SHEARMAN & STERLING LLP

Securities Enforcement: 2015 Year-End Review

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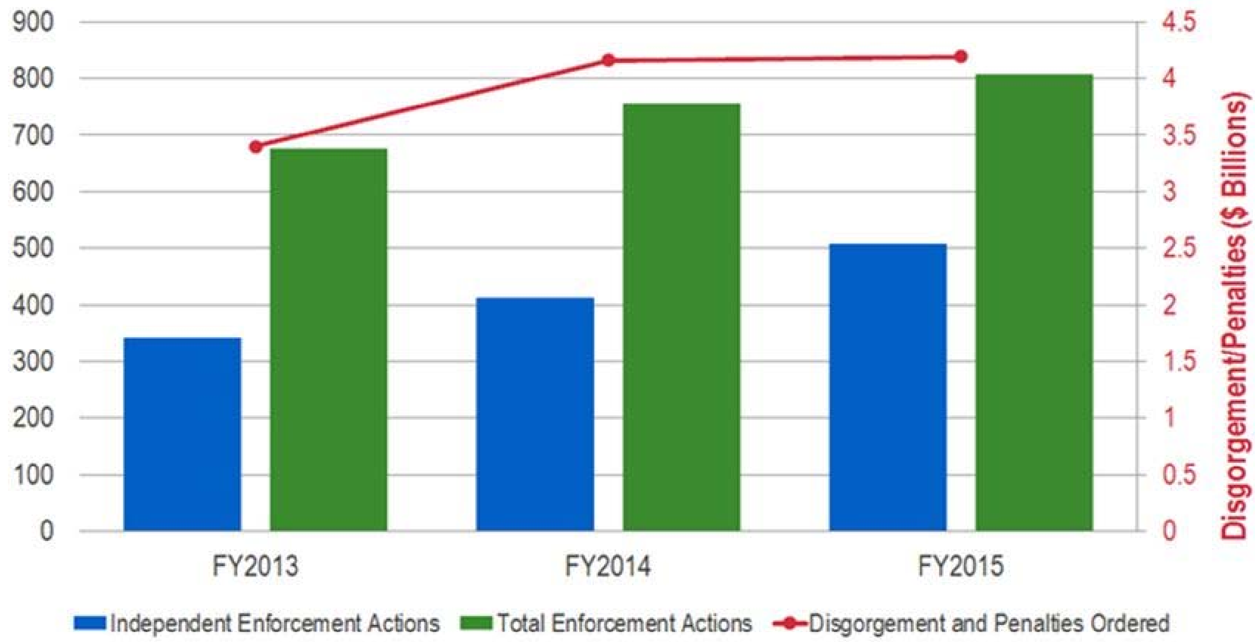
I. Executive Summary

The Securities and Exchange Commission (the SEC or the Commission) filed a record 807 enforcement actions in fiscal year 2015, 52 more than it filed in 2014.[1] The Commission instituted 507 actions against individuals and entities seeking sanctions for alleged violations of the federal securities laws, reflecting an increase of nearly 23% over 2014 and 48.6% over 2013.[2] The remaining 300 actions consisted of follow-on actions seeking industry bars against convicted, enjoined or otherwise ineligible individuals and enforcement actions against issuers who failed to comply with the reporting requirements of the federal securities laws.

Certain of the enforcement actions brought in 2015 were cases of first impression, including one against a "Big Three" credit ratings agency for allegedly fraudulent conduct in its rating of certain commercial mortgage-backed securities, which, as we reported in our *Securities Enforcement 2015 Mid-Year Review* (*Mid-Year Review*),[3] was settled on January 21, 2015, another against an underwriter for allegedly overcharging retail customers in the primary market for municipal securities, which was settled on August 13, 2015 (see Section IV.F below), and a third against a large financial institution for allegedly violating the Foreign Corrupt Practices Act (FCPA) by providing supposedly valuable student internships to family members of foreign government officials, which settled on August 18, 2015 (see Section IV.D below).

SEC Enforcement Trends



Source: SEC Press Release, SEC Announces Enforcement Results For FY 2015, Rel. No. 2015-245 (Oct. 22, 2015), available at http://www.sec.gov/news/pressrelease/2015-245.html

The Commission set another record in fiscal year 2015 by collecting approximately $4.2 billion in disgorgement and penalties, a modest increase over the $4.16 billion it collected in 2014. While the median fine imposed on individuals in 2015 was the highest in 10 years, the median fine imposed on companies was the lowest over the same period, which confirms that the SEC continues to take a particularly hard line against individuals.[4]

The record setting number of enforcement actions continues to reflect the controversial "broken windows" enforcement philosophy championed by SEC Chair Mary Jo White. Although some continue to express concern that the SEC's efforts may be leading to unfair settlements, with individuals increasingly facing harsher penalties under the Commission's tough approach,[5] the SEC has pointed to a reduction in enforcement activity in areas targeted by the "broken windows" philosophy as evidence that the policy has had a deterrent effect. For example, in a series of enforcement sweeps over the last two years, the SEC targeted firms that allegedly failed to abide by the restrictions on short-selling ahead of follow-on offerings in violation of Rule 105 of Regulation M. The number and amount of fines levied by the SEC annually in connection with enforcement sweeps have declined each year from 2013 to 2015. For example, 23 firms paid $14.4 million in fines in 2013, 19 firms paid approximately $9 million in 2014, and six firms paid $2.5 million in 2015. The Enforcement Division has touted this decline as evidence that its enforcement sweeps have a deterrent effect.[6]

The last year was notable for more than just unprecedented enforcement activity, however. Some of the key developments in the second half of 2015, discussed further in this review, included the following:

First, as expected, Commissioners Luis Aguilar and Daniel Gallagher left the SEC. If the replacements President Obama nominated are confirmed, the SEC will have its most diverse set of commissioners in its history. The political interests supporting each nominee, however, reflect the partisan divide within the government in general. Thus, it seems unlikely that the new nominees would bridge the policy gaps, some of which we have covered in our reviews, that have resulted in multiple disputes among the commissioners.

Second, the SEC's use of Administrative Proceedings (AP) as a forum to litigate contested enforcement actions continues to be a hotly debated topic. The Commission has strongly defended this practice both in the press and in a series of litigated cases, while at the same time slowing its use of litigated APs against non-registered respondents in 2015.

Third, the Commission sought and obtained admissions in eight actions in the second half of 2015, bringing the total for 2015 to 14 admissions, which is a slight increase over the 12 admissions obtained in 2014. While varied in scope and nature, the admissions obtained in 2015 seemed to suggest an increased focus on demanding admissions where the alleged wrongdoing at issue interferes, even unintentionally, with the SEC's ability to regulate the securities industry.

Fourth, after spending most of 2015 giving broad waivers from the disqualification provisions of the federal securities laws, the Commission closed out the year by granting a so-called conditional waiver in an approach that the Commission described as "different and more outcome-focused." The conditional waiver, among other things, required a bank to retain a compliance consultant for a five-year period to review and monitor the bank's activities as an investment manager and placement agent for private securities offerings, including related policies and procedures, and to make the consultant's annual report publicly available. This departure from past practice could signal that the Commission's days of routinely granting broad waivers are over.

Fifth, the SEC continued to be inundated with tips concerning alleged corporate wrongdoing as part of its Whistleblower Program, while at the same time the Second Circuit ruled that the anti-retaliation provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) protect employees who are fired for disclosing wrongdoing internally instead of to the SEC. These two developments could lead to increased whistleblowing and an increased risk for employers when dealing with potential whistleblowers.

Sixth, the SEC continued to emphasize cybersecurity, instituting a series of enforcement actions arising out of the review of cybersecurity systems conducted by its Office of Compliance Inspections and Examinations (OCIE). One of the SEC's first enforcement actions following OCIE's review was instituted based on perceived weaknesses not in the respondent's systems, but in the systems of a third-party vendor used by the respondent.

Seventh, while the Supreme Court rejected the government's request for *certiorari* from the Second Circuit decision in *United States v. Newman*, seemingly settling the standard for establishing a personal benefit in insider trading cases, on January 19, 2016, the Supreme Court granted *certiorari* in *United States v. Salman*, a Ninth Circuit decision that also considered the circumstances under which it is permissible to infer the existence of a personal benefit. The Supreme Court's ruling in *Salman* will likely clarify the standard for establishing what type of personal benefit will suffice in insider trading cases.

Eighth, the SEC's aggressive institution of enforcement actions against compliance personnel was one of the issues that most divided the Commission in 2015, with Commissioner Daniel Gallagher expressing concern that such actions would disincentivize vigorous compliance activity while Commissioner Aguilar and Chair White responded that compliance officers who did their jobs competently, diligently and in good faith had nothing to fear from the SEC.

Ninth, courts issued numerous significant rulings concerning the Commission in the second half of 2015. We highlight below rulings by the D.C. Circuit that held that the SEC could not apply the remedial provisions of Dodd-Frank concerning industry bars retroactively and that Section 4E of the Securities Exchange Act of 1934 (Exchange Act) does not set a jurisdictional limitation period for the SEC to bring an enforcement action after issuing a Wells notice; the Second Circuit's highly-anticipated decision concerning materiality in an appeal of a securities fraud conviction that, while coming in a criminal case, will likely allow the SEC to continue to push the envelope for what constitutes a material misstatement; and a decision from the Southern District of New York criticizing the SEC for obtaining an asset freeze in connection with the collapse of a bank in the Cayman Islands.

Finally, this review highlights some of the more important developments and cases from 2015 relating to insider trading, accounting fraud, independent auditors, the FCPA, investment advisers, broker dealers, crowdfunding, the financial crisis and credit rating agencies.

II. Significant Enforcement Division Developments

A. *Change in Commissioners*

Commissioners Luis Aguilar (Democrat) and Daniel Gallagher (Republican) left the SEC in the second half of 2015. On October 20, 2015, President Obama nominated Hester Peirce, a former aide to Senate Banking Committee Chairman Richard Shelby (R-Ala.) and current senior research fellow at the Mercatus Center at George Mason University (a free-market-oriented think tank), and Lisa Fairfax, a former member of the Financial Industry Regulatory Authority's (FINRA) National Adjudicatory Council and current George Washington University Law professor. If Peirce and Fairfax are confirmed, four of the SEC's five commissioners would be women for the first time, and Fairfax would be the third African-American commissioner in SEC history.[7]

The simultaneous departure of Gallagher and Aguilar is particularly notable because the two held sharply different views on a number of policy matters, including recent enforcement actions against compliance officers (which we discuss in Section II.H below). Although it is unclear how Peirce and Fairfax will approach this and other issues, the partisan interests that supported each nomination strongly suggests that they will have divergent policy views as well, largely mirroring Gallagher's and Aguilar's enforcement philosophies.

Peirce was nominated at the recommendation of the Senate Banking Committee, headed by Senator Shelby. She has been critical of the financial regulatory agenda promoted by Senator Elizabeth Warren (D-Mass) and other Democrats. Indeed, Peirce wrote *Dodd-Frank: What It Does and Why It's Flawed*, a book critiquing the landmark legislation signed in 2010. Fairfax, on the other hand, was championed by Senator Warren. In 2011, Fairfax published a book of her own, *Shareholder Democracy: A Primer on Shareholder Activism and Participation*.[8]

It is unclear when the Senate will hold confirmation votes on Peirce and Fairfax. The Senate Banking Committee must first hold hearings on both nominees. Although the confirmations of Peirce and Fairfax would result in the most diverse group of SEC commissioners in U.S. history, it seems unlikely that either nominee would change the current tenor and ideological divide within the Commission.

B. *The SEC's Use of Administrative Proceedings*

As we reported in our *Mid-Year Review*, federal court challenges to the SEC's use of its in-house administrative court as a forum for litigating contested enforcement actions began to gain traction in 2015. These federal court successes, together with the continued criticism from commentators, appear to have directly led to changes to the AP process.

First, on September 24, 2015, the SEC proposed amendments to "modernize" its AP process, including by adjusting the deadlines to allow more time for discovery, preparation for the hearing, and issuance of an initial decision following the hearing, and by granting the parties discretion to take limited depositions during the pre-hearing discovery period.[9] While these procedural changes would alleviate some of the discovery disadvantages of APs, they fall well short of providing respondents in APs with a reasonable opportunity to mount a defense, particularly when viewed against those provided by the Federal Rules of Civil Procedure. Nor does the SEC's proposal address recent district court decisions that have held that the Constitution requires that, if an ALJ is going to preside over a litigated AP, the ALJ must be appointed by the President of the United States, the federal courts, or the heads of federal departments. Thus while the amendments may "modernize" APs, the changes are by no means revolutionary.

Second, the SEC has begun to bring fewer cases as litigated APs. For example, between July and September 2015, the SEC brought only 11% of its contested cases as APs, down from 40% during the same period in 2014.[10] And it has seemingly stopped bringing litigated APs against non-regulated persons, one of the most controversial aspects of its increase in APs from 2014.

While proposed amendments to the AP rules and the Commission's reduced use of APs are significant developments, they are not likely to stem the controversy over the SEC's use of APs. Indeed, the SEC recently received a stinging rebuke from the First Circuit in *Flannery v. SEC*, which reversed a controversial decision by the Commission that had reversed an ALJ's finding that the respondents in the AP had not violated the federal securities laws.

In *Flannery v. SEC*, the SEC alleged that two former employees of a custodian bank specializing in services to mutual funds made willful and material misrepresentations in an investor presentation and in letters to investors about an unregistered bond fund managed by the bank. The fund was made up of asset-backed securities that substantially underperformed during the subprime mortgage crisis. After a nearly three-week hearing, the presiding ALJ found that (i) the respondents did not have ultimate authority over the documents containing the alleged misstatements and (ii) the documents themselves did not contain materially false or misleading statements or omissions. The Enforcement Division appealed the ALJ's ruling to the Commission. Chair White and the two Democratic commissioners then reversed the ALJ (over dissents from the two Republican Commissioners), finding that the respondents had committed fraud.

Notwithstanding the generally deferential standard that applies to appeals from a Commission opinion, the First Circuit rejected the Commission's findings, concluding that the findings were not supported by substantial evidence. The court noted that it would use a less deferential standard of review because the Commission had reached the opposite conclusion from its own ALJ, rejected several of the Commission's factual findings, and even found that the Commission had misread one of the communications at issue. The court also emphasized that the SEC had not introduced any testimony from fund investors to support the position that certain statements at issue were misleading or material.[11] In short, eight years after the conduct at issue, and five years after the Commission issued an order instituting proceedings to begin an AP, the First Circuit concluded that there was no evidence of fraud, implicitly raising a question about the SEC's repeated claim that APs are appropriate because of its specialized expertise in evaluating alleged federal securities law violations.

At the same time, constitutional challenges concerning how ALJs are appointed continue to wind their way through the courts and could ultimately have a significant impact on the SEC's use of APs. While the due process challenges, based, for example, on claims that APs violate respondents' rights to jury trials have generally been unsuccessful, respondents have achieved a measure of success in challenging the appointment of ALJs as unconstitutional pursuant to the Appointments Clause of Article II of the Constitution. Under the Appointments Clause, "inferior officers," or government officials exercising significant authority pursuant to the laws of the United States"[12] must be appointed by the President, the federal courts or the heads of the federal departments.[13] Respondents argue that ALJs are inferior officers and, because they have not been appointed by the President, SEC Commissioners, or a federal court, their appointment violates the Constitution.

