an advisory firm alleged to have shared expenses between two private equity funds, such that one fund paid more than its fair share for expenses that benefited the companies of both funds.

Ms. Riewe also discussed the Shelton matter, which was part of the Division's Undisclosed Adviser Revenue risk-analytic initiative, in which the Commission charged an investment adviser with hiding both the compensation received through an arrangement with a broker-dealer as well as the attendant conflict of interest. In addition, she cited the TransAmerica Financial Advisors action, in which a financial services firm failed to apply fee discounts agreed to with its clients and failed to have adequate procedures in place to ensure that fees were being properly calculated.

Finally, on the compliance front, Ms. Riewe mentioned that the Unit, working with examinations staff, is looking at firms that have been informed of compliance deficiencies in the past and have not remedied them, as well as instances where systematic compliance failures have been identified.

Daniel M. Hawke, Chief, Market Abuse Unit

Mr. Hawke explained that the Unit focuses on complex insider trading and market structure matters. He acknowledged that there has been a lot of debate around market structure issues due to commentary arising from *Flash Boys* and dark pools. He stressed, however, that market structure is now an established enforcement area and is a priority. He noted the Unit focuses on national security exchanges, broker-dealers, alternative trading systems, and high-frequency trading (HFT) firms. Mr. Hawke said that market structure cases are very complex and difficult to investigate. Whether problematic conduct should be addressed through regulation or enforcement presents difficult challenges. Although violations in this space might not result from intentional conduct, significant and widespread harm can follow from the misconduct that does occur, and investor confidence may suffer.

Mr. Hawke stated that in the past year, the Unit has been aggressive in policing market structure – policing gatekeepers, trading platforms, HFT firms, and manipulative trading. He highlighted several cases he deemed significant in this area. Among them were actions against: 1) two exchanges formerly owned by Direct Edge Holdings for failing to accurately describe to all members the order types being used on the exchanges and, instead, providing this information only to certain HFT firms; 2) Athena Capital Research, a HFT firm, for placing trades during a six-month period to manipulate in the firm's favor the closing prices of thousands of NASDAQ-listed stocks; and 3) Latour Trading LLC, a HFT firm, for repeatedly violating net capital rules and thereby failing to have a sufficient liquidity buffer to protect against certain trading risks.

In the area of dark pools (alternative trading systems), Mr. Hawke referenced LavaFlow, Inc., an action involving a Citigroup business unit that failed to protect confidential trading data of its subscribers while operating a dark pool. He also cited the Liquidnet, Inc. action, in which the Commission charged a brokerage firm operating a dark pool for large institutional investors with improperly using subscribers' confidential trading information to market an affiliated business unit's services.

With respect to manipulative trading, Mr. Hawke cited the case recently filed against Aleksandr Milrud for allegedly orchestrating a market manipulation scheme that relied on "layering," whereby a trader places non-bona fide orders which the trader cancels before execution to induce others to buy or sell publicly traded stocks at artificially inflated or depressed prices. He also mentioned an action against Gonul Colak and Milen Kostov, college professors who perpetrated a naked short selling scheme that involved executing sham transactions to create the illusion that they had delivered the underlying securities as required by the federal securities laws when they had not. Mr. Hawke pointed out that the Commission identified this misconduct using data analysis.

Mr. Hawke also stressed the Commission's actions against gatekeepers. For example, in the Wells Fargo Advisors LLC matter, the dually registered broker-dealer and investment advisory firm was charged with failing to adequately establish, maintain, and enforce policies and procedures reasonably designed to prevent the misuse of material non-public information, specifically the material nonpublic information obtained from its customers and its advisory clients, and used in one case by an employee to engage in insider trading. Mr. Hawke also noted that in the Linkbrokers Derivatives LLC action, the Commission charged the brokerage firm with unlawfully taking secret profits from customers by adding hidden markups and markdowns to their trades.

Mr. Hawke closed by saying that in the year ahead, the Commission would likely bring more cases involving dark pools, "layering" and "spoofing", best execution, and latency manipulation, a reference to the practice of some HFT firms of buying or selling an instrument slightly ahead of other market participants by taking advantage of small delays in price dissemination.

Michael J. Osnato, Chief, Complex Financial Instruments Unit

Mr. Osnato began his remarks by noting that his Unit has been reinvented to ensure that the Division of Enforcement stays at the cutting edge of complex financial instruments. The Unit's mandate is to identify and investigate potential misconduct arising from the creation, sale, usage, and valuation of complicated financial instruments. He stated that his staff has put infrastructure in place to proactively seek out misconduct; for example, a dedicated strategy officer builds the Unit's case pipeline and guides resources to where they should be deployed.

