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review

Select Broker-Dealer, Investment Adviser, and Investment Company Enforcement Cases and Developments: 2013 Year in Review

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This Outline highlights key U.S. Securities and Exchange Commission (the "SEC" or the "Commission") and Financial Industry Regulatory Authority ("FINRA") enforcement developments and cases regarding broker-dealers, investment advisers, and investment companies during 2013.[*]

The SEC

2013 was marked by notable changes in the SEC's enforcement program, including new personnel, new policies, and new specialized task forces.

The most notable personnel change came on April 10, 2013, when Mary Jo White was sworn in as Chairman of the Commission. In addition, two new Commissioners were appointed in August 2013: Kara M. Stein and Michael S. Piwowar. The current Commission includes Chair White and four Commissioners: Luis A. Aguilar, Daniel M. Gallagher, Ms. Stein, and Mr. Piwowar.

There were also significant changes in key Staff positions during 2013. In January, Robert Khuzami, Director of the Division of Enforcement, announced his departure after four years in the role. In April, Chair White named George Canellos and Andrew Ceresney as Co-Directors of Enforcement. Mr. Ceresney became the sole Director of Enforcement in 2014, when Mr. Canellos announced that he was leaving the Commission. In 2013, new Chiefs of Enforcement's Asset Management, Municipal Securities and Public Pensions, and Complex Financial Instruments units and a new Chief Litigation Counsel were appointed. Several new leaders in the Office of Compliance Inspections and Examinations (OCIE) were announced in 2013, including a new Director of the National Exam Program, a new National Associate Director for the Investment Adviser/Investment Company Examination Program, and a new National Associate Director for the Broker-Dealer Examination Program. Finally, new Directors were appointed in five of the SEC's 11 Regional Offices.

[*] This outline was prepared by partners Ben A. Indek, Merri Jo Gillette, Michèle A. Coffey, Jennifer Klass, E. Andrew Southerling, and Ivan P. Harris; of counsel Mary M. Dunbar; associates David Behar, Megan Braden, John Cosgriff, Jed Doench, Ariel Gursky, Dallas Kaplan, Benjamin Kwak, Kerry Land, Christine Lombardo, Nicholas Losurdo, Jonathan Maier, Julie Marcacci, Katarzyna Mularczyk, Mary Pennisi, Kaitlyn Piper, Ignacio Sandoval, Todd Smith, Zachary Vonnegut-Gabovitch, and Sam Wardle; and legal assistants Tanya Paul and Christina Mancing. Administrative support was provided by Veda Nieves and Angelita Henry. Morgan Lewis served as counsel in certain actions described herein.

In FY 2013, the Commission brought 686 enforcement actions, 48 fewer than the 734 initiated in FY 2012; this represents about a 7% decline year over year. Last year's total is the lowest number since FY 2010. According to the Commission, "these numbers do not, however, reflect the outstanding quality of the enforcement actions brought during the year." The Commission noted that 402 of the 686 cases were brought in the last six months of the fiscal year. The SEC also trumpeted its "strong pipeline" heading into FY 2014, pointing out that it had opened 908 investigations last year (representing a 13% increase) and issued 574 formal orders of investigation (up 20% on the year). Finally, the SEC reported that it had 1,444 open investigations as of the end of its FY 2013.

Of particular note, reversing a three-year trend, the SEC brought 121 actions against broker-dealers in FY 2013, compared to 134 in FY 2012. This represents about a 10% decrease year over year. Similarly, the SEC also brought fewer actions against investment advisers and investment companies, instituting 140 such cases in FY 2013, seven fewer than filed in the previous year. Nevertheless, taken together, it is clear that the SEC continued to devote significant resources toward investigating regulated entities last year; cases in that area represented about 39% of the Commission's FY 2013 docket.

Interestingly, and in contrast to the amount of headlines garnered, the number of insider trading cases filed by the Commission declined significantly last year. In FY 2013, the SEC brought 44 insider trading cases, 14 fewer than in the prior year. This figure is the lowest since FY 2010 and the third lowest in the last 10 years.

In FY 2013, the SEC obtained orders requiring the payment of $3.4 billion in penalties and disgorgement, a 10% increase from the amounts ordered in FY 2012 and a record for the Commission. Of that amount, approximately $1.167 billion represented orders to pay civil penalties (the highest amount since FY 2005), and about $2.257 billion represented orders for disgorgement of illegal profits.

As the SEC's financial crisis–related investigations began to be potentially affected by the statute of limitations, the Commission's enforcement activity in this area appeared to decline. It appears that, in FY 2013, the SEC initiated only several new cases related to the crisis. Over the last few years, however, the Commission has brought charges against 169 individuals and entities, including 70 CEOs, CFOs, and other senior officers in financial crisis–related cases. These actions have resulted in more than $3.02 billion in penalties and disgorgement.

The SEC's whistleblower program completed its third year of operation in FY 2013. Last year, the Office of the Whistleblower received 3,238 tips, complaints, and referrals from whistleblowers, an increase of 237 (or approximately 8%) from the 3,001 received in FY 2012. These notifications came from all 50 states, the District of Columbia, Puerto Rico, Guam, the U.S. Virgin Islands, and 55 foreign countries. The United Kingdom, Canada, and China led the way in referring complaints to the SEC from outside the country last year.

Most complaints fell into three categories: corporate disclosure and financials, offering fraud, and manipulation. The SEC reported that it had paid four whistleblowers a combined total of $14,831,965.64. However, that figure includes an award of more than $14 million to a single whistleblower on the last day of the Commission's fiscal year.

In June 2013, in a significant departure from past practice, Chair White announced that the SEC would begin requiring admissions of facts and misconduct from defendants as a condition of settlement in cases where there was a heightened need for public accountability. While she predicted that most cases would continue to settle with the defendants neither admitting nor denying the allegations of wrongdoing, the SEC would begin to require admissions as a condition of settlement in cases involving egregious intentional misconduct, substantial harm to investors, or serious risk to the markets. In FY 2013, the SEC required admissions in two matters.

In her short time at the helm, Chair White has been unequivocal in her pronouncements that the SEC is prepared and willing to take cases to trial. In fact, over the last three years, the SEC has won 80% of the cases it has tried. However, the Commission had mixed results at trial in the latter half of 2013.

In August 2013, the SEC had a highly publicized victory in connection with a jury trial related to the marketing of a collateralized debt obligation by an individual defendant. In contrast, a mere two months later, in October 2013, a jury acquitted an individual on all counts of insider trading in another high-profile SEC trial. Then, in December 2013, the SEC lost two additional cases, each charging individuals with misconduct in connection with financial fraud at public companies. Despite the SEC's mixed record of trial outcomes in recent months, the Commission is likely to continue to take difficult cases to trial, rather than accept what it perceives as weak settlements. Nonetheless, the SEC must contend with the pragmatic reality of limited resources. While it may have the talent and commitment to try cases, the SEC simply does not have the capacity to litigate more than a small percentage of its total caseload.

In July 2013, the SEC announced the creation of a new enforcement initiative in the form of a specialized task force targeting abusive and fraudulent conduct in securities issued by microcap companies, with an emphasis on those that do not regularly report their financial results to the public. The task force will investigate fraud in the issuance, marketing, and trading of microcap securities. In December 2013, the SEC announced that it would be creating a new enforcement task force to increase its focus on the activities of broker-dealers. The task force will focus on current issues and practices within the broker-dealer community and develop national initiatives for potential investigations. The SEC will use this task force, once in place, to coordinate broker-dealer-related initiatives across the agency. The task force will serve to centralize information and expertise concerning industry practices and trends. It will also coordinate with OCIE, and with FINRA, to generate quality referrals and investigations. Although still in the formative stages, the creation of a broker-dealer task force, presumably to be staffed with

investigators exclusively dedicated to ferreting out unlawful conduct by broker-dealers, suggests that there will be an increase in enforcement cases brought against broker-dealers and associated market participants.

In October 2013, Chair White reaffirmed the Commission's commitment to pursuing violations large and small and stated that the SEC would look for violations in all corners of the market. She analogized this enforcement strategy to the so-called "broken windows" strategy employed by former New York Mayor Rudolph Giuliani and made it clear that the SEC would pursue strategic prosecution of smaller violations in an effort to send a broader deterrent message. It remains to be seen whether the "broken windows" approach will result in a significant increase of cases charging less egregious violations of the law. One area where it may be reflected is in an increase of cases charging regulatory lapses initially identified through the SEC's examination program.

In November 2013, the SEC announced that it had entered into its first deferred prosecution agreement with an individual. This action signals that a majority of the Commissioners are comfortable with the SEC's use of this cooperation tool with respect to both companies and individuals.

The SEC's enforcement priorities under Chair White have included an increased emphasis on deterrence, consistent with a robust and effective enforcement program. In 2013, this emphasis on deterrence was reflected in aggressive charging decisions; the pursuit of stronger sanctions, including substantial monetary penalties; creative use of customized remedies, including conduct-based injunctions; the requirement of admissions as a condition of settlement in certain cases; and close coordination with other regulatory and criminal law enforcement agencies, both domestic and international. In the upcoming year, we are likely to see more of the same, together with a renewed focus on cases involving financial fraud and accounting issues, microcap fraud, broker-dealers and investment advisers, and market structure as well as the increased use of data analytics to focus enforcement resources on practices and industries where there is the highest likelihood or risk of misconduct.

Last year, the SEC brought broker-dealer cases in several traditional areas, including registration, commissions and markups, and insider trading. The Commission continued its efforts in the mortgage-backed securities area and opened new fronts involving the Market Access Rule and municipal securities. The SEC also brought several financial crisis–related actions as the events of 2008 reached their five-year anniversary. In the asset management space, it continued to focus on several practices, including best execution, compliance reviews and policies and procedures, trade allocation, and representations to investors.

FINRA

Last year, there were several notable personnel changes in FINRA's senior staff. Susan Axelrod was promoted to Executive Vice President of Regulatory Operations. In this role, Ms. Axelrod oversees Enforcement, the Office of Fraud Detection and Market Intelligence, and Member Regulation (which includes Sales Practice, Risk Oversight and Operational Regulation, and Shared Services). Carlo di Florio joined FINRA from the SEC as the Executive Vice President for Risk and Strategy. In his new role at FINRA, Mr. di Florio is responsible for assessing the most significant risks to investors and market integrity and developing ways to lessen, manage, and monitor those risks and trends in the industry. Finally, Mike Rufino was promoted to Head of Member Regulation Sales Practice, and Bill Wollman was elevated to the role of Head of Member Regulation Risk Oversight and Operational Regulation.

In 2013, FINRA brought 1,535 new disciplinary actions, a slight decline from the record 1,541 cases initiated in 2012. FINRA resolved 1,307 formal actions last year; 363 fewer cases than it had in the prior year. Last year, FINRA expelled 24 firms from its membership (compared to 30 in the prior year), barred 429 people (versus 294 in 2012), and suspended 670 individuals (an increase over the 549 such actions in the prior year).

In 2013, FINRA posted only three Targeted Examination letters on its website, versus five in the prior year. Last year's letters focused on Alternative Trading Systems, social media communications, and firms' controls and processes in connection with the development and use of trading algorithms and automated trading technology.

There were several FINRA enforcement developments of note last year, including the following:

- First, in late 2013, FINRA publicly described its efforts to monitor certain "high risk" brokers and the firms that hire such individuals. According to FINRA, two of the primary tools used in this area are its Broker Migration Model and Problem Broker Model. The Broker Migration Model tracks the movement of certain registered representatives from firm to firm using a variety of risk metrics. The information developed is used by FINRA's Staff to prioritize its surveillance, examination, and enforcement resources, enabling it to conduct targeted examinations and enforcement actions. The Problem Broker Model identifies and monitors registered representatives who have significant regulatory disclosures. FINRA also uses the information derived from this model to target brokers in its surveillance, examination, and enforcement activities. In its 2014 letter setting forth its regulatory and examination priorities, FINRA indicated that it will expand its "high risk" program and establish a dedicated team within the Department of Enforcement to prosecute such cases.

- Second, FINRA issued Regulatory Notice 13-27 announcing amendments to Rule 8313, which governs the publicity of its disciplinary actions. Key changes include the elimination of the publicity thresholds in the rule, the establishment of general standards for the release of disciplinary information, and clarity on the scope of information subject to Rule 8313. Of particular note, the prior monetary sanction threshold of $10,000 for publication of disciplinary actions has been eliminated. Effective December 16, 2013, disciplinary complaints and decisions, independent of the sanction amount, will be shared with the public. Moreover, the amendments also changed the scope of the information FINRA will share with the public regarding many types of disciplinary matters.
- Third, senior FINRA officials emphasized that the agency was focused on responding quickly to address fraudulent conduct. As examples of this effort, in at least two matters in 2013, FINRA filed for Temporary Cease-and-Desist Orders when it learned of alleged fraudulent conduct.

Based upon our review of currently available public information, we believe that FINRA's top enforcement priorities include the following: (i) structured and complex products sold to retail clients; (ii) single registered representative cases involving various types of significant misconduct; (iii) fraud and insider trading; (iv) sales to senior investors; (v) the use of social media to interact with retail investors; (vi) excessive commissions and markups/markdowns; (vii) cyber security and data breaches and losses; (viii) the Market Access Rule; (ix) anti-money laundering; (x) systems- and operations-related supervisory failures; (xi) microcap and penny stock fraud; and (xii) audit trail integrity, including Large Options Positions Reporting and options order marking capacity.

Last year, FINRA brought a number of actions in its traditional areas of focus, including the anti-money laundering, best execution, record retention, suitability, and trade reporting areas. It also continued its recent trends with cases regarding leveraged and inverse exchange-traded funds and private placements. Finally, FINRA initiated actions in new areas such as Direct Market Access and the retention of certain records in the required electronic format.

Personnel Changes[1]

There were many personnel changes at the SEC in 2013 at both the Commission and Staff levels. The most notable change came on April 10, 2013, when Mary Jo White was sworn in as Chairman of the Commission, replacing Elisse B. Walter. Chair White served as U.S. Attorney for the Southern District of New York for almost ten years, prosecuting securities actions, financial institution frauds, and international terrorism cases. After leaving the U.S. Attorney's Office, she joined Debevoise & Plimpton as a partner, where she stayed until assuming her role at the SEC.

In addition to the appointment of Chair White, two new Commissioners were appointed in August 2013: Kara M. Stein and Michael S. Piwowar. Most recently, Commissioner Stein served as Staff Director of the Senate Banking, Housing, and Urban Affairs Committee's Subcommittee on Securities, Insurance, and Investment. For Commissioner Piwowar, his appointment marked a return to the Commission. He previously served as a visiting academic scholar and senior financial economist in the SEC's Office of Economic Analysis. Prior to the SEC, Commissioner Piwowar was chief Republican economist for the U.S. Senate Committee on Banking, Housing, and Urban Affairs.

The current Commission includes Chair White and four Commissioners: Luis A. Aguilar, Daniel M. Gallagher, Ms. Stein, and Mr. Piwowar.

As set forth below, there were also significant changes in key Staff positions during 2013.

Enforcement

On January 9, 2013, Robert Khuzami, Director of the Division of Enforcement, announced his departure after four years in the role.

On April 22, 2013, Chair White named George Canellos and Andrew Ceresney as Co-Directors of Enforcement. Mr. Canellos had served as the Division's Deputy Director since June 2012 and, prior to that, he was Director of the SEC's New York Regional Office. Mr. Ceresney came to the SEC from the law firm of Debevoise & Plimpton. Previously, he had served as Deputy Chief Appellate Attorney in the United States Attorney's Office for the Southern District of New

[1] Unless otherwise noted, the information regarding these personnel changes was drawn from SEC Press Releases available on the Commission's website.

York under Ms. White. Mr. Ceresney became the sole Director of Enforcement in 2014 with the Commission's announcement that Mr. Canellos was leaving the agency.

On July 1, 2013, Julie Riewe and Marshall Sprung were named Co-Chiefs of Enforcement's Asset Management Unit. Previously, Ms. Riewe and Mr. Sprung both served as deputy chiefs of the Asset Management Unit since May 2012. They succeeded Bruce Karpati, one of the unit's inaugural Co-Chiefs, who left in May.

On September 27, 2013, Matthew Solomon was appointed to the position of Chief Litigation Counsel for the Division of Enforcement. Mr. Solomon had served as Deputy Chief Litigation Counsel since June 2012. Prior to joining the SEC, Mr. Solomon served as a federal prosecutor for more than 10 years. He replaced Matthew Martens, who left the agency.

On November 8, 2013, LeAnn Gaunt was named Chief of Enforcement's Municipal Securities and Public Pensions Unit. Ms. Gaunt had worked in the specialized unit for almost four years, and has worked in Enforcement in the SEC's Boston Regional Office since 2000.

In January 2014, Michael Osnato, Jr. was named Chief of Enforcement's Complex Financial Instruments Unit, formerly known as the Structured and New Products Unit. The Unit investigates potential misconduct related to asset-backed securities, derivatives, and other complex financial products. Mr. Osnato joined the SEC in 2008 and previously served as an Assistant Director in the New York Regional Office. Mr. Osnato succeeded Kenneth Lench, the unit's inaugural Chief, who left in July.

Regional Offices

New Directors were appointed in five of the SEC's 11 regional offices:

- Denver Regional Office: Julie Lutz
- Chicago Regional Office: David Glockner
- Salt Lake Regional Office: Karen Martinez
- Boston Regional Office: Paul Levenson
- San Francisco Regional Office: Jina Choi

Office of Compliance Inspections and Examinations

On May 9, 2013, Andrew Bowden was appointed Director of OCIE and head of the National Exam Program, succeeding Carlo di Florio, who departed for FINRA earlier in the year. Mr. Bowden named Joy Thompson, Associate Director for Examinations in the Philadelphia Regional Office, as his Acting Deputy Director.

On August 20, 2013, Jane Jarcho was named National Associate Director for the SEC's Investment Adviser/Investment Company Examination Program.

On November 14, 2013, Kevin W. Goodman was named National Associate Director for the SEC's Broker-Dealer Examination Program.

Enforcement Statistics[2]

In FY 2013, the SEC brought its lowest number of cases in the last three years. Due to the number of open investigations and new formal orders issued last year, however, the Commission believes that it is "well-positioned for significant achievements across its program" for FY 2014. Moreover, the SEC's actions resulted in a record amount of monetary sanctions imposed against securities law violators.

A Decline in the Number of Enforcement Actions Last Year; A "Strong Pipeline" for FY 2014

In FY 2013, the Commission brought 686 enforcement actions, 48 fewer than the 734 initiated in FY 2012; this represents approximately a 7% decline year-over-year.[3] Last year's total is the lowest number since FY 2010. According to the Commission, "these numbers do not, however, reflect the outstanding quality of the enforcement actions brought during the year."[4] The Commission noted that 402 of the 686 cases were brought in the last six months of the fiscal year.[5] The SEC also trumpeted its "strong pipeline" heading into FY 2014, pointing out that it had opened 908 investigations last year (representing a 13% increase) and issued 574 formal orders of investigation (up 20% on the year). Finally, the SEC reported that it had 1,444 open investigations as of the end of FY 2013.[6]

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2 Unless otherwise noted, the information in this section is drawn from the Commission's Press Release entitled "SEC Announces Enforcement Results for FY 2013," available at: http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540503617. The SEC's FY 2013 ended on September 30, 2013.

3 The SEC has indicated that, in the future, certain categories of cases will be excluded from the fiscal year total. Using such methodology in FY 2013 would have resulted in 10 fewer cases or a total of 676 actions.

4 *Id.*

5 *See* U.S. Securities and Exchange Commission "Fiscal Year 2013 Agency Financial Report," p.17.

6 *See* "Select SEC and Market Data Fiscal 2013" ("Select SEC and Market Data"), *available at:* http://www.sec.gov/about/secstats2013.pdf.

The chart below reflects the cases brought by the SEC over the last decade:

Fiscal Year	Number of Enforcement Actions
2004	639
2005	630
2006	574
2007	656
2008	671
2009	664
2010	681
2011	735
2012	734
2013	686

Categories of Cases

The major categories of cases and the number of actions for FY 2013 within each are as follows:

Type of Case	Number of Actions	Percentage of Total Actions
Investment Advisers/Investment Companies	140	21%
Delinquent Filings	132	20%
Broker-Dealer	121	18%
Securities Offering Cases	103	15%
Issuer Reporting and Disclosure	68	10%
Market Manipulation	50	7%
Insider Trading	44	6%
FCPA	5	1%
Municipal Securities and Public Pensions	8	1%
Miscellaneous	5	1%

Of particular note, reversing a three-year trend, the SEC brought 121 actions against broker-dealers in FY 2013, compared to 134 in FY 2012. This represents an approximately 10% decrease year over year. Similarly, the SEC also brought fewer actions against investment advisers and investment companies, instituting 140 such cases in FY 2013, seven fewer than filed in the previous year. Nevertheless, taken together, it is clear that the SEC continued to devote significant resources toward investigating regulated entities last year; cases in that area represent about 39% of the Commission's FY 2013 docket.

Interestingly, and in contrast to the amount of headlines garnered, the number of insider trading cases filed by the Commission declined significantly last year. In FY 2013, the SEC brought 44 insider trading cases, 14 fewer than in the prior year. This figure is the lowest since FY 2010 and the third lowest in the last 10 years.

Penalties, Disgorgement, and Distributions to Injured Investors

In FY 2013, the SEC obtained orders requiring the payment of $3.4 billion in penalties and disgorgement, a 10% increase from the amounts ordered in FY 2012 and a record for the Commission. Last year, the SEC obtained orders in judicial and administrative cases requiring the payment of approximately $1.167 billion in civil penalties (the highest amount since FY 2005), and about $2.257 billion in disgorgement of illegal profits.

Below is a chart reflecting the amount of fines and disgorgement orders obtained by the Commission between FY 2004 and FY 2013.

Fiscal Year	Penalties and Disgorgement
2004	$3.1 billion
2005	$3.1 billion
2006	$3.275 billion
2007	$1.6 billion
2008	$1.03 billion
2009	$2.435 billion
2010	$2.85 billion
2011	$2.806 billion
2012	$3 billion
2013	$3.4 billion

Financial Crisis-Related Cases

As the SEC's financial crisis–related investigations began to be potentially affected by the statute of limitations, the Commission's activity in this area appeared to decline last year. According to the SEC, in FY 2013, the Commission brought "several" enforcement actions related to the financial crisis.[7] As of December 12, 2013, according to the SEC's statistics, overall, the Commission has brought charges against 169 individuals and entities, including 70 CEOs, CFOs, and other senior officers in financial crisis–related cases. These actions have resulted in more than $3.02 billion in penalties and disgorgement, and 40 individuals have been barred from the securities industry, from serving as officers and directors of public companies, and/or from practicing or appearing before the Commission.

Additional Statistics

Recently, the Commission published its report titled "Select SEC and Market Data Fiscal 2013."[8] In the report's section on "Enforcement Milestones," the SEC noted the following FY 2013 statistics:

- The Commission sought orders barring 81 individuals from serving as officers or directors of public companies.
- The SEC filed 12 actions to enforce its investigative subpoenas.
- The Commission went to federal court and sought temporary restraining orders to stop ongoing fraudulent conduct in 19 actions and sought asset freezes in 24 cases.
- Prosecutors filed 126 indictments, informations or contempt actions in SEC-related criminal actions.

Office of the Whistleblower[9]

The SEC's whistleblower program completed its third year of operation in FY 2013. Persons who voluntarily provide the SEC with original information leading to a successful enforcement case resulting in monetary sanctions of more than $1 million may be eligible to receive an award between 10 and 30% of the funds collected by the Commission or in a related enforcement case.