For example, in *Hill v. SEC* and *Gray Financial Group, Inc. v. SEC*, Judge Leigh Martin May of the Northern District of Georgia preliminarily enjoined the two APs, finding that the SEC's hiring of ALJs (who exercise significant authority under the laws of the United States and their roles are specified by statute) violated the Appointments Clause because ALJs meet the Article II criteria that require appointment by the President, the federal courts, or the heads of federal departments.[14] The SEC appealed to the Eleventh Circuit, which consolidated the *Hill* and *Gray* appeals, and tentatively assigned them to the court's argument calendar for the week of February 22, 2016.

Other courts, however, have dismissed similar challenges as premature, noting that judicial review is available at the conclusion of the administrative process. For example, in *Bebo v. SEC*, Judge Rudolph Randa of the Eastern District of Wisconsin dismissed a respondent's action seeking to stop an AP for lack of subject matter jurisdiction, finding that "[i]f the process is constitutionally defective, [respondent] can obtain relief before the Commission, if not the court of appeals."[15] The Seventh Circuit affirmed on August 24, 2015 and denied rehearing *en banc* on November 5, 2015. Similarly, in *Jarkesy v. SEC*, the D.C. Circuit ruled that district courts lack subject matter jurisdiction to entertain respondents' constitutional challenges prior to the conclusion of the AP.[16] Judge Randa's analysis has been adopted by judges in the Southern District of New York (SDNY), including in *Tilton v. SEC*.[17] *Tilton* is presently on appeal before the Second Circuit, which signaled that it may take a different view from the Seventh and D.C. Circuits by staying the AP in *Tilton* the day after it heard oral argument in the appeal.[18]

C. *Admissions of Liability in Settled Cases*

The SEC obtained admissions in 14 enforcement actions in 2015 — eight in the second half of the year. The SEC still has yet to clarify its policy statements from June 18, 2013, when it announced that it would demand admissions in settling enforcement actions where (1) the misconduct harmed large numbers of investors or placed investors or the market at risk of potentially serious harm; (2) the alleged misconduct was egregious and intentional; or (3) the defendant engaged in an unlawful obstruction of the Commission's investigative processes.[19] Settlements that included admissions in the second half of 2015 suggest that the SEC may be particularly focused on securing admissions where the alleged wrongdoing at issue interferes, even unintentionally, with the SEC's ability to investigate securities violations or where the alleged wrongdoing involves information that has the potential to affect a large number of investment decisions.

For example, on July 14, 2015, the SEC filed a settled AP against an investment adviser for providing inaccurate trade data to its brokers, which allegedly caused errors in the brokers' books and records and in the "blue sheet" data the brokers submitted to the SEC. The SEC claimed that the investment adviser adjusted the way its sales data system identified certain trades, which caused some long sales to be erroneously shown as short sales. According to the SEC's order, the investment adviser inadvertently failed to appreciate that this adjustment would affect the data it sent to its brokers and, in turn, the brokers' blue sheets. The investment adviser admitted to the conduct and agreed to pay nearly $4,493,427, consisting of a civil monetary penalty of $4.25 million, disgorgement of $214,380, and prejudgment interest of $29,047.[20]

The settlement with the investment adviser was the second time in as many years that the SEC required an admission to settle an enforcement action involving unintentionally inaccurate blue sheet data. The SEC had previously obtained an admission of wrongdoing on January 29, 2014 from a broker-dealer for omitting trades from blue sheet data as a result of a computer error.[21] Enforcement Division Director Ceresney emphasized in both settlement releases that the SEC relies on accurate blue sheet data in its regulation of the securities markets.

Similarly, on September 9, 2015, as discussed more fully in Section IV.C below, the SEC filed a settled AP against BDO USA, LLP (BDO) and five of its partners for allegedly ignoring red flags and issuing false and misleading unqualified audit opinions.[22] The firm admitted wrongdoing — the first time a public accounting firm has admitted to such conduct, according to the SEC — and agreed to pay over $2.1 million to settle the claims. Without admitting or denying the SEC's allegations, the four audit partners who settled with the SEC paid a total of $65,000 in monetary fines and agreed to be suspended from practicing before the SEC for varying periods of time. In requiring that BDO admit wrongdoing, the SEC seemed to focus on the central role audit reports play in investment decisions, and thus how misleading audit reports could undermine the integrity of the securities market. The SEC did not indicate why it took a different view as to the individuals.

D. *Grants of "Bad-Actor" Waivers*

As discussed in our *Mid-Year Review*, journalists, politicians and even the SEC's own commissioners criticized the Commission's practice of consistently granting waivers from the disqualification provisions of the federal securities laws after multiple large financial institutions received waivers in the first half of 2015 following settlements with the Commission.[23] These "bad-actor" waivers allow defendants who are subject to certain administrative orders or injunctions or who have been convicted of specified crimes to continue to benefit from exceptions and safe harbors under the federal securities laws for which they would otherwise be disqualified, such as Well-Known Seasoned Issuer (WKSI) status, use of the safe harbor for forward-looking statements, or use of certain exemptions under the federal securities law. Supporters of waivers have generally argued that disqualification provisions are intended to protect markets from ongoing harm, not punish defendants,[24] while critics have complained that the waivers make certain firms "too big to bar."[25]

The SEC appeared to be continuing its prior policy of generally granting waiver requests in August when it granted a large financial institution a waiver after two of the bank's affiliates settled claims that they allegedly understated the risks and suitability of investments for traditional bond investors (as discussed below in Section IV.D).[26] On August 27, 2015, however, (now former) Commissioner Aguilar recommended that the SEC increase its use of conditional waivers, which would impose certain limitations but would not fully disqualify a defendant, to help dispel the notion that the breadth and severity of disqualification provisions have caused the

Commission to routinely grant blanket waivers, especially to large financial institutions.

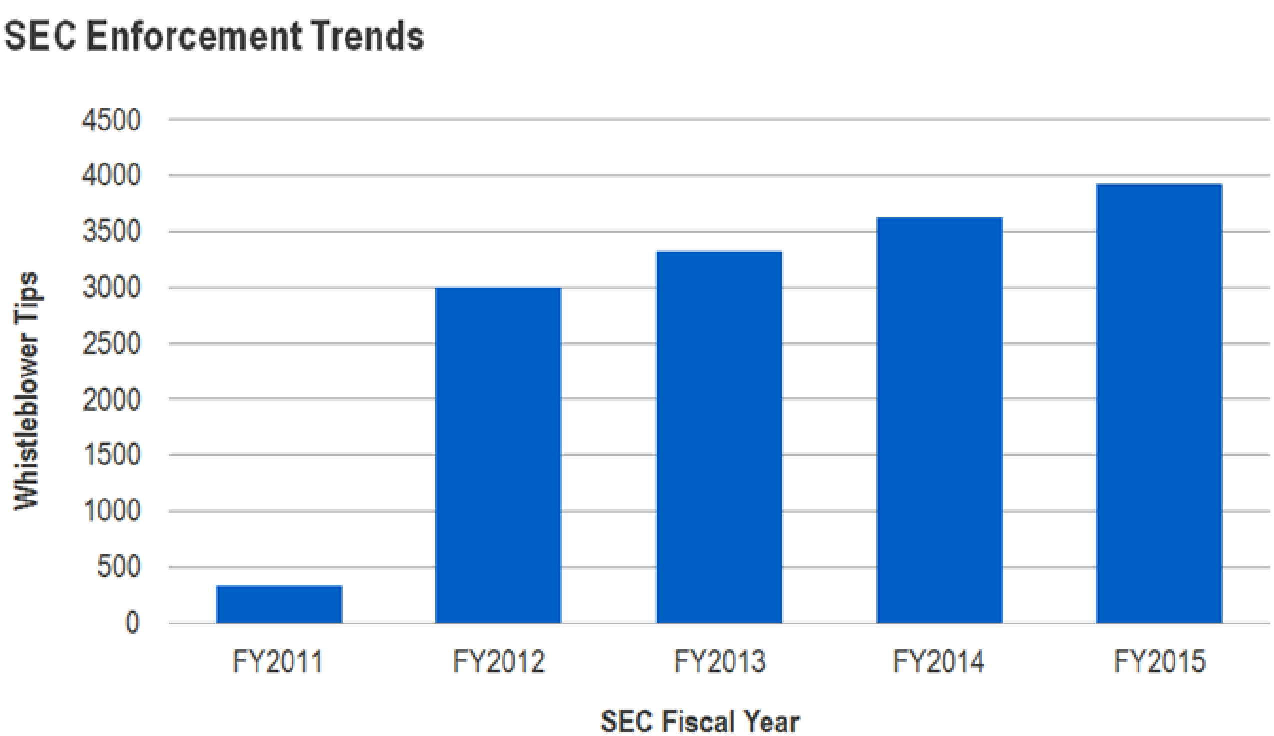
On December 18, 2015, the SEC granted such a conditional waiver when it and the Commodity Futures Trading Commission (CFTC) settled with a large financial institution that had allegedly failed to tell clients that it was steering them to the bank's own products, which would allow the bank to earn higher fees. As part of the settlement, the bank agreed to pay a total of $307 million and made certain admissions. In addition, the Commission granted the institution a conditional waiver that would allow it to continue to act as an investment manager and placement agent for private funds that issue unregistered securities under Rule 506 of Regulation D of the Securities Act of 1933 (Securities Act) and would allow its affiliates to continue to conduct business under Rule 506, but subject to a number of conditions.

First, the SEC or CFTC can revoke the conditional waiver if the bank fails to comply with either agency's order or is the subject of any action triggering the disqualification provisions under the federal securities laws for a period of five years.

Second, the conditional waiver requires the bank to engage a compliance consultant for a five-year period to conduct a comprehensive review of the bank's practices, policies and procedures relating to its management and placement of unregistered securities under Rule 506. The compliance consultant must issue an annual report each year summarizing its findings, which will be published on the Commission's website.

Third, the conditional waiver requires senior executives to assist in addressing identified compliance issues and certify that they have read the compliance consultant's report.[27]

The SEC's insistence on such terms suggests that the days of the Commission routinely granting broad, unconditional waivers may be coming to an end. The commentary by certain Commissioners about conditional waivers also indicates that the SEC will likely make greater use of conditional waivers in the coming months.



* The rules governing the SEC's Whistleblower Program became effective on August 12, 2011, thus only 7 weeks of data is available for Fiscal Year 2011, which ended September 30, 2011.

Source: SEC, 2015 Annual Report to Congress on the Dodd-Frank Whistleblower Program 21 (Nov. 16, 2015).

E. *Update on the SEC's Whistleblower Program*

Notable whistleblower awards by the Commission in the second half of 2015 included an award, on July 17, 2015, of $3 million — the third-highest award ever under the Whistleblower Program — and an award of over $325,000 on November 4, 2015.[28] In announcing the $325,000 award, the Commission included an admonition for future whistleblowers, stating that "[t]he whistleblower waited until after leaving [his employer] to come forward . . . and agency officials say the award could have been higher had this whistleblower not hesitated."

The Commission announced a joint award of 20% of monetary sanctions to a pair of foreign whistleblowers on September 28, 2015,[29] and an award of 28% of sanctions to a separate whistleblower on September 29, 2015.[30] The announcements of these awards did not include specific amounts because monetary sanctions have yet to be collected.

The SEC's Whistleblower Program also received a boost in 2015 from a decision by the Second Circuit regarding eligibility for anti-retaliation protection under Dodd-Frank. The decision, *Berman v. Neo@Ogilvy LLC*, deferred to the SEC's interpretation of "whistleblower" in Dodd-Frank and held that a whistleblower could sue for retaliation under Dodd-Frank even if the whistleblower was retaliated against for disclosing information to an employer, not the Commission.[31] The Second Circuit decision conflicts with the Fifth Circuit's holding in *Asadi v. G.E. Energy*, that Dodd-Frank's plain language only allowed an employee to sue for retaliation provisions if the employee was retaliated against for disclosing information to the SEC.[32]

Berman could further the SEC's policy of encouraging internal reporting, which is reflected in, among other things, Rule 21F-6(a)(4) of the Exchange Act, which considers a whistleblower's participation in an entity's internal reporting system a plus factor in determining the size of an award, and Exchange Act Rule 21F-4(b)(7), which creates a 120-day "look-back period" for whistleblowers who first report wrongdoing through an entity's internal processes.[33] The look-back period allows a whistleblower to receive credit for reporting information as of the date of the internal report.

Whistleblowers claiming to have been fired after reporting wrongdoing internally began bringing suits alleging violations of Dodd-Frank's anti-retaliation provisions within a week of *Berman*. For example, on September 17, 2015, a former branch manager at an international financial institution filed a whistleblower suit in the SDNY alleging that he had been fired after reporting a number of mortgage loans originated by unregistered loan officers in violation of federal mortgage laws.[34]

Separately, as the year came to a close, reports emerged of a pending whistleblower award that could be the largest in the program's history. As described in Section II.D above, a large financial institution agreed to a $307 million settlement in December with the SEC and CFTC. The actions against the bank reportedly stemmed from a whistleblower tip, and, based on the settlement amount, the whistleblower could receive an award of over $90 million.[35] Even an award on the low end of the range, however, could easily surpass $30 million, the highest award to date. Such staggering awards can only boost the Whistleblower Program's profile, which could further increase reporting to the SEC.

F. *Focus on Cybersecurity*

In the spring of 2014, OCIE released a risk alert announcing that the SEC would examine registered broker-dealers and investment advisers to assess their cybersecurity preparedness.[36] OCIE stated that its examinations would focus on cybersecurity governance, identification and assessment of cybersecurity risks, protection of networks and information, risks associated with remote customer access and funds transfer requests, risks associated with vendors and other third parties, detection of unauthorized activity and experiences with certain cybersecurity threats. OCIE completed its examinations on February 3, 2015 and issued a report that criticized companies for failing to prevent cyberattacks, notwithstanding written policies designed to prevent such attacks.[37] The SEC's Division of Investment Management then released guidance for the protection of customer information that emphasized that broker-dealers and investment advisers should limit employee access to data, employ encryption technologies and develop incident response plans.[38]

While the guidance was welcome, it was arguably too general to be particularly useful, much like the provisions of Rule 30(a) of Regulation S-P under the Securities Act (the Safeguards Rule). The Safeguards Rule generally requires that regulated entities adopt written policies and procedures that are reasonably designed to safeguard customer records and information. However, the rule does not define specific requirements for a reasonable cybersecurity program, so it is possible that the mere event of a data breach is enough to show that a company lacks reasonably designed procedures. Further, even a large and sophisticated institution with an advanced cybersecurity policy still faces the risk of a cyberattack — and a potential violation of the Safeguards Rule — through the smaller, less-sophisticated companies with which larger companies interact. For example, the hackers who stole customer data for 70 million of big-box retailer Target's customers in 2013 reportedly accessed Target's systems via the network of the small business responsible for Target's heating and air conditioning.[39]

The SEC brought one of the first enforcement actions related to OCIE's cybersecurity review in the second half of 2015, and that action involved a third-party service provider. Specifically, on September 22, 2015, the SEC instituted a settled AP against R.T. Jones Capital Equities Management, Inc. (RT Jones) for allegedly failing to adopt written policies and procedures reasonably designed to protect customer records and information in violation of the Safeguards Rule.[40] The SEC alleged that RT Jones stored sensitive personally identifiable information for over 100,000 clients and other persons on a server hosted by a third-party vendor without adopting written policies and procedures for the security, confidentiality or protection of that information. The SEC also alleged that a July 22, 2013 cyberattack left RT Jones's customers' data vulnerable to theft. Without admitting or denying the SEC's allegations, RT Jones agreed to pay a $75,000 civil monetary penalty. Prior to the settlement, RT Jones also engaged in remedial efforts by appointing an information security manager to oversee data security and protection and implementing a written information security policy.

OCIE has announced that it will conduct a second round of cybersecurity reviews,[41] which could lead to more enforcement actions. With this additional review and the enforcement actions that are also likely to come, calls may grow louder for the SEC to provide more detailed guidance on cybersecurity requirements.