Mr. Osnato stated that the Unit can conduct multiple targeted sweeps in challenging markets – *e.g.*, over-the-counter markets for complex instruments. Because the Unit's staff members understand these markets, they can look for specific misconduct. They have refined their ability to mine and analyze vast amounts of data to find patterns indicative of misconduct. Mr. Osnato commented on the Unit's ability to conduct a wide-ranging, holistic review of asset classes. He noted, for example, that the Unit has reached out to participants in the sub-prime auto market to ask questions and start a dialogue about market practices, and has inquired whether the collateralized loan obligation market currently exhibits the same fault lines that characterized pre-financial crisis collateralized debt obligations.

Mr. Osnato outlined the Unit's philosophy, which is to streamline investigations by taking a complicated process and shrinking it. The Unit's staff members try to find cooperators and use big-data analytics to identify potential misconduct with ease and precision, thereby circumventing the "trench warfare" common to many investigations. The Unit ends the investigative process not with a Wells notice but with a reverse proffer. When the investigative record is mature, the Unit's staff members have a discussion with the parties' lawyers and decision makers to lay out the facts and options for either settlement or litigation.

Among the significant cases handled by the Unit is the recent matter against Standard & Poor's, in which the Commission accused the credit rating agency of multiple forms of misconduct dating from 2011 to 2014, including misrepresenting which methodology it used to rate certain commercial mortgage-backed securities, misrepresenting the effectiveness of its ratings methodology, and failing to follow internal policies for conducting surveillance of residential mortgage-backed securities ratings without informing investors. Mr. Osnato remarked that the Commission settled this package of cases simultaneously by picking a strong case and leveraging it to settle the remaining cases. He further noted that the settlements reflected aggressive and creative sanctions, including a one-year time-out for S&P to rate certain commercial mortgage-backed securities.

Mr. Osnato also highlighted banking as an area of the Unit's focus. In particular, he observed that regulatory capital disclosures are susceptible to manipulation, and that the Commission had settled an action against Bank of America for overstating its regulatory capital by billions of dollars after certain structured notes had matured.

Mr. Osnato concluded his remarks by saying the Unit would continue its focus on credit rating agencies moving forward.

Andrew M. Calamari, Regional Director, New York Regional Office, and Antonia Chion, Associate Director, Division of Enforcement (addressing the Broker-Dealer Task Force and AML compliance initiative)

Mr. Calamari described the Broker-Dealer Task Force, which was formed approximately 18 months ago. The task force gives intensive, proactive focus to issues involving broker-dealers. Division of Enforcement senior officers from across the country and the heads of the Enforcement Division's specialized units are all members, with the day-to-day work done by a steering committee. The steering committee identifies initiatives to recommend to the task force. The task force is an incubator of ideas and does not have permanent staff; instead, Home and Regional Office staff execute on areas identified for investigation. The task force also coordinates with the Office of Compliance Inspections and Examinations, the Division of Trading & Markets, and FINRA.

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Mr. Calamari said the priorities are on the retail space in four major areas: churning/ excessive trading, anti-money laundering (AML) compliance, retail investments in alternative products, and IRA rollovers.

Ms. Chion discussed the AML compliance initiative. The task force leverages data and analytic review by the Commission's Bank Secrecy Act Review Group (BSARG), which reviews Suspicious Activity Reports (SARs) filed by financial institutions and broker-dealers. These institutions are required to file a SAR if they identify any suspicious activity. The BSARG has completed a review of broker-dealer SAR reporting over a year's time. The review revealed that some firms have filed an unusually low number of SARs (or none), indicating that some firms may not be complying with their filing requirements. The task force has refined the data using analytics to identify registrants who have not filed any SARs even though their profile suggests they should have seen suspicious activity, who have not timely filed SARs, or who have filed boilerplate SARs. Using these identifying factors, the task force has prepared and coordinated referrals for investigation. Division Director Ceresney said in a conference following SEC Speaks that the Enforcement Division is assessing whether it will bring stand-alone actions against broker-dealers for Bank Secrecy Act violations.[4]

A nationwide working group works on AML investigations. The initiative spotlights the critical importance of SAR reporting obligations. A SAR might be the first indication of wrongdoing. In that regard, SARs play an important role in investor protection and help the Commission to determine whether an inspection or investigation is needed. Information in a SAR might also be useful for ongoing investigations. It is also a source of intelligence to identify trends in the marketplace. The fact that the reports are prepared by sophisticated firms knowledgeable about the marketplace enhances their value to the Commission.

