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The SEC Speaks: Reflections and Enforcement Initiatives in 2013

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Each year at The SEC Speaks, the Commissioners and senior leadership of the Securities and Exchange Commission identify the agency's priorities and initiatives for the coming year. Of course, one of the most anticipated discussions concerns the Commission's enforcement trends and priorities, and this year the Division of Enforcement's most senior staff members provided their thoughts on the past, present, and future of their work. Though the many recently-announced changes in personnel at the SEC are certainly a distraction from the Division's work, the staff made clear that it intended to continue its aggressive enforcement program in 2013.

George Canellos, Acting Director for the Division of Enforcement, started the enforcement discussion by stating that the Division is presently going through "a period of reflection," while Congress undertakes the process of considering Mary Jo White as the next Chairman of the SEC. Prior to her current work in private practice, White was a long-time prosecutor, ultimately serving as the United States Attorney for the Southern District of New York. Canellos himself was recently appointed the Acting Director of the Division after Robert Khuzami announced his departure after four years at the helm. Prior to being appointed Acting Director, Canellos served as Deputy Director of the Division of Enforcement, and as the Regional Director of the SEC's New York Regional Office. Canellos appointed David Bergers, currently head of the Boston office, to be Acting Deputy Director for Enforcement.

Although the enforcement staff continued its SEC Speaks tradition of articulating aggressive positions and forecasting bigger and better cases in the next year, it appeared that the uncertainty as to what the SEC's leadership will look like a few months from now kept the staff from becoming too specific about long-term plans for 2013. Staffing uncertainties aside, however, the enforcement officials identified several areas that they believed would continue to be priorities for them as they begin 2013.

WHISTLEBLOWERS AND COOPERATORS

In the coming year, the SEC will continue to seek detailed and credible information regarding potential fraud through its whistleblower and cooperation programs. Jane Norberg, the Deputy Chief of the SEC's Whistleblower Office, highlighted the Office's success over the past year. According to Norberg, in 2012 the Whistleblower Office received 3,001 tips concerning a wide variety of potential violations. Tips were received from individuals in all 50 states, and 49 foreign countries. While Norberg had only one example of an award being made to a whistleblower under the SEC's program thus far,¹ she made it clear that further awards were on the horizon, and that she believed the payment of awards to whistleblowers would prompt more "high quality" tips for the Division to pursue.

¹ The first award made under the program is discussed in a prior article, available here: <http://www.mofo.com/files/Uploads/Images/120822-SEC-Whistleblower.pdf>.

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Eric Bustillo, the Regional Director of the Miami Regional Office, similarly noted that the Division's Cooperation Program has resulted in the staff gathering valuable evidence that allowed the SEC to bring better cases, faster. In a variety of actions—including FCPA, financial reporting, regulated entity and insider trading cases—the SEC has entered into 51 cooperation agreements (including a number of deferred prosecution or non-prosecution agreements) with entities and individuals. Bustillo went on to state that the staff continues to work with many of the cooperators in connection with ongoing investigations and active litigation. Although the staff will continue to promote the benefits of cooperation in 2013, and actively seek out cooperators, Bustillo cautioned that a cooperation agreement is not guaranteed for a company choosing to self-report a violation. Rather, the SEC will continue to consider a number of factors in connection with a potential agreement, including: the isolation of the misconduct within the company; the extent of cooperation; the remedial actions taken in response to the misconduct; the sharing of results of any internal investigation; and the willingness to perform undertakings aimed at improving future compliance.

FINANCIAL FRAUD AND DISCLOSURE

Andrew Calamari, the Regional Director of the New York Regional Office, confirmed that financial reporting cases are still a major focus of the enforcement program. Last year, the Division brought 79 cases in this area, including cross-border cases, actions against accountant and director gatekeepers, and actions against banking institutions pertaining to the valuation of loans and other instruments. In 2013, the Division will continue to closely monitor issuers and their gatekeepers for potential financial disclosure concerns.

Calamari noted that many of the financial reporting cases filed by the SEC in 2012 related to cross-border issues. For example, concerned with abuses connected with reverse mergers by foreign issuers, the SEC filed 40 fraud actions against foreign issuers and their executives. The SEC also commenced administrative proceedings against the Chinese affiliates of the five largest U.S. accounting firms over the production of work papers related to audits of China-based companies whose shares publicly trade in the U.S. Although the firms contend that they cannot produce the work papers requested by the SEC due to China's stringent state secrecy laws, the Division countered that, under the Sarbanes-Oxley Act, the auditors are required to provide the work papers if they are requested during the course of an SEC investigation. While the SEC, the PCAOB, and the Chinese government have been publicly attempting to resolve the conflicting regulatory requirements, the SEC apparently felt it was unable to fulfill its responsibilities to protect the U.S. markets under the existing international stalemate, and the Division took the issue to litigation.

The Division staff further indicated that it will seek to deter financial reporting fraud through more claims against CEOs and CFOs under the clawback provisions of section 304 of Sarbanes-Oxley. Under section 304, a company must seek reimbursement of certain incentive-based or equity-based compensation, including profits from sales of the company's stock, from the chief executive officer and chief financial officer who signed certifications of an issuer's financial statements that were required to be restated as a result of misconduct. The SEC brought twelve clawback actions in 2012, and three thus far in 2013. While most clawback claims are brought by the SEC when the CEO or CFO are also charged with the underlying accounting fraud, two of the SEC's cases have been filed against executives who were not charged with any misconduct themselves. The Division noted that caselaw related to section 304 is developing slowly, but that it is developing in the SEC's favor. For instance, in November 2012 in *SEC v. Baker*, the Western District of Texas ruled in the SEC's favor on

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multiple issues, including a ruling that (a) the executive need not be personally engaged in the conduct to be subject to the clawback provisions; (b) the amount of reimbursement is not limited to income attributable to the wrongdoing; and (c) the clawback provisions are constitutional even when applied to individuals who are in no way responsible for the company's wrongdoing.