G. *Insider Trading in the Wake of United States v. Newman*

The Supreme Court's denial of *certiorari* in *United States v. Newman* appeared to settle the debate over whether, to succeed in an insider trading enforcement action where the SEC's only evidence of a personal benefit to the insider is the existence of a personal relationship with the tippee, the SEC needed to offer "proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."[42] The debate will continue for at least a few more months, however, as the Supreme Court recently granted *certiorari* in *United States v. Salman*, a case out of the Ninth Circuit that is likely to address the personal benefit standard set by the Second Circuit in *Newman*.

The SEC may well seek to delay disposition of certain pending insider trading cases until the Supreme Court decides *Salman*, as the SEC has felt the impact of *Newman* in recent cases. On September 14, 2015, the SEC suffered a rare defeat in an AP when an ALJ dismissed insider trading claims against Joseph Ruggieri, a former trader at Wells Fargo Securities LLC. ALJ Jason Patil found that, although the SEC showed that Ruggieri traded on material non-public information on numerous occasions, the allegations did not meet the SEC's burden under *Newman* to show that the corporate insider gave Ruggieri the information in exchange for a personal benefit. ALJ Patil was not persuaded by the SEC's argument that Ruggieri received the information in exchange for positive feedback and instead found that it was more likely that Ruggieri's feedback was genuine and part of a standard practice, as Ruggieri had given the corporate insider positive feedback even before being provided with material non-public information.[43]

Newman may have also had a significant impact on the SEC's AP against Steven Cohen, the former head of hedge fund SAC Capital Advisors LP (SAC Capital), which settled on January 8, 2016. The SEC had alleged that during Cohen's time at the helm of SAC Capital he failed to reasonably supervise high-performing traders Michael Steinberg and Mathew Martoma, who had been criminally convicted of insider trading after jury trials. The SEC's settlement order found that Cohen failed to supervise Martoma (Steinberg's conviction was vacated after *Newman* for insufficient evidence of a personal benefit), ignored red flags that Martoma was engaged in insider trading, and encouraged Martoma to talk to a doctor about nonpublic drug trial results to inform trading decisions.

To settle the SEC's claims, Cohen, without admitting or denying wrongdoing, agreed to retain an independent consultant to conduct periodic reviews of his family office firms, to subject his firms to periodic SEC examinations and to be barred from supervising funds that manage outside money for two years. The settlement allows the SEC to extend the time period during which Cohen must comply with these requirements in the event the Commission brings a new action against Cohen, and requires any registered broker-dealer or investment advisor that retains Cohen in a supervisory capacity before 2020 to retain an independent consultant until the end of 2019.[44]

The SEC's AP against Cohen was perhaps the most anticipated AP in recent years, and its sudden and surprising settlement, which did not include a monetary penalty, suggests that the Commission may have had serious concerns about its case in the wake of *Newman*.

The continuing impact of *Newman* is now an open question in light of the Supreme Court's grant of *certiorari* in *Salman*. The question as to which the Supreme Court granted *certiorari* in *Salman* is whether the personal benefit to the insider that is necessary to establish insider trading requires proof of an exchange that is "objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature," as the Second Circuit held in *Newman*.[45] The Ninth Circuit's opinion in *Salman*, written by SDNY Judge Jed Rakoff (sitting by designation), can be easily distinguished from *Newman* on its facts, as it did not involve a remote tippee who lacked knowledge of any personal relationship between the insider and immediate tippee, and because the personal relationship between tipper and tippee appeared to be far more meaningful than in *Newman*.[46] Nevertheless, the Supreme Court's decision may reach more broadly than the facts of either case to bring some clarity to insider trading law, which could be a welcome development by all. A decision in *Salman* is expected by the end of the Supreme Court's current term in June 2016.

H. *Focus on Compliance Officers*

The SEC's pursuit of enforcement actions against compliance professionals was one of the most divisive issues of 2015. As we reported in our *Mid-Year Review*, after having typically limited enforcement actions against individuals with compliance authority to those who also had other management responsibilities or in cases of actual fraud, the SEC brought claims in the first half of 2015 against individuals responsible solely for compliance and in the context of their compliance roles. This sparked public statements of dissent and criticism from Commissioner Gallagher. Commissioner Aguilar responded with a statement addressing the criticism and reassuring compliance professionals that the SEC was not interested in bringing enforcement actions against compliance professionals who were obeying the law and fulfilling their responsibilities. Chair White added her voice to the debate on July 14, 2015 assuring compliance professionals that, "[w]e do not bring cases based on second guessing compliance officers' good faith judgments, but rather when their actions or inactions cross a clear line that deserve sanction."[47] And, on November 4, 2015, Enforcement Director Ceresney, attempting to assuage the fears of compliance officers who worry they will be targeted, reiterated that the overwhelming majority of the cases the SEC brings involve compliance officers who crossed a clear line by engaging in affirmative misconduct or obstructing regulators.[48]

On August 5, 2015, in an action illustrative of the types of acts that appear to result in enforcement actions against compliance officers, ALJ Cameron Elliot found that Judy Wolf, a former investment bank compliance officer, aided and abetted her employer's violation of the books and records provisions of the Exchange Act by altering documents during an SEC investigation. After learning that the SEC was investigating, Wolf admitted to altering her notes regarding a review of securities trades in a fast food chain restaurant's stock that she did not flag for her superiors by including reports of takeover rumors that would have bolstered a conclusion that the trades were improper. Although ALJ Elliot found that Wolf violated the Exchange Act, he declined to sanction her because, among other things, he concluded that her violations were isolated and not egregious. ALJ Elliot noted that some factors favored sanctions, but held that Wolf was a low-level employee and sanctions would allow her employer to label her a "bad apple" and move on without examining its practices. ALJ Elliot further alluded to the ongoing debate over the Commission's policy of bringing actions against compliance personnel by noting that sanctioning low-hanging fruit like Wolf could discourage competent persons from taking compliance positions.[49]

On August 6, 2015, the SEC agreed to settle claims it had brought against an investment advisory firm, its CEO, John P. Bott, II, and its chief compliance officer, Robert Falkenberg.[50] In March 2011, the SEC asked Falkenberg to provide copies of his 2010 review of the firm's policies and procedures, which Falkenberg allegedly told the Commission that he had conducted in February 2011. A review of the firm's metadata, however, allegedly revealed that Falkenberg had not actually conducted his review until April 2011 and had only spent a few hours drafting his report, which he never sent to the firm's CEO. The SEC claimed the firm had violated Sections 206(3), 206(4) and 206(4)(A) of the Investment Advisers Act of 1940 (the Advisers Act) and Rules 206(4)-2, 206(4)-7 and 206(4)A-1 thereunder and that Bott and Falkenberg had aided and abetted the firm's violations. Pursuant to the settlement, Bott agreed to pay $450,000 in disgorgement to the firm's clients, plus prejudgment interest, and Bott, Falkenberg and the firm were ordered to pay civil monetary penalties in the amounts of $70,000, $40,000 and $200,000 respectively, for a total of more than $760,000. Falkenberg was also required to complete 30 hours of compliance training for his alleged failure to monitor the firm by conducting an annual review of its policies and procedures.

In addition to its recent actions involving compliance officers, the SEC has been scrutinizing investment advisers' growing use of outside CCOs. For example, on November 9, 2015, OCIE released a report finding that several outsourced CCOs had not effectively implemented compliance programs for which they were responsible.[51] In its risk alert, OCIE reported that "certain outsourced CCOs could not articulate the business or compliance risks" their firms faced or whether the firms had adopted written policies and procedures to mitigate those risks.[52] In other instances, outside CCOs were not tailoring program templates to the adviser's business, meaning that the compliance materials were not applicable to the firm. The SEC concluded that advisers with outsourced CCOs should review their business practices to ensure that CCOs have enough authority to implement compliance programs and policies.

Even if the SEC follows through with its assurances that only compliance officers who cross a "clear line" will face enforcement action, the number of regulatory lines now drawn for compliance officers — and their new focus on outsourced compliance programs — makes it clear that this remains an area of heightened enforcement risk.

III. Selected Judicial Developments

Several judicial opinions of significance to the SEC's enforcement program were issued in the second half of 2015, and we summarize four of the most significant opinions below. *First*, the D.C. Circuit held that the SEC could not retroactively apply the remedial provisions of Dodd-Frank concerning industry bars to punish conduct that occurred before Dodd-Frank was enacted. *Second*, the D.C. Circuit, in a separate case, held that Section 4E of the Exchange Act does not set a limitation period for the SEC to bring an enforcement action after issuing a Wells notice. *Third*, the Second Circuit issued a long-awaited decision in an appeal of a securities fraud conviction in *Litvak* that, while coming in a criminal case, will likely allow the SEC to continue to push the envelope for what constitutes a material misstatement. *Finally*, Judge Pauley of the SDNY criticized the SEC for its use of an asset freeze in connection with the collapse of a Cayman Islands bank.

A. *Koch v. SEC*

On July 14, 2015, the D.C. Circuit ruled in *Koch v. SEC* that the SEC could not use remedial provisions of Dodd-Frank to punish an investment adviser for conduct that occurred before Dodd-Frank was enacted.[53] The SEC had instituted an AP against Donald Koch and his firm, Koch Asset Management (KAM), alleging that Koch engaged in a scheme to manipulate the prices of stocks in which KAM had invested. Koch purportedly instructed his broker on two different occasions in 2009 to increase the frequency of the broker's bids on stocks at the end of the trading day, which had the effect of inflating the stocks' prices. The SEC alleged that Koch and KAM violated Section 10(b) of the Exchange Act and Section 206(1) of the Investment Company Act, and requested, among other things, that Koch be barred from the securities industry.

Prior to Dodd-Frank, the SEC had the authority to bar individuals from associating with a subset of securities industry participants, including broker-dealers and investment advisers. Dodd-Frank, however, expanded the SEC's authority to bar individuals from associating with municipal advisors and ratings organizations, a power it did not have prior to the passage of Dodd-Frank.

Although Koch's alleged market manipulation occurred in 2009, a year before Dodd-Frank, the SEC sought to bar Koch from the securities industry pursuant to its authority under Dodd-Frank.

The presiding ALJ found that Koch engaged in market manipulation, but only imposed a limited industry bar that barred Koch from associating with investment advisers. Koch appealed to the Commission, which not only affirmed the ALJ's findings, but also expanded the industry bar imposed on Koch to include municipal advisers and ratings organizations. Koch appealed the Commission's ruling to the D.C. Circuit, which also affirmed that Koch had engaged in market manipulation, but reversed the Commission's expansion of Koch's industry bar. The panel held that the SEC could not use Dodd-Frank to penalize Koch for conduct that occurred before the statute was enacted because Dodd-Frank did not expressly allow the SEC to apply its provisions retroactively, and expanding Koch's industry bar would "would impair rights [Koch] possessed when he acted, increase [Koch's] liability for past conduct, or impose new duties with respect to transactions already completed."

A week after the D.C. Circuit ruled, Commissioners Gallagher and Piwowar, who had dissented from the SEC's order expanding Koch's industry bar, said in a joint statement that they were "pleased" with the court's holding and urged the SEC to address "all impermissibly retroactive collateral bars that have been misapplied since the enactment of Dodd-Frank."[54]

A. *Montford v. SEC*

On July 21, 2015, the D.C. Circuit issued its opinion in *Montford v. SEC*, holding that the requirement under Section 4E of the Exchange Act that enforcement proceedings be brought within 180 days of a Wells notice (enacted with Dodd Frank) is not an enforceable jurisdictional requirement.[55] *Montford* arose from an appeal of a final order from the Commission finding that respondents violated Sections 204, 206 and 207 of the Advisors Act for, among other things, allegedly failing to disclose the receipt of fees from an investment manager while disclosing to customers that it was "independent" and "conflict free." The Commission barred respondents from the securities industry, required the disgorgement of $210,000 and imposed civil penalties.[56]

Respondents appealed the Commission's order to the D.C. Circuit, raising two challenges, each of which the court rejected. *First*, respondents argued that the institution of administrative proceedings more than 180 days after issuing a Wells notice violated Section 4E of the Exchange Act and required dismissal. Section 4E of the Exchange Act provides that "[n]ot later than 180 days after the date on which Commission staff provide a written Wells notification to any person, the Commission staff shall either file an action against such person or provide notice to the Director of the Division of Enforcement of its intent not to file an action." The deadline of Section 4E may be extended by the Director of the Division of Enforcement "for certain complex actions," which the Commission submitted happened in the instant case.[57] Without reaching the issue of whether the Commission properly extended the Section 4E deadline, the court found that Section 4E of the Exchange Act was ambiguous as to whether its violation served to bar an action by the Commission. Accordingly, the court concluded that, under *Chevron*, the Commission's interpretation that Section 4E is not a jurisdictional bar was entitled to deference as long as it was reasonable, which the court found it was.

Second, respondents argued that the Commission abused its discretion in imposing civil penalties and ordering disgorgement because, in respondents' view, the receipt of money was not illegal and there was no causal link between the Commission's order of penalties and disgorgement and the alleged nondisclosure. The court rejected this argument too, noting that the Commission has flexibility in imposing such penalties, which will be upheld as long as they are reasonable.

Because the Enforcement Division is generally diligent about ensuring that enforcement actions are filed within 180 days of a Wells notice (or seeking an extension from the Division Director), *Montford* may have limited practical impact. More surprising is arguably the judicial finding of ambiguity in a statute that left little room for interpretation.

B. *SEC v. Caledonian Bank*

On November 10, 2015, in *SEC v. Caledonian Bank*, Judge William H. Pauley III of the Southern District of New York denied the defendants' motion to dismiss an SEC complaint that defendants had engaged in unregistered sales of securities, in violation of Sections 5(a) and 5(c) of the Securities Act, as part of an alleged penny stock "pump-and-dump" scheme that the SEC claimed netted them profits of $75 million. According to the SEC, the defendants allegedly aggressively marketed the stocks of four companies that contained few assets, using a series of sham transactions to conceal beneficial ownership of the securities before offering them to the public. The opinion on a motion to dismiss would likely be of limited interest if only considered for its holding.

In declining to dismiss the pending case, however, Judge William H. Pauley III aggressively criticized the SEC's failure to coordinate its enforcement efforts, which he stated led to unintended consequences and collateral victims. According to the court's opinion, at the same time a team of Washington, DC-based SEC attorneys had persuaded Judge Pauley in February 2015 to freeze the assets of a Cayman Islands bank that allegedly sold the fraudulent securities, another team of New York-based SEC attorneys, who were investigating the some of the same defendants, had information showing that the bank had *not* sold the securities for its own account, but merely acted as a broker. According to the Judge Pauley, the freeze order (which was predicated in part on the belief that the bank had *not* acted as a broker) had the effect of bankrupting the bank shortly thereafter. Judge Pauley blamed the SEC's "bureaucratic siloing" for causing what he described as an unfortunate and unnecessary outcome. In a broader criticism of the SEC, Judge Pauley stated: "it is hard to believe that those charged with overseeing enforcement are not monitoring activities to avoid needless duplication of effort," and that "[g]iven the high stakes in securities enforcement actions, and in the face of a workload the SEC describes as an 'overwhelming burden,' a self-examination may be appropriate." It remains to be seen what impact the criticism will have.

