SHEARMAN & STERLING LLP

CAPITAL MARKETS

CLIENT PUBLICATION

September 2014

Broken Windows: SEC Enforcement Reminds Officers, Directors and 5% Shareholders to Comply with Reporting Requirements

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

Richard J.B. Price
London
+44.20.7655.5097
rprice@shearman.com

Robert Evans III
New York
+1.212.848.8830
revans@shearman.com

Claudius O. Sokenu
New York
+1.212.848.4838
claudius.sokenu@shearman.com

Matthew Bersani
Hong Kong
+852.2978.8096
matthew.bersani@shearman.com

David Dixter
London
+44.20.7655.5633
david.dixter@shearman.com

Stephen T. Giove
New York
+1.212.848.7325
sgiove@shearman.com

Kristen Hutchens
Washington, DC
+1.202.508.8157
kristen.hutchens@shearman.com

Masahisa Ikeda
Tokyo
+81.3.5251.1601
mikeda@shearman.com

On September 10, 2014, the United States Securities and Exchange Commission (the "SEC") announced enforcement proceedings against officers, directors and major shareholders and publicly-traded companies for violations related to beneficial ownership filings. The broader lesson of these enforcement actions is that, consistent with Chair White's "broken windows" enforcement philosophy, the SEC's threshold for pursuing violations of the securities laws has been lowered. Publicly-traded companies, regulated entities and all those that are subject to the federal securities laws should ensure that they have robust policies and procedures in place to ensure compliance with all applicable reporting requirements.

SEC Institutes Enforcement Action for Failure to Comply with Reporting Obligations

The SEC alleged violations of reporting requirements under Section 13(d) and Section 16(a) of the Securities Exchange Act of 1934 (the "Exchange Act") that apply to officers, directors and certain major shareholders of SEC reporting companies. The SEC's enforcement sweep resulted in charges against 34 individuals and companies. Thirty-three individuals and companies settled the charges, accepted cease-and-desist orders and agreed to pay civil penalties ranging from $25,000 to $150,000.[1]

[1] The SEC's press release announcing the enforcement actions is available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542904678.

Contacts (cont.)

Lisa L. Jacobs
New York
+1.212.848.7678
ljacobs@shearman.com

Jason R. Lehner
Toronto
+1.416.360.2974
jlehner@shearman.com

Marc O. Plepelits
Frankfurt
+49.69.9711.1623
mplepelits@shearman.com

Martin Schmidt
Frankfurt
+ 49.69.9711.1000
martin.schmidt@shearman.com

Sami L. Toutounji
Paris
+33.1.53.89.70.62
stoutounji@shearman.com

Robert C. Treuhold
New York
+1.212.848.7895
rtreuhold@shearman.com

In the enforcement proceedings, the SEC charged 13 officers and directors (including three CEOs, two CFOs, one general counsel and one corporate controller) as well as 15 beneficial owners (including five individuals) of public companies. In addition, the SEC filed administrative proceedings against six publicly traded companies for contributing to the insiders' filing failures and for failing to report their insiders' filing delinquencies. The SEC noted that some of these companies had voluntarily agreed to perform certain tasks on behalf of insiders, including the preparation and filing of Section 16(a) reports, but that these reports were not filed on a timely basis on numerous occasions, even though the companies had received timely notification of all information necessary to make the filings. Some of the companies also failed to disclose delinquent Form 4s in their Annual Report on Form 10-K or proxy statement in accordance with Item 405 of Regulation S-K.

SEC disclosure requirements with respect to holdings and transactions apply to officers, directors and beneficial owners of more than 10% of any class of registered equity securities of US public companies.[2] These persons are required to make filings on Forms 3, 4 and 5 to disclose their share ownership and to report purchases, sales or other changes in ownership. Additionally, the SEC's beneficial ownership reporting rules require any person or group that directly or indirectly acquires beneficial ownership of more than 5% of voting equity securities of a company that is listed on a national exchange to disclose their ownership and provide certain background information. These persons must file a Schedule 13D with the SEC within ten days after the acquisition and amend it promptly after a material change occurs in the facts set forth in the Schedule 13D. Certain investors, including eligible institutions and passive investors, are permitted to file a short-form statement on Schedule 13G, which must be amended periodically to report any changes from a previously filed Schedule 13G.