David Glockner, Regional Director, Chicago Regional Office (addressing the whistleblower program and cybersecurity)

Mr. Glockner spoke about the Commission's whistleblower program, referring to it as tremendously successful in 2014. He noted that both the amount of money the Commission awarded and the number of awards were more than the combined totals of the three prior years. This was in no small measure due to the September 2014 payment of a $30 million whistleblower award to a non-US resident – the largest to date and the fourth award given to a non-US resident. Mr. Glockner stressed that the Commission's ability to provide awards to foreign nationals is significant, as the Commission wants to encourage foreign nationals to come forward with complaints.

Mr. Glockner noted that the Commission brought its first whistleblower retaliation action as part of the Paradigm case (discussed earlier by Ms. Riewe), and that the Division of Enforcement is looking for more of these cases to bring. In addition, the Commission has authorized the filing of *amicus* briefs in the Second and Third Circuits advancing the Commission's view that Dodd-Frank's anti-retaliation provisions extend to those who report violations only internally (a position rejected by the Fifth Circuit). Finally, Mr. Glockner stressed that the Division of Enforcement is very focused on looking at efforts by firms or companies to discourage whistleblowers and whistleblowing activity through severance and employment agreements.[5]

Mr. Glockner also addressed cybersecurity. He described it as an area that has been of considerable interest to a number of divisions, including the Division of Enforcement. Although the Division of Enforcement has not brought cases in this area, it is high on its radar screen. In particular, the Division of Enforcement is looking at cybersecurity controls that companies and firms have in place to protect market integrity. Additionally, the Division of Enforcement is focusing on the adequacy and timeliness of

[4] *See* Stephanie Russell-Kraft, *SEC Mulls Bank Secrecy Act Cases Against Broker-Dealers*, Law360 (Feb. 25, 2015).

[5] Substantiating these remarks, *The Wall Street Journal* later reported that the Commission has requested years of employment and non-disclosure agreements from a number of companies to determine whether these were used to prevent whistleblowing. Rachel Louise Ensign, *SEC Probes Companies' Treatment of Whistleblowers*, The Wall Street Journal (Feb. 25, 2015). This follows a 2014 FINRA Regulatory Notice "remind[ing] firms" that it violates FINRA rules to use confidentiality provisions to prevent any person from communicating with regulatory authorities "regarding a possible securities law violation." FINRA Regulatory Notice 14-40 (Oct. 2014).

companies' disclosures regarding material cybersecurity events. Mr. Glockner said the Division of Enforcement is coordinating with the Office of Compliance Inspections and Examinations staff on cybersecurity controls-related concerns. He also mentioned that the Commission is coordinating with outside law enforcement agencies and other sources to ensure it understands what is important to registrants and regulated entities in this space.

Matthew C. Solomon, Chief Litigation Counsel

Mr. Solomon commented that the Commission is seeing positive results from its efforts to recruit top-shelf legal talent and to rigorously evaluate cases before bringing them to trial. The Commission has 130 litigators who not only try cases but also help the Commission achieve admission settlements, bring subpoena enforcement actions, achieve significant wins on summary judgment, and successfully obtain asset freezes and enforcement judgments from courts nationwide. Mr. Solomon said Chair White is very focused on litigation. The Division has significant in-house resources and a large enough budget for experts and jury consultants.

In 2014, the Commission had 30 trials, the most in the last 10 years and over 5 times the number of jury trials than in the previous year. Approximately two-thirds of the trials were in federal court and one-third were administrative proceedings. Mr. Solomon stated that the Commission's win rate was approximately 80%, but it bears mentioning that some of these victories were mixed verdicts. According to Mr. Solomon, the Commission has won 10 of its last 12 jury trials, losing only circumstantial insider trading cases. Mr. Solomon said that if the Commission doesn't lose some trials it means the Commission's litigation program is not being aggressive enough.

Among the cases Mr. Solomon identified as noteworthy was BankAtlantic Bancorp, where the Commission alleged that BBX Capital Corp. and CEO Alan B. Levan failed to fully disclose the credit quality of its bank loan portfolio and engaged in improper accounting treatment of some loans, resulting in the fraudulent understatement of the company's losses. Mr. Solomon said the Commission litigated the case without any cooperators or friendly witnesses, relying on emails to paint a picture to the jury of fraud at the bank.