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[7] The statistics in this section appear in "SEC Enforcement Actions Addressing Misconduct That Led to or Arose from the Financial Crisis," available at: http://www.sec.gov/spotlight/enf-actions-fc.shtml. The Commission's FY 2013 enforcement activity Press Release did not provide the exact number of crisis-related cases instituted last year.

[8] *See* Select SEC and Market Data.

[9] "Annual Report on the Dodd-Frank Whistleblower Program: Fiscal Year 2012" (Nov. 2012), *available at:* http://www.sec.gov/news/studies/2010/whistleblower_report_to_congress.pdf.

In FY 2013, the SEC's Office of the Whistleblower received 3,238 tips, complaints, and referrals from whistleblowers, an increase of 237 (or approximately 8%) from the 3,001 received in FY 2012. These notifications came from all 50 states, the District of Columbia, Puerto Rico, Guam, the U.S. Virgin Islands and 55 foreign countries. The United Kingdom (66), Canada (62), and China (52) led the way in referring complaints to the SEC from outside the country last year. Most complaints fell into three categories: corporate disclosure and financials (17.2%), offering fraud (17.1%), and manipulation (16.2%). The number of allegations received by the SEC in these and other categories is presented below.

Allegation Type	Number of Allegations	Approx. Percentage of Total Allegations
Corporate Disclosure and Financials	557	17.2%
Offering Fraud	553	17.1%
Manipulation	525	16.2%
Insider Trading	196	6.0%
Trading and Pricing	168	5.1%
FCPA	149	4.6%
Unregistered Offerings	105	3.2%
Market Event	89	2.7%
Municipal Securities and Public Pension	48	1.4%
Other	764	23.5%
Blank	84	2.6%

Last year, the SEC reported that it had paid four whistleblowers a combined total of $14,831,965.64. However, that figure includes an award of more than $14 million to a single whistleblower on the last day of the Commission's fiscal year. Based upon the foregoing, the vast majority of the money paid out by the SEC in connection with its whistleblower program last year went to a single person.

Key Enforcement Developments

A Year of Change

2013 was a year marked by notable changes in the SEC's enforcement program. As noted above, in January, Robert Khuzami announced that he would be stepping down as Director of Enforcement. In April, Mary Jo White was sworn in as Chairman and named George Canellos and Andrew Ceresney as her Co-Directors of Enforcement. All three are former criminal prosecutors who also

have extensive big law firm experience. (Mr. Canellos has since left the Commission.) Chair White wasted no time in announcing her priorities in a series of public speeches, promising a tough and robust enforcement program that would not shy away from difficult cases, nor fail to bring smaller ones. She outlined her belief that an effective enforcement program must demand public accountability from wrongdoers, particularly in cases involving significant investor harm.

Requirement of Admissions in Some Settlements

In June 2013, in a significant departure from past practice, Chair White announced that the SEC would begin requiring admissions of facts and misconduct from defendants as a condition of settlement in cases where there was a heightened need for public accountability. While she predicted that most cases would continue to settle with the defendants neither admitting nor denying the allegations of wrongdoing, the SEC would begin to require admissions as a condition of settlement in cases involving egregious intentional misconduct, substantial harm to investors, or serious risk to the markets.

In FY 2013, the SEC required admissions in two matters. The Commission announced the first settlement implementing this policy shift in August 2013. In a case alleging the misappropriation of $113 million in hedge fund assets by Philip Falcone, Falcone and his advisory firm, Harbinger Capital Partners, admitted to multiple acts of misconduct that harmed investors as part of a settlement with the SEC.[10] Thereafter, in September, the SEC settled with JPMorgan Chase in connection with the so-called "London Whale" trading loss. JPMorgan admitted to a lengthy recitation of detailed facts and that its conduct violated the federal securities laws.[11]

While it is too early to predict the frequency with which the SEC will require admissions as a condition of settlement, it is safe to assume that admissions will be required in settlements in increasing numbers over the upcoming year. It remains to be seen whether this will become a settlement "term" subject to negotiation and whether, in cases charging multiple parties, all defendants will be treated similarly as the first party to settle in terms of the admissions requirement. This shift in the SEC's settlement policy alters the monetary risk/benefit calculus of settling a matter with the Commission and will require a settling party to factor in the impact of admissions on collateral actions. For regulated entities and individuals, an SEC demand for admissions also reframes the issue of the advisability of litigating against one's primary regulator.

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10 *See* SEC Press Release, "Philip Falcone and Harbinger Capital Agree to Settlement" (Aug. 19, 2013), *available at:* http://www.sec.gov/News/Press Release/Detail/PressRelease/1370539780222.

11 *See* SEC Press Release, "JPMorgan Chase Agrees to Pay $200 Million and Admits Wrongdoing to Settle SEC Charges" (Sept. 19, 2013), *available at:* http://www.sec.gov/News/PressRelease/Detail/PressRelease/13070539819965.

SEC's Trial Record

In her short time at the helm, Chair White has been unequivocal in her pronouncements that the SEC is prepared and willing to take cases to trial. In November 2013, Chair White reiterated this theme in a speech entitled "The Importance of Trials to the Law and Public Accountability."[12] In fact, over the last three years, the SEC has won 80% of the cases it has tried. However, the Commission had mixed results at trial in the latter half of 2013.

In August 2013, the SEC had a highly publicized victory when it prevailed against former trader Fabrice Tourre. The jury found Tourre liable on six of seven counts for his role in forming and selling a collateralized debt obligation with limited disclosure of the risks inherent in the investment.[13] In contrast, a mere two months later, in October 2013, a jury acquitted Mark Cuban on all counts of insider trading in another high-profile SEC trial.[14]

But the Commission also won two lesser publicized trials in October 2013. In a case alleging a $21 million offering fraud by a real estate lending fund, its adviser, and the owner of the adviser, after a five week trial, the jury returned a verdict finding the defendants liable on all charges.[15] In another case, in which the SEC had charged AIC, Inc., a financial services holding company for three broker-dealers and an investment adviser, its subsidiary, and an executive with an unregistered offering fraud targeting elderly, unsophisticated brokerage customers, the jury found defendants liable on all counts.[16]

Then, in December, the SEC lost two additional cases, each charging individuals with misconduct in connection with financial fraud at public companies. On December 4, a Kansas City jury cleared Stephen Kovzan, an executive at the technology company NIC, Inc., of all charges. The SEC had accused Kovzan of concealing a payment of more than $1.8 million to NIC's then-CEO and circumventing accounting controls.[17] Just one week later, following an eight-day bench trial, a California court rejected the SEC's accounting fraud allegations against two former executives of Basin Water, Inc., holding that the SEC had failed to meet its burden of proof.[18]

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12 See Chair White's remarks titled "The Importance of Trials to the Law and Public Accountability," delivered at the 5th Annual Judge Thomas A. Flannery Lecture, Washington, D.C. (Nov. 14, 2013), available at: http://www.sec.gov/News/Speech/Detail/Speech/1370540374908.

13 *SEC v. Goldman Sachs & Co., et al.*, 10 Civ. 3229 (BJ) (S.D.N.Y. filed Apr. 16, 2010).

14 *SEC v. Mark Cuban*, Civil Action No. 3-CV-2050-D (SF) (N.D. Tex. filed Nov. 17, 2008).

15 *SEC v. True North Finance Corporation et al.*, Civil Action No. 10-3995-DWF/JJK (D. Minn. filed Sept. 21, 2010).

16 *SEC v. AIC, Inc., et al.*, Civil Action No. 3:11-cv-00176 (E.D. Tenn. filed Apr. 18, 2011).

17 *SEC v. Kovzan*, Civil Action No. 2:11-cv-02017 (JWL) (D. Kan. filed Jan. 12, 2011).

18 *SEC v. Jensen, et al.*, Civil Action No. 2:11-cv-05315 (C.D. Cal. filed June 27, 2011).

Despite the SEC's mixed record of trial outcomes in recent months, the Commission is likely to continue to take difficult cases to trial, rather than accept what it perceives as weak settlements. Nonetheless, the SEC must contend with the pragmatic reality of limited resources. While it may have the talent and commitment to try cases, the SEC simply does not have the capacity to litigate more than a small percentage of its total caseload.

The Microcap Fraud Task Force

In July 2013, the SEC announced the creation of a new enforcement initiative in the form of a specialized task force targeting abusive and fraudulent conduct in securities issued by microcap companies, with an emphasis on those that do not regularly report their financial results to the public. The task force will investigate fraud in the issuance, marketing, and trading of microcap securities. The release announcing this new initiative stated that the "principal goal of the task force would be to develop and implement long-term strategies for detecting and deterring fraud in the microcap market," with a particular focus on targeting "gatekeepers" such as broker-dealers, transfer agents, stock promoters, and other significant participants in this market. The task force is headed by Assistant Directors in Enforcement in the SEC's New York and Miami offices and is staffed by enforcement personnel dedicated exclusively to the investigation of participants in the microcap securities market.

SEC Enforcement Announces New Broker-Dealer Task Force

In December, the SEC announced that it would be creating a new Enforcement task force to increase its focus on the activities of broker-dealers. As described in the agency's 2013 Financial Report, the task force will focus on current issues and practices within the broker-dealer community and develop national initiatives for potential investigations. The SEC will use this task force, once in place, to coordinate broker-dealer related initiatives across the agency. The task force will serve to centralize information and expertise concerning industry practices and trends. It will also coordinate with OCIE, and with FINRA, to generate quality referrals and investigations. Although still in the formative stages, the creation of a broker-dealer task force, presumably to be staffed with investigators exclusively dedicated to ferreting out unlawful conduct by broker-dealers, suggests that there will be an increase in enforcement cases brought against broker-dealers and associated market participants.[19]

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[19] By way of comparison, in 2010, the SEC's Enforcement Division created the Asset Management Unit to focus on the activities of investment advisory firms. In the year prior to the creation of that unit (FY 2009), the Enforcement Division reported filing 76 new enforcement matters (or 11% of the total cases filed in FY 2009) involving investment advisers or investment companies. With the exception of a small decline in FY 2013, that number has increased steadily in each year since the creation of the specialized unit. In FY 2013, the SEC filed 140 new enforcement matters (or 21% of its total cases filed for the year) involving investment advisers or investment companies.

Prosecuting Large and Small Violations of the Law

In October 2013, Chair White reaffirmed the agency's commitment to pursuing violations large and small, and stated that the SEC would look for violations in all corners of the market.[20] She analogized this enforcement strategy to the so-called "broken windows" strategy employed by former New York Mayor Rudolph Giuliani and made it clear that the SEC would pursue strategic prosecution of smaller violations in an effort to send a broader deterrent message. It remains to be seen whether the "broken windows" approach will result in a significant increase of cases charging less egregious violations of the law. One area where it may be reflected is in an increase of cases charging regulatory lapses initially identified through the SEC's examination program. For example, it would not be surprising to see additional cases enforcing the investment adviser compliance rule.

First Deferred Prosecution Agreement with an Individual

In 2010, then SEC Enforcement Director Khuzami announced a Cooperation Program, pursuant to which the SEC developed a range of cooperation tools for use in enforcement cases. These include formal cooperation agreements, non-prosecution agreements and deferred prosecution agreements ("DPAs"). In May 2011, the SEC entered into its first DPA with a company in an FCPA case (Tenaris). In November 2013, the agency announced that it had entered into its first DPA with an individual, Scott Herckis. Herckis was a hedge fund administrator whose "voluntary and significant cooperation" assisted the SEC in filing an emergency enforcement action alleging that the Heppelwhite Fund's founder and manager had misappropriated $1.5 million from the hedge fund and overstated its performance to investors. Under the DPA, Herckis admitted that he had aided and abetted violations of the federal securities laws, agreed not to serve as a fund administrator or to be associated with any broker, dealer, investment adviser or registered investment company for five years, and agreed to pay approximately $50,000 in disgorgement of fees he received as the fund administrator.[21]

A deferred prosecution agreement is an agreement between a cooperating individual or entity and the Commission itself (as opposed to the SEC Staff). Thus, the announcement of the first DPA with an individual signals that a majority of the Commissioners are comfortable with the SEC's use of this cooperation tool with respect to both companies and individuals. Now that the Staff has obtained Commission approval for use of a DPA with an individual, we should expect to see a measured but increasing use of this tool in the resolution of enforcement cases involving misconduct by individuals.

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[20] *See* Chair White's remarks at the Securities Enforcement Forum (Oct. 9, 2013), *available at:* http://www.sec.gov/News/Speech/Detail/Speech/1370539872100.

[21] *See* SEC Press Release, "SEC Announces First Deferred Prosecution with Individual" (Nov. 12, 2013), *available at:* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540345373.

Looking Ahead

To date, SEC enforcement priorities under Chair White have included an increased emphasis on deterrence, consistent with a robust and effective enforcement program. In 2013, this emphasis on deterrence was reflected in aggressive charging decisions; the pursuit of stronger sanctions, including substantial monetary penalties; creative use of customized remedies, including conduct-based injunctions; the requirement of admissions as a condition of settlement in certain cases; and close coordination with other regulatory and criminal law enforcement agencies, both domestic and international. In the upcoming year, we are likely to see more of the same, together with a renewed focus on cases involving financial fraud and accounting issues, microcap fraud, broker-dealers, and market structure, as well as the increased use of data analytics to focus enforcement resources on practices and industries where there is the highest likelihood or risk of misconduct.

SEC Enforcement Priorities Relating to Broker-Dealers

Based upon our review of currently available information, we believe the following list reflects some of the SEC's top priorities for broker-dealer enforcement:

Sales Practices/Fraud

- Unsuitable recommendations of higher yield and complex products (e.g., leveraged ETFs and structured products), as well as the adequacy of due diligence;
- Suitability, representations, advertising or churning when recommending the movement of assets from a retirement plan to an IRA rollover account;
- Suitability/disclosures around variable annuity buyback offers;
- Microcap fraud and pump and dump schemes;
- Affinity fraud targeting seniors or other groups; and
- Unregistered entities engaged in the sale or promotion of unregistered offerings or other unusual capital raising activities.

Trading

- Best execution;
- Market access controls related to erroneous orders;
- Use of technology, with a focus on algorithmic and high frequency trading;

- Information leakage and cyber security;
- Market manipulation (practices such as marking-the-close, parking, spoofing, and excessive markups and markdowns);
- Relationships between broker-dealers and Alternative Trading Systems (“ATS”); and
- Application of the Market Access Rule (15c3-5) to proprietary trading.

Internal Controls

- Effectiveness of key control functions (liquidity, credit, and market risk management practices);
- Internal audit function;
- Valuation practices; and
- Overall compliance function.

Anti-Money Laundering

- Focus on AML programs of proprietary trading firms that allow customers direct access to the markets from higher-risk jurisdictions.

Fixed Income Market

- The structure and transparency of the market and its effect on the quality of executions;
- Use of filters by market participants to control what is displayed by fixed income ATSs; and
- Focus on transparency in the municipal securities market.

Broker-Dealer Enforcement Actions[22]

Broker-Dealer Registration

Last year, the SEC brought two interesting cases in the broker-dealer registration area.

A. *SEC v. Banc de Binary Ltd., No. 2:13-cv-00993 (D. Nev. June 5, 2013)*

1. On June 5, 2013, the SEC filed a civil injunctive action against a Cyprus-based company, Banc de Binary Ltd. ("Banc de Binary"), charging that it acted as an unregistered broker when it illegally offered and sold binary options to investors in the United States through the Internet, You Tube videos and spam emails without having registered those securities. The Commodity Futures Trading Commission announced a parallel action against Banc de Binary on the same day. Subsequently, on July 30, 2013, the SEC obtained a preliminary injunction against Banc de Binary. In granting the injunction, the court found that binary options are "securities" that the SEC has power to regulate under the Exchange Act.

2. Binary options are not options to buy or sell a security but are instead wagers that turn on the price of the reference stock. The purchaser receives no current or future interest in the stock but makes a bet on whether the price of the stock will increase or decrease. When the option becomes due, investors either receive a pre-determined amount of money, if the value of the underlying asset increased over a fixed period, or no money at all if it decreased.

3. The SEC alleged that Banc de Binary induced U.S. investors to create and deposit money into accounts with the company and then purchase binary options. According to the complaint, Banc de Binary attracted, among others, unemployed and low net worth customers.

4. The complaint seeks disgorgement and prejudgment interest, financial penalties, and injunctions against Banc de Binary, among other relief. On June 6, 2013, the SEC and the CFTC issued a joint Investor Alert detailing the potential risks of binary options, and warning investors that if they purchase the securities through unregistered brokers, they may not have the full protection of the federal securities and commodities laws.

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[22] Unless otherwise apparent from the context of the descriptions of the actions, the cases described herein are settlements in which respondents neither admitted nor denied the allegations against them.

B. *In re William M. Stephens, Admin. Pro. File No. 3-15233 (Mar. 8, 2013)*

1. On March 8, 2013, the SEC instituted a settled administrative proceeding against William M. Stephens, an independent consultant hired by Ranieri Partners LLC, a private equity firm, to find and introduce potential investors in private funds managed by Ranieri Partner's affiliates, alleging that Stephens exceeded his role as a "finder" and operated as an unregistered broker in violation of Section 15(a) of the Exchange Act. In a separate settled administrative proceeding instituted the same day, the SEC charged Ranieri Partners and Donald W. Phillips, a senior managing partner in the firm, with having aided and abetted Stephens' violations. The firm was also charged with having caused those violations.

2. Stephens is a former investment strategist at a registered investment adviser who had previously been found to have violated the federal securities laws and had been barred for two years from associating with a registered investment adviser, with the right to re-apply. He never re-applied. The SEC alleged that Phillips, who was a friend of Stephens and was aware of his disciplinary history with the SEC, caused Ranieri Partners' affiliates to hire Stephens as an independent consultant to act as a finder for potential investors in private funds managed those affiliates. According to the SEC, Phillips told Stephens that his responsibilities were limited to contacting potential investors to arrange introductions, and that he was not permitted to provide offering materials directly to potential investors or to contact investors directly to discuss his views of the funds.

3. The SEC alleges that Phillip and others at Ranieri Partners thereafter sent Stephens with materials relating to the funds, including the private placement memorandum, subscription documents and presentation and marketing materials. The SEC alleged that Stephens in turn provided these materials to investors, met with potential investors both with and without Phillips after making initial introductions, and encouraged at least one investor to consider adjusting its asset allocation plan to facilitate an investment in the funds. In so doing, he engaged in the business of effecting transactions in securities without first being registered as a broker.

4. In its proceeding Ranieri Partners and Phillips, the SEC alleged that Ranieri Partners caused Stephens to violate the Exchange Act by failing to adequately oversee his conduct and by allowing him to obtain PPMs and subscription agreements. Phillips was alleged to have willfully aided and abetted Stephens' violations because he failed to stop Stephens even after he learned of Stephens' conduct.

5. For his actions, Stephens was ordered to cease-and-desist continued violations of the Exchange Act and barred from 1) participating in any offering, 2) associating with a broker, dealer, investment adviser, statistical rating organization, or similar entity, and 3) serving or acting as an employee, officer, director, board member, investment adviser, depositor, or principal underwriter for any registered investment adviser, depositor, or principal underwriter. Stephens was also ordered to pay disgorgement of $2.4 million and prejudgment interest of $410,248, but those payments were waived because of his financial condition.

6. Ranieri Partners was ordered to cease-and-desist continued violations of the Exchange Act and to pay a civil penalty of $375,000. Phillips was ordered to cease-and-desist continued violations of the Exchange Act, suspended for nine months from associating in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or statistical rating organization, and ordered to pay a $75,000 civil penalty.

Financial Crisis-Related Cases

As noted above, the SEC's financial crisis-related caseload appeared to decline last year as the events of 2008 passed the five-year mark. Below are several actions initiated in this area by the SEC in 2013 or concluded last year.

A. *In the Matter of Merrill Lynch, Pierce, Fenner & Smith, Inc., Exchange Act Release No. 34-71051 (Dec. 12, 2013)*

1. As part of the SEC's continued enforcement efforts involving securitized debt offerings related to the financial crisis, the Commission filed a settled administrative action against Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") finding that Merrill Lynch made faulty disclosures in 2006 and 2007 about collateral selection for two collateralized debt obligations ("CDOs"), Octans I CDO Ltd. and Norma CDO I Ltd., and maintained inaccurate books and records on a third, Auriga CDO Ltd. In particular, the SEC found that Merrill Lynch failed to inform investors that an undisclosed third party, Magnetar Capital LLC ("Magnetar"), a hedge fund that had bought the equity in the transaction, had exercised significant influence over the selection of the CDO's collateral.

2. A CDO is a special purpose vehicle that issues debt to investors and uses the proceeds to invest in fixed income securities or loans. The CDO's debt is issued in multiple tranches featuring varying levels of risk and reward. The highest rated (known as the "senior" tranche) is usually prioritized first for repayment; the tranche with

the lowest risk rating (and thus with the highest rate of return), referred to as the “equity” tranche, is last in the priority of repayment. Intermediate risk-tranches are referred to as “mezzanines” and are typically rated BBB and BBB-.

3. The CDOs at issue were backed by credit default swaps (“CDSs”). A CDS is a derivative through which two parties transfer the risk of ownership of a particular “reference” obligation, in this case the RMBS. The SEC found that Merrill Lynch and Magnetar agreed that Magnetar would play a significant role in the structure and composition of the portfolio thus giving Magnetar substantial leverage in the assembly of the CDO transactions, including influence over portfolio composition.

4. With respect to the Octans I CDO, worth $1.5 billion, the SEC found that Magnetar had a contractual right to object to the inclusion of capital in the Octans I CDO, selected by an ostensibly independent collateral manager. However, according to the SEC, the disclosure Merrill Lynch provided to investors failed to mention Magnetar’s role.

5. As to the Norma CDO offering, worth $1.5 billion, the SEC found that Merrill Lynch recommended that NIR Capital Management LLC (“NIR”) be named the designated collateral manager. The SEC found, however, that Magnetar was extensively involved and played a significant role in the collateral selection for this offering, a fact absent from Merrill Lynch’s investor disclosure which inaccurately stated that the collateral would consist of a portfolio selected by NIR and made no mention of Magnetar.

6. Regarding both offerings, the SEC found that information regarding Magnetar’s involvement in the structuring of the securities would have been important to investors; investors would have wanted to know that someone other than the collateral manager, in particular an equity investor with interests no necessarily the same as their own, had played a significant role in selecting collateral for the portfolio.

7. The SEC also found that Merrill Lynch violated certain books-and-records requirements of the Exchange Act of 1934 in connection to the Auriga CDO, a $1.5 billion offering that closed December 20, 2006. In the Aurgia CDO, which was managed by a Merrill Lynch affiliate, Merrill Lynch had agreed to pay interest on the accumulated warehoused assets to Magnetar, but avoided recording these warehouse trades at the time they occurred, until after the CDO priced and it became clear the warehouse trades would be included in the asset portfolio underlying the CDO.

8. In its Order, the SEC alleged that the foregoing conduct constituted willful violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933, as well as Section 17(a)(1) of the Exchange Act of 1934 and Rule 17a-3(a)(2).

9. Merrill Lynch consented to entry of the administrative order, requiring that it cease and desist from future violations of the federal securities laws, and agreed to disgorgement of $56,286,000, prejudgment interest of $19,228,027, and a civil monetary penalty of $56,286,000 (for a total of payment of $131,800,027).

B. *In the Matter of Joseph G. Parish III and Scott H. Shannon, Admin. Proc. File No. 3-15643 (Dec. 12, 2013)*

1. On the same day the Commission announced the Merrill Lynch case summarized above, the SEC filed a settled administrative proceeding against Joseph G. Parish III and Scott H. Shannon, the managing partners of NIR Capital Management, LLC. The SEC alleged that Parish and Shannon failed to disclose to the investors in a collateralized debt obligation for which NIR was the collateral manager that a third party had rights over selection of the collateral.

