

Client Alert

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SEC FY 2016: A Record Year for Enforcement Cases Against Funds and Advisers

By Jay G. Baris

On October 11, 2016, the Securities and Exchange Commission announced that it prosecuted a record number of enforcement cases against investment advisers and investment companies in the fiscal year ended September 30, 2016.

During this period, the SEC brought a record-breaking 868 enforcement actions against companies and their executives and gatekeepers for alleged misconduct. Of this amount, the SEC targeted 160 (“the most ever”) cases as involving investment advisers or investment companies. The SEC also brought 98 (“the most ever”) standalone, or independent, cases involving investment advisers or investment companies. Add to this a record of 548 standalone enforcement actions, judgments and orders totaling more than \$4 billion in disgorgement and penalties, a record \$57 million distributed to whistleblowers during the fiscal year.

First-of-their-kind actions. During fiscal year 2016, the SEC brought several first-of-their-kind actions, including:

- a case against a firm solely for failing to file Suspicious Activity Reports when required;
- a case against audit firm for auditor independence failures based on close personal relationships with audit clients; and
- a case against a private equity adviser for acting as an unregistered broker when selling fund interests.

Advisers and funds. In its announcement, the SEC tallied up its score card. Among other things, it:

- brought eight enforcement actions related to private equity advisers, bringing the two year total of cases against private equity-related actors to 11;
- charged an investment adviser and its top executives with allegedly hiding its rapidly deteriorating financial condition while raising more than \$350 million from more than 1,500 investors;
- sanctioned three affiliated broker-dealers for steering mutual fund clients toward more expensive share classes allegedly so they could earn more fees;
- charged an investment adviser for “parking” trades that favored certain clients over others; and
- sanctioned 13 investment advisers for allegedly repeating false claims made by another investment adviser about its flagship product without sufficient documentation to support those claims.

Client Alert

Gatekeepers. The SEC went after “attorneys, accountants and other gatekeepers” for alleged failures to comply with professional standards. Among other things, the SEC:

- charged an auditor and two of its partners for ignoring red flags and fraud risks while conducting deficient audits of publicly traded companies;
- charged two auditing firms with violating auditor independence rules; and
- charged a private fund administrator with missing or ignoring clear indications of fraud while it was contracted to keep records and prepare financial statements and account statements for two funds that the SEC charged with fraud.

Admissions of liability. The SEC emphasized that it has demanded and obtained acknowledgements of wrongdoing under its admissions policy in a number of areas.

Other areas. The SEC also commenced enforcement actions involving insider trading, Foreign Corrupt Practices Act (FCPA) violations, disclosure, market fairness, market manipulation, multilayered marketing schemes, complex financial products, and public finance markets.

Our take. The SEC has added more notches to its very large revolver than in other years. Over the past few years, the SEC has broken new ground and has shown that it will aggressively go after corporate executives and gatekeepers, including fund directors, lawyers, administrators, and accountants.

Yet, legislators continue to hound SEC Chair Mary Jo White. While recent complaints lobbed by Senator Elizabeth Warren (“Today I am more disappointed than ever”) and Senator Charles Schumer (“You’re hurting America”) do not directly accuse Chair White of being soft on wrongdoers, they imply that the SEC is not doing enough to protect investors. The data seem to contradict those characterizations.

We hope that in its zeal, the SEC enforcement division does not begin to second-guess advisers and fund directors after the fact for exercising their informed business judgment in making tough calls when implementing the barrage of new regulations affecting advisers and funds.

Client Alert

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