C. *United States v. Litvak*

On December 8, 2015, in a highly anticipated ruling, the United States Court of Appeals for the Second Circuit reversed bond trader Jesse Litvak's conviction on false statement charges and vacated his conviction on securities fraud charges.[58] The panel held that the trial court abused its discretion when it excluded critical expert testimony regarding pricing in the bond market, which could have bolstered Litvak's arguments that his allegedly false statements were not material. The panel only vacated Litvak's securities fraud conviction, however, rejecting his central argument that the statements at issue were immaterial as a matter of law. The SEC had brought a parallel civil action against Litvak arising out of the same allegations, which remains on hold pending the outcome of Litvak's criminal case.[59]

The panel's decision was not a complete win for Litvak, and could have broad implications for future SEC actions. Litvak's central defense at trial and on appeal was that his alleged misrepresentations, which related to the profit he stood to make from counterparties on bond transactions, were immaterial as a matter of law. Specifically, he argued that the statements were immaterial as a matter of law because they related to how much Litvak paid for the securities himself and had no impact on the value of the securities themselves. Put another way, Litvak argued that counterparties could not have considered his false statements important because they did not pertain to any objective valuation of the underlying securities.

The panel rejected Litvak's arguments, pointing to testimony from Litvak's counterparties who stated that Litvak's alleged misstatements were "important" to them and that the counterparties were injured by those misrepresentations by ultimately paying more than they would otherwise have bid for the securities. Even though Litvak had credibly argued that the kind of statements at issue were a common business practice that should have had no relevance to pricing, the panel concluded the testimony precluded a finding that no reasonable mind could find Litvak's statements material. And although the decision was not written as though it broke new ground, the panel's approach to materiality and deference to what investors considered to be important may have a lasting impact on the way the SEC pursues investigations by putting a greater focus on gathering evidence concerning investors' expectations. At the same time, the court's decision that excluding Litvak's proffered materiality expert was an abuse of discretion will ensure that future defendants have more leeway to argue their positions in court.

In sum, while the district court cannot dismiss the remaining charges against Litvak on materiality grounds, Litvak will have much more ammunition to fight these charges at trial. And for future defendants (in both criminal and SEC actions), this opinion is a stark reminder that questions of materiality are highly fact-specific, and that no misrepresentation should be presumed to be harmless or immune from prosecution.

IV. Selected Significant Investigations and Cases

Below we highlight some of the more notable SEC enforcement actions from the latter half of 2015.

A. *Investment Advisers*

The SEC continued its especially vigorous oversight of investment advisers in 2015. It brought enforcement actions focused on representations of investment risk and performance, disclosure of conflicts of interest, the Custody and Compliance Rules of the Advisers Act, and disclosure of fees and expenses, while signaling a particularly increased focus on private equity.

1. Misrepresentation of Investment Risk and Performance

On July 31, 2015, the SEC filed a settled AP against a financial advisory firm and its founder, Walter F. Grenda, Jr. The SEC alleged that Grenda made false and misleading statements to the firm's advisory clients in recommending and selling investments in a hedge fund called Prestige Wealth Management Fund, LP (Prestige Fund). Grenda's statements allegedly misled clients into believing that the investments were less risky than they actually were. Grenda also allegedly borrowed $175,000 from two of his clients, which the SEC claimed he misrepresented would be for business purposes, but which he spent on personal expenses and debts. In its settlement order, the SEC found that the advisory firm and Grenda violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The SEC also found that the advisory firm and Grenda violated Sections 206(1) and 206(2) of the Advisers Act and that Grenda willfully aided and abetted Prestige Fund's violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. The advisory firm was censured by the Commission and had its registration as an investment adviser revoked, but did not pay any financial penalties. Without admitting or denying wrongdoing, Grenda agreed to pay $77,410.91, consisting of a $50,000 civil monetary penalty and $22,410.91 in disgorgement and prejudgment interest.[60]

On August 4, 2015, the SEC instituted a settled AP against Gold Mountain, LLC, an investment adviser in Iowa, and its founder, Gregory Bied, for allegedly defrauding investors through false statements in quarterly reports. Allegedly, Gold Mountain and Bied made false statements from 2012 through mid-2014 to investors in a hedge fund managed by Gold Mountain, namely that the fund was achieving positive quarterly returns, when, in fact the hedge fund had lost around 75% of its value over that time. The SEC claimed that Gold Mountain and Bied violated Sections 9(b) and 206(4) of the Advisers Act. Without admitting or denying the SEC's findings, Gold Mountain and Bied consented to an industry bar and to pay a civil monetary penalty of $200,000, which will be distributed to investors.[61]

On November 30, 2015, the SEC instituted settled APs against investment adviser Alpha Fiduciary, Inc. (AFI), Arthur Doglione, AFI's majority owner and president, and Michael Shea, AFI's vice president and business development director. The SEC alleged that AFI's executive summaries, firm profiles, presentations and advertising materials contained certain hypothetical performance information, but did not disclose that this data was completely hypothetical. Moreover, the SEC claimed that, while some of AFI's materials contained disclosure language, the disclosure language did not appear on the same page as the hypothetical performance data, rendering it misleading. The SEC also found that although AFI's compliance and procedures manual required the chief compliance officer's prior review and approval of any marketing materials, Doglione had exercised sole authority over AFI's policies and procedures. Thus, the SEC alleged that he was solely responsible for the review and approval of AFI's marketing materials prior to their distribution to clients or prospective clients. The SEC also claimed that Shea knew that some of the data was hypothetical, yet still included this information in materials he sent to clients. Moreover, Shea allegedly provided prospective clients with a report of an existing client's portfolio, which represented a 14.4% return, without taking any steps to determine if it was representative of the performance of other AFI clients. The SEC claimed that AFI, Doglione, and Shea violated Sections 206(2) and 206(4) of the Advisers Act. As part of the settlement, the parties, without admitting or denying the Commission's findings, agreed to censures and a total of $550,000 in penalties. AFI agreed to pay a civil monetary penalty of $250,000, to notify existing and prospective clients of the SEC's order and to obtain an independent compliance consultant. Doglione agreed to a civil monetary penalty of $250,000, and Shea agreed to a civil monetary penalty of $25,000.[62]

2. Conflicts of Interest

On July 24, 2015, the SEC instituted a settled AP against investment adviser Dion Money Management, LLC (Dion) for allegedly failing to disclose adequately to clients a compensation arrangement whereby Dion received payments from third parties when client assets were invested in certain mutual funds. The SEC asserted that, although Dion disclosed the conflict of interest, it understated the maximum payment rate under the arrangements with third parties and omitted the possibility that investors would receive payments from multiple parties based on the same client assets. The SEC found that Dion violated Sections 206(2) and 207 of the Advisers Act. Without admitting or denying the SEC's findings, Dion agreed to amend its disclosures to provide notice to its clients of the SEC's order and pay a civil monetary penalty of $50,000.[63]

On August 6, 2015, the SEC instituted a settled AP against Tri-Star Advisors (TSA), TSA CEO William T. Payne and TSA president Jon C. Vaughan for alleged violations of the Advisers Act. The SEC alleged that TSA made investment recommendations to its clients and executed trades while charging clients a sales credit, *i.e.*, a percentage mark-up, without disclosing the credit to clients. Payne and Vaughan allegedly received 55% of the sales credit generated by each trade. The SEC claimed that TSA violated Sections 206(3) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder and that Payne and Vaughan caused TSA to violate Sections 206(3) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. Without admitting or denying the Commission's findings, the respondents agreed to pay $779,149 to settle the SEC's claims. TSA agreed to pay a $150,000 civil monetary penalty, Payne agreed to pay disgorgement of $142,500, prejudgment interest of $3,235.21 and a civil monetary penalty of $195,635.21, and Vaughan agreed to pay disgorgement of $232,500, prejudgment interest of $5,278.50, and a civil monetary penalty of $50,000.[64]

On August 10, 2015, the SEC instituted a settled AP against an investment management company for allegedly failing to disclose a conflict. The SEC claimed that an advisory client made a $50 million loan to a senior executive, which the SEC claimed allowed the executive to personally participate in an acquisition led by the management company's parent. Allegedly, the management company subsequently invested certain other clients' funds in two transactions in which the advisory client had invested on different terms. The SEC asserted that the management company thus breached its fiduciary duty by failing to disclose the potential conflict of interest to both sets of clients. The SEC also alleged that the management company violated the Advisers Act by inadvertently billing a client approximately $6.5 million in asset management fees on non-managed assets by inaccurately coding the non-managed assets. Finally, the SEC alleged that the management company failed to implement certain compliance policies and procedures, enforce its code of ethics, and maintain required books and records. The SEC found that the management company violated Sections 206(2), 206(4), 204(a), and 204A of the Advisers Act and Rules 206(4)-7, 204-2(a)(3), 204-2(a)(5), and 204A-1 thereunder. The management company agreed to pay a $20 million penalty without admitting or denying the Commission's findings.[65]

Also, on September 29, 2015, the SEC filed a complaint in federal court against Lee D. Weiss and his investment advisory firm, Family Endowment Partners LP (FEP), for allegedly misappropriating investments and concealing conflicts of interest. Weiss and FEP allegedly advised their clients to make investments in companies Weiss owned and controlled without telling the clients of their relationship to the companies. The SEC claimed that Weiss and FEP then used the investment funds to pay FEP's financial obligations and delinquent interest owed to other clients. The SEC further claimed Weiss and FEP advised clients to invest approximately $5 million in a portfolio of consumer loans with a company that offered to pay an annual return of 18%, but Weiss structured the investments so his clients received only 9% while he pocketed the remaining 9%. The SEC claimed that Weiss and FEP violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 206(1), 206(2), 206(3) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, and Section 204(b)(5) of the Advisers Act and Rule 204-1 thereunder. The SEC is seeking disgorgement from Weiss, FEB, and several companies owned by Weiss.[66] The action is ongoing.

On September 30, 2015, the SEC settled claims against Focus Media Holding Ltd. (Focus), a China-based advertising company, and its founder, Jason Jiang. The SEC alleged Focus and Jiang failed to adequately disclose the partial sale of securities of Focus's wholly owned subsidiary, Allyes Online Media Holdings Ltd. (Allyes), to certain Allyes and Focus insiders before the securities were sold to a private equity firm. Allegedly, the securities were sold to the private equity firm at approximately six times the price the insiders had paid for the securities. The SEC alleged that the failure to disclose the sales to insiders violated the reporting and antifraud provisions of the federal securities laws. Without admitting or denying the SEC's allegations, Focus agreed to pay a civil monetary penalty of $34.6 million and Jiang agreed to pay a civil monetary penalty of $9.69 million, disgorgement of $9,690,000 and prejudgment interest of $1,647,865.[67]

On October 16, 2015, the SEC filed a civil injunctive action in federal court in the District of Colorado against Donald J. Lester and his private equity firm alleging violations of the federal securities laws. The SEC alleged that, starting in January 2010 and continuing for five years, Lester and his firm sold unregistered securities in two investment funds they managed, CFI Fund, LLC (CFI) and NuPower, LLC (NuPower), raising approximately $10 million. The SEC further alleged that the funds acted as unregistered investment companies, and neither Lester nor his firm were registered as brokers or associated with registered brokers while trading in securities. Additionally, Lester purportedly devised a fraudulent scheme to use $2.8 million of CFI investment funds to meet his firm's repayment obligation to a group of investment funds called Equity Edge that Lester's firm guaranteed. Specifically, the SEC alleged that Lester's firm transferred NuPower to Equity Edge for no consideration, after which CFI purchased a 50% interest in NuPower from Equity Edge for $2.8 million. CFI's investors allegedly were not informed about the conflict of interest in the transaction or about the purchase. The SEC is seeking, among other relief, permanent injunctions, civil monetary penalties, and disgorgement with prejudgment interest.[68] The action is pending.

On June 29, 2015, the SEC filed a settled AP against Welhouse & Associates, Inc. (WAI), a state-registered investment adviser, and its owner, principal and CCO, Mark Welhouse, for an alleged "cherry-picking" scheme, which purportedly violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and 206(2) of the Advisers Act. According to the SEC, from February 2010 until January 2013, Welhouse and his firm allocated options trades in an S&P 500 exchange traded fund in a manner that violated his fiduciary duty. Specifically, the SEC claims that Welhouse disproportionately allocated profitable trades to his personal and business accounts and allocated unprofitable trades to his advisory clients. Welhouse allegedly made this unfair allocation through purchasing options in an omnibus account and delaying allocation of the purchases until after the value of the trades could be determined. Without admitting or denying the SEC's findings, Welhouse and WAI agreed to jointly and severally pay disgorgement of $418,141, prejudgment interest of $50,918.60 and a $300,000 civil monetary penalty. In addition, WAI was censured and Welhouse was barred from the securities industry.[69]

3. Custody and Compliance Rules of the Advisers Act

On August 6, 2015, the SEC instituted a settled AP against Reid S. Johnson, founder, sole owner, president and managing director of The Planning Group of Scottsdale, LLC (TPGS), an Arizona-based investment adviser, for allegedly aiding and abetting violations of Rules 206(4)-2 (the Custody Rule) and 206(4)-7 (the Compliance Rule) under the Advisers Act. The Custody Rule imposes detailed requirements governing the manner in which a SEC-registered investment adviser must hold client assets and related obligations. The Compliance Rule requires registered investment advisers to adopt and implement written policies and procedures that are reasonably designed to prevent violations of the Advisers Act by the adviser and any of its supervised persons.

The SEC alleged that TPGS violated the Custody Rule by failing to accurately determine the securities over which it had custody and by failing to ensure that the securities were maintained by a qualified custodian. The SEC also charged that TPGS violated the Compliance Rule by failing to maintain an adequate compliance manual because TPGS's compliance manual did not address the 2009 amendments to the custody rule. Finally, the SEC charged that TPGS and Johnson willfully made materially false representations in TPGS's Forms ADV from 2010 through 2012.[70] The action is ongoing.

On August 6, 2015, the SEC instituted a settled AP against a Texas-based investment advisory firm, its sole owner and manager, John P. Bott, and its former Chief Compliance Officer, F. Robert Falkenberg, for allegedly violating the principal transaction prohibitions and Custody and Compliance Rules under the Advisers Act. The SEC claimed that the investment advisory firm failed to provide any prior written disclosure or obtain consent from clients for at least 2,000 securities transactions and failed to provide investors in a pooled investment vehicle with audited financial statements. In addition to allegedly failing to maintain and enforce a written code of ethics, the investment advisory firm also allegedly failed to implement and monitor written policies and procedures designed to prevent violations of the Advisers Act. The SEC claimed that Bott and Falkenberg willfully aided and abetted the investment advisory firm's violations of Sections 206(3), 206(4) and 204A of the Advisers Act and Rules 206(4)-2, 206(4)-7, and 204A-1 thereunder. Without admitting or denying the claims, the investment advisory firm agreed to pay a civil monetary penalty of $200,000, Bott agreed to pay disgorgement of $450,000, prejudgment interest of $5,604, and a civil monetary penalty of $70,000, and Falkenberg agreed to pay a civil monetary penalty of $40,000.[71]

On November 19, 2015, the SEC instituted settled APs against an investment advisory firm and its co-founders, Martin and Steven Sands, for allegedly violating the Custody Rule by failing to provide investors with timely audited financial statements. Notably, in 2010, the SEC entered into a settlement with these parties for alleged violations of the Custody Rule as well. The SEC alleged that notwithstanding its prior order, the investment advisory firm continued to fail to comply with the Custody Rule in the years that followed. Without admitting or denying liability, the investment advisory firm and Martin and Steven Sands agreed to engage an independent monitor to perform reviews of the investment advisory firm and submit reports that confirm that the investment advisory firm distributed its audited financial statements in a timely fashion. The investment advisory firm and Martin and Steven Sands also agreed to jointly and severally pay a $1,000,000 civil monetary penalty and be suspended from acting as investment advisors for a year.[72]

4. Disclosure of Fees and Expenses

On September 2, 2015, the SEC instituted a settled AP against Taberna Capital Management LLC (Taberna), a subsidiary of a real estate investment trust, over claims that Taberna pocketed high fees that belonged to its clients in violation of Section 15(a) of the Exchange Act and Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act, and Rule 206(4)-8 thereunder. Taberna allegedly began collecting fees on exchange transactions after the 2008 financial crisis, when the real estate investment trusts it invested in began trying to restructure collateralized debt obligations while the real estate market stabilized. Allegedly, these fees greatly exceeded Taberna's actual out-of-pocket costs and were concealed from investors as "third-party costs" on term sheets and exchange agreements. Taberna purportedly represented that these fees were used to pay legal and other administrative costs and attempted to dodge investors' questions about the fees. This, the SEC claimed, led to a conflict of interest, where Taberna sometimes sought to restructure transactions as exchanges instead of other structures, even when it reduced the amount of cash available to the CDOs. Without admitting or denying the findings, Taberna agreed to pay $15 million in disgorgement and prejudgment interest and a $6.5 million penalty. It also agreed to a five-year investment adviser bar.[73]

On September 21, 2015, the SEC instituted a settled AP against First Eagle Investment Management, LLC, an investment manager, and FEF Distributions, LLC, its affiliated distributor. This was the Commission's first enforcement action arising from its "Distribution-in-Guise Initiative," an industry-wide set of OCIE examinations focusing on payments to sub-transfer agents and other intermediary contracts for fund distributions. The settlement focused on agreements between the firm and two intermediaries that the firm had treated as sub-TA agreements that could be paid for by the Funds, but which the SEC believed related, at least in part, to distribution services. Without admitting or denying the SEC's allegations, the investment manager agreed to reimburse the funds for the payments to the intermediaries, regardless of whether any of the payments could reasonably be deemed for sub-transfer agent services.[74]

The settlement with the firm put pressure on fund managers to ensure that intermediary contracts contain clear and precise language regarding the services intermediaries provide. The settlement itself did not clearly articulate the language that the SEC believed should be used or the approach that boards should take regarding oversight of fees.