2. The SEC alleged that disclosures given to CDO investors stated that NIR, as designated collateral manager, was the sole party selecting CDO assets. According to the SEC, however, Shannon and Parish allowed a hedge fund, Magnetar Capital LLC, to select certain assets of the CDO and influence the selection of others. Magnetar's involvement in the collateral selection process was contrary to NIR's attestation in the collateral management agreement that it would act in good faith and exercise reasonable care in selecting the assets that would comprise the CDO's portfolio.

3. The SEC also alleged that Shannon and Parish knew that, in addition to purchasing equity in the CDO, Magnetar would take short positions on the CDO debt. They should have realized as a result that Magnetar's interests were at odds with the interests of potential investors in the debt tranches of the CDO.

4. The SEC alleged that Parish willfully violated Section 206(2) of the Advisers Act and that Shannon willfully violated Sections 206(1) and 206(2) of the Advisers Act.

5. Parish and Shannon consented to dissolving NIR within 75 days of the issuance of the Order. Shannon consented to a cease and desist order, a two-year industry bar, disgorgement and prejudgment interest of $140,662 and a civil monetary penalty of

$116,553. Parish consented to a cease and desist order, a one-year industry bar, disgorgement and prejudgment interest of $140,662 and a civil monetary penalty of $75,000.

6. Also noted, the SEC also settled with Merrill Lynch, who structured and marketed the CDO, in a related action.

C. *SEC v. Bank of America, N.A., et al., 3:13-cv-447 (W.D.N.C. Aug. 6, 2013)*

1. In August 2013, the SEC charged Bank of America, N.A. ("BANA"), Banc of America Mortgage Securities, Inc. ("BOAMS"), and Merrill Lynch Pierce, Fenner & Smith Inc. f/k/a Banc of America Securities LLC ("BAS") (collectively the "Bank of America Entities") with making material misrepresentations and omissions in connection with residential mortgage-backed securities ("RMBS") backed by more than $855 million of residential mortgages, known as BOAMS 2008-A.

2. The SEC's lawsuit alleges that the Bank of America Entities portrayed BOAMS 2008-A as being safe, conservative investments backed by higher credit quality mortgage loans ("prime" loans as opposed to loans of lower credit quality known as "subprime "or "Alt-A" loans). The SEC alleges that, in fact, an unprecedented portion of the mortgage loans backing the security had originated through mortgage brokers unaffiliated with the Bank of America Entities (referred to as "wholesale channel" or "wholesale loans"). The Bank of America Entities were allegedly aware that these loans were more likely to be subject to material underwriting errors, become severely delinquent, fail early in the life of the loan, or prepay. According to the complaint, by the time the BOAMS 2008-A was being offered and sold, the CEO of BAC had referred to the wholesale loans as "toxic waste" and BAC had closed its wholesale channel.

3. In addition, the SEC's complaint alleges that the Bank of America Entities misrepresented in its public filings and loan tapes provided to investors that the mortgage loans backing BOAMS 2008-A were underwritten in accordance with BANA's underwriting standards when the Bank of America Entities knew or should have known that material percentage of the loans had significant deviations from BANA's guidelines. The SEC also alleged that the loan tapes provided to investors and rating agencies also miscalculated the debt-to income and original combined loan-to-value ratios of the mortgages backing BOAMS 2008-A, making them appear less risky.

4. The SEC is charging each of the Bank of America Entities with violating Sections 17(a)(2) and 17(a)(3) of the Securities Act and BAS and BOAMS with violating Section 5(b)(1) of the Securities Act and seeking disgorgement, penalties, and a permanent injunction.

5. The SEC's action is pending.

D. *In the Matter of UBS Securities LLC, Admin. Proc. File No. 3-15407 (Aug. 6, 2013)*

1. The SEC filed a settled administrative proceeding against UBS Securities LLC ("UBS") alleging that UBS made misstatements in marketing materials and failed to disclose the receipt of certain payments to prospective investors in connection with the structuring and marketing of a largely synthetic collateralized debt obligation known as ACA ABS 2007-2 ("ACA 07-2").

2. According to the Order, ACA Management ("ACA"), the collateral manager for ACA 07-2, was responsible for the price that ACA 07-2 paid for its collateral, which consisted largely of credit default swaps. Typically with CDOs the collateral manager would solicit bids to obtain the highest yield in the form of periodic interest payments or "running spreads." In the case of ACA 07-2, however, UBS and ACA agreed on a bifurcated bidding process through which ACA had bidders split their bid into a fixed running spread and "upfront points," a one-time cash payment. The running spread and the upfront points together were equal to the yield on the CDS collateral. The spread went to ACA 07-2, whereas the upfront points were retained by UBS.

3. The SEC alleged that UBS failed to disclose its retention of $23.6 million in upfront payments in the process of acquiring credit default swaps as collateral for ACA 07-2. Rather than transferring the proceeds of these upfront payments to ACA 07-2 when the collateral was contributed to the CDO, UBS retained the full amount of upfront payments in addition to its disclosed fee of $10.8 million.

4. The SEC also alleged that UBS failed to disclose its retention of the upfront payments in marketing and offering materials for ACA 07-2, and that such materials inaccurately represented that ACA 07-2 had to acquire all collateral at either fair market value or the price it was acquired by UBS. The SEC alleged that this representation was inaccurate because ACA 07-2 did not receive the $23.6 million in upfront cash kept by UBS as an additional undisclosed fee, and the collateral was not acquired at fair market value. Further, ACA employees allegedly were aware that UBS would not transfer the upfront points to ACA 07-2 and that the collateral was not acquired "on an 'arm's-length basis' for fair market value" as required by the

indenture and the best execution obligation contained in the collateral management agreement to which ACA was subject.

5. The SEC's Order charged that UBS violated Sections 17(a)(2) and (3) of the Securities Act and negligently caused ACA to violate Section 206(2) of the Advisers Act.

6. Pursuant to the settlement, UBS consented to a cease and desist order and a censure, and to pay a disgorgement of $34,408,185, prejudgment interest of $9,719,002.24, and a civil monetary penalty of $5,655,000.

E. *SEC v. Goldman Sachs & Co. and Fabrice Tourre, 1:10-cv-03229 (S.D.N.Y. Apr. 16, 2010)*

1. In April 2010, the SEC charged Goldman Sachs & Co. ("GS&Co") and a GS&Co Vice President, Fabrice Tourre ("Tourre"), with securities fraud for making material misstatements and omissions in connection with the marketing of a synthetic collateralized debt obligation ("CDO") called ABACUS 2007-AC1 ("ABACUS") that was tied to the performance of subprime residential mortgage-backed securities ("RMBS").[23] On August 1, 2013, after a trial lasting almost three weeks, the jury returned a verdict finding Tourre liable for six of seven counts of securities fraud.

2. According to the SEC, the marketing materials for this CDO represented that the reference portfolio of RMBS underlying the CDO was selected by ACA Management LLC ("ACA"), without disclosing the fact that a large hedge fund, Paulson & Co. Inc. ("Paulson"), with adverse economic interest to the investors in the ABACUS CDO played a significant role in the portfolio selection process.

3. The SEC alleged that Tourre, as the employee principally responsible for the ABACUS CDO, prepared the marketing materials and communicated directly with investors. The SEC alleged that Tourre knew of Paulson's undisclosed adverse economic interest and its role in the portfolio selection process. The SEC also alleged that Tourre misled ACA into believing that Paulson's interests in the portfolio selection process were aligned with ACA's when in fact they were in direct conflict. By January 29, 2008, 99% of the portfolio underlying the CDO had been downgraded causing the investors of ABACUS to lose over $1 billion and yielding a project of approximately $1 billion for Paulson.

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[23] In 2010, GS&Co agreed to settle with the SEC by paying a $550 million fine, leaving Tourre as the remaining defendant in the lawsuit.

4. In June 2013, Tourre moved for summary judgment arguing, among other matters, that he could not be liable for offers made to two foreign investors under the Supreme Court's 2010 decision, Morrison v. National Australia Bank Ltd, which limited the reach of Section 10(b) of the Securities Exchange Act and Rule 10b-5 to transactions involving the purchase or sale of a security in the United States or listed on an American stock exchange. The court rejected Tourre's motion, distinguishing between Section 10(b) and Section 17(a) of the Securities Act and holding that Section 17(a) prohibits both the offer or sale of any securities and that a domestic offer may be actionable regardless of whether it results in a sale provided the offer is, in fact, domestic. Tourre worked in New York at all relevant times. The case proceeded to trial.

5. As noted above, at the conclusion of the trial, the jury returned a verdict finding Tourre liable for six of seven counts of securities fraud. Tourre's motion for a new trial or dismissal of the verdict was recently denied.

Insider Trading

In 2013, there was a decline in the absolute number of insider trading cases brought by the SEC (44 cases last year versus 58 in FY 2012). Nevertheless, the Commission continued its aggressive campaign against insider traders, filing cases against a wide range of entities and individuals, including financial professionals, hedge fund managers, and corporate insiders. To support its enforcement efforts in this priority area, in 2013, the SEC developed the Advanced Bluesheet Analysis Program, an initiative to analyze data on specific securities transactions provided to the SEC by market participants and identify suspicious trading in advance of market moving events.

Gaining widespread attention in 2013 was the SEC's enforcement efforts, in collaboration with the Department of Justice, against individuals and entities associated with Steven A. Cohen, the founder and owner of S.A.C. Capital Advisors LLC (which later became S.A.C. Capital Advisors L.P.) and a number of affiliated investment advisers which managed portfolios with assets exceeding $15 billion. These actions ultimately led to the SEC filing a highly publicized contested administrative action against Cohen, individually, in July 2013, alleging that Cohen failed reasonably to supervise two portfolio managers employed by subsidiaries of S.A.C. Capital and controlled by him.

In addition to its intense pursuit of Cohen and related entities, the SEC continued its crackdown on individuals and entities associated with the widespread insider trading scheme led by Raj Rajaratnam and his hedge fund advisory firm Galleon Management, including a recent action against Rajaratnam's younger brother, among several other cases.[24]

Finally, in a litigated case, on October 16, 2013, after five years of contentious litigation, including an important Fifth Circuit ruling on what might constitute an agreement to keep information confidential and not trade while in possession of material nonpublic information for purposes of insider trading liability, a federal jury found billionaire Dallas Mavericks owner Mark Cuban not liable for insider trading.

These matters and several other insider trading cases are described below.

A. *SEC v. Sigma Capital Management LLC, 13 CV 1740 (S.D.N.Y. Mar. 15, 2013) and SEC v. Michael Steinberg, 13 CV 2082 (S.D.N.Y. Mar. 29, 2013)*

1. In March 2013, the SEC charged hedge fund advisory firm Sigma Capital Management ("Sigma") and Michael Steinberg, a portfolio manager employed by Sigma, with trading on insider information ahead of quarterly announcements by Dell and Nvidia Corporation. The SEC alleged that Steinberg's conduct caused Sigma and its affiliate S.A.C. Capital Advisors to generate more than $6 million in illegal profits and avoid losses. The SEC additionally named two affiliated hedge funds – Sigma Capital Associates and S.A.C. Select Fund – as relief defendants that unjustly benefited from Sigma's violations. S.A.C. Select Fund was managed by S.A.C. Capital, controlled by Steven A. Cohen.[25]

2. The SEC's complaint alleges Sigma received material nonpublic information concerning quarterly earnings at Dell and Nvidia through one of its research analysts Jon Horvath, and traded on that information in advance of the companies' earnings

[24] The SEC has reported charging a total of 34 firms and individuals in Galleon related enforcement matters. *See* Morgan Lewis's 2011 and 2012 Year in Review outlines for a discussion of some of these cases.

[25] The first of the actions against entities and individuals associated with Cohen was filed in November 2012 against hedge fund advisory firm CR Intrinsic Investors, LLC, an affiliate of S.A.C. Capital, its former portfolio manager Matthew Martoma, along with a medical consultant for an expert network firm, for their roles in an insider trading scheme involving a clinical trial for an Alzheimer's drug being jointly developed by two pharmaceutical companies. In March 2013, CR Intrinsic agreed to the largest insider trading settlement in SEC history. The terms of the settlement required CR Intrinsic to pay more than $600 million in disgorgement, penalties and prejudgment interest. *See SEC v. CR Intrinsic Investors, LLC et al.*, 12 Civ. 8466 (S.D.N.Y. Mar. 18, 2013). Also in November 2012, the Department of Justice filed parallel criminal charges against Mr. Martoma; he was recently found guilty of certain charges.

announcements. The SEC alleged that Horvath relayed this information to Steinberg, who was a portfolio manager at Sigma, who then executed trades in Dell and Nvidia, and tipped other portfolio managers this same information. In a parallel action, the U.S. Attorney's Office for the Southern District of New York charged Steinberg with one count of conspiracy to commit securities fraud and four counts of securities fraud.

3. According to the SEC, Horvath received the material nonpublic information from a group of analysts at other hedge funds who regularly shared information. The Commission has alleged that the inside information Horvath obtained differed significantly from the predictions of market analysts.

4. The SEC's complaints charged Sigma and Steinberg with violating Section 17(a) of the Securities Act, and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.

5. On March 28, 2013, the Honorable Harold Baer of the United States District Court for the Southern District of New York approved settlements reached with the SEC and Sigma in which the hedge fund along with the two relief defendant affiliates, Sigma Capital Associates and S.A.C. Select Fund, agreed to pay nearly $14 million in disgorgement and civil penalties to settle the charges.

6. With respect to Steinberg, the SEC alleged that he understood that he was receiving quarterly financial information from Horvath that originated from insiders within Dell and Nvidia. For example, the SEC alleged that Steinberg was copied on an email from Horvath that stated that he had a "2nd hand read from someone at the company [Dell]" and indicated that the company was going to miss gross margins. Based on this and other inside information, Steinberg executed illegal trades in advance of at least four quarterly earnings announcements during 2008 and 2009 and, on at least one occasion, arranged to share the Dell inside information with another portfolio manager at Sigma.

7. Although the SEC's case against Mr. Steinberg is continuing, on December 18, 2013, in the criminal case, a jury convicted Mr. Steinberg on four counts of securities fraud charges and a conspiracy charge for insider trading. He is scheduled to be sentenced on April 25, 2014.

B. *In the Matter of Steven A. Cohen, Admin. Proc. File No. 3-15382 (July 19, 2013)*

1. As noted above, borne out of its ongoing settlements and litigation with S.A.C. related entities and individuals, on July 19, 2013, the SEC instituted public administrative proceedings against chief executive officer of S.A.C. Capital Advisors, LLC (S.A.C.), Steven A. Cohen, for failing to supervise Mathew Martoma and Michael Steinberg, two senior portfolio managers whom Cohen supervised, and prevent them from insider trading under his watch.

2. Martoma and Steinberg were portfolio managers who worked at CR Intrinsic Investors, LLC and Sigma Capital Management, LLC respectively, subsidiaries of S.A.C. Cohen allegedly received highly suspicious information from Martoma and Steinberg, as well as their colleagues, regarding trades related to pharmaceutical companies Elan and Wyeth, as well as Dell Computers, which, according to the SEC, should have caused any reasonable hedge fund manager to investigate the basis for the trades. Instead, Cohen allegedly ignored numerous red flags and praised the portfolio managers for the trades at issue and rewarded Martoma with a $9 million bonus for his work on Elan and Wyeth. Cohen's hedge funds earned profits and avoided losses of more than $275 million as a result of the trades. The SEC seeks to bar Cohen from overseeing investor funds.

3. According to the SEC's Order, Cohen required Martoma and Steinberg to provide to him updates on their stock trading generally and the reasons for their trades. The SEC alleges that both individuals were at various times unlawfully in possession of material nonpublic information regarding the Elan, Wyeth, and Dell trades, and that they traded on this information. The SEC alleges that Martoma received material nonpublic information from Dr. Sidney Gilman who served as a consultant to Elan and Wyeth and who participated in a clinical trial of a drug with the potential to treat patients with Alzheimer's. The SEC alleges that Steinberg received material nonpublic information about an upcoming earnings announcement at Dell from a research analyst who reported to him, and that Steinberg traded on this information.

4. The SEC's Order alleges that on several occasions Martoma and Steinberg provided information to Cohen indicating their potential access to inside information to support their trading. For example, Cohen was aware that Martoma and other portfolio analysts had spoken to a doctor who "implied" that he had seen confidential clinical trial data compiled by Elan and Wyeth. With respect to the Dell trades, the SEC alleges that a research analyst forwarded to Cohen an email on which Steinberg was copied suggesting that the

research analyst had a read from "someone at the company" that Dell's gross margins would miss analyst expectations. The SEC alleges that Cohen failed to take any action to determine whether these employees under his supervision were engaged in unlawful conduct or in possession of material nonpublic information and failed to take reasonable steps to prevent violations of the federal securities laws.

5. Notably, the SEC alleges in its Order that other CR Intrinsic analysts raised concerns to Cohen about Martoma being in possession of undisclosed data on the results of the trial.

6. The SEC's Order alleges that Cohen failed reasonably to supervise Martoma and Steinberg with a view toward preventing their violations of the antifraud provisions of the federal securities laws. The administrative proceedings will determine what relief is in the public interest against Cohen, including financial penalties, a supervisory and financial services industry bar, and other relief.

7. As noted, late last December a federal jury convicted Steinberg of four securities fraud charges and a conspiracy charge for insider trading related to his use of material nonpublic information during his tenure at Sigma Capital. In February 2014, Martoma was convicted of two counts of securities fraud and one count of conspiracy.

C. *SEC v. Rajarengan (a/k/a Rengan) Rajaratnam, 13 CV 1894 (S.D.N.Y. Mar. 21, 2013)*

1. In 2013, the SEC continued to bring charges related to the massive insider trading ring spearheaded by Raj Rajaratnam and hedge fund advisory firm Galleon Management. The SEC reports having charged a total of 34 firms and individuals in its Galleon-related enforcement actions involving more than 15 companies and illicit profits of more than $96 million.

2. On March 21, 2013, the SEC filed a civil complaint against Rajarengan "Rengan" Rajaratnam, the younger brother of Raj Rajaratnam and former principal of Galleon Management, L.P., for illegally trading in the securities of five public companies (Polycom, Inc., Hilton Hotels, Corporation, Clearwire Corporation, Akamai Technologies, Inc., and Advanced Micro Devices, Inc.). According to the complaint, this trading was part of larger insider trading scheme masterminded by his brother to elicit confidential information through relationships with highly placed sources in public companies. On the same day, the U.S. Attorney's Office for the Southern District of New York charged Rengan Rajaratnam with

one count of conspiracy to commit securities fraud and six counts of securities fraud arising from the same allegations.

3. Rengan was a former portfolio manager at the now-defunct hedge fund advisory firms Sedna Capital Management, LLC and Galleon Management The SEC alleges that from 2006 to 2008 Rengan Rajaratnam repeatedly received material non-public information from his brother about each of these companies from corporate professionals and others who had duties to keep the information they were passing along to Raj confidential. The SEC alleges that Raj tipped this information to Rengan, who in turn, traded on the information to reap more than $3 million in illicit gains in his personal brokerage account, and hedge funds that he managed at Sedna and Galleon.

4. For example, the SEC alleges that Raj received material nonpublic information from a friend at a global consulting firm that was advising Advanced Micro Devices, Inc. in connection with AMD's negotiations to obtain an investment from two foreign sovereign entities. The SEC alleges that in a recorded telephone conversation, the consultant told Raj that the parties had "shaken hands" and "they're going ahead with the deal" so "I think, uh, you can now just buy . . . ." Later that day, during another recorded conversation, Raj told Rengen, "I just heard that . . . AMD had a handshake with the Arabs . . to put six billion dollars. I'm buying some, I am buying two-fifty for you, O.K." Rengen replied, "alright, thanks a lot, man. I appreciate it." The SEC's complaint alleges that Galleon's trading records reflect a 250,000 share purchase of AMD stock that day, and on the following days, Rengan caused Galleon hedge funds to purchase shares of AMD stock.

5. The SEC's complaint charges Rengan with violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder for insider trading and for tipping others material nonpublic information, and seeks a final judgment permanently enjoining Rengan from future violations of these provisions of the federal securities laws, ordering him to disgorge his ill-gotten gains plus prejudgment interest, and ordering him to pay financial penalties. The SEC's litigation against Rengan is ongoing.

D. *SEC v. Scott London, et al., CV 13 -02588 (C.D.C. Apr. 11, 2013)*

1. On April 11, 2013, the SEC charged Scott London, a former partner at KPMG, and his friend Bryan Shaw, with insider trading on material nonpublic information relating to five KPMG audit clients in advance of earning and merger announcements. The SEC alleges that London tipped Shaw with confidential details about these audit clients and enabled Shaw to make more than $1.2 million in illicit

profits trading ahead of earnings or merger announcements. In exchange for these tips, Shaw gave London more than $50,000 in cash, a $12,000 Rolex watch, and tickets to entertainment events.

2. In a parallel action, the U.S. Attorney's Office for the Central District of California charged London with one count of conspiracy to commit securities fraud through insider trading. On July 1, 2013, London pleaded guilty to these charges. Shaw pleaded guilty in May 2013 to a conspiracy charge.

3. According to the SEC's complaint, London provided Shaw with extensive material, nonpublic information he obtained as a result of his role as the lead partner on several KPMG audits, including Herbalife and Sketchers USA. London also was KPMG's account executive for Deckers Outdoor Corp. For example, the SEC alleges that London provided material nonpublic information to Shaw about numerous earnings announcements and releases of financial results of these companies. Shaw then traded on this information prior to these releases and announcements. Additionally, London provided Shaw with information about impending mergers involving two KPMG audit clients, RSC Holdings and Pacific Capital.

4. In an Appendix A to the SEC's complaint, London offers an explanation and apology for his conduct. London claims to have tipped his friend in order to allow Shaw to overcome financial hardship when his business hit tough times during the economic downturn. In an Appendix B to the SEC's complaint, Shaw offers that his actions were "incredibly stupid" and discloses that he had cooperated with the FBI, SEC, and Department of Justice in their respective investigations.

5. On September 27, 2013, the SEC instituted public administrative proceedings and cease-and-desist proceedings against London based upon London's violations of auditor independence rules for accepting cash and other things of value for tips he provided to Shaw on at least 18 occasions concerning the KPMG five audit clients at issue in his insider trading scheme. The SEC found that, among other things, London had engaged in improper professional conduct and ordered that, among other things, London be denied the privilege of appearing or practicing before the Commission as an accountant.

E. *SEC v. Mark Cuban, Civil Action, 08-CV-2050-D (N.D. Tex., filed Nov. 17, 2008)*

1. On November 17, 2008, the SEC filed a civil complaint in the United States District Court for the Northern District of Texas against billionaire Dallas Mavericks owner Mark Cuban (Cuban) alleging that Cuban engaged in insider trading in securities issued by Mamma.com, Inc., a Montreal-based Internet company. The SEC alleged that, after Cuban agreed to maintain the confidentiality of material, nonpublic information concerning a planned private investment in public equity ("PIPE") offering by Mamma.com, he sold his stock in the company without first disclosing to Mamma.com that he intended to trade on the information thereby avoiding substantial losses when the stock price declined after the PIPE was publically announced. The SEC maintained that Cuban was liable for insider trading under the misappropriation theory in violation of the antifraud provisions of the federal securities laws. Cuban moved to dismiss the SEC's complaint. The question presented by Cuban in his motion to dismiss was whether the SEC adequately alleged that Cuban undertook a duty of non-use of information. The court ruled that the SEC had not and granted Cuban's motion to dismiss. The court found that, at most, the complaint alleged an agreement to keep the information confidential but did not include an agreement not to trade. Therefore, the court held that a confidentiality agreement itself is insufficient to create a duty to abstain from trading.