Sam Waldon, Assistant Chief Counsel (addressing Commission opinion regarding antifraud provisions)

Mr. Waldon's remarks focused exclusively on the Commission's recent opinion in *In re Flannery and Hopkins*, SEC Release 33-9689 (Dec. 15, 2014), a decision respecting Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5. The Commission's opinion, which Mr. Waldon characterized as both broader and narrower than what courts have adopted in the past, focused on the various subparts of these antifraud provisions, what they mean, and how they work together.

The *Flannery* decision is lengthy, but Mr. Waldon focused on four main aspects of the opinion.

First, the opinion reflects the Commission's view that the subsections of Section 17(a) and Rule 10b-5 are mutually supporting rather than mutually exclusive, and particular conduct can violate more than one subsection.

Second, *Flannery* stands for the proposition that primary liability for misstatements is not based solely in Section 17(a)(2) of the Securities Act and Exchange Act Rule 10b-5(b). According to the opinion, primary liability under Section 17(a)(1) of the Securities Act and Exchange Act Rule 10b-5(a) and (c) may extend to anyone who employs a manipulative or deceptive device, including misstatements. In addition, liability under Section 17(a)(3) of the Securities Act extends to anyone who makes misstatements to the extent they are deemed fraudulent transactions, practices or courses of business.

Mr. Waldon indicated that *Flannery* was not an attempt by the Commission to circumvent the Supreme Court's holding in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), that liability under Exchange Act Rule 10b-5(b) extends in a private action only to the person or entity which has ultimate authority over a false statement. He remarked that *Janus* has had no effect on the Commission's ability to charge people for misstatements even if they did not make the misstatements. He also noted that the Commission has charged defendants for secondary liability under a control theory or by or through another person under Section 20(b) of the Exchange Act, which makes it unlawful for anyone to do anything by means of another person that would be unlawful for that person to do on their own.

Third, unlike Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, where a person must engage in manipulative and deceptive conduct to be charged, Section 17(a) of the Securities Act does not require a defendant's own conduct to be manipulative or deceptive for a violation to exist. Mr. Waldon used the hypothetical situation of a defendant engaged in a transaction knowing that the counterparty will use the transaction to misstate revenue. Under Section 17(a)(1) of the Securities Act, that conduct could be charged if the Commission could establish *scienter*, but under Section 17(a)(3) of the Securities Act, primary liability could be based solely on negligent behavior and, under the hypothetical, the person engaging in the transaction could be liable under Section 17(a)(3) of the Securities Act.

Finally, Mr. Waldon commented that in *Flannery* the Commission explained that materiality is an objective standard – *i.e.*, the inquiry focuses on whether a misstatement would be important to a reasonable investor – and, therefore, an investor's actual level of sophistication is irrelevant. Mr. Waldon also stated that the Commission need not show that accurate disclosure would have changed an investment decision and that *Flannery* rejected the notion that a misstatement is immaterial if a reasonable investor would have known where to find accurate information.

Commissioners' Remarks Regarding Statutory Disqualification Waivers

A number of the Commissioners addressed the issue of whether and when the Commission should grant waivers from certain statutory disqualification provisions that are triggered based upon certain violations of the federal securities laws. Noting that disqualification is not intended to be a punishment or an enforcement tool, Commissioner Stein said she views the bars as providing a forward-looking, prophylactic tool designed to promote trust in the markets. She criticized disqualification waivers, which she views as being inconsistently applied. She opined that it "defies common sense" to grant a waiver whenever the grounds for automatic disqualification are "unrelated" to the waiver, and stated that the Commission should not wait for a securities law violation to occur to disqualify a "bad actor" if the actor has already engaged in other, serious misconduct. Commissioner Stein urged her fellow Commissioners to consider a firm's compliance culture and the firm leadership's actual and constructive knowledge of legal violations when evaluating a potential disqualification.

Commissioner Piwowar stated that other Commissioners have been ignoring established staff guidelines on waiver eligibility, implicitly referring to Commissioner Stein's and Aguilar's recent actions to disapprove waivers or include tougher language in them. He expressed his view that the Commission should adhere to these guidelines in the interests of transparency and predictability. He also made note of a recent speech in which Commissioner Gallagher stated that waivers are improperly being used as enforcement tools.