Following the settlement, on January 6, 2016, the SEC Division of Investment Management issued guidance resulting from the Distribution in Guise Initiative. The guidance focused on the need for fund boards to develop and maintain a process to evaluate intermediary payments and, in particular, sub-TA payments. At the same time, the guidance acknowledged that the volume and complexity of intermediary contracts at a typical fund firm make it challenging to develop clear lines. The guidance was perhaps most notable for its list of "red flags," which it indicated require particular scrutiny by fund Boards.

Those include distribution activity conditioned on payment of sub-TA fees, the lack of a 12b-1 plan, tiered and bundled payments to intermediaries, and large disparities in fees paid to various intermediaries. While the guidance provides some protection to fund Boards by acknowledging the challenges they face, it could also present a roadmap for future enforcement cases against any fund Boards that fail to institute a thoughtful and comprehensive process to evaluate intermediary relationships.[75]

On October 21, 2015, the SEC instituted a settled AP against Oklahoma-based investment advisor Retirement Investment Advisors, Inc. (RIA), investment manager Research Holdings, LLC (Research Holdings), and RIA's president and Research Holdings' co-manager, Joseph Wayne Bowie. The SEC alleged that Research Holdings, which was not a registered investment adviser, and Bowie offered and sold interests in five private funds to advisory clients at RIA. The SEC also alleged that, among other things, RIA and Bowie valued the clients' investments in the funds based on the acquisition cost, even though many had little or no value, which resulted in fee overcharges to clients. Finally, the SEC asserted that Bowie caused RIA to fail to maintain copies of its business communications. The SEC found that RIA, Research Holdings and Bowie violated Sections 204, 206(2) and 206(4) of the Advisers Act and Rules 204-2(a)(7)(i) and 206(4)-8 thereunder. Without admitting or denying the Commission's findings, RIA agreed to pay disgorgement of $144,243, prejudgment interest of $14,724 and a civil monetary penalty of $37,500. Bowie agreed to pay a civil monetary penalty of $25,000 and Research Holdings agreed to pay a civil monetary penalty of $37,500.[76]

On November 5, 2015, the SEC instituted settled APs against Cherokee Investment Partners, LLC (CIP) and Cherokee Advisers, LLC (CA) (collectively, Cherokee) for the alleged improper allocation to clients of consulting, legal, and compliance-related expenses. According to the SEC, Cherokee incurred $455,698 in costs in the course of preparing for registration as investment advisers and complying with legal obligations arising from registration. While the agreements with respect to the funds allowed for expenses to be charged based on Cherokee's good faith judgment, Cherokee allegedly did not disclose that funds would be charged for the advisers' legal and compliance expenses. Moreover, the SEC alleged that both Cherokee entities failed to adopt written policies or procedures reasonably designed to prevent such misallocation. The SEC claimed that Cherokee violated Section 206(2) of the Advisers Act and Section 206(4) of the Advisers Act. Without admitting or denying the allegations, Cherokee agreed to pay a civil monetary penalty in the amount of $100,000.[77]

On November 23, 2015, the SEC announced a settled AP against Cranshire Capital Advisors, LLC (CCA), an investment adviser that allegedly charged expenses to its fund clients and failed to adopt and implement compliance policies and procedures. CCA purportedly used fund assets to pay for CCA's legal, compliance, and operating expenses in a manner that was not disclosed or authorized in the fund's organizational documents. According to the SEC, this resulted in the improper use of $158,650 of fund assets to pay compliance consultant fees and attorney fees, as well as $118,378 to pay for office supplies and utilities. Moreover, the SEC claimed that the improper allocation of expenses to the fund was caused in part by CCA's failure to adopt or implement an adequate compliance program and asserted claims against CCA for violations of Sections 206(2) and 206(4) of the Advisers Act. As part of the settlement with the SEC, and without admitting or denying the findings, CCA agreed to a censure and to pay a civil monetary penalty of $250,000. CCA also agreed to retain a compliance consultant and provide a copy of the settlement order to all shareholders and limited partners.[78]

5. Stock Manipulation

The SEC also brought enforcement actions in the second half of 2015 against investment advisers who allegedly engaged in schemes to manipulate stock prices.

On September 24, 2015, the SEC instituted a settled AP against Michael A. Glickstein and his investment advisory firm, G Asset Management, LLC (GAM). The SEC alleged that the Glickstein and GAM violated the antifraud provisions of the federal securities laws by announcing their intent to purchase a majority stake in Barnes & Noble, even though GAM had no ability to finance the purchase, which caused Barnes & Noble's share price company to rise and allowed respondents to make a $168,000 profit on shares and options that GAM had purchased shortly before its announcement. Without admitting or denying the SEC's allegations, GAM and Glickstein consented to a settlement that requires them to return $175,000, representing their $168,000 profits, plus interest. GAM also agreed to be censured and Glickstein agreed to pay a civil monetary penalty of $100,000 and to a five-year minimum industry bar.[79]

On September 30, 2015, the SEC instituted a settled AP against investment adviser Securus Wealth Management, LLC (Securus) and James Goodland, its President and Chief Compliance Officer, for violations of Section 203(e) of the Advisers Act. The SEC claimed that Goodland failed to properly supervise Howard Richards, an advisory representative associated with Securus. Richards had purportedly been engaged in a scheme to support the market price of the common stock of Gatekeeper USA, Inc. (Gatekeeper), in order to help Gatekeeper obtain financing. From 2010–2013, Richards allegedly manipulated Gatekeeper's share price by using his clients' accounts to purchase shares at higher prices when Gatekeeper's stock price fell below a certain level, until eventually these accounts held over $1 million in Gatekeeper shares. Goodland was Richards's direct supervisor and allegedly failed to follow up on several red flags, including Richards's unusual trading in client accounts and numerous emails with a Gatekeeper insider.[80] Without admitting or denying the SEC's findings, Securus was censured and Goodland consented to an industry bar and agreed to a civil monetary penalty of $30,000.

6. Private Equity

The SEC's enforcement activity in the private equity area in the second half of 2015 reflected the Commission's continuing focus on disclosures of fees and conflicts of interest.

On October 7, 2015, the SEC instituted settled APs against three related private equity funds and fund advisers regarding alleged breaches of fiduciary duties to investors for purportedly failing to disclose certain fee arrangements in violation of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder. Specifically, the SEC alleged that the funds did not adequately disclose the acceleration of monitoring fees paid by fund-owned portfolio companies before the companies' sales or initial public offerings. Even though such acceleration of payments is relatively common, the SEC claimed that these payments allegedly reduced the value of the portfolio companies before the sale, which the SEC claimed harmed the funds and their investors. Without admitting or denying the findings, the funds agreed to pay $67.6 million, consisting of $26.2 million in disgorgement, $2.6 million in prejudgment interest, a $10 million civil monetary penalty, and $28.8 million for affected fund investors.[81]

On November 3, 2015, the SEC announced that Fenway Partners LLC (Fenway), a New York-based private equity firm, and its current principals, Peter Lamm and William Gregory Smart, its former principal, Timothy Mayhew Jr., and its Chief Financial Officer, Walter Wiacek, agreed to settle claims that they allegedly failed to disclose conflicts of interest. The SEC claimed that Fenway, Lamm, Smart, Mayhew and Wiacek did not adequately disclose to clients and investors facts about, among other things, transactions with an affiliated entity for consulting services. Without admitting or denying the SEC's findings, the respondents agreed to pay $9,417,000 to settle the claims, consisting of a payment of disgorgement by Fenway, Lamm, Smart, and Mayhew of $7.892 million, and a payment by Fenway, Lamm, Smart, Mayhew and Wiacek of $1.525 million in penalties.[82]

When considered together with the Commission's action against Kohlberg Kravis Roberts & Co. earlier in 2015, in which the SEC alleged that KKR incurred $338 million in broken deal or diligence expenses related to unsuccessful buyout opportunities and other deals, but did not allocate those expenses to KKR's co-investors, these actions suggest that private equity firms should continue to pay increasing attention to line-by-line expense disclosures, as the SEC is taking a granular approach in its misallocation investigations.

B. *Broker-Dealers*

The SEC appears more focused on broker-dealers than at any point over the last ten years. From FY 2005 to FY 2014, the last year for which data is available, the number of broker-dealer enforcement cases nearly doubled, from 94 to 166.[83] This focus continued during the second half of 2015, when the Commission brought enforcement actions against broker-dealers involving a wide range of misconduct, including technical errors, failures to satisfy broker-dealer reporting requirements and "spoofing." Below are descriptions of certain of the most notable cases.

1. Unregistered Sales of Securities

On July 23, 2015, the SEC instituted settled APs against Scott A. Eisler, former registered representative at a New York-based investment bank, branch manager Arthur W. Lewis and supervisor and private client division head Robert Okin for allegedly participating in unregistered sales of penny stocks. According to the SEC, Eisler executed and Lewis approved or participated in the sales, and, despite red flags, failed to make reasonable inquiries into the propriety of the sales as required by the federal securities laws. The SEC also alleged that Lewis and Okin failed to adequately supervise employees by ignoring red flags that suggested that the shares were not exempt from registration. To settle the SEC's claims, and without admitting or denying the allegations, Eisler was barred from the securities industry, associating with an investment company and participating in a penny stock offering for one year and agreed to pay a civil monetary penalty of $50,000, Lewis was barred from acting as a supervisor for a broker-dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for one year and agreed to pay a civil monetary penalty of $50,000, and Okin was barred from acting as a supervisor for a broker-dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for one year and agreed to pay a civil monetary penalty of $50,000.[84]

On August 5, 2015, the SEC instituted a settled AP against Murat Dorkan for allegedly participating in the sale of unregistered bonds issued by Empire Corporation (Empire). The SEC claimed that from 2006 to 2010, Dorkan, the president, chairman and CEO of Empire, Wilfred Azar, III, and an unnamed registered representative of Empire fraudulently raised more than $7 million from investors through the unregistered sale of Empire bonds. The SEC further claimed that Azar paid Dorkan at least $143,000 for selling these bonds. Without admitting or denying the SEC's findings, Dorkan agreed to be barred from associating with broker-dealers, affiliating with registered investment companies and participating in penny stock sales. Dorkan also agreed to pay $143,000 in disgorgement, $23,593 in prejudgment interest and an $115,000 civil monetary penalty.[85]

On August 13, 2015, the SEC instituted settled APs against Signator Investors, Inc. (Signator), a Boston-based registered broker-dealer and investment adviser, and a Signator director, Gregory J. Mitchell, for allegedly failing to identify and prevent a fraud conducted by Signator employees James R. Glover and Cory D. Williams. The SEC claimed that Glover defrauded members of his religious community, who were not financially sophisticated and relied on Glover for advice, by enticing the religious community members to purchase partnership units in a real estate development called Colonial Tidewater Realty Income Partners, LLC (Colonial Tidewater). Glover and Williams allegedly provided false and misleading written statements about Colonial Tidewater's value and financial condition, lied about the expected returns, and failed to disclose the conflicts of interest posed by undisclosed commissions that Glover and Williams received when clients invested in the development. Signator and Mitchell allegedly failed to identify and prevent the fraud carried out by Glover and Williams since Signator and Mitchell did not conduct thorough reviews or ensure that reasonable policies and procedures were in place. The SEC claimed that Signator and Mitchell violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. Without admitting or denying the SEC's findings, Signator agreed to pay a $450,000 civil monetary penalty and Mitchell agreed to pay a $15,000 civil monetary penalty and was barred from associating with a broker-dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally-recognized statistical rating organization for one year.[86]

2. Spoofing

"Spoofing" is a practice in which traders attempt to trick other investors into buying and selling securities or commodities at artificially high or low prices by entering and quickly canceling large buy or sell orders on an exchange. Spoofing is specifically forbidden under Dodd-Frank, and in 2015, the SEC brought actions against traders who it claimed had engaged in spoofing to manipulate the prices of stocks and options.

On October 8, 2015, the SEC instituted a settled AP against Briargate Trading LLP, a proprietary trading firm, and one of its co-founders, Eric Oscher, alleging that they engaged in spoofing from October 2011 through September 2012 in violation of Sections 17(a)(1) and 17(a)(3) of the Securities Act and Sections 9(a)(2) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder. Briargate and Oscher allegedly placed multiple, large, non-bona fide orders for certain stocks on the New York Stock Exchange (NYSE) before the exchange opened for trading. The SEC claimed that Oscher's orders moved the prices of the stocks and Oscher took advantage of the price movement by sending orders for the stocks on the opposite side of the market. Without admitting or denying the SEC's findings, Briargate agreed to pay a civil monetary penalty of $350,000, Oscher agreed to pay a civil monetary penalty of $150,000, and Briargate and Oscher agreed to pay $37,842 in prejudgment interest.[87]

On December 3, 2015, the SEC instituted APs against three Chicago-based traders, twin brothers Behruz Afshar and Shahryar Afshar and their friend, Richard Kenny, for allegedly circumventing market structure rules in a pair of options trading schemes. The SEC alleged that the Afshar twins used two trading companies to take advantage of the fiscal incentives offered to non-professional traders, which allowed orders from non-professional traders to get higher priority, higher rebates and lower fees than trades from professionals. The SEC claimed that the trio would run all trades for one quarter out of one company, which would then be deemed a professional trader for the next quarter, then shift to their second company, which had been dormant in the previous quarter, and thus identified as a customer. According to the SEC, by alternating between the two entities every quarter, the Afshar brothers were able to consistently trade large volumes at customer rates.