2. In October 2009, the SEC appealed the district court's decision to the Fifth Circuit. The SEC argued that (1) a confidentiality agreement does create a duty to disclose or abstain from trading, (2) regardless, the confidentiality agreement had in fact contained an agreement not to trade on the information and that agreement would create such a duty, and (3) Cuban obtained additional material, nonpublic information from the company, which relied on Cuban's acknowledgment that he could not sell his shares until after the public announcement.

3. In response, Cuban disputed the SEC's version of the facts and relied on *United States v. O'Hagan,* 521 U.S. 642 (1997), in which the Supreme Court held that a mere agreement to keep information confidential fails to give rise to a duty of disclosure and, therefore, cannot form the basis for insider trading liability under a misappropriation theory. Cuban argued that if an insider trading claim is based solely on the violation of an agreement, that agreement must create a duty of disclosure concerning the defendant's trading. Claiming that the SEC was improperly trying to convert an alleged breach of contract into securities fraud, Cuban

argued that courts have uniformly held that a confidentiality agreement does not create the type of relationship of trust and confidence that gives rise to a duty of disclosure. Cuban also argued that, even assuming that a duty did exist, the agreement was to keep the information confidential not to withhold from trading on it.

4. The Fifth Circuit took a different path than that of the district court and held that the allegations, viewed together, could support the finding that there was an agreement between Cuban and Mamma.com not to trade on the confidential information regarding the PIPE, that the understanding was more than a simple confidentiality agreement not to disclose the information, and that Cuban had gained access to additional confidences and nonpublic information concerning the PIPE by virtue of conversations with the company's CEO who believed that Cuban had acknowledged that he was forbidden from trading on the information. The court noted that the paucity of jurisprudence on the question of what constitutes a relationship of trust and confidence and the fact bound nature of determining whether such a duty exists. Accordingly, the appellate court vacated the decision of the lower court and remanded the case for further proceedings.

5. The matter ultimately proceeding to trial, and on October 16, 2013, a federal jury found Mark Cuban not liable for insider trading.

F. *SEC v. One or More Unknown Traders in the Securities of Onyx Pharmaceuticals, Inc. (July 3, 2013)*

1. On July 3, 2013, the SEC simultaneously filed a complaint against unknown traders who traded in call option contracts of Onyx Pharmaceuticals and obtained an emergency court order to freeze the assets of traders using foreign accounts to reap potentially illegal profits by trading in advance of the June 30, 2013 announcement from Onyx that it received and subsequently rejected an offer from Amgen, Inc. to acquire all of Onyx's outstanding shares and share equivalents. The freeze also prohibited the traders from destroying any evidence in advance of the SEC's investigation. In its press release announcing the action, the Commission underscored that it will not hesitate to freeze assets of suspicious foreign traders when the timing and size of the trades indicate that they were misusing inside information.

2. The SEC alleged that the unknown traders placed risky bets that Onyx's stock price would increase following the announcement by purchasing call options in the three trading days before the public announcement of the Amgen offer. The SEC asserted that the trades were highly suspicious in that they deviated from historical

trends for these series of calls collectively earning the defendants approximately $4.6 million in profits in just three days. Because they were equity call options, the defendants had the right, but not the obligation, to purchase Onyx's stock at a set price, otherwise known as a strike price, for a certain period of time.

3. The SEC further alleges that the defendants were in possession of material nonpublic information about the potential acquisition at the time they purchased the Onyx call options, many of which were out-of-the-money. This demonstrated a risky bet that the Onyx stock would be certain to increase. The timing, size, and profitability of the trades in addition to the riskiness of the options involved and the fact that one of the traders' accounts had not traded in Onyx call options for at least a year prior to June 26, 2013 collectively raised red flags.

4. On November 21, 2013, U.S. District Judge Paul Oetken for the United States District Court for the Southern District of New York dismissed the SEC's complaint upon the motion to dismiss filed by two individuals who identified themselves as two of the Defendants in the SEC's complaint. The court held that the facts, without evidence of material nonpublic information to or from specific individuals, did not support a reasonable inference of insider trading. Furthermore, in dismissing the SEC's complaint, the court held that the SEC failed to allege facts that raise a strong inference of scienter; even if there was a tip of material nonpublic information (which the Court found that it was not reasonable to infer from the facts alleged by the SEC) the allegations do not support a reasonable inference it was in violation of a fiduciary duty owed to a source of the information or that the defendants knew or should have known about the violation. The court rejected the SEC's request that the court infer that someone tipped the defendants about the Amgen offer in violation of a duty of confidentiality, and on that basis, to infer that the tippers was deceptively breaching a fiduciary duty, and on that basis, to infer that the Defendants knew or were reckless in not knowing that the tip (whatever its content) constituted material nonpublic information, and that Defendants knew or should have known that the tipper (whoever she was) breached a fiduciary duty by passing on the tip. The court reasoned that piling inference upon inference in that way did not provide the requisite strong support for the inference that the Defendants acted with scienter. Lastly, the judge held that the trades themselves were not risky enough to be characterized as highly suspicious.

5. In dismissing the SEC's complaint, Judge Oetken granted the Commission 30 days to file an amended complaint. In doing so, the judge also sustained the freeze of assets for an additional 30 days because the SEC nevertheless demonstrated at least a tenuous basis for a possible inference that the defendants were liable tippees.

6. On December 23, 2013, the SEC filed an amended complaint against the two known Defendants.

G. *In the Matter of Richard Bruce Moore, Admin. Proc. File No. 3-15307 (Apr. 26, 2013); In re Richard Bruce Moore, No. 13 Civ. 2514 (S.D.N.Y. Apr. 26, 2013)*

1. On April 26, 2013, the SEC filed a settled Administrative Proceeding against Richard Bruce Moore permanently barring him from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent, among other things. The Order was based on a final judgment entered by consent against Moore in the United States District Court for the Southern District of New York permanently enjoining him from future violations of the antifraud provisions of the federal securities laws.

2. Moore, a Canadian citizen and former investment banker at Canadian Imperial Bank of Commerce ("CIBC"), was charged with misappropriating information from CIBC related to a firm client, the Canada Pension Plan Investment Board ("CPPIB") and its Managing Director, involving a large potential corporate acquisition offer from the Canada Pension Plan Investment Board and a Canadian private equity firm to Tomkins, plc, a United Kingdom engineering and manufacturing company. Specifically, the SEC alleged that through his friendship with the Managing Director, Moore was able to piece together various snippets of information, such as the fact that the Managing Director had been traveling extensively to the United Kingdom and witnessing the Managing Director and the Chief Executive Officer of Tomkins together at charity event Moore also had attended. According to the complaint, Moore then used the information he learned to purchase American Depositary Receipts of Tomkins, plc on the New York Stock Exchange in advance of a July 19, 2010 announcement by Tomkins that the firm had received an offer to be acquired by CPPIB and a private equity firm, and realized profits of nearly $164,000.

3. Moore, without admitting or denying the allegations in the Commission's complaint, consented to the entry of a final judgment, enjoining him from future violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and ordering him to pay $163,293 in disgorgement and a onetime civil penalty also in the amount of $163,293.

Market Access Rule

Last year the SEC brought its first Market Access Rule case.

A. *In the Matter of Knight Capital Americas LLC, Admin Proc. File No. 3-15570 (Oct. 16, 2013)*

1. On October 16, 2013, the SEC announced that Knight Capital Americas LLC ("Knight") had agreed to settle charges that it had violated the Market Access Rule, Exchange Act Rule 15c-3-5, which requires brokers and dealers to have risk controls in place before providing their customers with access to the market. In its first enforcement case under the 2010 rule, the SEC alleged that Knight failed to have in place a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory and other risks of market access. As a result, Knight failed to prevent a significant error in the operation of its automated routing system for equity orders, with the result that the system routed millions of erroneous orders into the market, leaving Knight with billions of dollars in unwanted equity positions and over $460 million in losses associated with those positions.

2. According to the SEC, Knight deployed new software code in its automated, high speed, algorithmic order routing system, called SMARS, as part of an effort designed to facilitate customer participation in the Retail Liquidity Program ("RLP") at the New York Stock Exchange. The new code was deployed in stages on eight servers on successive days. In that process, a Knight technician failed to copy the new code to one of the designated servers. Knight did not have written procedures requiring a review of the deployment, and a second technician did not review it. As a result, Knight did not detect that the new SMARS code had not been installed on the eighth server, or that unused code from a discontinued parent-child order functionality that had not been removed from that server. On August 1, 2012, the first day that Knight received RLP-eligible orders, the seven servers on which the new SMARS code had been deployed processed them correctly; orders sent to the eighth server triggered the obsolete code, which caused the generation of millions of erroneous child orders and, consequently, millions of erroneous executions. In the 45 minutes before the error was detected, Knight inadvertently

accumulated a net long position of approximately $3.5 billion in 80 stocks and a net short position of approximately $3.15 billion in 74 securities.

3. The SEC also alleged that on the morning of August 1, 2012, before the markets opened, a Knight system generated nearly 100 automated emails that referenced SMARS and identified an error. Although email messages of the kind generated on that date were not designed as alerts and were not generally reviewed by recipients when received, the SEC alleged that the messages were caused by the deployment failure and provided a potential opportunity to detect and correct the coding errors prior to the market open and to diagnose the problem after the open.

4. In addition to the market access rule violation, the SEC also charged Knight with violations Rules 200(g) and 203(b) of Regulation SHO. Without admitting or denying the SEC's findings, Knight consented to an order imposing a censure and ordering it to cease and desist from committing or causing of the noted rules, and agreed to pay a $12 million penalty and retain an independent consultant to conduct a comprehensive review of the firm's controls and procedures to ensure compliance with the market access rule.

Markups and Markdowns

Cases involving the fees charged by broker-dealers have always been a part of the Commission's enforcement program. The case described below is an example of the SEC's efforts in this area.

A. *In the Matter of ConvergEx Execution Solutions LLC ("CES"), ConvergEx Global Markets Limited ("CGM"), G-Trade Services LLC ("G-Trade") Admin. Proc. File No. 3-15654 (Dec. 18, 2013); Jonathan Samuel Daspin Admin. Proc. File No. 3-15652 (Dec. 18, 2013); and Thomas Lekargeren Admin. Proc. File No. 3-15653 (Dec. 18, 2013)*

1. The SEC filed a settled administrative proceeding involving G-Trade, CES, and their Bermuda-based offshore affiliate, CGM, that alleged that they charged undisclosed mark-ups and mark-downs for executing certain trading orders routed to CGM for certain institutional clients. In separate matters, the SEC also settled with two former employees, Daspin, CGM's head of trading, and Lekargeren, a sales trader.

2. According to the Order, from 2006 through 2011, certain divisions of CES and G-Trade routinely routed customer orders, including orders for U.S. equities, to CGM, which executed them on a riskless principal basis through a local broker. On certain orders, CGM then added a mark-up or mark-down on the price of the

security received from the local broker as CGM's compensation. The executions were then delivered back to the U.S. affiliate, which confirmed the trades to customers.

3. As noted in the SEC's Order, CES and G-Trade charged a commission, which was disclosed to clients on trade confirmations. Moreover, CES and G-Trade disclosed in their client agreements and other documents that they might route orders to third parties, including affiliates, for execution and that those third parties could trade as principal and earn a spread. However, the amount of mark-ups or mark-downs that CGM added to the price received from the local broker in Bermuda was not disclosed. The Order alleged that the difference between the price received from the local broker and the price confirmed to the client was retained by CGM as profit.

4. According to the Order, the practice of charging additional mark-ups or mark-downs was at times employed when it was believed that certain clients were unlikely to detect the mark-ups or mark-downs. For example, CGM did not charge additional mark-ups for certain clients who monitored real-time trade data throughout the day. At times, CGM also suspended the practice of charging additional mark-ups during times of the day when it knew certain clients were scrutinizing the broker-dealers' executions.

5. The Order also alleged that in certain instances, false and misleading statements were made to clients when they asked about the compensation, and certain clients were provided with false trading data to cover up the undisclosed mark-ups.

6. The Order also charged the broker-dealers with failing to seek best execution for certain clients' orders as a result of employing this practice.

7. The broker-dealers admitted to the facts underling the SEC's charges and acknowledged that the conduct violated the federal securities laws, agreeing to pay disgorgement and prejudgment interest of $87,424,429, and a penalty of $20 million. G-Trade and CES agreed to certain undertakings related to their compliance and ethics programs. In determining the penalty amount, the SEC considered the broker-dealers' substantial cooperation and significant remedial measures, including conducting an internal investigation, closing the Bermuda affiliate, and terminating certain employees.

8. In separate settled matters, Daspin and Lekargeren, who also cooperated in the SEC's investigation, admitted to taking steps to conceal the practice of taking mark-ups and mark-downs. Daspin

agreed to pay a total of $1,111,550 in disgorgement and prejudgment interest, and Lekargeren agreed to pay a total of $117,042 in disgorgement and prejudgment interest. The SEC considered their cooperation in determining the appropriate settlement.

9. In a parallel action, the Department of Justice resolved its investigation concerning CGM and ConvergEx Group, LLC and the two individuals. The Department of Justice resolutions were narrower than the SEC Order, focusing on the limited number of specific instances of misconduct in which clients were affirmatively misled. CGM pled guilty to certain charges; CGM and ConvergEx Group also agreed to pay a total of $43.6 million in criminal penalties, forfeitures, and restitution. In announcing a deferred prosecution agreement with ConvergEx Group, the DOJ highlighted the internal review undertaken by the firm; its extraordinary and continuing cooperation; its extensive remediation, including terminating various employees, stopping all trading at CGM and voluntarily relinquishing the subsidiary's Bermudan securities registration; enhancing its compliance program and internal controls; and the guilty plea by CGM and its agreement to pay restitution and the substantial sanctions imposed in the SEC action.

Microcap Securities

Microcap securities enforcement is a top priority at the Commission. Here is one example of its efforts in this area.

A. *SEC v. Carillo Huettel, No. 13-CV-1735 (S.D.N.Y. Mar. 15, 2013)*

1. On March 15, 2013, the SEC filed a complaint against several Canadian stock promoters, their American attorneys, Bahamian broker-dealer Gibraltar Global Securities, and Gibraltar's president for their roles in a "pump and dump" scheme.

2. The SEC's complaint alleged that the stock promoters took control of two companies and used false and misleading tactics to attract investors in order to artificially increase ("pump") their value. Specifically, the promoters are alleged to have used two websites that they controlled to send false and misleading emails to potential investors and directly solicited investors to purchase within the United States, using what they claimed was "independent research" to induce investments. Once the investments caused the value of the companies to increase, the promoters secretly sold ("dumped") their shares for a profit.

3. The SEC also charged two American attorneys with fraud, alleging that they helped the promoters acquire the companies, drafted false and misleading documents, provided the promoters with knowingly false legal opinions, and allowed the promoters to use an attorney-client trust account to funnel and disperse proceeds from the pump and dump scheme.

4. Gibraltar was also accused of facilitating the stock promoters "dump" by providing false information and affidavits to American broker-dealers for the purpose of concealing that the stock promoters were the beneficial owners of the company stock being sold. The SEC charged Gibraltar's president with fraud as the signatory to a number of false affidavits attesting to the beneficial ownership of the company shares.

5. The SEC charged all defendants with distributing unregistered shares in violation of Sections 5(a) and (c) of the Securities Act of 1933. all but two violating, and aiding and abetting others' violations of the antifraud provisions of the Securities Act and the Securities Exchange Act. The SEC seeks disgorgement of ill-gotten gains, with interest, civil monetary penalties, and to bar all individual defendants from participating in future offerings or serving as public company officers or directors. In related litigation, the president of one of the traded companies settled claims that he also made false statements in connection with the pump and dump scheme.

Mortgage-Backed Securities

In 2013, the SEC continued to bring actions in the mortgage-backed securities area.

A. *SEC v. RBS Securities Inc., Civil Action No. 3:13-cv-01643 (D. Conn. Nov. 7, 2013)*

1. On November 7, 2013, the SEC charged the Royal Bank of Scotland ("RBS") with misleading investors about the quality and safety of their investments in a 2007 subprime residential mortgage-backed security offering by inaccurately claiming that the subprime loans backing the $2.2 billion dollar offering were "generally" in compliance with the lender's underwriting guidelines, notwithstanding that due diligence before the offering showed that approximately 30% of the loans fell short of the guidelines and should have been excluded from the offering.

2. The SEC alleges that the May 2007 offering, called Soundview Home Loan Trust 2007-OPT1 (the "Subprime Offering"), was backed by loans selected by RBS from two large pools of subprime

loans it had purchased from Option One Mortgage Corporation ("Option One"). In connection with that purchase, RBS had hired a third party to conduct due diligence on a limited sample of the Option One loans. The diligence showed that Option One had failed materially to comply with its underwriting guidelines in connection with 186 loans in the sample, or nearly 30%. According to the SEC, the number of deviations from guidelines was as much as six times higher than in prior Option One loan pools.

3. Although RBS excluded the 186 loans from the Subprime Offering, it did not take adequate steps to identify and exclude additional loans. The SEC alleges that RBS knew or should have known, based on the failure rate in the sampling, that there were likely a substantial number of additional subprime loans in the pool that materially deviated from the underwriting guidelines, yet included false and/or misleading statements in a prospectus supplement for the Subprime Offering, including a statement by Option One that the loans included in the offering were "generally in accordance with Option One's underwriting guidelines." The SEC also alleges that RBS failed to disclose the historically high rate of guideline deviations among the Option One loans included in the Subprime Offering, creating a misimpression of the quality of those loans and the likelihood of their repayment.

4. The SEC alleges that RBS's failure to replace the loans that materially deviated from the guidelines with acceptable loans caused investor losses of at least $80 million.

5. Without admitting or denying the SEC's allegations, RBS agreed to a final judgment ordering that it disgorge $80.3 million, plus prejudgment interest of $25.2 million, and pay a civil penalty of $48.2 million.

B. *SEC v. Jesse C. Litvak, 3:13-cv-00132 (D. Conn Jan. 28, 2013)*

1. In January 2013, the SEC charged Jesse Litvak, a senior trader at Jefferies & Company, Inc. ("Jefferies"), with securities fraud by misleading investors about the market price for mortgage-backed securities ("MBS").

2. Litvak's responsibilities included arranging trades of MBS between his customers. His customers included Legacy Securities Public-Private Investment Program ("PPIP") funds that were established by the United States government to help support the market for MBS in the financial crisis. The SEC alleges that to negotiate higher sales prices to customers in over 25 trades between 2009 and 2011, Litvak misrepresented the prices Jefferies had paid for the securities. In doing so, he also misled customers as to how

much Jefferies was receiving as compensation for arranging the trade.

3. In some instances he led customers to believe that he was arranging an MBS trade between two customers by fabricating negotiations with an outside party to purchase the security and resell it to customers. In fact, there was no seller and Litvak was selling the MBS from the firm's inventory.

4. According to the SEC, Litvak's fraudulent conduct generated more than $2.7 million in additional revenue for Jefferies, which improperly increased his performance-based bonus.

5. The SEC charged Litvak with violating the antifraud provisions of the federal securities laws and seeks disgorgement, penalties, and a permanent injunction. Simultaneously with the SEC's action, the U.S. Attorney's office for the District of Connecticut filed criminal charges against Litvak.

Municipal Securities

Last year, the SEC brought several significant municipal securities actions. Examples involving broker-dealers are summarized below. The Commission has indicated that it intends to continue to focus in this area in the 2014.

A. *SEC v. City of Victorville, et al., EDCV 13-776 (C.D. Cal. Apr. 29, 2013)*

1. In April 2013, the SEC charged the City of Victorville (the "City"), the Southern California Logistics Airport Authority (the "Airport Authority"), Keith Metzler, the Director of Economic Development for the City, Kinsell, Newcomb & De Dios ("KND"), the underwriter of the Airport Authority's bonds, Jeffrey Kinsell, the owner of KND, Janees Williams, Vice President of KND, and KND Affiliates, LLC ("KND Affiliates"), an entity partially owned by Kinsell, with defrauding investors by vastly inflating valuations of property securing an April 2008 municipal bond offering resulting in false and misleading disclosures regarding tax increment and debt service ratios in the Official Statement provided to investors in the April 2008 offering.

2. The SEC's action focused on tax increment municipal bonds issued by the Airport Authority, which financed redevelopment projects in the region, including the construction of four airplane hangars on a former Air Force base. The tax increment bonds were secured by, and to be repaid from, property-tax increases attributable to increases in the assessed value of property in the redevelopment project area.

3. The SEC alleged that the Airport Authority was forced to refinance part of the debt incurred to construct the hangers and other redevelopment projects by issuing additional bonds in April 2008. The financing was premised, in part, on an assessed value of $65 million for the four hangars. The SEC alleged that Metzler, Kinsell, and Williams knew the assessed value of the hangars was vastly inflated, yet they each withheld this information from investors resulting in materially misleading disclosures and a substantially oversized bond offering while misleading investors about the value of the security available to repay them.

4. As to underwriter KND, the SEC alleged that as underwriters for the bond offering, KND made an implicit representation that it reviewed the accuracy of the Authority's Official Statements, including the debt service schedule and formed a reasonable basis for belief in the truthfulness and completeness of the key representations made in the offering documents. According to the SEC, these implicit representations were false. In addition, the SEC alleged that Kinsell and Williams substantially assisted in preparing the Official Statement and each knew the offering relied of the inflated value of the hangers.

5. The SEC also separately alleged that Kinsell, KND, and KND Affiliates misappropriated more than $2.7 million of the bond proceeds by taking unauthorized and undisclosed construction and property management fees in connection with the hangar construction project.

6. The SEC's complaint charges the Airport Authority, Kinsell, KND, and KND Affiliates with violating the antifraud provisions of the federal securities laws, KND with violating rules of the Municipal Rulemaking Board and section 15B(c)(1) of the Exchange Act, and the City, KND, and the individual defendants with aiding and abetting various violations. The SEC seeks disgorgement, financial penalties, and permanent injunctions against all the defendants, in addition to disgorgement from relief defendant KND Holdings, the parent company of KND

B. *In the Matter of City Securities Corporation and Randy G. Ruhl, Admin. Proc. File No. 3-15390 (July 29, 2013)*

1. The SEC filed a settled administrative action against City Securities Corporation ("City Securities"), a registered broker-dealer and municipal bond underwriter, and Randy G. Ruhl, the executive vice president and supervisor of City Securities' Public Finance & Municipal Bond Department, in connection with misrepresentations related to a $31 million negotiated municipal 2007 bond offering by West Clark Community Schools ("West Clark"), a school district in

Indiana. According to the SEC, an examination conducted by OCIE uncovered evidence that the school district had falsely stated to investors in its offering materials that it had been properly providing annual financial information and material event notices that were required as part of prior bond offerings. In fact, West Clark never submitted any annual reports or notices of its failure to submit these reports as was required pursuant to its continuing disclosure obligations.

2. City Securities, acting as the sole underwriter for the 2007 bond offering by West Clark Community Schools, assisted in compiling information for, and reviewing a near-final version of, the Official Statement used in connection with the offering. The SEC found that City Securities conducted inadequate due diligence, and as a result, failed to form a reasonable basis for believing the truthfulness of material statements in the Official Statement, in particular, West Clark's assertion that it had complied with its prior continuing disclosure undertakings, a fact City Securities could have easily verified. Instead, City Securities relied solely upon the representations of West Clark, which the SEC alleged was insufficient.