FOREIGN CORRUPT PRACTICES ACT

Kara Brockmeyer, Chief of the Division's FCPA Unit, provided the audience with compelling guidance for companies with international operations: The enforcement staff in 2013 will be looking for companies to develop and enforce a robust and continually-evolving FCPA compliance program. Brockmeyer urged companies to move away from the "one size fits all" approach. Rather, she stated that, in evaluating compliance programs, the staff will be looking for programs that address the risks specific to a company's business, and identify emerging risks as they develop. Moreover, companies must investigate and remediate potential issues quickly and thoroughly. In addition, Brockmeyer stated that compliance programs should be fundamentally intertwined with, and piggyback on, the firm's existing financial controls used for SOX certifications. Absent a customized compliance program—which is understood by employees, enforced by management and compliance, and effective at addressing issues specific to the company's operations—the staff is not likely to exercise its discretion favorably for a company finding itself involved in a potential FCPA violation.

INSIDER TRADING

Both Dan Hawke, Chief of the Division's Market Abuse Unit, and Sanjay Wadhwa, Deputy Chief of the unit, emphasized that insider trading has been, and will continue to be, a high-priority area for the Enforcement Division. Since charging Raj Rajaratnam in October 2009, the SEC has brought 175 enforcement actions against 425 defendants, in cases involving more than \$900 million in allegedly illicit profits. Expert network investigations and the expanse of the Galleon case have uncovered a "treasure trove" of information about insider trading, according to Wadhwa. And thus, he continued, investigations into hedge fund insider trading will continue to demand a significant portion of the Division's time. Additionally, the staff will continue its aggressive international reach when enforcing U.S. insider trading laws. Wadhwa highlighted the SEC's recent successes in (1) freezing funds in a Swiss account within 48 hours of trading in advance of a large M&A transaction, and (2) freezing funds in U.S. brokerage accounts controlled by individuals in Asia for alleged insider trading in anticipation of a significant acquisition. He further stated that the staff will closely scrutinize trading around significant corporate transactions, particularly as the M&A market is expected to uptick in 2013.

ASSET MANAGEMENT

Bruce Karpati, Chief of the Asset Management Unit, emphasized the unit's focus on the mutual fund and private equity industry. With regard to mutual funds, Karpati said that the Division will actively investigate: whether funds follow their stated investment strategies; asset valuation issues (such as the staff's recent case against the independent directors of a mutual fund complex for alleged issues with their oversight of the firm's valuation practices); adviser fee arrangements (referring to a recent case against a firm for allegedly approving payments to a sub-adviser that did no work); conflicts of interest (akin to a case against a fund complex that allegedly mismanaged one fund to benefit another); and oversight and compliance failures (such as a recent case against a large fund complex for its alleged control failures concerning the use of leverage).

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Julie Riewe, Deputy Chief of the Asset Management Unit, also highlighted the unit's focus on the newly-registered private equity industry. In this still "maturing industry," Riewe stated that she expects to see a large number of cases in the coming year. Riewe indicated, among other things, that the staff will focus on private equity conflicts of interest (such as where the partner in a PE firm allegedly syndicated investment opportunities away from his firm's funds and towards an entity that he co-owned) and valuation issues (akin to writing up the value of fund assets while seeking investors, only to write them down after the close of the solicitation period).²

EVOLVING BASIS FOR LIABILITY AND FORUMS

Joseph Brenner, Chief Counsel for the Division of Enforcement, and Matthew Martens, Chief Litigation Counsel, discussed various changes in the Division's litigation program. Brenner noted that although the Supreme Court's 2011 *Janus Capital Group v. First Derivative Traders* ruling may have limited the scope of primary violations under Exchange Act section 10(b) and Rule 10b-5, the Division's ability to hold people accountable through secondary liability claims has not diminished. According to Brenner, the Second Circuit bolstered the SEC's position when it made clear in *SEC v. Apuzzo* that the Commission is not required to show that an aider and abettor "proximately caused" the primary securities violation. Rather, the aider and abettor need only be associated with the enterprise and tried to make it succeed. Brenner also noted that the SEC has at its disposal section 20(b), which makes it unlawful to directly or indirectly do anything unlawful through the acts of another person. And since the remedies available to the staff are the same for either primary or secondary claims, Brenner reported no reluctance to pursue secondary liability claims in 2013.

Martens stated that, because penalties are now available in administrative proceedings, the enforcement staff will explore a broader use of the administrative forum in 2013, despite the fact that Martens claimed the Division's record in district court trials in 2012 was 23-1. If the Division does move toward more administrative proceedings, defendants can expect a significantly faster-paced litigation, with very limited discovery.

CONCLUSION

The SEC continues to refine its techniques aimed at fulfilling its role as the "investor's advocate." Empowering skilled enforcement staff to be more aggressive in investigations, allowing a choice of forums to benefit the Division in litigation, working with other regulators across the nation and overseas, undertaking proper planning, and ensuring the availability of adequate resources remain keys to an effective enforcement program. If the staff follows through on its promises and predictions at *The SEC Speaks*, we will continue to see aggressive action from the Division of Enforcement in the coming year.

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² Additional private equity enforcement priorities are discussed in a prior article, available here:
<http://www.mofo.com/files/Uploads/Images/130201-SEC-Enforcement-Priorities-and-Compliance-Opportunities.pdf>.

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