The SEC also alleged that the trio carried out a spoofing scheme from May 2011 through December 2012 designed to take advantage of the "maker-taker" program offered by an options exchange. A maker-taker program is a pricing structure in which an exchange generally pays its members a per-share rebate to provide, or "make," liquidity on the exchange and charges a fee to remove, or "take," liquidity from the exchange. The defendants allegedly carried out their scheme through All-Or-None options orders, or orders that require a trader to use the whole option or not use the option at all. According to the SEC, the Afshars and Kenny placed smaller orders that were intended to alter the options' best bid or trick other market participants into placing orders at the same price. The SEC alleged that the Afshars and Kenny violated Section 17(a) of the Securities Act as well as Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 thereunder.[88]

3. Dark Pools

On August 12, 2015, the SEC instituted settled APs against a broker-dealer and AlterNet Securities (AlterNet), for allegedly operating an undisclosed proprietary trading desk, "Project Omega," and misusing the confidential trading information of subscribers to the broker-dealer's alternative trading system, or "dark pool," called POSIT. AlterNet provides brokerage services to the broker-dealer's customers through trading algorithms and order routers, which send orders for execution to exchanges and dark pools, including POSIT. The broker-dealer's customers submitted orders to buy and sell equity securities to POSIT, and POSIT accepted, matched and executed those orders.

The SEC alleged that although the broker-dealer claimed to protect the confidentiality of its dark pool subscribers' trading information, for a period of eight months, Project Omega accessed live feeds of POSIT subscribers' order and execution information and used it to implement high-frequency algorithmic trading strategies, including one in which it traded against subscribers in POSIT. The SEC alleged that the failure to disclose Project Omega violated Section 17(a)(2) and (3) of the Securities Act. The SEC further claimed that in failing to amend its Form ATS filings regarding Project Omega and related oversights in protecting confidential information, the broker-dealer violated Rules 301(b)(2) and 301(b)(10) of Regulation ATS. The broker-dealer admitted wrongdoing and agreed to pay an $18 million civil monetary penalty, $2,081,034 in disgorgement and prejudgment interest of $256,532.[89]

4. Compliance and Surveillance Safeguards

On August 19, 2015, the SEC instituted a settled AP against an affiliate of a large international financial institution for allegedly failing to have adequate compliance and surveillance safeguards. The alleged violations purportedly occurred from 2002 to 2012. Over this period, the financial institution allegedly inadvertently diverted nearly half a million trades on behalf of its clients to an affiliated market maker, which executed the trades as principal without the required disclosures. Additionally, the SEC claimed that these trades were not detected for two years because the financial institution relied on reports that failed to include information on principal transactions executed by affiliates. The SEC alleged that the affiliate violated Section 15(g) of the Exchange Act and Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. As part of the settlement, the affiliate was censured and agreed to pay a $15 million in civil monetary penalty. The affiliate also agreed to retain a compliance consultant.[90] The affiliate also voluntarily remitted $2.5 million, the profits from the principal transactions, to its clients.

On August 24, 2015, OCIE released a risk alert that observed that certain broker-dealers had failed to enforce controls on retail sales of structured securities products (SSP) in violation of the broker-dealers' duties of fair dealing.[91] Without naming any firms, OCIE stated that it had examined ten branch offices of registered broker-dealers and analyzed over 26,000 sales of SSPs, totaling more than $1.25 billion in principal transactions.

OCIE found that *all* of the examined firms failed to maintain and/or enforce adequate controls relating to determining whether a particular SSP was in the best interests of the firms' customers. In some instances, OCIE claimed that these branches aggressively sold SSPs to elderly, non-English speaking individuals and other conservative investors. One branch purportedly put its investors in structured products in excess of the firm's concentration guidelines; local management approved these transactions without documenting any reasons why they were suitable for a particular investor. This initiative and the resulting findings may foreshadow future enforcement actions.

On September 29, 2015, the SEC instituted a settled AP against a financial institution relating to its alleged failure to supervise a registered representative who directed customers to invest in the institution's affiliated mutual funds with money borrowed from an affiliated bank. According to the SEC, the use of such loans to buy securities was prohibited by both the institution and the affiliated bank. The SEC further alleged that the office manager of the branch where the registered representative was employed accepted his explanation with no follow-up after being alerted to the possibility that such use was occurring, and that the institution's policies were deficient in this regard. Without admitting or denying the SEC's findings, the institution agreed to pay $1,188,149 in disgorgement, $174,197 in prejudgment interest, and a civil monetary penalty of $13,637,654, to be held in a fund for affected investors. FINRA also announced an action against the institution on September 29, 2015 for the firm's alleged violation of FINRA's rules on supervision and principles of trade, which the institution agreed to settle by paying a $7.5 million fine with interest on up to $11 million in restitution to more than 150 investors.[92]

On October 8, 2015, the SEC instituted a settled AP against Wolverine Trading LLC (WTL), a broker-dealer, and Wolverine Asset Management LLC (WAM), an investment adviser (together, Wolverine), for allegedly failing to maintain and enforce policies and procedures to prevent material nonpublic information from being disclosed in violation of Section 15(g) of the Exchange Act and Section 204A of the Advisers Act. The SEC alleged that from February to March 2012, Wolverine repeatedly shared material non-public information with third parties despite their firms' policies and procedures on preventing the misuse of material non-public information. The SEC also alleged that the sharing of information revealed weaknesses in Wolverine's policies. Without admitting or denying the SEC's findings, WTL and WAM each agreed to pay $375,000 in penalties and WAM will pay $364,145.80 in disgorgement along with $39,158.47 in prejudgment interest.[93]

On September 30, 2015, the SEC instituted a settled AP against a high-frequency proprietary trading firm, regarding alleged violations of Section 15(c)(3) of the Exchange Act, and Rule 15c3-5 thereunder (the Market Access Rule) and Rule 611(c) of Regulation National Market System (NMS). According to the SEC, the trading firm allegedly sent around 12.6 million intermarket sweep orders (ISOs) for more than 4.6 billion shares that were not in compliance with Regulation NMS, due primarily to a coding change made by another firm that introduced an error into the electronic trading infrastructure it shared with the trading firm. Some of these orders were allegedly processed, causing the trading firm to receive gross trading profits as well as rebates paid by stock exchanges. According to the SEC, the trading firm violated Rule 611(c) of Regulation NMS because it did not take reasonable steps to establish that its ISOs complied with Regulation NMS. Without admitting or denying the findings, the trading firm agreed to pay a $5,000,000 civil monetary penalty, disgorgement of $2,784,875 of gross trading profits and exchange-paid rebates, and $268,564 in prejudgment interest.[94]

5. Market Manipulation

On September 10, 2015, the SEC initiated a civil injunctive action against New York Global Group (NYGG) and its CEO, Benjamin Wey, for allegedly manipulating the stock of Chinese companies they were purporting to guide through the process of raising capital and becoming publicly-traded in the United States. The complaint alleged that Wey and NYGG structured reverse mergers between clients and publicly-traded shell companies so that Wey and his family members could obtain ownership of the newly listed companies. The SEC further alleged that to avoid detection, Wey and his family members diverted their shares into several foreign accounts. The sale of these securities allegedly generated tens of millions of dollars in illicit profits. The complaint also names Wey's wife, Michaela Wey, and sister, Tianyi Wei, as well as Wey's Switzerland-based broker, Seref Dogan Erbek. The SEC also brought claims against two attorneys, former Newman & Morrison managing partner Robert Newman and former SEC attorney William Uchimoto, for allegedly assisting in presentations to underwriters and exchanges on behalf of the Chinese companies. The SEC asserts that the defendants violated Sections 17(a), 17(a)(1)-(3), 15(b) of the Securities Act and Sections 10(b), 20(a), 20(e), 13(d), and 16(a) of the Exchange Act and Rules 10b-5, 13d-1, 16a-2 and 16a-3 thereunder. The U.S. Attorney's office for the Southern District of New York announced parallel criminal charges against Wey and Erbek.[95] The action is pending.

6. Additional Miscellaneous Actions

On August 13, 2015, the SEC announced that Edward Jones, a St. Louis-based brokerage firm and Stina R. Wishman, the former head of its municipal underwriting desk, settled allegations that they overcharged customers in new municipal bonds sales. Edward Jones and Wishman allegedly took new bonds into the firm's inventory and improperly offered them to customers at higher prices instead of offering them to customers at the initial offering price. Edward Jones also purportedly offered bonds at higher prices than in the initial offering process by waiting to offer the bonds to customers until after trading in the secondary market had begun, which the SEC claimed caused the firm's customers to pay at least $4.6 million more than they should have for the bonds. To settle the case, the firm agreed to pay more than $20 million, including $5.2 million in disgorgement and prejudgment interest, which will go to current and former customers who were overcharged. Wishman agreed to pay a civil monetary penalty of $15,000 and to be barred from the securities industry for at least two years. Neither Edward Jones nor Wishman admitted or denied wrongdoing in the settlement. Notably, this was the SEC's first case against an underwriter for pricing-related fraud in the primary municipal bond market.[96]

On September 8, 2015, the SEC brought fraud claims against three traders, Ross Shapiro, Michael Gramins, and Tyler Peters, for alleged misstatements about the acquisition prices of certain residential mortgage-backed securities (RMBS). The SEC alleged that Shapiro, Gramins, and Peters defrauded investors to generate at least $5 million in revenues and violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Relatedly, the SEC entered into deferred prosecution agreements with three other individuals who cooperated with the investigation and provided access to evidence that the SEC described as critical, and which it claimed would not have been available otherwise. In commenting on the use of deferred prosecution agreements, Michael Osnato, Chief of the SEC's Complex Financial Instruments Unit, said that "[t]he SEC is open to deferring charges based on certain factors, including when cooperators come forward with timely and credible information while candidly acknowledging their own misconduct. The decision to defer charges in this matter reflects the early and sustained assistance provided by these individuals."[97]

On September 17, 2015 the SEC instituted settled APs against Philip A. Pendergraft, a co-founder and director of clearing firm Penson Financial Services, Inc. (Penson), Penson's CFO, Kevin McAleer, Penson director and CEO of Call Now, Inc., Thomas Johnson, and Penson's CEO, Charles Yancey, for alleged improper accounting practices. After suffering significant losses on margin loans to customers, Penson allegedly delayed in reporting these losses, contrary to accounting standards, and then declared bankruptcy in 2013. The SEC claimed that the improper accounting practices also resulted in false filings with the SEC. The order alleged violations of antifraud provisions Sections 17(a)(2) and 17(a)(3) of the Securities Act and Sections 7(c), 13(a), 13(b)(2)(A), 13(b)(2)(B), 13(b)(5), 14(a), 17(a) and 17(e) of the Exchange Act. Without admitting or denying the allegations, Pendergraft agreed to be barred from the securities industry with the option to apply for reinstatement after an unspecified period of time, McAleer agreed to a bar from appearing before the SEC for at least one year, and Yancey agreed to a six-month suspension from association in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization. Pendergraft ($100,000), McAleer agreed to ($25,000), Johnson ($25,000), and Yancey ($25,000) agreed to pay civil monetary penalties.[98]

On September 28, 2015, the SEC instituted a settled AP against an affiliate of a large financial institution for allegedly submitting deficient blue sheet data to the SEC for two years in violation of Section 17(a) of the Exchange Act and Rules 17a-4(j) and 17a-25 thereunder. As noted above in Section II.C, the respondent admitted that from January 2012 to January 2014, it made at least 593 deficient blue sheet submissions to the SEC. After discovering the issue, the respondent implemented remedial measures to ensure the accuracy of its blue sheets notified the SEC that it had corrected and fully remediated the errors. The respondent consented to a censure, agreed to pay a $4.25 million civil monetary penalty and admitted that it violated the recordkeeping and reporting provisions of the federal securities laws. In announcing the settlement, Sharon B. Binger, Director of the Philadelphia Regional Office, stated that "[a]ccurate and complete blue sheet data is essential to the Commission's efforts to detect many forms of unlawful conduct. We will continue to hold broker-dealers who fail to comply with their obligation to provide the Commission with reliable blue sheet data accountable for their failure."[99]

On October 13, 2015, the SEC instituted a settled AP against a financial institution for allegedly making false or misleading statements and omissions in offering documents regarding structured notes linked to a foreign currency index in violation of Section 17(a)(2) of the Securities Act. According to the allegations, the institution misleadingly stated that the investment relied on a transparent and systematic currency trading strategy using market prices to calculate the financial instruments underlying the index, but did not disclose that it would charge mark-ups and execute hedging trades with non-systematic spreads and trades in advance of certain hedging transactions, which could negatively impact pricing inputs. Without admitting or denying the SEC's findings, the institution agreed to pay disgorgement and prejudgment interest totaling $11.5 million, distribute $5.5 million of the disgorged funds to investors to cover the total investor losses, and to pay an $8 million penalty.[100]

On October 28, 2015, the SEC instituted a settled AP against two former brokers, Hal Tunick and Patrick Burke, of Rochdale Securities, a now-defunct brokerage firm. The SEC alleged that Tunick and Burke failed to fulfill their duty to provide their clients with best execution, which requires a broker-dealer to obtain the most favorable terms for a customer under the circumstances of the transaction. Tunick and Burke allegedly arranged for orders to be performed by proprietary traders, which caused their customers to pay higher prices to buy and receive lower prices to sell securities and allowed to Tunick and Burke to receive larger commissions. The SEC alleged that Tunick and Burke violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Without admitting or denying the allegations, Tunick agreed to a bar from the securities industry and to pay a civil monetary penalty of $125,000, and Burke agreed to a bar from the securities industry for a period of at least five years and to pay $56,959 in disgorgement and prejudgment interest.[101]

C. *Insider Trading*

The Second Circuit's landmark insider trading decision in *United States v. Newman* has not slowed the SEC's pursuit of alleged insider trading violations. The Commission filed insider trading actions against 87 individuals and entities in FY 2015,[102] a slight increase over the 80 people against whom it brought insider trading claims in FY 2014. Although *Newman* did not reduce the volume of insider trading actions, it may have caused a shift in the types of insider trading cases brought by the SEC. The actions pursued during the second half of 2015 generally appeared to be traditional insider trading cases involving tipping or clear misappropriation of information before corporate transactions or announcements, with few of the aggressive theories pursued in prior years against expert networks and hedge funds. Below are the summaries of three of the highest profile cases.

On August 11, 2015, the SEC charged 32 defendants with insider trading in connection with an alleged scheme to trade on the basis of information in stolen corporate earnings announcements. The SEC alleged that for a period of five years, two Ukrainian nationals, Ivan Turchynov and Oleksandr Ieremenko, used "advanced techniques" to hack into multiple newswire services and steal hundreds of corporate earnings announcements before the announcements were publicly released. Turchynov and Ieremenko then transmitted the stolen announcements to traders in traders in Russia, Ukraine, Malta, Cyprus, France, and three U.S. states, Georgia, New York, and Pennsylvania. The traders then allegedly traded on the nonpublic information and reaped over than $100 million in profits. The United States Attorneys for the Eastern District of New York and District of New Jersey announced criminal charges against Turchynov and Ieremenko and Arkadiy Dubovoy, Igor Dubovoy, Pavel Dubovoy, Vitaly Korchevsky, Vladislav Khalupsky, Aleksandr Garkusha, and Leonid Momotok, who traded in the Ukraine.[103] On September 14, a Ukraine based investment banking firm and its CEO agreed to pay $30 million to settle charges against them in connection with the hacking scheme.[104] The cases against the remaining defendants are pending.