3. The SEC also found that City Securities failed to have adequate procedures in place that provide reasonable assurance it will receive prompt notice of required disclosure submissions by an issuer, or notice of an issuer's failure to make required submissions. As to Ruhl, the SEC found that as supervisor of the Department, he failed to take reasonable steps to ensure that City Securities had reasonable compliance procedures and failed to provide training to Department employees regarding issuer continuing disclosure obligations and an underwriter's obligation to ensure that the issuer is providing annual reports and other required information to investors.

4. In addition, the SEC found that City Securities mischaracterized expenses related to charitable donations, entertainment, and travel for "Printing, Preparation and Distribution of Official Statements" to obtain reimbursement from bond proceeds without the issuers' knowledge. The SEC also found that City Securities approved and provided improper entertainment and gratuities, including multi-day, out-of-state golf trips and tickets to multiple sporting events, to representatives of issuers of municipal bonds.

5. City Securities, without admitting or denying the findings, consented to an SEC order to cease and desist from committing or causing any violations of the antifraud provisions of the federal securities laws, Section 15B(c)(1) of the Securities Exchange Act, Rule 15c2-12, and MSRB Rules G-17 and G-20. City Securities agreed to pay

disgorgement of $238,000, prejudgment interest of $41,446, and civil penalties of $300,000. In addition, City Securities was ordered to retain an independent compliance consultant to conduct a comprehensive review of the firm's municipal securities business to ensure compliance with the federal securities laws.

6. Ruhl, without admitting or denying the findings, similarly consented to cease and desist from committing or causing any violations of the same provisions of the federal securities laws and MSRB rules, and to pay disgorgement of $18,155, prejudgment interest of $2,165, and civil penalties of $18,155. Ruhl also consented to a collateral bar from associating with any broker, dealer, investment adviser, and investment company (among others), with the right to reapply for reentry after one year, and was permanently barred from association in a supervisory capacity with these entities.

7. The SEC also charged West Clark with falsely claiming in the Official Statement that it was fully compliant with the annual disclosure obligations it had agreed to in prior offerings as required under the federal securities rules and regulations, the first time the SEC has charged a municipal issuer for this offense. Without admitting or denying the SEC's findings, West Clark consented to an order to cease and desist from committing or causing violations of the antifraud provisions of the federal securities laws.

C. *In the Matter of Piper Jaffray & Co. and Jane Towery, Admin. Proc. File No. 3-15603 (Nov. 5, 2013)*

1. The SEC filed a settled administrative action against registered broker-dealer and municipal securities underwriter Piper Jaffray & Co. ("Piper"), and Jane Towery, Piper's lead investment banker, in connection with misrepresentations in connection with $41.77 million in Bond Anticipation Notes ("BANs") issued by the Greater Wenatchee Regional Events Center Public Facilities District ("District") to finance a multi-use arena and ice hockey rink (the "Regional Center") in 2008. Piper served as sole underwriter for the offering and Towery as lead investment banker. The SEC also separately filed a settled administrative action against the District finding that the District made false statements in the project's Official Statement and withheld negative information from the document giving investors a false picture of the future performance of the project. In 2011, the District defaulted on its principal payments due on the BANs.

2. In connection with the offering, the District hired a developer to build and operate the Regional Center. The developer, with the assistance of an independent financial consultant requested by the local city council, prepared a series of financial projections for

operation of the Center to be used both for budgeting purposes and inclusion in the project's Official Statement. After several independent reviews, the independent consultant raised questions in two separate reports about the economic viability of the project and identified anomalies in the financial projections. Nevertheless, the District stated in the Official Statement that no financial advisor had reviewed the financial projections to verify the reasonableness of the developer's financial projections, assumptions, and conclusions. In addition, the District failed to include negative information in the Official Statement regarding its ability to obtain permanent financing to repay the BANs, or that the developer had revised the latest projections upward upon the District's urging.

3. The SEC found that Piper and Towery failed to conduct adequate due diligence into the work of the developer or its business and further failed to conduct adequate due diligence concerning the offering to form a reasonable basis for believing the truthfulness and completeness of material statements in the Official Statement related to the offering. For example, while conducting only a cursory review of the offering materials, Piper and Towery did not inquire about prior financial projections or ask to review the independent consultant's review of the projections despite knowing that the review had occurred. In addition, Piper and Towery failed to examine initial drafts of the Official Statement which warned that the District could have difficulty in repaying the BANs in the event of a default; thus, the final Offering Statement failed to disclose to purchasers of the BANs materials information concerning the District's ability to repay them.

4. Based on the conduct described above, the SEC found that Piper and Towery willfully violated Sections 17(a)(2) and (3) of the Securities Act. Piper agreed to be censured and pay civil penalties of $300,000. The SEC's order requires Piper to retain an independent consultant to conduct a review of the firm's municipal underwriting due diligence policies and procedures as well as its supervisory policies and procedures related to municipal underwriting due diligence.

5. Towery agreed to be censured and to cease and desist from committing or causing violations of the antifraud provisions of the federal securities laws. Towery agreed to pay a civil penalty of $25,000 and to limit her activities as an associated person of a broker-dealer or municipal adviser for one year by refraining from any contact with any existing or prospective municipal issuer client and making decisions on behalf of a broker-dealer in connection with due diligence activities.

6. The SEC also charged the District with falsely claiming in the Official Statement that there had been no independent reviews of the financial projections for the Regional Center. In addition to agreeing to undertake remedial measures, the District agreed to pay a civil penalty of $20,000. This case marked the first time the SEC imposed a financial penalty against a municipal issuer.

D. *In the Matter of Neil M. M. Morrison, Admin. Proc. File No. 3-15049 (May 23, 2013)*

1. On May 23, 2013, the SEC filed a settled administrative cease-and-desist order imposing remedial sanctions on respondent Neil M.M. Morrison, a former vice president in the investment banking division of Goldman, Sachs & Co. ("Goldman Sachs"), a broker-dealer and registered municipal securities dealer.

2. According to the Order, from 2008 to 2010, Morrison engaged in a pay-to-play scheme involving the Massachusetts Treasurer's Office (the "Treasurer's Office"). Specifically, while employed by Goldman Sachs to solicit municipal securities underwriting business from the Treasurer's Office, Morrison was also "substantially engaged" in political campaigns of Timothy P. Cahill, then-Treasurer of Massachusetts, including Cahill's 2010 gubernatorial campaign.

3. Morrison's work on Cahill's campaign gave him complete access to Cahill and his staff, who often provided him with information about the office's internal deliberations involving selection of securities underwriters.

4. While engaged with Cahill's campaign, Morrison violated a number of rules promulgated by the Municipal Securities Rulemaking Board. For instance, Morrison worked on campaign activities during Goldman Sachs work hours and while using Goldman Sachs' resources, such as phones, email, and office space. Morrison's work for Cahill's campaign was broad and included fundraising, drafting speeches, writing campaign memos, preparing for press conferences, approving personnel decisions, among other things. This conduct constituted valuable "in-kind" campaign contributions attributable to Goldman Sachs in violation of MSRB pay-to-play rules, which prohibits brokers, dealers, or municipal securities dealers from engaging in municipal securities business with an issuer within two years after making any contribution to an official of such issuer. In addition, Morrison made an indirect contribution to Cahill's campaign through an intermediary. Finally, Morrison solicited campaign contributions for Cahill while Goldman Sachs was soliciting municipal underwriting business from the Treasurer's Office.

5. Morrison's conduct on behalf of Goldman Sachs violated MSRB Rules G-8, G-9, G-17, and G-37. Additionally, the Order found that Morison willfully aided and abetted Goldman Sachs' violations of these same rules, as well as Section 15B(c)(1) of the Exchange Act of 1934.[26]

6. Pursuant to the Order, Morrison was barred from association with a broker dealer, investment adviser, or municipal securities dealer, prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser, or principal underwriter, for a registered investment company, among other things, and was ordered to pay a civil penalty of $100,000.

Mutual Fund Market Timing

The case described below involves a long-running mutual market timing action.

A. *SEC v. Frederick J. O'Meally, No. 06-CV-6483-LTS (S.D.N.Y. Aug. 28, 2006)*

1. On March 12, 2013, the SEC obtained a final judgment against Frederick O'Meally, a former representative of Prudential Securities, Inc., finding that he violated Section 17(a) of the Securities Act of 1933 by using deceptive trading practices to evade trading blocks designed to prevent market timing trading in mutual funds. The judgment followed a month-long federal trial in which a jury returned a verdict for the SEC, finding that O'Meally had negligently violated Sections 17(a)(2) or (3). The final judgment concludes seven years of litigation relating to market timing activity by various representatives of Prudential's broker-dealer services.

2. The case arose in 2006 when various representatives of Prudential Securities were accused of using deceptive trade practices to evade trading blocks established by a number of mutual funds. The blocks were put in place by the mutual funds to prevent market timing – the frequent buying, selling, or exchanging of mutual fund shares to exploit inefficiencies in mutual fund pricing. Market timing is not illegal, but according to the SEC can be harmful to the traded fund.

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[26] As we reported in our 2012 Year in Review, in September 2012, the SEC filed a settled administrative proceeding against Goldman for alleged pay-to-play violations based upon Mr. Morrison's conduct. *In the Matter of Goldman, Sachs & Co.*, Admin. Proc. File No. 3-15048 (Sept. 27, 2010).

3. Both Prudential and the other involved representatives had previously settled enforcement and administrative proceedings against them in connection with this matter. As part of its settlement, Prudential agreed to pay $270 million to recoup losses of investors in the targeted mutual funds that were harmed by the market timing activity.

4. The final judgment orders O'Meally to pay $444,836 in disgorgement of ill-gotten gains, $258,402 in pre-judgment interest, and $60,000 in civil penalties. Judge Laura Taylor Swain noted that civil penalties against O'Meally were limited because he was not found to have willfully violated the law and denied the SEC's request for a permanent injunction against him on the same grounds.

5. O'Meally has appealed the jury's verdict.

National Securities Exchanges

Continuing a trend, in 2013, the SEC filed administrative proceedings against two registered national securities exchanges. Both cased resulted in monetary penalties being imposed upon the exchanges.

A. *In the Matter of Chicago Board Options Exchange, Inc., et al., ("CBOE") Admin. Proc. File No. 3-15353 (June 11, 2013)*

1. The SEC filed a settled administrative proceeding against the CBOE and an affiliate, C2 Options Exchange, Inc. ("C2") in connection with systemic breakdowns in their self-regulatory organization ("SRO") regulatory and compliance functions. The failures included (i) failing to enforce SEC rules by not adequately investigating a member firm's compliance with Regulation SHO ("Reg SHO"); (ii) interfering with the SEC's Division of Enforcement staff's Reg SHO investigation of the same member firm; and (iii) failed to adequately enforce Reg SHO.

2. According to the Order, CBOE had an ineffective surveillance program that failed to detect wrongdoing despite numerous red flags of abusive short selling. In 2008, CBOE moved its surveillance program from one department to another which, according to the SEC, negatively impacted CBOE's Reg SHO enforcement program. The CBOE staff failed to adequately review or understand exception reports generated for Reg SHO surveillance, and did not conduct adequate investigations regarding firms' responses to inquiries regarding Reg SHO compliance. The Order alleged that the CBOE's staff lacked sufficient understanding of the requirements of Reg SHO and never received formal training.

3. The Order alleged that CBOE, after receiving a compliant in February 2009 about a possible short sale violation involving a member firm, conducted an inadequate investigation by employees who were confused about the requirements of Reg SHO. The Order alleged that CBOE employees improperly focused on whether the member firm's customer was in violation of Reg SHO and failed to conduct analysis on whether the member firm itself was in violation of Reg SHO.

4. The Order also alleged that CBOE interfered with a Commission investigation by failing to provide information requested by the SEC Staff and by improperly assisting the member firm with its Wells submission made to the SEC Staff by providing information and edits for the submission.

5. The Order charged CBOE with failing to enforce Reg SHO because its surveillance system failed to detect a single violation, despite the presence of numerous red flags indicating that member firms were not complying with Reg SHO.

6. After the SEC started its investigation, CBOE and C2 undertook a series of voluntary remedial efforts, including, among other things, mandatory annual training for all staff responsible for surveillance and investigation, and updating and implementing additional written policies. The SEC took these remedial measures into account at the time of the settlement when it decided not to impose limitations on the activities, functions or operations of CBOE.

7. CBOE agreed to pay a $6 million penalty and implement significant remedial measures. This was the first time the SEC imposed a financial penalty on an exchange for violations related to the exchange's regulatory oversight function. C2 also agreed to significant remedial undertakings.

B. *In the Matter of NASDAQ Stock Market, LLC ("NASDAQ") and NASDAQ Execution Services, LLC, ("NES") Admin. Proc. File No. 3-15339 (May 29, 2013)*

1. The SEC filed a settled administrative proceeding against NASDAQ, and NES, charging the exchange with violating order priority rules in connection with the Facebook, Inc. ("Facebook") initial public offering as a result of design limitations in NASDAQ's IPO cross system.

2. In a typical IPO, NASDAQ's IPO trading platform analyzes orders to determine the price at which the largest number of shares will trade and then NASDAQ's matching engine matches buy and sell orders at that price. (The matching of the buy and sell orders is referred to

as the “cross.”) NASDAQ’s system then runs a “validation check,” which will fail if one of the orders used to set the price of the cross is cancelled. If the validation check fails, the cross volume and price is recalculated.

3. The Order alleged that the design of the system created the risk that if orders continued to be cancelled during each re-calculation, a repeated cycle of validation checks and re-calculations – known as a “loop” – would occur, preventing NASDAQ’s system from: (i) completing the cross; (ii) reporting the price and volume of the executions in the cross; and (iii) commencing normal secondary market trading. This risk was greatest during crosses in which a large volume of orders and cancellations were submitted in rapid succession.

4. According to the Order, on the day of the Facebook IPO, a delay in the validation check process resulting from the large number of Facebook orders caused such a loop to occur and delayed normal trading. However, in the course of taking corrective actions, NASDAQ failed to identify that the cross application was stuck in a loop.

5. NASDAQ’s inability to identify and escape from the loop caused the cross application to fall 19 minutes behind orders received, a discrepancy that ultimately resulted in 30,000 marketable orders not being included in the cross. These “stuck” orders were either cancelled or not released to the secondary market for over two hours, causing violations of NASDAQ’s price/time priority rule (Rule 4757(a)(1)).

6. Additionally, the Order alleged that NASDAQ failed to deliver trade confirmations to members who placed orders in the cross, so members could not determine what position they held in Facebook securities.

7. The same design errors that kept the “stuck” orders out of the cross also caused NASDAQ’s error position in Facebook to become significantly larger than originally thought. Substantially more shares in sell orders than buy orders had been cancelled during the delay, so NASDAQ assumed a short position of more than 3 million Facebook shares, valued at approximately $129 million. NASDAQ ordered its third-party broker to cover the position, but because the share price had dropped, NASDAQ profited by $10.8 million on the short position. This activity also caused NES to violate SEC rules regarding effecting transactions without minimum required net capital.

8. In addition, the Order alleged that errors in the Facebook IPO cross spilled over, causing trading in Zynga stock to be halted twice. According to the Order, when Zynga was able to start trading again, 365 cross-eligible orders in Zynga were processed in violation of price/time priority rules. When trading in Zynga restarted, NASDAQ violated its own rules by failing to require a five minute member's only order-setting period before terminating the halt.

9. Finally, the Order charged violations of Reg SHO and Reg NMS for failing to establish price test requirements and establish, maintain, or enforce policies and procedures designed to prevent trade-throughs.

10. The administrative settlement required that NASDAQ pay a $10 million civil monetary penalty and that it cease and desist from future violations of Sections 19(g)(1) and Regulations SHO and NMS, and that NES must cease and desist from future violations of Section 15(c)(3).

Regulation M

As evidence of its "broken windows" approach to enforcement, last year the SEC announced a large sweep involving compliance with the requirements of Rule 105 of Regulation M. These matters are summarized below. In addition, a separate case involving a registered investment adviser is also summarized in this section.

A. *Regulation M - Rule 105 Cases*[27]

1. On September 17, 2013, the SEC commenced enforcement actions against 23 firms, charging that they violated Rule 105 of Regulation M of the Securities Exchange Act of 1934. The firms include registered investment advisors, asset managers, registered broker-dealers, and trading firms. All but one of the firms agreed to settle with the SEC and agreed to pay more than $14.4 million in the aggregate in monetary penalties.

2. The firms charged in these cases allegedly participated in public stock offerings after having sold short the same security during the Rule 105 restricted period. In an accompanying Press Release announcing the enforcement actions, the SEC's Co-Director of Enforcement noted that "the benchmark of an effective enforcement program is zero tolerance for any securities violations, including violations that do not require manipulative intent." He cited the

[27] For a list of the cases brought by the SEC, see the Press Release entitled "SEC Charges 23 Firms with Short Selling Violations in Crackdown on Potential Manipulation in Advance of Stock Offerings," (Sept. 17, 2013).

"streamlined investigation and resolution" of the Rule 105 violations underlying the actions as a "clear message that firms must pay the price for violations while also conserving agency resources."

3. At same time the SEC announced the enforcement actions, its National Examination Program released a "risk alert" to firms reminding them of their compliance obligations under the Rule and the risks of non-compliance. The SEC said in the risk alert that it has collected in excess of $42 million for violations of Rule 105 since January 2010.

B. *In the Matter of UBS O'Connor, LLC, Proc. File No. 3-15347 (June 3, 2013)*

1. The SEC commenced a settled administrative proceeding against UBS O'Connor, LLC, an Illinois-based registered investment adviser, for its alleged violations of Rule 105 of Regulation M.

2. The SEC alleged that between 2009 and 2011, UBS O'Connor violated Regulation M 16 times by effecting short sales in funds it managed during the restricted period defined in the Rule 105 (typically the five business days prior to the pricing of a firm commitment public offering, ending with the pricing date) and subsequently purchasing shares of the securities in the offering, without an applicable exception.

3. In the relevant time period, the UBS O'Connor funds were managed through portfolio management teams that employed differing trading strategies and made investment decisions for a specified portion of a particular fund's total assets. Each team was a unique aggregation unit, but multiple aggregation units could buy and sell securities on behalf of the same fund.

4. At the time, UBS's Rule 105 Policies and Procedures permitted an aggregation unit to direct a fund to purchase securities in an offering even if a different aggregation unit had directed the same fund to sell the security short in the restricted period. The policies and procedures were based on a mistaken belief that each aggregation unit qualified for the Rule 105 separate accounts exception, which permits the purchase of the offered security in an account of a person where that pursuant sold the security short in a separate account if the investment decisions for each account are made separately and without coordination or cooperation between accounts. But because traders and portfolio managers worked with more than one aggregation unit at a time and had access to trades and positions placed by other aggregation units, it was possible for an aggregation unit that directed a fund to trade in a particular security to have knowledge of another aggregation unit's planned

activity for the same fund in the same stock. In addition, consistent with the firm's "culture of information sharing," details about offerings were discussed in weekly meetings attended by portfolio managers from all aggregation units, and the firm did not restrict discussion between and among aggregation units. In these circumstances, the SEC found, the separate accounts exception to Rule 105 was inapplicable.

5. During the investigation, UBS O'Connor revised its Rule 105 Policy and Procedures to comply with Rule 105, and required every trader and portfolio manager to take an examination regarding the new Policy and Procedures. The SEC considered these remedial steps in imposing a sanction against UBS O'Connor in total of $5,297,356.00, including disgorgement of $3,787,590, prejudgment interest of $369,766, and a civil penalty of $1,140,000. UBS O'Connor was also censured and agreed to cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M.

Valuation

Last year's investment valuation case involving JPMorgan Chase in the so-called "London Whale" matter is summarized below.

A. *In the Matter of JPMorgan Chase & Co., Admin. Proc. File No. 3-15507 (Sept. 19, 2013)*

1. On September 19, 2013 the SEC instituted a settled administrative proceeding against JPMorgan charging the company with misstating financial results and lacking effective internal controls to detect and prevent its traders from fraudulently overvaluing investments in a Synthetic Credit Portfolio ("SCP") held by the firm's Chief Investment Office ("CIO").

2. In the first quarter of 2012, the SCP experienced significant mark-to-market losses. At the direction of the most senior SCP trader, SCP traders altered their historical practices in marking SCP positions to intentionally understate those losses. In April 2012, JPMorgan issued its earnings release for the first quarter, which included the understated losses in the SCP. Thereafter, in May 2012, the firm disclosed in its Form 10Q for the first quarter and a call with analysts that the SCP had suffered significant mark-to-market losses. It also disclosed at that time that it had evaluated its disclosure controls and procedures and concluded they were effective. In July 2012, JPMorgan announced that it would restate its first quarter results in light of its discovery of information that caused it to question the integrity of the SCP marks.

3. At the same time, the firm disclosed that a material weakness in internal controls over financial reporting had existed in the CIO as of the end of the first quarter, causing management to conclude that disclosure controls and procedures were not effective as of that date. The internal control function was known as the Valuation Control Group ("CIO-VCG"). Several reviews of the function conducted in late April and mid-May uncovered deficiencies, including that CIO-VCG's price-testing process was compromised by errors and that SCP traders may have exerted influence over that process. A number of the deficiencies were not timely escalated to senior management. With respect to information that was escalated, senior management did not adequately assess whether facts existed that were required to be disclosed to the Audit Committee and, as a result, did not disclose to the Audit Committee the existence of significant deficiencies or material weaknesses before the firm filed its first quarter report. Senior management also failed to include the Audit Committee in its efforts to remedy the deficiencies identified in the reviews.

4. In settling the action, JPMorgan admitted the facts underlying the SEC's charges, publicly acknowledged that it violated the federal securities laws, and agreed to pay a $200 million fine. The SEC order acknowledged JPMorgan's substantial cooperation in the investigation, its voluntary undertaking of a comprehensive program of remediation to address the control deficiencies, and that the firm had substantially strengthened the valuation control functions within CIO. JPMorgan's settlement with the SEC was part of a coordinated global settlement with three other agencies, pursuant to which JPMorgan agreed to pay a total of approximately $920 million in penalties. The SEC previously charged two former JPMorgan traders with fraud in connection with alleged efforts to hide losses in the SCP portfolio.

Investment Adviser Enforcement Actions[28]

Best Execution

The following cases reflect the SEC Staff's continuing scrutiny of the use of affiliated broker-dealers and the potential impact of those arrangements on best execution.

A. *In the Matter of Goelzer Investment Management, Inc. and Gregory W. Goelzer, Admin. Proc. File No. 3-15400 (July 31, 2013)*

1. The SEC filed a settled administrative proceeding against Goelzer Investment Management, Inc. ("GIM"), a dually registered investment adviser and broker-dealer, and Gregory W. Goelzer, GIM's Chief Executive Office and Chief Compliance Officer, for allegedly making misrepresentations in its Form ADV about the process of selecting itself as broker for advisory clients. The SEC also alleged that GIM failed to seek best execution for its clients by neglecting to conduct an appropriate analysis to substantiate its decision to place trades for advisory clients through itself as broker.

2. The SEC alleged that GIM's Form ADV stated that transactions for GIM's advisory clients would generally be effected through GIM as broker, "consistent with its obligation to obtain best price and execution" and that GIM's recommendation that clients use GIM as their broker was based on GIM's consideration of several factors, including the products offered, the level of service, the quality of trade execution, the recordkeeping and reporting capabilities, the trading platforms offered, and the ability to meet client needs. The SEC alleged that these statements were misleading because GIM did not take steps to ensure that it was seeking best price and execution for its advisory clients and failed to evaluate brokerage options for its advisory clients in a manner that was consistent with its Form ADV disclosure.

