

# Client Alert

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## Enforcement Heads Reveal All at SIFMA Annual Seminar

By Daniel A. Nathan

The federal budget sequester and recent Supreme Court decision in Gabelli et al. v. Securities and Exchange Commission, 568 U.S. \_\_\_\_ (2013), will not substantially slow down regulators' enforcement efforts, according to senior enforcement officials and other top regulators who spoke at the Annual Seminar of SIFMA's Compliance & Legal Society this week. While conceding that those recent events might impose some limitations on their work, the officials presented an impressive array of enforcement priorities for the year, and provided strong suggestions to the industry and securities bar attendees about how to make investigations easier on both the enforcers and "enforcees."

What is compromised by the sequester at the SEC, according to George Canellos, Acting Director of the SEC's Division of Enforcement, is the ability to hire examination staff and to continue the SEC's efforts to upgrade technology. According to Enforcement Division Director David Meister, the CFTC is substantially underfunded, with the Enforcement Division smaller than when Meister became its Director three years ago. The limited resources are particularly troubling, he said, when the agency has been charged with dramatically enhanced jurisdiction under Dodd-Frank. Meister then explained that Chairman Gary Gensler's recent remarks about "shelving Enforcement investigations" means just that—putting them on the shelf, but not closing them.

The panelists discussed the effect of Gabelli, in which the Supreme Court asserted that the SEC's five-year statute of limitations does not allow for a "discovery" rule, that is, does not begin to run when the SEC actually discovered the violations. Canellos indicated that the decision will not materially affect existing cases. Meister said he did not think that defense counsel will be any less willing to sign tolling agreements in investigations that are butting up against the five-year statute, since that would only drive the agencies to make their decisions on enforcement action more quickly. In fact, according to the panel, the requests from SEC Enforcement staffs for tolling agreements have increased dramatically since the decision, but the subjects of the investigation are tending to insist on shorter extensions than those in the past.

Other enforcement trends and priorities were discussed:

- **Insider Trading.** Canellos indicated that the industry should expect more cases, with a focus on non-traditional players such as hedge funds, and non-traditional trading mechanisms such as sophisticated options strategies. He observed that more of the violative trading seems to be focused on unexpected earnings announcements, rather than merger and acquisition activity. He pointed out that the recent record-setting CR Intrinsic settlement did not name the individuals who made the trading decisions, but also named as relief defendants the hedge fund management company and the hedge funds that benefitted from the illegal trading.
- **Structured Products.** FINRA Chief of Enforcement Brad Bennett stated that FINRA's cases alleging problems with retail sales of structured products are relatively straightforward; they typically involve products sold by brokers who don't understand them, to customers who didn't understand them. He focused on recommended holding periods for certain products that do not make sense, such as a recommendation for

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customers to trade out of products even before the first coupon payment is due. (During his remarks the next day, FINRA head Rick Ketchum reiterated his belief that, even if a fiduciary standard is not currently applicable to broker-dealers, a broker should be able to write down in one sentence why a particular product is better for the customer than alternate investments.) Bennett also cautioned the industry about products that are not proprietary to their firms, but brought in by brokers who sold them successfully elsewhere, describing it as “an infiltration of your platform.” The SEC, Canellos said, is focusing less on individual sales of CDOs or RMBSs, and more on entire offerings that failed during the credit crisis.

- **Non-traditional Powers.** Meister discussed the provision under Dodd-Frank that gives the CFTC so-called “civil perjury” jurisdiction, that is, the power to bring an action against someone who made a false statement to the Commission in an investigation. He also disclosed that the agency currently has a pending case under that provision. Discussing trends in injunctive relief, Canellos stated his view that a narrowly tailored injunction forbidding someone, say, from committing a non-scienter-based violation actually creates greater risks for a defendant than a scienter-based injunction, since it is easier for the SEC to prove a violation that does not require a showing of scienter and is therefore easier to prove a violation of the injunction. Bennett stated that FINRA is getting more comfortable with the use of its temporary cease-and-desist-order authority, and the industry can anticipate more such emergency actions.

Finally, each of the Enforcement chiefs offered observations and practice tips to the attendees:

- In FINRA insider-trading investigations, which include requests for information made by FINRA’s Office of Fraud Detection and Market Intelligence, Bennett admonished the industry not to stand on the SRO’s lack of jurisdiction over the investment-advisory side of the business, but to provide information even if on a voluntary basis. He also encouraged member firms to escalate examination and investigative issues within FINRA, stating that they want to hear these concerns and get the process right.
- Canellos encouraged the subjects of SEC investigations to present the facts to the staff early on in an investigation if they have a good story to tell, in order to save the staff from conducting an extensive and unnecessary investigation.
- Meister urged counsel to be candid with the CFTC staff and not to oversell their positions.

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