On August 13, 2015, the SEC filed a civil action in federal court in the SDNY against Cedric Cañas Maillard, a former adviser to the CEO of a Spanish bank, alleging that Cañas traded in connection with a proposed acquisition for which the bank was acting as adviser and underwriter. Specifically, the SEC alleged that Cañas learned that a global natural resources company had engaged the bank to advise on and underwrite a proposed acquisition of a Canadian commercial producer of nitrogen, phosphate and potash. According to the SEC, the day before the target company rejected the potential acquirer's bid, Cañas and a close friend purchased call options in the target company. The target company's stock rose 27% after it rejected the bid, and Cañas allegedly reaped illicit profits of $278,156.97. The SEC asserts that Cañas violated Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder and seeks disgorgement with prejudgment interest and penalties.[105]

On October 23, 2015, the SEC announced a settlement with an insider trading defendant who allegedly received illegal tips about pending corporate transactions via napkins or post-it notes exchanged at Grand Central Terminal. As previously reported in our *2014 Year-End Enforcement Review*,[106] Vladimir Eydelman, a former stockbroker, allegedly received inside information regarding pending corporate transactions from a law firm employee, Steven Metro, who transmitted the information to Eydelman through a mutual friend, Frank Tamayo. The SEC alleged that Tamayo provided the information to Eydelman via notes exchanged in person, and thereafter Tamayo would eat the notes and Eydelman would then trade and create a false paper trail that appeared to justify the trades. Eydelman paid $1,383,550 to settle claims for violations of Section 17(a) of the Securities Act and Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder, consisting of $1,236,657 in disgorgement (which was deemed satisfied by orders of forfeiture or restitution in a parallel criminal case), a $1,236,657 civil monetary penalty, and $146,893 in prejudgment interest.[107]

D. *Financial Reporting Fraud*

The SEC has increased the number of financial reporting fraud actions it has pursued every year since Chair White announced the creation of the Financial Reporting and Audit Task Force on July 2, 2013.[108] In FY 2015, the SEC brought 134 accounting-fraud enforcement actions, a 37% increase over the 99 reporting fraud actions it brought in FY 2014.[109] The SEC's focus on financial reporting fraud is reflected in the breadth of actions it brought in the second half of 2015, including actions involving allegations of stock price manipulation, channel stuffing, fallout from the financial crisis and the failure to implement adequate accounting controls. These enforcement actions help shed light on current SEC trends – the SEC has been targeting not just issuers, but also individuals, and is pursuing enforcement in connection with both large-scale violations and more minor infractions. Below are summaries of some of the more significant actions from the second half of 2015.

On August 6, 2015, the SEC instituted a contested AP against Miller Energy Resources Inc. (Miller Energy), its former CFO, Paul Boyd, and its current COO, David Hall, for allegedly inflating the values of Miller Energy's oil and gas properties, resulting in allegedly fraudulent financial statements. The SEC claimed that, after acquiring oil and gas properties in Alaska in 2009, Miller Energy boosted the company's net income and total assets by overstating the value of those properties by more than $400 million. The SEC further alleged that the inflated valuation resulted in the company's eventual listing on the NYSE, where the stock value peaked at nearly $9 per share. The SEC alleged that Miller Energy and Boyd violated Sections 10(b) and 17(a) of the Exchange Act and Rule 10b-5 thereunder, that Miller Energy violated Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and various rules thereunder, and that Boyd aided and abetted Miller Energy's violations. Boyd and Hall are also alleged to have violated Section 13(b)(5) of the Exchange Act, and Boyd was alleged to have violated Rule 13a-14 thereunder.[110] The action is pending.

On August 17, 2015, the SEC instituted a settled AP against two affiliates of a large financial institution for allegedly misleading hedge fund investors in the run-up to the financial crisis. According to the SEC, between 2002 and 2007, the affiliates marketed two funds as safe investments akin to "bond substitutes" and raised nearly $3 billion from qualified investors. The SEC claimed that contrary to the affiliates' representations, however, the funds were risky and highly leveraged, and in 2007, one fund was forced to sell $2 billion in assets to meet margin calls. Despite ongoing liquidity problems, the affiliates allegedly continued to market the funds as safe investments. The SEC alleged that the affiliates violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder. Without admitting or denying the allegations, the affiliates agreed to pay nearly $140 million in disgorgement and $40 million in prejudgment interest.[111] As discussed in Section II.D above, the SEC also granted the affiliates' parent, a large financial institution, a waiver from the disqualification provisions of the federal securities laws that would have otherwise been triggered by the settlement.

On September 8, 2015, the SEC instituted a settled AP against MusclePharm Corporation (MSLP), a sports supplements and nutrition company, its CEO, Brad Pyatt, Donald Prosser, audit committee chair, and former CFOs Gary Davis and Lawrence Meer, for alleged accounting and disclosure violations, including the claimed failure to properly report as compensation nearly a half-million dollars spent on executive perks such as golf club memberships, private jet use, and vehicles. Despite initiating an internal review of the undisclosed perks, MSLP allegedly continued to file inaccurate financial statements that omitted the perks. The SEC also charged that MSLP issued stock without a registration statement where third parties agreed to pay cash to MSLP's vendors in exchange for MSLP shares.

The SEC claimed that MSLP violated Sections 17(a)(2), 17(a)(3), 5(a), and 5(c) of the Securities Act, Rule 302 of Regulation S-T and Sections 14(a), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 14a-9, 13a-1, 13a-13, and 12b-20 thereunder. The SEC further claimed that Pyatt, Meer, Davis likewise violated Sections 17(a)(2), 17(a)(3), 5(a) and 5(c) of the Securities Act, and Rule 13b2-2 of the Exchange Act, and caused MSLP to violate Sections 14(a), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 14a-9, 13a-1, 13a-13, 13b2-1 and 12b-20 thereunder. Finally, the SEC claimed that Prosser caused MSLP's violations of Sections 14(a), 13(a), and 13(b)(2)(A) of the Exchange Act and Rules 14a-9, 13a-1, and 12b-20 thereunder.

MSLP paid a $700,000 penalty and agreed to an independent monitor for one year, without admitting or denying the SEC's findings. Pyatt paid a $150,000 penalty, Prosser and Davis paid $30,000 penalties, and Meer and Davis were suspended from practicing as accountants, all without admitting or denying the SEC's findings.[112] The SEC highlighted its pursuit of the individuals when, in announcing the settlement, Director Ceresney said, "Prosser, MusclePharm's audit committee chair, subjected himself to liability when he substituted his wrong interpretation of SEC rules for the views of experts the company had hired, resulting in an incorrect disclosure."

On September 8, 2015, the SEC instituted a settled AP against Bankrate, Inc. (Bankrate) and Hyunjin Lerner, its former vice president of finance, for allegedly fraudulently manipulating the company's financial results. The SEC claimed that Edward DiMaria, then-CFO of Bankrate, Matthew Gamsey, then-director of accounting, and Lerner fabricated revenues and avoided booking certain expenses to meet analyst estimates for key financial metrics such as adjusted earnings before interest, taxes, depreciation, and amortization. As a result, Bankrate allegedly overstated its net income for the second quarter of 2012 and the stock rose as a result. More specifically, the SEC alleged that DiMaria, Lerner, and Gamsey directed the insurance and credit cards divisions to book improper revenue without any support and lied to Bankrate's auditor regarding the improper entries. As a result, Bankrate allegedly violated Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 13a-11, 13a-13, and 12b-20 thereunder. The SEC further claimed that Lerner (1) violated Section 17(a) of the Securities Act and Sections 10(b), 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1, and 13b2-2 thereunder and (2) willfully aided and abetted and caused the Bankrate's violations. Bankrate and Lerner agreed to pay $15 million and $150,000 in penalties, respectively, without admitting or denying the Commissions' findings. Lerner has also agreed to disgorge $30,045 in illicit profits that he obtained from selling Bankrate's stock after the financial results at issue were announced. The litigation against DiMaria and Gamsey continues.[113]

On September 8, 2015, the SEC initiated a civil injunctive action in the SDNY against KIT Digital, Inc.'s (KIT) then-CEO Kaleil Isaza-Tuzman and then-CFO Robin Smyth for allegedly falsifying financial statements to make the company appear more profitable.[114] Allegedly, Isaza-Tuzman and Smyth employed a number of schemes to manipulate KIT's books and mislead investors, including using an off-the-books slush fund to generate payments back to the company and create the false appearance that KIT was being paid for its products. Purportedly, the defendants violated Section 17(a) of the Securities Act, Section 10(b) and Section 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1, 13b2-2, and 13a-14. Additionally, the defendants are charged with aiding and abetting violations of Sections 13(a) and 13(b)(2) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder. The SEC is seeking disgorgement, prejudgment interest and penalties.

On September 16, 2015, the SEC instituted a settled AP against Joseph F. Apuzzo, a CPA, under Rule 102(e) of the Commission's Rules of Practice.[115] Apuzzo allegedly helped former officers of United Rentals, Inc. (URI) improperly recognize revenue from two fraudulent sale-leaseback transactions between URI and a heavy equipment manufacturer, whereby URI would sell equipment to a financing company, lease it back for an eight-month period, use the manufacturer to remarket the equipment (and guarantee the financing company 96% of the equipment's purchase price), and then secretly contract with the manufacturer to assume the remarketing obligations and price guarantees itself. According to the SEC, these sale-leaseback agreements allowed URI to file materially false and misleading financial statements and Apuzzo knew of the fraudulent conduct when he helped facilitate it. Without admitting or denying the findings, Apuzzo consented to an order imposing remedial sanctions, including a civil penalty of $100,000 for violating Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder. The Commission also barred Apuzzo indefinitely from appearing or practicing before it as an accountant, with eligibility to request reinstatement after five years.

On September 22, 2015, the SEC instituted a settled AP against Stein Mart, Inc.,[116] alleging that from at least 2010 to November 2012, Stein Mart materially misstated its pre-tax income for certain quarters by improperly valuing inventory subject to price discounts or markdowns. Stein Mart allegedly used three types of markdowns, one of which did not value the inventory in accordance with GAAP, causing Stein Mart to materially overstate its pre-tax income by almost 30%. The SEC alleged violations of the Exchange Act, including Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B), as well as violations of Exchange Act Rules 12b-20, 13a-1, 13a-11, and 13a-13. Without admitting or denying the allegations, Stein Mart agreed to pay an $800,000 civil monetary penalty.

On September 25, 2015, the SEC filed suit in the Southern District of Florida against four former SMF Energy Corp. officers — Richard E. Gathright (CEO), Michael S. Shore (CFO), Laura P. Messenbaugh (Chief Accounting Officer), and Robert W. Beard (senior vice president of sales and investor relations officer) — for allegedly violating and aiding and abetting violations of Section 17(a) of the Securities, Sections 10(b) and 13(b)(5) of the Exchange Act, and Exchange Act Rules 10b-5, 13b2-1, and 13b2-2.[117] The SEC alleged that SMF overbilled customers, including the United States Postal Service, by charging for undelivered fuel and adding surcharges not permitted by the customers' contract. Consequently, SMF purportedly materially overstated its revenues, profit margins, shareholders' equity, and net income, as well as understated its liabilities in several of its SEC filings. The SEC is seeking disgorgement, monetary penalties, and prejudgment interest, as well as an officer and director bar against the each of the four former officers and permanent injunctive relief.

On September 28, 2015, the SEC filed a settled AP against Trinity Capital Corporation (Trinity), its wholly owned subsidiary, Los Alamos National Bank (Los Alamos) and Trinity's former CEO William Enloe, former Chief Credit Officer Jill Cook, former Senior Lending Officer Mark Pierce, former CFO Daniel Bartholomew, and VP of Internal Audit Karl Hjelvik in connection with Trinity and Los Alamos's alleged material misstatements of their provisions for loan losses. The SEC claimed that Enloe, Cook, Pierce, Bartholomew and Hjelvik conspired to avoid reporting loan losses during the financial crisis by misreporting income to shareholders and regulators, concealing an increase in problem loans, and hiding the damaged nature of the bank's portfolio. The SEC further alleged that the bank hid problems with its loan portfolio by refusing to downgrade loans on a timely basis, failing to designate loans as impaired, failing to measure impairment properly, and purposely overvaluing real estate it owned. In some cases, the SEC alleged, the bank extended credit to troubled borrowers to make required payments on existing debt. This was allegedly done so the borrower appeared current on loan payments when in fact the bank was not making any collections on the loans. The SEC found Trinity, Enloe, Cook, Pierce, Bartholomew and Hjelvik violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13 and 12b-20 thereunder and Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.[118]

Without admitting or denying the findings, Trinity agreed to provide ongoing cooperation to the SEC and pay a $1.5 million in civil monetary penalty, an amount the SEC claimed took into account the company's significant cooperation during the investigation. Enloe, who also did not admit or deny the findings, agreed to a $250,000 penalty and a five-year bar from serving as an officer or director of a public company. Bartholomew and Hjelvik admitted to books and records violations and entered into cooperation agreements with the SEC to assist in the Commission's actions against Cook and Pierce. The pending charges against Cook and Pierce allege various violations of Sections 5(a) and 5(c), 17(a)(l) and 15(b) of the Securities Act, Sections 9(a)(1) and 20(e) of the Exchange Act, and Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c) thereunder.

On September 30, 2015, the SEC filed civil injunctive proceedings against the CEO and CFO of ContinuityX Solutions Inc., an Internet service sales company, alleging revenue inflation in violation of Sections 17(a)(1), 17(a)(2), and 17(a)(3) of the Securities Act, and Sections 10(b) and 13(b)(5) of the Exchange Act and related rules. According to the SEC, almost 99% of the $27.2 million in the company's reported revenue came from fraudulent and fictitious sales. Anthony G. Roth (CFO) and David P. Godwin (CEO) allegedly used the SEC filings containing the fraudulent financials to raise millions from investors and derived personal financial gains of up to $1.3 million in compensation for Godwin and $351,800 in compensation for Roth, as well as $456,098 of profits from ContinuityX stock sales. The SEC seeks disgorgement with interest, monetary penalties, and permanent injunctions against future violations of the federal officer and director bar, and reimbursement to the company of bonuses, incentive and equity-based compensation, and stock sale profits.[119]

On October 5, 2015, the SEC instituted a settled AP against Home Loan Servicing Solutions Ltd. (HLSS) for alleged material misstatements about related-party transactions and the valuation of its primary asset, as well as for inadequate internal accounting controls. Allegedly, from 2012 to 2014, HLSS disclosed in SEC filings that it had conflicts of interest policies that required its chairman to recuse himself from transactions with related parties. However, the SEC claimed that HLSS had no written policy requiring recusal for related-party transactions and its chairman had approved many transactions between HLSS and another mortgage loan servicing company, whose Chairman also served as HLSS's Chairman. Further, HLSS allegedly misstated its net income in 2012, 2013, and the first quarter of 2014 because the accounting methodology used to value its primary asset — mortgage servicing rights purchased from the other mortgage loan servicing company — did not comply with GAAP. Without admitting or denying the SEC's findings, HLSS agreed to a settlement, consenting to pay a $1.5 million penalty.[120]

Relatedly, on January 20, 2016, the SEC instituted a settled AP against the other mortgage loan servicing company involved in the transactions with HLSS. Like HLSS, the mortgage servicer allegedly misstated in its SEC filings that it had a written recusal policy for related-party transactions and its financial results in the last three quarters of 2013 and the first quarter of 2014. Without admitting or denying liability, the mortgage servicer agreed to a settlement, consenting to a cease-and-desist order and a $2 million penalty.[121]

On October 6, 2015, the SEC brought two separate actions in the Northern District of California against the former CEO of OCZ Technology Group Inc. (OCZ), Ryan Petersen, and the former CFO, Arthur Knapp, alleging that Petersen and Knapp inflated OCZ's revenue and gross margins in violation of Section 17(a) of the Securities Act, Sections 10(b) and 13 of the Exchange Act and Rules 10b-5 12b-20, 13a-1, 13a-11, 13a-13, 13a-14 and 13b2-1 thereunder. The SEC claimed that Petersen falsified OCZ's books and records and then certified the accuracy of OCZ's financial statements while hiding his conduct from OCZ's auditors and finance department. The SEC further alleged that Knapp failed to implement sufficient internal accounting controls and instituted or maintained policies that resulted in OCZ recording transactions in a way that did not comply with GAAP. Specifically, the SEC claimed that Peterson mischaracterized sales discounts as marketing expenses and had employees create false documentation to conceal the scheme, engaged in channel-stuffing with OCZ's largest customer by shipping more goods than the customer could sell in the normal course of business and concealed large product returns from OCZ's finance department and auditor so that those returns would not be recorded in OCZ's books and records. Knapp settled with the SEC on October 23, 2015, without admitting or denying the claims.[122] The case against Petersen is ongoing, and the SEC is seeking disgorgement, a civil monetary penalty and an officer and director bar.