3. The SEC also alleged that GIM failed to seek best execution for its advisory clients because it did not conduct any analysis of its brokerage services that gave it a basis for using itself as broker. The SEC alleged that GIM, instead, used itself as broker for its advisory accounts by default rather than as the result of a best execution analysis.

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[28] Again, unless otherwise apparent from the context of the descriptions of the actions, the cases described herein are settlements in which respondents neither admitted nor denied the allegations against them.

4. The SEC also alleged that GIM failed to adopt and implement policies and procedures reasonably designed to prevent and detect misrepresentations by GIM and that it failed to disclose the negotiability of its advisory fees in its Form ADV.

5. The SEC's settled Order charged that GIM violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which Goelzer caused GIM's violations, and that GIM and Goelzer violated Section 207 of the Advisers Act.

6. Pursuant to the settlement, GIM and Goelzer consented to a cease and desist order. GIM agreed to pay disgorgement of $309,994 and $53,799 in prejudgment interest, and to pay a civil monetary penalty of $100,000. Goelzer consented to a civil monetary penalty of $35,000. GIM also agreed to the engagement of a compliance consultant to conduct a comprehensive review of GIM's compliance program.

B. *In the Matter of A.R. Schmeidler & Co., Inc., Admin. Proc. File No. 3-15399 (July 31, 2013)*

1. The SEC filed a settled administrative proceeding against A.R. Schmeidler & Co., Inc. ("ARS"), a dually registered investment adviser and broker-dealer, for allegedly failing to seek best execution in breach of its fiduciary duty and allegedly failing to implement policies and procedures reasonably designed to prevent its purported best execution violations.

2. The SEC alleged that ARS' clients generally entered into advisory agreements with ARS whereby the client authorized ARS to, among other things, select brokers and dealers to execute trades. According to the SEC, unless specifically directed by a client to use a particular broker-dealer, ARS executed trades for advisory accounts in its capacity as an introducing broker. In February 2007, ARS renegotiated its agreement with its clearing firm and increased the percentage of commissions it received on trades for taxable accounts from 80% to 90%. Although the commission rate charged to clients remained consistent at 6 cents per share, the SEC alleged that ARS did not conduct a sufficient analysis to determine whether it properly sought best execution for trades executed on behalf of advisory clients with taxable accounts. The SEC also alleged that although ARS' policies and procedures governed how to discharge ARS' best execution obligations, ARS failed to implement such policies and procedures.

3. The SEC's settled Order charged that ARS violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

4. ARS consented to a cease and desist order, a censure and to pay a disgorgement payment of $757,876.88 and $78,688.57 in prejudgment interest, and a civil monetary penalty of $175,000. ARS also agreed to engage an independent consultant to undertake to assist ARS in developing and implementing policies and procedures reasonably designed to promote compliance with its duty to seek best execution for advisory clients.

C. *In the Matter of Manarin Investment Counsel, Ltd., Admin Proc. File No. 3-15549 (Oct. 2, 2013).*

1. The SEC filed a settled administrative proceeding against Manarin Investment Counsel, Ltd. ("MIC"), a registered investment adviser, Manarin Securities Corp. ("MSC"), a registered broker-dealer, and Roland R. Manarin, the founder, owner and President of MIC and MSC. The SEC alleged that MIC and Manarin failed to obtain best execution for three investment funds managed by MIC (including a mutual fund) (the "Funds") by purchasing higher cost mutual fund shares, even though cheaper shares in the same mutual funds were available. As a result, the Funds paid avoidable fees on their mutual fund holdings and passed these fees through to MSC, the affiliated broker-dealer that executed the purchases.

2. According to the SEC, from at least June 2000 through mid-2010, Manarin and MIC breached their fiduciary duties as investment advisers by causing the Funds to buy the Class A shares of underlying mutual funds even when the Funds were eligible to own lower-cost, so-called "institutional" shares of the same mutual funds. As a result, the Funds paid approximately $3.3 million in avoidable 12b-1 fees on their mutual fund holdings, which were passed through to MSC. The SEC alleged that this practice was a violation of MIC's and Manarin's duty to seek best execution and was inconsistent with disclosures in the Fund's offering materials and MIC's Form ADV.

3. The SEC also alleged that, between October 2008 and December 2011, MSC executed transactions in ETF shares on behalf its affiliated mutual fund and charged commissions that exceeded the usual and customary broker's commission for such transactions.

4. The SEC's settled Order charged that MIC and Manarin violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8(a)(1) thereunder, (ii) Manarin violated Section 34(b) of the Investment Company Act, MIC, MSC and Manarin violated Section 17(a)(2) of the Securities Act, and MSC violated Section 17(e)(2)(A) of the Investment Company Act.

5. Pursuant to the settlement, MIC, MSC and Manarin consented to cease and desist orders and censures. MSC and Manarin also agreed, jointly and severally, to pay disgorgement totaling $685,006.90 and prejudgment interest totaling $267,741.72. Further, Manarin agreed to pay a civil penalty of $100,000.

Compliance Reviews and Policies and Procedures

In 2013, the SEC continued to focus on advisers and their associated persons who failed to have in place required policies and procedures or failed to follow required procedures. Two of the cases discussed below also point to the importance of correcting deficiencies noted in prior SEC examinations, while another involved compliance with the Advisers Act's personal trading requirements.

A. *In the Matter of IMC Asset Management, Inc., Admin. Proc. File No. 3-15190 (Jan. 29, 2013).*

1. The SEC filed a settled administrative proceeding against IMC Asset Management, Inc. ("IMCAM"), a registered investment adviser, alleging that the firm failed to conduct annual compliance reviews, employed a compliance officer who performed virtually no compliance functions and failed to adopt and implement written compliance policies and procedures reasonably designed to prevent such violations.

2. According to the SEC, from April 2009 through June 2010, IMCAM employed a chief compliance officer who had no prior compliance experience and who performed virtually no compliance-related functions. Additionally, for more than three years, IMCAM's only written compliance policies and procedures were designed primarily to address IMCAM's predecessor's broker-dealer activities, did not apply to IMCAM's advisory business and, upon the broker-dealer's withdrawal from registration as a broker-dealer, no longer applied at all to the firm. Further, the firm failed to conduct an annual review of its policies and procedures. During this time, IMCAM provided discretionary investment management services to collateralized debt obligations and two offshore investment funds.

3. Subsequent to a SEC examination that was initiated in November 2010 and that resulted in a deficiency letter issued on March 10, 2011, IMCAM made a number of enhancements to its compliance program. However, in July 2012, IMCAM terminated its CCO and again designated a current employee with minimal compliance experience or training as CCO.

4. The SEC's settled Order charged that IMCAM violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

5. Pursuant to the settlement, IMCAM consented to a cease and desist order, a censure and a civil penalty of $30,000. IMCAM also agreed to require its CCO to complete comprehensive training on Advisers Act compliance requirements and to retain a compliance consultant for two years.

B. *In the Matter of Equitas Capital Advisors, LLC ("Equitas"), Equitas Partners, LLC ("Equitas Partners"), David S. Thomas, Jr., and Susan Christina, Admin. Proc. File No. 3-15585 (Oct. 23, 2013).*

1. The SEC filed a settled administrative proceeding against Equitas, a registered investment adviser, arising from its alleged inadvertent over-billing and under-billing of certain clients and negligently making false and misleading disclosures to clients and potential clients about its historical performance, compensation, conflicts of interest and prior examination deficiencies. The settled administrative proceeding also named Equitas Partners, a registered investment adviser under common control with Equitas, for allegedly failing to conduct annual compliance reviews, and as with Equitas, failing to maintain written policies and procedures. David Thomas, the principal and CEO of the two advisers and Susan Christina, their CCO, was also charged.

2. The SEC alleged that from at least January 2008 through 2010, Equitas overcharged at least 16 clients a total of approximately $70,826 for investment advisory services and undercharged 44 clients a total of approximately $411,855. According to the Order, Equitas refunded the overcharged amounts, plus interest, and decided not to pursue collections of the undercharged amounts. The SEC alleged that although these billing errors were inadvertent, they resulted from Equitas' failure to adopt and implement sufficient policies and procedures reasonably designed to prevent billing errors. These compliance exceptions were identified in three SEC examinations occurring in 2005, 2008 and 2011.

3. In addition, the SEC alleged that despite prior warning from the staff regarding inadequate and misleading disclosure regarding fee offsets, credit balances and the conflicts created by each, Equitas failed to sufficiently remedy such disclosure in client communications. The SEC further alleged that Equitas failed to disclose financial incentives to recommend that clients invest in a related fund-of-fund vehicle and that Equitas distributed advertisements containing misleading and out-dated historical performance and advertisements without appropriate disclosures. Equitas and Equitas Partners also allegedly failed to conduct annual reviews of their compliance policies and procedures as noted in the deficiency letters the firms received. According to the

SEC, Christina was partially responsible for failing to conduct annual reviews in accordance with the SEC's prior examination comments and she also did not take sufficient steps to make compliance improvements that she herself identified.

4. The SEC further alleged that in 2005, 2008 and 2011 the Staff notified Equitas and Thomas orally and in writing about numerous deficiencies, which Equitas, Equitas Partners and Thomas should have, but did not, disclose to potential clients in response to questions posed in certain RFPs and due diligence questionnaires.

5. The SEC's Order charged that Equitas violated Sections 206(2), 206(4) and 207 of the Advisers Act and Rules 206(4)-1(a)(5) and 206(4)-7 thereunder, that Equitas Partners violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, that Thomas aided and abetted and caused Equitas' violation of Advisers Act Section 206(4) and Rules 206(4)-1(a)(5) and 206(4)-7 and Equitas Partners' violations of Advisers Act Section 206(4) and Rule 206(4)-7 thereunder, and that Christina aided and abetted and caused Equitas and Equitas Partner's violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

6. Pursuant to the settlement, Equitas consented to a cease-and-desist order, a censure and to pay a civil monetary penalty of $100,000. Equitas Partners consented to a cease–and-desist order and a censure. Thomas consented to a cease-and-desist order and to pay a civil monetary penalty of $35,000. Christina consented to a cease-and-desist order.

C. *In the Matter of Modern Portfolio Management, Inc. ("MGM"), G. Thomas Damasco II, and Bryan F. Ohm, Admin. Proc. File No. 3-15583 (Oct. 23, 2013)*

1. The SEC filed a settled administrative proceeding against MGM, a SEC registered investment adviser, and its principals, Damasco and Ohm, for allegedly failing to correct ongoing violations of the Advisers Act, including by failing to complete an annual compliance review, making misleading statements on MPM's website, omitting disclosures in its performance information that were required by MPM's own policies and procedures, and making misleading statements in its performance information by providing model results that did not deduct advisory fees. The SEC further alleged that despite providing assurances that the violations would be corrected, MPM the same failures were identified in a subsequent SEC examination. The SEC alleged that Damasco and Ohm were aware of the deficiencies identified in the initial 2008 examination and did not take appropriate corrective steps to prevent future violations.

2. The SEC alleged that MPM's policies and procedures required, among other things, that MPM's CCO complete annual compliance reviews, and that MPM's marketing materials "be truthful and accurate, and prepared and presented in a manner consistent with applicable rules and regulatory guidelines," and that "all relevant disclosures and facts be made as necessary in marketing materials," including "making any and all disclosures required by the Clover Capital Management no-action letter." The SEC further alleged that Damasco and Ohm were responsible for reviewing such materials but delegated that responsibility to MPM's Chief Operating Officer, however they were unaware and took no steps to determine, whether the COO was familiar with the Clover Capital Management no-action letter or the rules and regulatory guidelines applicable to marketing materials.

3. The SEC Staff conducted an examination in 2008 in which the staff identified compliance failures relating to annual compliance reviews and misleading information in MPM's marketing materials. The SEC alleged that the Staff sent a deficiency letter to MPM identifying the compliance failures and stating its concern whether the MPM's designated Chief Compliance Officer was sufficiently knowledgeable to administer the compliance program. The SEC further alleged that Damasco and Ohm sent a written response to the deficiency letter providing assurances that MPM would take corrective action to remedy the compliance exceptions noted in the deficiency letter.

4. The SEC Staff commenced a subsequent examination in 2011 where it found that MPM, among other things, had not taken sufficient steps to remedy the deficiencies identified in its 2008 examination.

5. The SEC alleged that MPM violated Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1(a)(5) and 206(4)-7 thereunder. The SEC also alleged that Damasco and Ohm aided and abetted and caused MPM's violations of Advisers Act Sections 206(2) and 206(4) and Rules 206(4)-1(a)(5) and 206(4)-7 thereunder.

6. MPM consented to a cease-and-desist order, a censure, and to pay a civil monetary penalty in the amount of $75,000. Damasco consented to a cease-and-desist order, a censure and to pay a civil monetary penalty of $25,000. Ohm consented to a cease-and-desist order, a censure and to pay a civil monetary penalty of $50,000. Further, Damasco and Ohm undertook to complete thirty hours of compliance training relating to the Advisers Act. MPM agreed to continue to retain a compliance consultant to provide ongoing compliance services for three years and to designate a new CCO.

7. In considering the settlement, the SEC took into account the remedial actions promptly undertaken by MPM, Damasco and Ohm, including engaging a compliance consultant, and the cooperation afforded to the SEC Staff.

D. *In the Matter of Carl D. Johns, Admin. Proc. File No. 3-15440 (Aug. 27, 2013)*

1. The SEC filed a settled administrative proceeding against Carl D. Johns, an assistant portfolio manager to several registered investment companies (the "Boulder Funds"), alleging that Johns failed to comply with SEC reporting requirements regarding personal securities trading and that Johns failed to comply with the reporting and pre-clearance requirements for personal securities transactions outlined in the Code of Ethics of the investment advisers with which Johns was associated ("Code of Ethics"). The SEC further alleged that Johns intentionally misled the Chief Compliance Officers of the investment advisers with which he was associated, in violation of Rule 38a-1(c) of the Investment Company Act. Notably, this is the first time the SEC issued an order alleging violations of Rule 38a-1(c).

2. According to the Order, Johns was required to submit quarterly reports of his securities transactions and annual reports of his securities holdings under Rule 17j-1 of the Investment Company Act. Further, under the Code of Ethics, Johns was (i) required to pre-clear all securities transactions, subject to limited exceptions, (ii) restricted from trading in securities that the Boulder Funds were buying or selling, and (iii) required to certify annually that he had complied with the terms of the Code of Ethics.

3. The SEC alleged that Johns engaged in active personal trading in securities, including securities of companies held or to be acquired by the Boulder Funds, without complying with the SEC's reporting requirements or the Code of Ethics. Specifically, the SEC alleged that between 2006 and 2010 Johns executed approximately 850 personal securities transactions, approximately 640 of which were not pre-cleared or reported. The SEC also alleged that in order to conceal his personal securities trading, Johns submitted false quarterly and annual reports, and falsely certified his annual compliance with the Code of Ethics. The SEC further alleged that Johns physically altered brokerage statements, trade confirmations and pre-clearance approvals.

4. The SEC's Order charged that Johns violated Section 17(j) of the Investment Company Act, Rules 17j-1(b) and 17j-1(d) thereunder, and Rule 38a-1(c) under the Investment Company Act.

5. Pursuant to the settlement, Johns consented to a cease and desist order and to pay a disgorgement payment of $231,169, prejudgment interest of $23,889 and a civil monetary penalty of $100,000. Johns further consented to being barred from the securities industry with the right to reapply for reentry after five years.

Custody Rule

The three cases discussed below, which were all announced on the same day by the SEC, demonstrate a renewed focus on compliance with the Advisers Act's Custody Rule. An additional action against an individual is also summarized in this section.

A. *In the Matter of Further Lane Asset Management, LLC, Osprey Group, Inc. and Jose Miguel Araiz a/k/a Joseph Michael Araiz, Admin. Proc. File No. 3-15590 (Oct. 28, 2013)*

1. The SEC filed a settled administrative proceeding against Further Lane Asset Management ("FLAM"), Osprey Group, Inc. (an adviser associated with FLAM) and Araiz, FLAM's CEO and CCO, for allegedly failing to arrange for an annual surprise examination in accordance with the Custody Rule. FLAM also allegedly caused a fund-of-funds under its control to invest in instruments that materially differed from its investment strategy, failed to obtain client consent prior to engaging in principal transactions, failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and failed to maintain certain required books and records. FLAM advises three hedge funds and a number of separately-managed accounts, and OGI manages a fourth hedge fund.

2. During a prior SEC examination in 2003, FLAM received a deficiency letter advising FLAM of certain issues associated with the custody of client assets and noting that it had engaged in principal transactions without prior client consent. The SEC alleged that in 2008 FLAM and Araiz caused a hedge fund with a fund-of-funds strategy to invest in promissory notes issued by entities that were controlled by Araiz, causing the fund to materially deviate from its investment strategy. FLAM did not provide investors with notice of the change in the Fund's investment strategy or disclose that it had acquired promissory notes that constituted 58% of the portfolio.

3. Although FLAM was deemed to have custody of client funds and securities because it had physical possession of the promissory notes and due to the fact that FLAM and its affiliates served as general partners of the Fund, it allegedly violated the Custody Rule by failing to be subject to an annual surprise examination for four consecutive years.

4. The SEC also alleged that FLAM and OGI engaged in undisclosed principal transactions in their client's accounts through their affiliated broker-dealer without obtaining appropriate consent. With respect to their hedge fund clients, FLAM and OGI engaged in unlawful principal transactions because the limited partnership agreements for those funds required FLAM and OGI to obtain investors' consent to principal traders. FLAM and OGI alleged failed to do so. The affiliated broker allegedly earned markups and markdowns of at least $312,760 on those principal transactions.

5. FLAM's Form ADV also allegedly contained false statements in that it stated that FLAM did not have custody over client assets and did not engage in principal transactions. Finally, the SEC alleged that FLAM's compliance manual was materially outdated, FLAM failed to conduct an annual compliance review and FLAM failed to maintain certain books and records relating to order tickets, correspondence with clients, contracts related to the firm's business and custody.

6. The SEC's settled Order charged that FLAM violated Sections 206(2), 206(3), 206(4), 204(a) and 207 of the Advisers Act and Rules 206(4)-8, 206(4)-2, 206(4)-7, 204-2(a)(3), 204-2(a)(7), 204-2(a)(10) and 204-2(a)(17) thereunder, that Araiz committed, aided and abetted and caused certain of these same violations, and that OGI violated Section 206(3) of the Advisers Act.

7. Pursuant to the settlement, the respondents each consented to a cease and desist Order and a censure. FLAM, OGI and Araiz also agreed to pay disgorgement of $338,017 and prejudgment interest of $9,105. FLAM also undertook to, among other things, implement a new set of compliance policies, develop a new supervisory framework and internal controls, conduct the annual reviews required under Rule 206(4)-7 for 2013 and 2014, prominently display a summary of the SEC Order with a link to the entire Order on its website and distribute the Order to existing clients and investors. It also agreed that for a period of five years from the entry of the Order it would employ a CCO who does not simultaneously hold any other officer or employee position at FLAM.

B. *In the Matter of GW & Wade, LLC, Admin. Proc. File No. 3-15589 (Oct. 28, 2013)*

1. The SEC filed a settled administrative proceeding against GW &Wade, LLC ("GW & Wade") alleging that GW & Wade violated the Custody Rule and failed to adequately implement its policies and procedures for calculating advisory fees for discretionary accounts.

2. The SEC alleged that GW & Wade used pre-signed Letters of Authorization ("LOAs") for over 900 accounts. The pre-signed LOAs permitted GW & Wade to transfer client funds without obtaining client signatures in connection with each transfer. This practice allegedly contributed to a third-party fraud that occurred in one client account.

3. GW & Wade was deemed to have custody of client assets for those accounts for which it maintained pre-signed LOAs, as well as for other accounts where it has been granted check-writing authority or possessed login information and passwords for outside client accounts such as employee retirement and brokerage accounts. Although it was deemed to have custody over client assets, GW & Wade allegedly failed to obtain annual surprise audits, as required by the Custody Rule, inaccurately disclosed the amount of assets over which it had custody, failed to implement appropriate policies and procedures to safe keep client assets and failed to maintain appropriate books and records.

4. Finally, the SEC alleged that GW & Wade overbilled certain clients by incorrectly including class C shares in advisory fee calculations when it had a policy of excluding class C shares from its fee calculation.

5. The SEC's settled Order charged that GW & Wade violated Sections 206(4), 207 and 204 of the Advisers Act and Rules 206(4)-2, 206(4)-7, 204-2(a)(3) and 204-2(b)(1) thereunder.

6. Pursuant to the settlement, GW & Wade consented to cease and desist order, a censure and to pay a civil monetary penalty of $250,000. GW & Wade also agreed to hire an independent compliance consultant to review its written compliance policies and procedures relating to custody and the calculation of advisory fees.

7. In considering the settlement, the SEC took into account remedial acts undertaken by GW & Wade, including (i) implementing a Wire, Checks and Journal Disbursements Policy that eliminates the use of pre-signed LOAs; (ii) agreeing to implement an account management system under which access to most client accounts is read-only; (iii) implementing policies and procedures for password

and login information for client accounts and maintaining books and records of all transactions in custodied outside accounts; (iv) implementing a policy for heightened review of client bills to prevent overbilling; and (v) reimbursing overcharged clients.

C. *In the Matter of Knelman Asset Management Group, LLC and Irving P. Knelman, Admin. Proc. File No. 3-15588 (Oct. 28, 2013)*

1. The SEC filed a settled administrative proceeding against Knelman Asset Management Group, LLC ("KAMG") and Knelman, KAMG's CEO and CCO, for allegedly violating the Custody Rule, using a distribution methodology that differed from a fund's LLC Agreement and PPM, failing to conduct an annual compliance review, failing to maintain certain books and records and making false statements on KAMG's Form ADV.

2. The SEC alleged that KAMG, which was the manager of Rancho Partners I, LLC ("Rancho"), a fund of private equity funds, did not maintain Rancho's assets with a qualified custodian as required by the Custody Rule. Further, the SEC alleged that Rancho's funds were not subject to annual surprise examinations and its financial statements were not audited or distributed to members. Further, KAMG was aware of the custody issue as it had previously received a deficiency letter in 2005 notifying the firm of Custody Rule violations.

3. The SEC also alleged that KAMG made improper distributions to members by allocating distributions to clients pro rata based on members' capital commitments rather than on their capital account balances as set forth in Rancho's LLC Agreement and PPM. Further, the SEC alleged that KAMG made improper discretionary cash distributions to some, but not all, of Rancho's members.

4. The SEC also alleged that KAMG failed to adopt written policies and procedures reasonably designed to prevent violations of the Custody Rule and failed to conduct annual compliance reviews. KAMG also allegedly failed to keep certain books and records and made false statements on its Form ADV, stating that it did not have custody of client assets.

5. The SEC's alleged Order charged that KAMG and Knelman violated Sections 206(2), 206(4) and 207 of the Advisers Act and Rule 206(4)-8 thereunder. The SEC also alleged that KAMP violated, and Knelman aided and abetted KAMG's violation of, Sections 206(4) and 204 of the Advisers Act and Rules 206(4)-2, 206(4)-7, 206(4)-8, 204-2(b)(1), 204-2(b)(2) and 204-2(c)(2) thereunder.

6. Pursuant to the settlement, KAMG consented to a cease and desist order, a censure and to pay a civil monetary penalty of $60,000. KAMP also agreed to retain an independent compliance consultant, hire a new CCO other than Knelman and deliver a copy of the SEC Order to existing clients and investors. Knelman consented to a cease and desist order, to be barred from acting as CCO of any SEC registrant for three years and to pay a civil monetary penalty of $75,000. Knelman also agreed to complete 30 hours of compliance training.