Lessons from the SEC's Sweep

The SEC's efforts to hold corporate insiders and companies accountable for failures to comply with beneficial ownership reporting requirements lead us to these observations:

First, the SEC remains focused on developing and using technology that will allow it to keep up with the complexities of the financial markets by using the tools of big data. Of note, the SEC announced that it used "quantitative data sources and ranking algorithms" to identify corporate insiders whose filings were repeatedly late, in some cases "by weeks, months, or even years." In January 2014, the SEC's Division of Enforcement announced the rollout of a new program — known as NEAT (National Exam Analytics Tool) — designed to identify instances of non-compliance with the federal securities laws through the analysis of large amounts of trading data. In September 2014, the SEC announced the creation of a new office (called the Office of Risk Assessment) within the Division of Economic and Risk Analysis that will coordinate efforts at the SEC to provide data-driven risk assessment tools and

[2] Rule 3a12-3 under the Exchange Act exempts most non-US companies from Section 16 of the Exchange Act.

models to support a wide range of SEC activities, including the development of predictive analytics to support the SEC's enforcement programs. The SEC's use of quantitative analytics to identify individuals and companies with high rates of filing deficiencies could indicate a broader trend of the SEC leveraging its quantitative data analytics tools to identify violations of the federal securities laws.

Second, the SEC will likely continue to focus on beneficial ownership reporting delinquencies because of their recurring nature and because in these cases, the SEC can establish violations by a large number of filers without committing significant enforcement resources. Using its quantitative data analysis tools, the SEC can effectively identify numerous delinquent filers and, since neither Section 13(d) nor Section 16(a) of the Exchange Act requires the SEC to prove intent to violate the reporting obligations, the violation is complete once a required filing is not made.

Third, the SEC will likely bring more enforcement actions relating to other types of reporting violations. If the SEC can use quantitative analytics to identify violations of Section 13(d) and Section 16(a) of the Exchange Act, the SEC will most likely be able to use these tools to identify other reporting violations. The SEC's enforcement sweep demonstrates that there are no areas of the federal securities laws that are free of enforcement oversight.

Fourth, though it has been nearly a year since Chair White's "broken windows" speech, the SEC remains focused on holding companies and individuals accountable for violations of the federal securities laws. In a speech on October 9, 2013, Chair White explained that the SEC would like companies and individuals "to start thinking that every issue you face in the SEC's space is a very important one. . . . One of our goals is to see that the SEC's enforcement program is — and is perceived to be — everywhere, pursuing all types of violations of our federal securities laws, big and small." The underpinning of the SEC's thinking, Chair White explained, was outlined in an article titled "Broken Windows." The theory, according to Chair White, is that "when a window is broken and someone fixes it — it is a sign that disorder will not be tolerated. But, when a broken window is not fixed, it 'is a signal that no one cares, and so breaking more windows costs nothing.'"

What Public Companies Can Do to Avoid Compliance Issues

Public companies and other filers should make certain that they have robust policies and procedures in place to ensure that their filings comply with all applicable SEC disclosure requirements and are made within the required deadlines. Companies should also have policies requiring compliance with reporting obligations by their officers, directors and major shareholders, particularly if the company has agreed to provide assistance to insiders, such as the preparation and filing of Section 16(a) reports on behalf of officers and directors. Public companies should view the announcement of these enforcement actions as an opportunity to remind their officers, directors and major shareholders of their reporting obligations.

ABU DHABI | BEIJING | BRUSSELS | FRANKFURT | HONG KONG | LONDON | MILAN | NEW YORK | PALO ALTO
PARIS | ROME | SAN FRANCISCO | SÃO PAULO | SHANGHAI | SINGAPORE | TOKYO | TORONTO | WASHINGTON, DC

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069

Copyright © 2014 Shearman & Sterling LLP. Shearman & Sterling LLP is a limited liability partnership organized under the laws of the State of Delaware, with an affiliated limited liability partnership organized for the practice of law in the United Kingdom and Italy and an affiliated partnership organized for the practice of law in Hong Kong.