On October 9, 2015, the SEC instituted a settled AP against David Derrick, Chairman and CEO of SecureAlert, Inc. (SecureAlert). In 2007, Derrick allegedly caused SecureAlert to enter into an exclusive distribution agreement wherein the distributor would not pay for the product if he was unable to sell it. The SEC charged that Derrick shipped $2 million worth of merchandise to the distributor and then reported $1 million in sales revenue and a $1 million receivable, even though the distributor sold none of the product. Derrick allegedly sought but was unable to obtain financing from a third party to make the payment for the accounts receivable, and the SEC claimed that Derrick used personal funds to make the payment. The SEC also alleged that SecureAlert made material misrepresentations regarding the transaction in public filings and to its independent auditor and that Derrick failed to implement adequate internal accounting controls for SecureAlert. Without admitting or denying the findings, Derrick agreed to be barred from acting as an officer or director of any issuer and to pay a monetary penalty of $232,500.[123]

On October 19, 2015, the SEC instituted a settled AP against two advisory firms affiliated with a major financial institution for allegedly failing to disclose a change in investment strategy by a fund that the affiliates advised. The SEC claimed that although the fund's marketing materials stated that it primarily made investments in distressed debt, in 2008 the fund purchased large quantities of credit default swaps, which incurred substantial losses. The SEC claimed that the change in investment strategy was not disclosed to investors. The SEC found that the affiliates violated of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-8(a)(1) and 206(4)-8(a)(2) thereunder. The SEC also found that the affiliates caused violations of Section 34(b) of the Investment Company Act. Without admitting or denying the Commission's allegations, the affiliates agreed to pay $8.2 million in disgorgement, $1.4 million in prejudgment interest, a civil monetary penalty of $3 million, and $4.9 million for investor compensation.[124]

On October 27, 2015, the SEC filed a settled AP against The St. Joe Company (St. Joe), a Florida-based real estate developer and landowner, its former CEO, William Greene, former CFO, William McCalmont, former Chief Accounting Officer, Janna Connolly and former Director of Accounting, J. Brian Salter for allegedly improperly accounting for the declining value of its residential real estate holdings during the financial crisis. Greene, McCalmont, Connolly and Salter allegedly failed to ensure that the company's impairment testing of real estate developments included all costs and that the company's internal controls were properly applied. Without admitting or denying the findings, St. Joe, Greene, McCalmont, Connolly and Salter consented to the entry of an order against them. The order found that they violated or caused the violation of various provisions of the federal securities laws, including the antifraud, books and records, and internal controls. St. Joe agreed to pay a $2.75 million civil monetary penalty to settle the SEC's claims. Greene agreed to a $120,000 penalty and disgorgement of $400,000 plus prejudgment interest. McCalmont agreed to a $120,000 penalty and disgorgement of $180,000 plus prejudgment interest. Connolly agreed to a $70,000 penalty and disgorgement of $60,000 plus prejudgment interest. Salter agreed to pay a $25,000 penalty. McCalmont, Connolly, Salter, and former Director of Accounting Phillip Jones, agreed to be suspended from appearing or practicing before the SEC as an accountant.[125]

E. *Auditors*

Consistent with its focus on accounting and financial fraud generally, in the second half of 2015, the Commission continued to pursue its stated goal of holding auditors accountable for alleged misconduct[126] by bringing enforcement actions against auditors who it claims failed to recognize and respond appropriately to red flags or who violated auditor independence standards.

On August 31, 2015, the SEC instituted a settled AP against accounting firm Johnson Lambert LLP (Johnson Lambert) and CPA Bradley Scott Diericx for allegedly improper audits of two insurance companies, Maven Assurance Ltd. and Maven Life International Ltd. (together, Maven). Maven allegedly invested $95 million in the "Private International Wealth Management" program created by investment manager Nikolai Battoo, which funds were allegedly either lost or stolen by Battoo. The SEC alleged that Johnson Lambert and Diericx failed to (i) exercise due professional care, (ii) adequately staff audits, (iii) obtain sufficient audit evidence regarding the existence and valuation of the purported investments, and (iv) exercise professional skepticism by overlooking red flags and warnings. As a result, the respondents allegedly failed to discover that Maven's investments with Battoo either did not exist or had lost virtually all their value. In the settlement, neither Johnson Lambert nor Diericx admitted or denied the allegations. Diericx was banned from practicing as a public accountant for three years, and Johnson Lambert was censured, but not fined. Johnson Lambert was also required to review its written policies and procedures, retain an independent consultant to evaluate its audit and interim review policies and procedures, implement new training and professional development and not accept new clients for one year.[127]

On September 4, 2015, the SEC instituted a settled AP against external auditors Raymond Holmdahl and Kanako Matsumoto, who allegedly violated the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice. Holmdahl and Matsumoto performed the 2013 audit of investment advisory firm Summit Asset Strategies Investment Management (Summit). Summit's CEO, Chris Yoo, allegedly misstated the value of certain fund assets to manufacture millions of dollars in illusory profits. As a result, the SEC claimed that Summit's 2013 financial statements materially overstated the fund's investment value. The SEC alleged that the auditors failed to (i) obtain sufficient appropriate audit evidence about the existence of certain fund assets, (ii) exercise appropriate professional judgment and professional skepticism and (iii) failed to properly supervise the financial statement audit. Without admitting or denying the SEC's findings, the respondents agreed to a three-year suspension from practicing accounting on behalf of any publicly traded company.

The SEC also filed a separate fraud action against Yoo and Summit, which had allegedly received undisclosed management fees based on the inflated asset valuations. Both settled the SEC's claims without admitting or denying the allegations by agreeing to pay disgorgement of $889,301 plus prejudgment interest of $104,632, and a penalty of $150,000. Another advisory firm owned by Yoo paid disgorgement of $81,729.14, plus prejudgment interest of $6,611.75, and a penalty of $100,000.[128]

On September 9, 2015, as noted above in Section II.C, the SEC filed a settled AP against BDO USA, LLP (BDO) and several of its auditors, Sean C. Henaghan, John E. Rainis, James J. Gerace, Leland E. Graul, and Wendy M. Hambleton, arising out of audits by BDO of General Employment Enterprises, Inc. (GEE) in 2009.[129] BDO purportedly learned that $2.3 million (roughly half of GEE's assets) had gone missing but later resurfaced. BDO allegedly originally raised concerns over the financial statements, but after the resignation of Ronald Heineman, BDO withdrew its concerns and issued an audit report containing an unqualified opinion on the financial statements. Allegedly, BDO implemented inadequate audit procedures, failed to obtain sufficient information, and failed to exercise due professional care, in violation of the Sections 4C, 10A and 13(a) of Exchange Act and Rule 13a-1 thereunder, as well as Rule 102(e) of the Commission's Rules of Practice. As part of the settlement, BDO admitted wrongdoing and agreed to pay disgorgement of $536,000, prejudgment interest of $76,000 and a civil money penalty of $1.5 million. Without admitting or denying the Commission's charges, Henaghan, Rainis, Gerace, Graul, and Hambleton agreed to pay civil penalties ranging from $10,000 to $30,000. The SEC also filed suit against GEE's then-chairman of the board and majority shareholder, Stephen B. Pence, who is a former U.S. attorney and a former lieutenant governor of Kentucky, for allegedly making materially misleading statements and omissions to BDO's auditors.[130] The litigation against Pence is ongoing.

On September 18, 2015, the SEC instituted a settled AP against CPA Christopher D. Whetman for allegedly conducting deficient audits for Idle Media, Inc. and La Paz Mining Corp. The SEC asserted that Whetman's audit of La Paz ignored red flags indicating sham purchases and services between entities and failed to (i) resolve discrepancies in the audit evidence, (ii) properly audit the company's cash resources, and (iii) adequately respond to concerns about potential fraud by company executives. In connection with Whetman's audit of Idle Media, the SEC alleged that Whetman did not adequately vet a number of conclusions about Idle Media's corporate structure and failed to (i) prepare and retain adequate audit documentation, (ii) exercise professional due care, (iii) obtain sufficient competent evidentiary material, (iv) apply heightened scrutiny to related party transactions and (v) issue accurate audit reports. The SEC found that Whetman violated Sections 17(a)(1), (2), and (3) of the Securities Act, engaged in improper professional conduct pursuant to Section 4C(a)(2) of the Exchange Act and Rule 102(E)(1)(ii) of the SEC's Rules of Practice and caused a violation of Rule 2-02(b)(1) of Regulation S-X. Whetman consented to a five-year bar from appearing before the SEC as an accountant and to a civil monetary penalty of $15,000.[131]

On October 1, 2015, the SEC instituted settled APs against Grant Thornton India LLP (GTI) and Grant Thornton Audit Pty Limited (GTA), alleging that they violated auditor independence rules, including Rule 2-02(b)(1) of Regulation S-X, and improper professional conduct rules, including Sections 4C(a)(c) and 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice, and caused their client to violate several provisions of the federal securities laws as well. According to the SEC, Grant Thornton Mauritius (GTM) partners sat on the boards of subsidiaries of clients audited by GTA. Through a third company, Anex, the GTM partners allegedly provided prohibited services for the audit clients, including controlling bank accounts and acting on the clients' behalf. The GTI and GTA also allegedly failed to follow parent company Grant Thornton International's compliance control procedures regarding independence relationship checks, resulting in Grant Thornton International, GTI and GTA not discovering the violations until several months or even years later. The SEC alleged specifically that GTA failed to obtain independence relationship checks and confirmation letters from member firms in countries where its audit clients have business operations, as required by Grant Thornton International, and GTI failed to obtain a confirmation letter. Without admitting or denying the claims, the GTI and GTA agreed to pay $365,085 in disgorgement and penalties.[132]

On December 10, 2015, the SEC instituted a settled AP against CPAs Peter Messineo, Robin Bigalke, Joseph Mohr, Richard Confessore and Charles Klein and two auditing firms, Messineo & Co. LLC (M&C) and DKM Certified Public Accountants, Inc. (DKM). Allegedly, Messineo and his firm skipped mandatory quality reviews for their audits and Bigalke falsified and backdated documents to cover up the violations. Further, the SEC asserted that Messineo served as the CFO of two public companies that were audited by Klein and that Confessore served as both a member of the DKM audit team and an employee of M&C. Messineo allegedly certified company filings despite knowing that Confessore's conflicting roles violated auditor independence rules. The SEC found that the defendants violated Sections 13, 15, and 16 of the Exchange Act and rules promulgated thereunder, as well as, Rule 2-02 of Regulation S-X. Messineo and M&C agreed to pay a civil monetary penalty of $25,000 and were permanently barred from practicing as accountants on behalf of any SEC-regulated entity; Mohr and Bigalke were suspended for at least four and three years respectively; and Klein and DKM agreed to disgorgement of $33,000, prejudgment interest of $2,043.87, and a $25,000 penalty. Both were also suspended for at least two years. Confessore agreed to a $15,000 penalty and a suspension of at least two years.[133]

F. *Foreign Corrupt Practices Act*

After a busy 2014 in which the SEC brought seven FCPA enforcement actions on its own and six more jointly with the DOJ, the Commission maintained a similar pace in 2015, bringing 12 FCPA enforcement actions, including ten corporate enforcement actions alone.[134] The SEC's corporate enforcement activity was striking because it coincided with a slowdown in corporate enforcement by the DOJ, which brought only two such actions in 2015, down from nine in 2014. In addition to the high volume, the SEC notably brought an action that expanded the definition of receiving "value" under the FCPA to include summer internships and other employment opportunities, which we describe below. For an in-depth discussion of the SEC and DOJ's FCPA enforcement activity in 2015, please see our publication entitled, *FCPA Digest: Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act*.

On August 18, 2015, the SEC instituted a settled AP against a major financial institution alleging FCPA violations related to hiring practices for internships. The SEC alleged that the bank hired three interns in an effort to obtain or retain existing business from an unnamed Middle East sovereign wealth fund. The SEC allegedly reviewed emails indicating that the bank hired the relatives of two government officials affiliated with the fund for a custom-tailored, specially designed trainee program, even though they did not meet the rigorous criteria the bank applied to other interns. The SEC alleged that the bank violated Sections 30A and 13(b)(2)(B) of the Exchange Act. Without admitting or denying liability, the bank agreed to pay $14.8 million, consisting of disgorgement of $8.3 million, prejudgment interest of $1.5 million, and a penalty of $5 million. The SEC said that it agreed not to pursue additional penalties due to the bank's cooperation.[135]

G. *Crowdfunding*

On October 13, 2015, the SEC brought its first enforcement action for fraud in connection with a crowdfunding Web site. The SEC alleged that Ascenery LLC (Ascenery) and its CEO, Joseph Gabaldon, engaged in offering fraud by using crowdfunding websites to solicit investors to purchase interests in oil and gas wells. Although Ascenery and Gabaldon raised $5 million from investors, the SEC claimed that only a few thousand dollars were used for oil and gas expenses. Instead, the SEC alleged that $1.2 million was used for other unrelated expenses and the remaining funds were transferred to Pyckl LLC.[136] The SEC alleged that Ascenery and Gabaldon violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder). The action is pending.

H. *Credit Ratings Agencies*

On October 26, 2015, the SEC announced a $5.81 million settlement with a large credit rating agency for allegedly misrepresenting the surveillance methodology it used to rate real estate securities. Notably, the SEC did not take issue with agency's actual ratings or its methodology. Instead, the SEC criticized what it claimed was the agency's lack of adherence to its own policies. The agency allegedly told investors that it would use a three-step process on a monthly basis to monitor the ratings it assigned and would also subject its ratings to a monthly review by its surveillance committee. The SEC alleged, however, that between 2009 and 2011, the agency only ran the first step of the three step process, reviewing monthly remittance or performance data to identify underperforming loan pools, each month. According to the SEC, the agency only took the second and third steps of the process, deriving expected losses and running cash flow analyses, when it convened a committee to review certain ratings because the agency did not have the staffing and technological resources to conduct all the reviews it promised to conduct. The SEC's order found that the agency violated Sections 15E(b)(1)-(2), 15E(c)(3)(A), 15E(d)(1)(E) and 17(a) of the Exchange Act and Rules 17g-1(e), 17g-1(f) and 17g-2(a)(2)(iii) thereunder. Without admitting or denying the findings, the agency agreed to be censured and to retain an independent consultant to assess and improve its internal controls. The firm also agreed to pay disgorgement of $2.742 million plus prejudgment interest of $147,482 and a civil monetary penalty of $2.925 million.[137]

V. Conclusion

The Commission continued to aggressively police the securities markets in 2015. In its annual financial report, the SEC stated that in 2016, it will continue to focus on data to target and streamline its efforts, while bringing actions involving complex financial products, gatekeepers, financial reporting, market structure, insider trading, investment advisers and private funds, and municipal securities. Accordingly, we expect that in 2016 the Commission will continue to pursue its priorities, undeterred by the temporary setbacks and criticisms it faced in 2015.

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