7. In considering the settlement, the SEC took into account remedial acts promptly undertaken by KAMG.

D. *In the Matter of Mark M. Wayne, Admin Proc. File No. 3-15644 (Dec. 12, 2013)*

1. The SEC filed a settled administrative proceeding against Mark M. Wayne, the former President, CEO and CCO of Freedom One Investment Advisers, Inc. ("Freedom One") alleging that Wayne and Freedom One failed to comply with various provisions of the Custody Rule.

2. The SEC alleged that, from 2008 through 2010, Freedom One was deemed to have custody of client assets held in two omnibus accounts because its affiliate had the authority to direct the custodians to make client distributions. Despite the fact that Freedom One was deemed to have custody over those assets, it allegedly failed to t have an independent public accountant conduct annual surprise exams to verify those assets. According to the SEC, Freedom One engaged an accountant to perform a surprise exam in 2008, but Wayne took no action to determine whether the accountant completed the examination. For 2009 and 2010, Wayne allegedly delegated responsibility for the surprise examinations to an employee who did not have any training or experience in investment advisory regulation or compliance and was not familiar with which accounts Freedom One was deemed to have custody of. The 2009 and 2010 examinations were completed by another accounting firm, but they were deficient because they apparently covered only one of the omnibus accounts that contained client assets.

3. The SEC further alleged that Freedom One violated the Custody Rule's account statement delivery requirement because during 2008 and 2009, an affiliate of Freedom One that was not a qualified custodian delivered quarterly account statements in violation of the requirement under the prior version of the Custody Rule that a qualified custodian provide statements to clients. Furthermore, for 2010, when the current version of the Custody Rule became

effective, Freedom One was required to have a reasonable basis for believing that a qualified custodian was sending quarterly statements to clients, but it failed to do so.

4. The SEC also alleged that, from October 2008 through March 2011, Freedom One's policies and procedures, which Wayne approved in his capacity as CCO, were not reasonably designed to prevent violations of the Custody Rule and that, from January 2009 through July 2010, certain Freedom One transactions were not properly reflected in its books and records. According to the SEC, Wayne appointed a Controller who lacked the necessary skills and did not provide her with adequate support and training to accurately maintain the firm's books and records.

5. The SEC alleged that Wayne willfully aided and abetted and caused Freedom One's violations of Sections 204 and 206(4) of the Advisers Act and Rules 204-2, 206(4)-2 and 206(4)-7 thereunder.

6. Wayne agreed to a cease and desist order, to complete 30 hours of compliance training relating to the Adviser's Act and to be barred for one year from acting as the chief compliance officer for any firm in the securities industry. Further, Wayne agreed to pay a civil monetary penalty of $40,000.

7. In a separate case, the SEC filed a settled administrative proceeding against Rodney A. Smith, Michael Santicchia, CPA, and Stephen D. Cheaney, CPA (the "Accountants"), who were associated with one of the accounting firms engaged to conduct surprise exams of Freedom One. The SEC alleged that the Accountants failed to perform the surprise exams (i.e., conduct fieldwork, prepare and issue a surprise exam report and file Form ADV-E) that they were hired to complete. According to the SEC Order, the Accountants caused or willfully aided and abetted Freedom One's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder and two of the Accountants engaged in improper professional conduct within the meaning of Section 4C of the Exchange Act and Rule 102(e)(1)(ii) of the SEC's Rules of Practice. The Accountants agreed to be denied the privilege of appearing or practicing before the SEC as accountants, with the possibility of applying for reinstatement in two or three years, subject to certain conditions. See In the Matter of Rodney A. Smith, Michael Santicchia, CPA, and Stephen D. Cheaney, CPA, Admin Proc. File No. 3-15645 (Dec, 12, 2013).

Gifts and Gratuities

A. *In the Matter of Nicholas Delbrocco, Proc. File No. 3-15222 (Mar. 1, 2013)*

1. The SEC commenced a settled administrative proceeding against Nicholas Delbrocco for allegedly violating Section 203(f) of the Investment Advisers Act of 1940 by bribing a pension fund official to obtain investment management business for New England Asset Management, LLC, later changed to Ocean State Asset Management, LLC. Delbrocco was chief executive officer, part owner and investment adviser representative of NEAM/OSAM.

2. On October 18, 2012, in a related criminal action, Delbrocco pled guilty to one count of violating Title 18 United States Code Section 1954 (Offer, Acceptance, or Solicitation to Influence Operations of Employee Benefit Plan) and conspiracy. *See United States of America v. Nicholas Delbrocco*, Case No. 1:12-CR-00448-SL (N.D. Ohio).

3. Delbrocco admitted that from 2005 through 2011, for the purpose of obtaining and maintaining investment management business for NEAM/OSAM, he provided the Executive Secretary-Treasurer of the Ohio and Vicinity Regional Council of Carpenters with airline tickets, frequent flyer miles, rental vehicles, and hotel rooms. He also provided meals, theater tickets, sporting event tickets, and firearms to an individual associated with the Executive Secretary-Treasurer.

4. Delbrocco also admitted to having conspired with others to deprive the Carpenters' Union of its right to the honest and faithful services of the Executive Secretary-Treasurer through a scheme of bribery and kickbacks and to having concealed material information relating to that scheme.

5. Delbrocco was barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent or nationally recognized statistical rating organization.

Misappropriation of Assets

A. *SEC v. MayfieldGentry Realty Advisors, LLC, et al., Civil Action No. 13-cv-12520 (E.D. Mich. June 10, 2013)*

1. The SEC charged MayfieldGentry Realty Advisors, a registered investment advisor, and its founder, president and CEO, Chauncey C. Mayfield, with misappropriating approximately $3.1 million assets from a pension fund that the firm managed for the Police

and Fire Retirement System of the City of Detroit in violation of Sections 206(1) and 206(2) of the Investment Advisers Act of 1940.

2. The SEC also charged four of the firm's top executives with aiding and abetting those violations by attempting to help conceal the theft.

3. The SEC alleged that Mayfield stole the money from PFRS master account and used it to purchase two shopping malls. His action was thereafter discovered by MayfieldGentry's chief financial officer. Over the next three years, neither Mayfield nor the CFO disclosed the theft to PFRS, and instead took steps to try to replace the stolen funds and conceal the theft. The theft was later disclosed to other MayfieldGentry executives, who similarly failed to disclose it to PFRS, and instead sought to find ways to put the money back in the account before the theft was discovered. In addition, the SEC alleges that the defendants affirmatively misled PFRS, including in an annual budget meeting that included an asset-by-asset analysis of the PFRS portfolio that failed to include mention of the shopping malls purchased with stolen funds. In the budget meeting, MayfieldGentry executives claimed to have achieved record returns for PFRS and projected that MayfieldGentry would remit $4.96 million to PFRS in the coming year. They did not disclose the impact of the theft on the remittance and return.

4. The SEC alleges that the defendants continued to cover up the theft for more than four years. They ultimately disclosed it to PFRS on the evening before the SEC filed a complaint against Mayfield and MayfieldGentry for alleged participation in a pay-to-play scheme in which they sought to influence the pension funds investment process for the city of Detroit by bestowing lavish gifts on Detroit's former mayor and treasurer.

5. PFRS thereafter terminated its relationship with MayfieldGentry, which subsequently unwound its operations.

6. To settle the charges against them relating to the misappropriation, Mayfield and the firm agreed to disgorgement in the amount of $3,076,365.88 and be permanently enjoined from violating Sections 206(1) and 206(2) of the Advisers Act.

7. Mayfield pled guilty to criminal charges relating to his participation in the pay-to-play scheme.

Material Non-Public Information – Policies and Procedures

A. *In the Matter of Institutional Shareholder Services Inc., Admin. Proc. File No. 3-15331 (May 23, 2013)*

1. The SEC filed a settled administrative proceeding against Institutional Shareholder Services Inc. ("ISS") for allegedly failing to establish and enforce policies and procedures reasonably designed to prevent the misuse of clients' material, non-public proxy voting information.

2. The SEC alleged that from approximately 2007 through early 2012 an ISS employee disclosed proxy voting information for approximately 100 of ISS's institutional investment adviser clients to a proxy solicitor in return for approximately $20,000 in meals, approximately $11,500 in tickets to concerts and sporting events and an airline ticket. According to the SEC, the employee obtained the information by logging in to ISS' voting website from home or work and using his personal email account to send the proxy solicitor client-specific information, including the number of shares a client voted and the direction of the client's vote. Some of the ISS clients did not reveal their vote information before the shareholder meeting because, given the size of their positions, their vote could move the market.

3. The SEC also alleged that ISS failed to monitor ProxyExchange, a proxy voting application that could have been audited by ISS to identify potential employee misconduct, including access from a remote location. The SEC also alleged that ISS failed to properly train its employees regarding its parent company's gift policy and did not require employees to report gifts. Finally, the SEC alleged that ISS failed to routinely monitor employee email communications.

4. The SEC alleged that ISS violated Section 204A of the Advisers Act.

5. ISS consented to the entry of an order requiring that the firm cease and desist from committing or causing any violations and any future violations of Section 204A of the Advisers Act, be censured and pay a civil monetary penalty of $300,000. ISS also agreed to hire an independent consultant to conduct a comprehensive review of its policies and procedures relating to the treatment of confidential information, communications with proxy solicitors and gifts and entertainment.

6. In considering the settlement, the SEC took into account ISS's: (i) implementation of a policy on interactions with proxy solicitors; (ii)

training of its employees regarding the new policy as well as additional code of ethics and gifts and entertainment policy training; (iii) implementation of modifications to limit access to proxy voting information within ProxyExchange and to enhance the system's monitoring capabilities; and (iv) institution of a gift log.

Mutual Fund Board Approval of Advisory Contracts

A. *In the Matter of Northern Lights Compliance Services, LLC, Gemini Fund Services, LLC, Michael Miola, Lester M. Bryan, Anthony J. Hertl, Gary W. Lanzen, and Mark H. Taylor, Admin. Proc. File No. 3-15313 (May 2, 2013)*

1. The SEC filed a settled administrative proceeding against Northern Lights Compliance Services, LLC ("NLCS"), Gemini Fund Services, LLC ("GFS"), Michael Miola, Lester M. Bryan, Anthony J. Hertl, Gary W. Lanzen, and Mark H. Taylor (collectively, the "Trustees") alleging disclosure, reporting, recordkeeping and compliance violations in connection with the Northern Lights Fund Trust and the Northern Lights Variable Trust (together, the "Trusts"). The Trusts are offered as a turnkey investment company platform to advisers that wish to manage their own mutual funds without incurring the overhead associated with developing their own fund complex. The Trusts uses the administrative services of GFS and a common board of trustees and officers.

2. The SEC alleged that the Trustees caused violations of Section 34(b) of the 1940 Act by approving certain board minutes that contained boilerplate language that either misrepresented material information considered by the Trustees or omitted material information relating to the factors and conclusions that formed the basis for the approval or renewal of advisory contracts under Section 15(c). The board minutes were in turn used by GFS to draft shareholder reports, which contained inaccurate or incomplete information about the contract evaluation process.

3. The SEC alleged that NLCS and the Trustees caused certain funds to violate Rule 38a-1(a)(1) under the 1940 Act by failing to ensure that such funds implemented policies and procedures relating to their review of the compliance programs of the advisers that managed the funds. Specifically, the SEC alleged that NLCS failed to provide the Trustees with copies of the advisers' policies and procedures or an adequate summary of the salient features of the advisers' compliance programs.

4. The SEC also alleged that GFS caused certain funds to violate the books and records requirements of Section 31(a) of the 1940 Act and Rule 31a-2(a)(6) thereunder by failing to preserve certain 15(c) files. GFS also purportedly caused certain funds to violate Section

30(e) of the 1940 Act and Rule 30e-1 thereunder relating to the distribution of annual and semi-annual reports by failing to ensure that certain shareholder reports contained the required discussion of the 15(c) process.

5. The SEC alleged that the Trustees caused violations of Section 34(b) of the 1940 Act. The SEC alleged that NLCS and the Trustees violated Rule 38a-1(a)(1) under the 1940 Act. The SEC alleged that GFS caused violations of Sections 30(e) and 31(a) of the 1940 Act and Rules 30e-1 and 31a-2(a)(6) thereunder.

6. NLCS consented to cease and desist from violations and future violations of 1940 Act Rule 38a-1. GFS consented to cease and desist from violations and future violations of Sections 30(e) and 31(a) of the 1940 Act and Rules 30e-1 and 31a-2(a)(6) thereunder. The Trustees consented to cease and desist from violations or future violations of Section 24(b) of the 1940 Act and Rule 38a-1(a)(1) thereunder. NLCS and GFS agreed to pay a civil money penalty of $50,000. Respondents agreed to hire an independent consultant to review their policies and procedures relating to the investment advisory contract review process and the associated disclosure, recordkeeping and reporting obligations, as well as those applicable to the review of services provider compliance programs.

Principal Trading

The SEC filed two cases in 2013 that demonstrate its focus on principal trading by advisers and the advisers' compliance with the disclosure and consent requirements regarding principal trades.

A. *In the Matter of Shadron L. Stastney, Admin. Proc. File No. 3-15500 (Sept. 18, 2013)*

1. The SEC filed a settled administrative proceeding against Shadron Stastney, a principal of Vicis Capital LLC ("Vicis Capital"), a registered investment adviser, for allegedly breaching his fiduciary duty to the Vicis Capital Master Fund (the "Fund") by failing to disclose a material conflict of interest and engaging in an undisclosed principal transaction with the Fund.

2. The SEC alleged that in late 2007, Stastney hired a friend and outside business partner to help him manage the Fund's illiquid investments. As a condition of employment, Stastney required the friend to divest those of his personal securities holdings that overlapped with the Fund's investments (the "conflicted securities"). To facilitate the divesture, Stastney arranged for the Fund to purchase from his friend approximately $7.5 million in illiquid,

conflicted securities. The SEC alleged that Stastney informed two of his partners of the contemplated transaction but did not disclose to them or to the Trustee of the Fund that he would be participating as a principal in the transaction because he had a personal financial interest in some of the conflicted securities and would receive a portion of the proceeds of their sale to the Fund.

3. The SEC alleged that as a result of the sale, Stastney personally benefited and received over $2.7 million from the sale of the securities to the Fund.

4. The SEC's settled Order charged that Stastney willfully violated Sections 206(2) and 206(3) of the Advisers Act.

5. Pursuant to the settlement, Stastney consented to a cease and desist order, an industry bar, the payment of disgorgement and prejudgment interest of $2,535,095, and the payments of a civil monetary penalty of $375,000. He also agreed, among other things, to cause the Fund to hire, at his personal expense, an independent monitor to monitor his activities relating to the wind down of the Fund and to forego compensation from Vicis Capital.

B. *In the Matter of Parallax Investments, LLC, John P. Bott, II and F. Robert Falkenberg, Admin. Proc. File No. 3-15626 (Nov. 26, 2013)*

1. The SEC filed an administrative proceeding against Parallax Investments, LLC ("Parallax"), Parallax's owner, John P. Bott, II and Parallax's CCO, Robert Falkenberg, for allegedly engaging in thousands of principal transactions without obtaining client consent, failing to provide investors with audited financial statements in a timely fashion as required under the Custody Rule, failing to have written policies and procedures reasonably designed to prevent violations of the Advisers Act and failing to maintain a written code of ethics.

2. The SEC alleged that Parallax engaged in at least 2,000 principal transactions that were executed by an affiliated broker-dealer, Tri-Star Financial ("TSF"), without providing prior written disclosure to clients that it would effect the trades on a principal basis and without obtaining prior consent. TSF used its inventory account to purchase mortgage-backed bonds for Parallax advisory clients and then transferred the bonds from the TSF account to the applicable client account. TSF charged advisory clients a mark-up or mark-down for the trades and Bott, who was a registered representative of TSF, received 55% of the sales credit generated by each trade. TSF earned approximately $1.9 million in gross sales credits (mark-ups and mark-downs) and paid approximately $1 million to Bott.

3. Parallax also allegedly failed to comply with the Custody Rule because it did not distribute annual audited financial statements to private fund clients within 120 days of the fund's fiscal year end. In addition, the financial statements, which were delivered more than a month after the deadline, were not audited by a PCAOB-registered auditor and contained fair value disclosures that did not conform to GAAP.

4. The SEC also alleged that for nearly two years after registering as an investment adviser Parallax failed to adopt and implement policies and procedures and a code of ethics. In particular, the SEC alleged that in response to a 2009 state examination, Parallax purchased an "off the shelf" compliance manual that was never tailored to Parallax's business. In addition, Parallax allegedly failed to conduct an annual review of its policies and procedures until after he received notice that the SEC Staff would be performing an examination. Finally, Parallax apparently never implemented its code of ethics, including, for example, by identifying access persons or obtaining the required written acknowledgements or reporting of securities transactions and holdings.

5. The SEC alleged that Parallax violated, and Bott aided and abetted Parallax'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. The SEC alleged that Falkenberg aided and abetted Parallax's violations of 206(4) and 204A of the Advisers Act and Rules 206(4)-2, 206(4)-7 and 204A-1 promulgated thereunder.

6. In a separate administrative proceeding, the SEC brought charges against Tri-Star Advisors, Inc. ("TSA"), a related investment adviser, TSA's CEO, William T. Payne and TSA's President, Jon C. Vaughan, alleging that TSA engaged in 2,212 principal trades without obtaining client consent. The principal trades were executed through its affiliated broker, TSF. In addition, TSA's compliance manual purportedly did not contain any policies and procedures addressing principal transactions. The SEC alleged that TSA violated, and Payne and Vaughan caused TSA to violate, Sections 206(3) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.[29]

7. Both matters are currently pending.

[29] *See In the Matter of Tri-Star Advisors, LLC, William T. Payne and Jon C. Vaughan*, Admin. Proc. File No. 3-15627 (Nov. 26, 2013).

Recordkeeping

In the following litigated case, the SEC sanctioned an investment adviser for violating certain recordkeeping rules, but the SEC's Enforcement Staff was unsuccessful in its efforts to have an administrative law judge impose penalties and certain other relief.

A. *In the Matter of Peak Wealth Opportunities, LLC, and David W. Dube, CPA, Admin. Proc. File No. 3-14979 (Mar. 5, 2013)*

1. The SEC commenced an administrative proceeding against Peak Wealth Opportunities, LLC ("Peak Wealth") and its owner, president, and sole managing member, David W. Dube, (collectively "Respondents") alleging that Respondents failed to comply with various reporting and record-keeping requirements. After Respondents failed to appear for multiple proceedings, and after expressing concern about the strength and nature of the SEC's case against Respondents and directing the SEC to submit additional legal authority and evidentiary support, an administrative law judge issued an Order Making Findings and Imposing Sanctions by Default.

2. Peak Wealth was a registered investment adviser to StockCar Stocks Index Fund (the "Fund"), a mutual fund that invested in companies that support NASCAR racing events. After Peak Wealth allegedly failed to reimburse the Fund for certain expenses owed under the advisory agreement, the Fund's board of directors liquidated Dube's personal holdings in the Fund to satisfy the obligation. The board also made multiple requests for documents to Peak Wealth in connection with its review of Peak Wealth's investment advisory contract. Peak Wealth did not supply the requested materials and the board terminated the contract and liquidated the Fund.

3. Peak Wealth also allegedly failed to produce documents requested in the course of an SEC field examination and Dube failed to appear for investigative testimony pursuant to a subpoena.

4. Peak Wealth was found to have violated a number of reporting and record-keeping provisions and regulations, including without limitation Section 15(c) of the Investment Company Act, Sections 203A and 204 of the Advisers Act and certain rules thereunder, and C.F.R. § 275.204-2(a). Dube was found to be secondarily liable for aiding and abetting Peak Wealth's violations. Respondents were ordered to cease and desist from violating Sections 204 and 203A of the Advisers Act and Rules 204-1(a)(1), 204-2(a)(1), (2), (4), (5), and (6), and 203A-1(b)(2) thereunder. Peak Wealth's investment adviser registration was revoked and Dube was barred permanently

from association with an investment adviser or other member of the securities industry and appearing or practicing before the SEC.

5. The ALJ declined to impose a civil monetary penalty against Respondents, despite Dube's prior disciplinary history and reckless disregard of regulatory requirements, finding that, among other things, Respondents were not unjustly enriched, there was no demonstrated harm to others, and the remaining sanctions were sufficient to deter future violations.

Representations to Investors

The SEC continues to bring actions against investment advisers and their personnel for allegedly misleading statements to existing and prospective investors.

A. *In the Matter of Chariot Advisors, LLC and Elliott L. Shifman, Admin Proc. File No. 3-15433 (Aug. 21, 2013)*

1. The SEC filed an administrative proceeding against Chariot Advisors, LLC ("Chariot Advisors"), a registered investment adviser, and Elliott L. Shifman, Chariot Advisors' former owner. The SEC alleged that Chariot Advisors and Shifman misled the board of directors of the Chariot Absolute Return Currency Portfolio (the "Fund"), a registered investment company, about the firm's ability to conduct algorithmic currency trading so they would approve Chariot Advisors' contract to manage the Fund. The Fund was a series of the Northern Lights Variable Trust ("Northern Lights"), which serves as an umbrella trust for a series of mutual funds and provides those funds with turnkey services, including fund governance.

2. The SEC alleged that in December 2008 and again in May 2009, during the approval process for the investment advisory agreement of Chariot Advisors required by Section 15(c) of the Investment Company Act (the "15(c) process"), Shifman misrepresented to the Fund's board of directors Chariot Advisors' ability to conduct algorithmic currency trading and, as a result, misled the Fund's board about the nature, extent, and quality of services that Chariot Advisors could provide.

3. According to the SEC, at the time of Shifman's representations to the Fund's board, Chariot Advisors had not devised nor did it possess any algorithms or computer models capable of engaging in the currency trading that Shifman described during the 15(c) process. Moreover, after the Fund launched in July 2009, Chariot Advisors initially did not use an algorithm to perform the Fund's currency trading as represented to the Fund's Board, but instead hired an individual trader who was allowed to use discretion with

respect to trade selection and execution. According to the SEC, these misrepresentations also led directly to misrepresentations and omissions in the Fund's registration statement and prospectus.

4. The SEC's Order alleged that Chariot Advisors violated Section 15(c) of the Investment Company Act and Shifman aided and abetted Chariot Advisors' violation of Section 15(c) of the Investment Company Act, Chariot Advisors and Shifman aided and abetted and caused the Fund's violations of Section 34(b) of the Investment Company Act, Chariot Advisors violated Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder and Shifman aided and abetted and caused Chariot Advisors' violations of Sections 206(1) and 206(2) of the Advisers Act.

5. The SEC's action is pending.

B. *In the Matter of Timbervest, LLC, Joel Barth Shapiro, Walter William Anthony Boden, III, Donal David Zell, Jr., and Gordon Jones II, Admin. Proc. File No. 3-15519 (Sept. 24, 2013)*

1. The SEC filed an administrative proceeding against Timbervest, LLC ("Timbervest"), an Atlanta-based investment adviser, and against Timbervest's CEO Joel Barth Shapiro, CIO Walter William Anthony Boden, III, COO Donal David Zell, Jr., and President Gordon Jones II, (the "Principals") for allegedly receiving unauthorized and undisclosed real estate commissions paid out of the pension plan assets of Timbervest's largest client (the "Client").

2. The SEC's order alleges that in or around 2005, the Client ordered Timbervest to reduce the size of the Client's fund by selling substantial amounts of timberland property owned by the fund. The SEC alleges that, in violation of ERISA (which prohibits investment advisers from selling pension plan assets to other funds that they manage) and in violation of the operating agreement entered into between itself and the Client, Timbervest and the Principals sold the Client's fund property to another fund managed by Timbervest and concealed the unauthorized nature of the transaction from the Client through a "parking arrangement" with a middleman.

3. The SEC alleges that the Principals sold the property to a real estate company with the understanding that they would repurchase it in the near future. Six months later, Timbervest repurchased the property with cash from another fund that it managed, paying an undisclosed \$1.05 million "parking fee" to the middleman. The SEC alleges that the Principals received unauthorized and undisclosed commissions from the Client's pension fund assets related to the sale of the property. The payments were made to two shell

companies that were beneficially owned by one of the Principals. Those companies performed no services in connection with the sale and were established for the sole purpose of receiving the commissions. The SEC alleges that the shell companies were structured to conceal the identity of the recipients and that the commissions were remitted in such a way as to obfuscate the fact that they went to the Principals.

4. The SEC's Order alleges that as a result of these actions, Timbervest violated Sections 206(1) and 206(2) of the Advisers Act and that the Principals willfully aided, abetted, or caused these violations.

5. The SEC's action is pending.

C. *In the Matter of ZPR Investment Management, Inc. and Max E. Zavanelli, Admin. Proc. No. 3-15263 (Apr. 4, 2013)*

1. The SEC initiated administrative and cease-and-desist proceedings against ZPR Investment Management, Inc. ("ZPR" or "the firm") and its President, Max E. Zavanelli (collectively, "Respondents"), alleging that they distributed misleading advertisements that overstated the firm's performance in relation to its benchmark and falsely claimed compliance with Global Investment Performance Standards ("GIPS").

2. The SEC alleges that Respondents omitted material information from advertisements in financial magazines that would have revealed the firm was underperforming its benchmark index, rather than outperforming it as suggested in the advertisements, by including only long-term capitalized returns and omitting period-to-date performance.

3. Respondents claimed, in magazine advertisements and in newsletters distributed to clients and published on the firm's website, that the firm was in compliance with GIPS standards relating to the calculation and reporting of investment results, yet failed to include with those claims GIPS-required information, such as composite period-to-date performance returns. The SEC alleges that, by omitting the required information, Respondents were able to conceal that ZPR was underperforming the market.

4. The SEC further alleges that Respondents made false statements in reports to Morningstar, Inc. (i) overstating the time period during which its performance figures had been audited for GIPS compliance; and (ii) indicating that it was not under a pending SEC investigation.

5. Respondents are charged with willfully violating Sections 206(1) and 206(2) of the Advisers Act. Zavanelli, in the alternative, is charged with aiding and abetting ZPR's alleged violations of Sections 206(1) and 206(2) of the Advisers Act. Further, ZPR is charged with willfully violating, and Zavanelli is charged with willfully aiding and abetting and causing ZPR to violate, Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder.

6. The SEC's action is pending.

D. *Securities and Exchange Commission v. New Stream Capital, LLC, New Stream Capital (Cayman), Ltd., David A. Bryson, Bart C. Gutekunst, Richard Pereira, and Tara Bryson, et al., Civil Action No. 3:13-cv-264 (D. Conn. Feb. 26, 2013)*

1. On February 26, 2013, the SEC filed an action in the United States District Court for the District of Connecticut against hedge fund managers David Bryson and Bart Gutekunst, and their unregistered investment advisory firm, New Stream Capital, LLC, for undertaking a scheme and making false statements about their fund's capital structure and financial condition in violation of Section 17(a) of the Securities Act of 1933, Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5, and Sections 206(1), 206(2) and 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-8. The SEC also charged New Stream Capital (Cayman), Ltd., a Caymanian adviser entity affiliated with New Stream, Richard Pereira, New Stream's former CFO, and Tara Bryson, New Stream's former head of investor relations, for their alleged role in the scheme.

2. In March 2008, Defendants allegedly schemed to secretly revise the hedge fund's capital structure in response to a threat by its largest investor, Gottex Fund Management Ltd., that it would redeem its nearly $300 million investment in the fund unless preferential liquidation rights that Gottex had previously enjoyed were restored.

3. The SEC alleged that, after revising the capital structure to afford Gottex and certain other preferred investors priority over other investors in the event of a liquidation, defendants falsified the fund's financial statements to conceal the restructuring and continued to market the fund as if all investors had equal liquidation rights. New Stream raised nearly $50 million in new investor funds and secured increased advisory fees on the basis of these misrepresentations.

4. The SEC further alleged that defendants misled investors about the level of redemption requests it received from Gottex and others. By September 2008, as the financial crisis worsened, the fund faced

$545 million in redemption requests. In response, it suspended redemptions and fund raising. The fund ultimately filed for bankruptcy. According to the SEC, the defrauded investors are expected to receive approximately 5 cents on the dollar -- substantially less than what Gottex and other preferred investors are expected to receive.

5. In settlement of the SEC's charges against her, Tara Bryson, the fund's former head of investor relations, consented to the entry of final judgment that permanently enjoins her from violating, inter alia, Section 206(4) of the Advisers Act and Rule 206(4)-8 and bars her from associating with any investment adviser, broker-dealer, municipal securities dealer or transfer agent.

6. The SEC's case against the remaining defendants remains pending. Its complaint seeks a final judgment permanently enjoining them from committing future violations of these provisions, ordering them to disgorge their ill-gotten gains plus prejudgment interest, and imposing financial penalties.

Soft Dollar Payments

The following related cases involve the use, documentation and disclosure of soft dollar payments.

A. *In the Matter of J.S. Oliver Capital Management, L.P., Ian O. Mausner, and Douglas F. Drennan, Admin. Proc. File No. 3-15446 (Aug. 30, 2013)*

1. The SEC filed an administrative proceeding against J.S. Oliver Capital Management, L.P. ("JS Oliver"), a registered investment adviser and Ian O. Mausner, its founder, president, and sole owner, alleging that they engaged in separate schemes to (i) disproportionately allocate favorable trades to affiliated and/or favored hedge fund clients to the detriment of other clients; and (ii), with substantial assistance from Douglas F. Drennan, an outside research analyst also named in the SEC's Order, used soft dollar credits from client commission arrangements for personal and other undisclosed and unauthorized purposes.

2. The SEC alleges that from June 2008 to November 2009, JS Oliver and Mausner allocated profitable equity trades on a preferential basis to six client accounts, including affiliated hedge funds, to the detriment of three other JS Oliver clients. The SEC's Order states that Mausner placed block trades in omnibus accounts at various broker-dealers, which were then reported to JS Oliver's prime broker. Thereafter, he allegedly used the prime broker's online platform to allocate the shares among client accounts, often waiting until after the close of trading so that he could determine the value

of the securities and allocate to preferred accounts those that had increased in value and to disfavored account those that had decreased in value. Where there were multiple trades in the same security on the same day, Mausner allegedly allocated the most favorably priced trades to favored accounts.

3. The preferential allocations were contrary to JS Oliver's written policies and procedures and to representations made in client agreements, which required that allocations among clients would be fair and equitable and in proportion to account assets or target percentage levels. In addition, the SEC alleges, JS Oliver received performance fees from the favored funds, and Mausner and his family profited at certain clients' expense because they were personally invested in some of the favored funds.

4. The SEC's alleges that a separate scheme operated from January 2009 through November 2011, in which JS Oliver misused over $1.1 million in soft dollar credits accrued from trading commissions paid by JS Oliver clients. JS Oliver disclosed in its Form ADV allowable uses of soft dollar credits, but Mausner, allegedly with substantial assistance from Drennan, misrepresented and falsely documented the purpose of certain payments, which were directed to unauthorized uses such as Mausner's personal expenses and salary and bonus payments to Drennan.

5. Finally, the SEC alleges that JS Oliver failed to maintain a memorandum of each order it gave for the purchase or sale of securities and to maintain originals of Mausner's email messages promoting one of the funds that he favored in his cherry-picking scheme.

6. The SEC's Order alleges that JS Oliver and Mausner violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 206(1), (2), and (4), and Section 207 of the Advisers Act and Advisers Act Rule 206(4)-8 thereunder; that JS Oliver willfully violated, and Mausner willfully aided, abetted, and caused JS Oliver's violations of Sections 204 and 206(4) of the Advisers Act and Advisers Act Rules 204-1(a)(2), 204-2(a)(3), 204-2(a)(7) and 206(4)-7 thereunder; and that Drennan willfully aided, abetted, and caused JS Oliver's violations of Sections 17(a)(1) and (2) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), (2), and (4) of the Advisers Act and Advisers Act Rule 206(4)-8 thereunder.

7. The SEC's action is pending.

B. *In the Matter of Instinet, LLC ("Instinet"), Admin. Proc. File No. 3-15663 (Dec. 26, 2013)*

1. In a follow-up to the J.S. Oliver matter, the SEC filed a settled administrative proceeding against Instinet for allegedly paying approximately $430,000 in client commission credits (soft dollars) as requested by its investment adviser customer, J.S. Oliver Capital Management, L.P. ("JS Oliver"), for expenses that JS Oliver had not properly disclosed to its clients, including improper personal expenses of JS Oliver's president. The SEC alleged that Instinet made the payments pursuant to JS Oliver's requests despite the fact that the information JS Oliver provided to Instinet when requesting approval of the payments contained significant red flags that suggested that each payment was improper.

2. The SEC alleged that JS Oliver, through Instinet, used soft dollar credits on brokerage commissions to pay for personal expenses that fell outside of the safe harbor provided under Section 28(e) of the Securities and Exchange Act of 1934 and that were not properly disclosed to clients. For example, the SEC alleged that in June 2009 Instinet, pursuant to JS Oliver's request, paid JS Oliver $329,365 using soft dollar credits for a payment to Mausner's ex-wife based on JS Oliver's representations to Instinet that the payment was for employee compensation. The SEC further alleged that a Instinet employee knew of significant red flags that the payment to Mausner's ex-wife was importer, including that: (1) the recipient of the payment was Mausner's ex-wife, (2) the payment was purportedly related to the Mausners' parting ways professionally after their divorce, (3) JS Oliver gave Instinet a series of inconsistent justifications for the payment, (4) despite Instinet's requests, JS Oliver never provided Instinet with the purported employment agreement or a legal opinion from counsel stating that the use of soft dollars for the payment was permissible, and (5) JS Oliver provided Instinet an excerpt of the purported employment agreement (that had been materially altered by JS Oliver) and did not indicate that Mausner's ex-wife had conducted any work for JS Oliver in 3 years and did not substantiate the amount paid. The SEC alleged that despite these red flags, the Instinet employee approved the payment.

3. The SEC further alleged that Instinet employees knew of additional red flags relating to the subsequent payment of soft dollars for increased rent on office space located in Mausner's home and for Mausner's personal time share property in New York City. The SEC alleged that despite significant red flags, Instinet employees approved such soft dollar payments.

4. The SEC's Order charged that Instinet willfully aided and abetted and caused JS Oliver's violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

5. Pursuant to the settlement, Instinet consented to a cease and desist order, a censure and to pay disgorgement of $378,673.76, prejudgment interest of $59,607.66 and a civil monetary penalty of $375,000. Instinet further consented to retain an independent consultant to undertake to review and report on Instinet's policies, procedures and practices relating to the payment of soft dollars.

Trade Allocation

In the following cases, the SEC sanctioned advisers for engaging in alleged "cherry picking" in which they allocated trades improperly to the detriment of their clients.

A. *SEC v. Dushek, Case. No. 13-cv-3669 (Oct. 10, 2013)*

1. The SEC filed a settled action in Illinois federal court against Charles J. Dushek ("Dushek Sr."), an investment adviser, and his son, Charles S. Dushek ("Dushek Jr.") (collectively, "the Dusheks") and Dushek Sr.'s advisory firm, Capital Management Associates, Inc. ("CMA"). The SEC alleged that the Dusheks and CMA conducted a "cherry picking" scheme to defraud CMA clients of almost $2 million.

2. The SEC alleged that, from 2008 to 2012, the Dusheks entered into securities trades on behalf of clients without designating trades as "client" or "personal" orders or creating any written record distinguishing client trades from personal trades. According to the SEC, the Dusheks typically waited a day, or in many cases, several days to allocate trades to client accounts or personal accounts. In that time, the Dusheks monitored the profitability of these trades and allocated the profitable trades to their personal accounts and the unprofitable trades to client accounts.

3. According to the SEC, the Dusheks placed and allocated more than 13,500 securities trades in the four-year period. More than 75% of the trades that the Dusheks allocated to themselves were profitable at the time of allocation while fewer than 25% of the trades allocated to clients were profitable at the time of allocation. In that same period, the Dusheks earned positive returns in their personal accounts for 17 consecutive quarters and earned almost $2 million in profits, whereas clients earned negative returns for 17 consecutive quarters and lost over $2 million.

4. The Dusheks' preferential allocations were contrary to representations made to clients, including that CMA does not merge or aggregate client and employee orders.

5. The SEC's complaint charged the Dusheks and CMA with violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and 206(2) of the Advisers Act.

6. The Dusheks consented to an injunction and agreed to disgorgement, prejudgment interest thereon and civil penalties in amounts to be determined by the court.

B. *In the Matter of MiddleCove Capital, LLC and Noah L. Myers, Admin. Proc. File No. 3-14993 (Jan. 16, 2013)*

1. In a settlement of a litigated proceeding filed in August 2012, the SEC settled with MiddleCove Capital, LLC ("MiddleCove"), a registered investment adviser, and its sole owner Noah L. Myers, over a cherry-picking scheme to the detriment of their advisory clients.

2. The SEC alleged that, from approximately October 2008 to February 2011, Myers used an omnibus account (the "Account") to place orders for MiddleCove advisory client accounts and for accounts in which he or family members had a beneficial interest. He would delay allocation of trades until later in the day or the next day, after he was able to see which securities had appreciated in value. When a security appreciated in value on the day of purchase, Myers would often sell the security and disproportionately allocate the purchase and profit to personal/family accounts; when a security depreciated in value on the day of the purchase, Myers would disproportionally allocate the purchase to advisory client accounts where they would be held for longer than one day. The SEC noted that these purchases and sales often involved leveraged and inverse ETFs, products it believed were generally not designed to be held for more than one day and inappropriate investments for many clients.

3. These preferential allocations were contrary to trade allocation policies contained in MiddleCove's Form ADV, which require that batched trades would be allocated fairly and not favor Myers or MiddleCove.

4. The SEC alleged that as a result of this scheme, Myers fraudulently realized over $460,000 in profits and caused his clients more than $2 million in losses.

5. The SEC's Order charged that MiddleCove and Myers both violated Section 10(b) of the Exchange Act and Rule 10(b)5 thereunder and Sections 206(1) and 206(2) of the Advisers Act, and that MiddleCove violated Section 207 of the Advisers Act.

6. Pursuant to the settlement, MiddleCove and Myers consented to a cease and desist order, a revocation of MiddleCove's investment adviser registration, an industry bar for Myers, disgorgement and prejudgment interest of $489,118 and a civil money penalty of $300,000.

Valuation

In 2013, the SEC filed a valuation case involving private equity fund valuation practices, and settled a high profile administrative proceeding against the directors of a mutual fund.

A. *In the Matter of Oppenheimer Asset Management Inc. and Oppenheimer Alternative Investment Management, LLC, Admin. Proc. File No. 3-15238 (Mar. 11, 2013)*

1. The SEC filed a settled administrative proceeding against registered investment advisers Oppenheimer Asset Management Inc. ("OAM") and Oppenheimer Alternative Investment Management, LLC ("OAIM") alleging that the firms made misrepresentations and omissions to investors and prospective investors about the net asset value of a fund of funds private equity vehicle (the "Fund-of-Funds") that they managed. The SEC further alleged that the firms' policies and procedures did not contain provisions reasonably designed to prevent such misrepresentations and omissions.

2. The SEC alleged that, from October 2009 through 2010, OAM and OAIM disseminated marketing materials to prospective investors and quarterly reports to existing investors stating that the Fund-of-Fund's net asset values were "based on the underlying managers' estimated values" when, in fact, the portfolio manager for the Fund-of-Funds decided to value its largest holding at par, which was a significant markup to the underlying manager's estimated value. The change in the valuation methodology for its largest holding made the Fund-of-Fund's performance appear significantly better as measured by its internal rate of return. The employees of OAIM allegedly made further representations in connection with marketing the Fund-of-Funds, including that the increase in the value of the portfolio holding was attributable to performance, when, in fact, it was due to the change in valuation methodology.

3. According to the SEC, the above misrepresentations and omissions were made possible, in part, by the firms' failure to adopt and implement policies and procedures reasonably designed to ensure that valuations were determined in a manner consistent with written representations provided to investors.

4. The SEC's settled Order charged that the firms violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder.

5. Pursuant to the settlement, OAM and OAIM consented to a censure and a cease and desist order. OAM and OAIM also agreed to distribute $2,269,098 to investors who invested in the Fund-of-Funds during the period of the alleged misrepresentations. This amount represented $2,128,232 in disgorgement and $140,866 in prejudgment interest. The firms also agreed to pay a civil penalty of $617,579. The firms agreed to retain an independent consultant to conduct a review of the firms' valuation policies and procedures, send a copy of the order to existing advisory clients and prominently post a hyperlink to the order on their website.

6. In considering whether to accept the civil penalty offered by OAM and OAIM, the SEC took into account the firms' cooperation in the investigation and enforcement action.

7. In a separate action brought by the Commonwealth of Massachusetts, OAM and OAIM agreed to pay $376,700 in disgorgement and $23,935 in prejudgment interest. The firms also agreed to pay a penalty of $132,421.

8. In a separate administrative proceeding, the SEC brought charges against the portfolio manager alleging that he made material false and misleading statements and omissions to investors related to the valuation and performance of the Fund-of-Funds. The SEC alleged that Williamson violated Section 17(a) of the 1933 Act, Section 10(b) of the 1934 Act and Rule 10b-5 thereunder and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. In the alternative, the SEC alleged that OAM and OAIM violated the aforementioned statutes and rules and Williamson willfully aided and abetted and caused OAM's and OAIM's violations. This matter is currently pending. *See In the Matter of Brian Williamson*, Admin. Proc. File No. 3-15430 (Aug. 20, 2013).

B. *In the Matter of J. Kenneth Alderman, CPA, et al., Admin. Proc. File No. 3-15127 (June 13, 2013)*

1. In a settlement of a litigated administration proceeding filed in December 2012, the SEC settled with J. Kenneth Alderman and seven other directors ("the Directors") of five registered investment companies ("the Funds") (collectively, "Respondents") for allegedly abrogating their responsibility to determine the value of the Funds' below-investment grade debt securities, some of which were backed by subprime mortgages, and failing to establish adequate policies and procedures to determine the fair value of those securities.

2. The SEC alleged that the Directors improperly delegated the determination of the fair value of portfolio securities to the investment adviser of the Funds without providing a fair valuation methodology or other substantive guidance. The SEC asserted the abrogation of duty was particularly significant because fair valued securities made up the majority of the Funds' net asset values.

3. The SEC alleged that changes to the fair value of a security were arbitrarily made by the Portfolio Manager without any basis or explanation and were made for the purpose of postponing the decline in the Funds' net asset values. The SEC also asserted that the Funds' accounting group engaged in smoothing prices to gradually reduce, over days or weeks, the value of a security to its lower valuation as provided by the Portfolio Manager.

4. Although the Valuation Procedures that were in place required that the Directors receive an explanatory note for the fair values assigned to the securities, the SEC alleged that explanatory notes were not provided and that the Directors failed to inquire or determine what methodology was used to assess the fair value of any particular security.

5. The Directors were found to have caused the Funds to violate Rule 38a-1 under the Investment Company Act by not properly determining the fair value of the securities in accordance with the requirements of Section 2(a)(41)(B) of the Investment Company Act.

6. Respondents consented to a cease and desist order to refrain from committing or causing any future violations of Rule 38a-1 under the Investment Company Act.

Personnel Changes

Last year, Susan Axelrod was promoted to Executive Vice President of Regulatory Operations. In this role, Ms. Axelrod oversees Enforcement, the Office of Fraud Detection and Market Intelligence, and Member Regulation (which includes Sales Practice, Risk Oversight and Operational Regulation and Shared Services). Ms. Axelrod previously served as head of Member Regulation Sales Practice, and Senior Vice President and Deputy of Regulatory Operations. Prior to joining FINRA, Ms. Axelrod was Chief of Staff to the Chief Executive Officer of NYSE Regulation and a Staff Attorney and later an Enforcement Director at the New York Stock Exchange.

Carlo di Florio joined FINRA from the SEC as the Executive Vice President for Risk and Strategy. In his new role at FINRA, Mr. di Florio is responsible for assessing the most significant risks to investors and market integrity, and developing ways to lessen, manage and monitor those risks and trends in the industry. While at the SEC, Mr. di Florio was the Director of OCIE, where he oversaw the national examination program. Prior to his tenure at the Commission, Mr. di Florio was a consultant in the financial services industry.

Mike Rufino was promoted to Head of Member Regulation Sales Practice and Bill Wollman was elevated to the role of Head of Member Regulation Risk Oversight and Operational Regulation. Mr. Rufino and Mr. Wollman have been regulators for many years. Prior to joining FINRA in 2007 upon the merger of NYSE Regulation and the NASD, they worked for the NYSE in various roles since the late 1980s.

Enforcement Statistics

In 2013, FINRA brought 1,535 new disciplinary actions, a slight decline from the record 1,541 cases initiated in 2012. FINRA resolved 1,307 formal actions last year; 363 fewer cases than it had in the prior year. Last year, FINRA expelled 24 firms from its membership (compared to 30 in the prior year), barred 429 people (versus 294 in 2012), and suspended 670 individuals (an increase over the 549 such actions in the prior year).[30]

[30] See the 2013 Regulatory Actions data on the FINRA website at the FINRA Statistics and Data page available at: http://www.finra.org/Newsroom/Statistics/.

Targeted Examination Letters and Sweeps

In 2013, FINRA posted only three Targeted Examination letters on its website, versus five in the prior year.

- In May 2013, the Trading Examination Unit of the Market Regulation Department announced that it was conducting a review of Alternative Trading Systems ("ATSs").[31] FINRA's ATS's examination letter sought a significant amount of information from the firms that received the letter, including (i) a list of all orders and their attributes available to the ATS's subscribers; (ii) a statement of whether the firm tracks the use of different order types; (iii) a statement regarding whether the ATS permits subscribers to elect the types of orders with which they will interact within the ATS; (iv) identification of all surveillance conducted by the firm regarding trading on the ATS; (v) a list of the top ten subscribers by executed share volume; (vi) a description of how the firm ensures that its Form ATS filings are accurate; and (vii) a statement regarding whether any third parties have access to subscriber order or trade data.

- In June 2013, FINRA posted a letter indicating that the Advertising Regulation Department was beginning a "spot-check" of firms' social media communications pursuant to Rule 2210(c)(6). FINRA's request included (i) an explanation of the way in which the firm uses social media (including Facebook, Twitter, and LinkedIn); (ii) a description of how the firm's employees use social media in conducting the firm's business activities; (iii) a description of the steps taken to monitor for compliance with the firm's social media policies; and (iv) a list of the firm's top 20 producing brokers who used social media to communicate with retail investors.

- In July 2013, the Trading Examinations Unit of the Market Regulation Department began a review regarding firms' controls and processes in connection with the development and use of trading algorithms and automated trading technology. As part of its review, FINRA requested a number of items from firms, including (i) a detailed description of the firm's software development life cycle; (ii) identification of the individuals responsible for the oversight and supervision of the "planning, implementation, testing, deployment, and maintenance of algorithms and related software"; (iii) a statement regarding whether changes to algorithms require supervisory approval or testing before implementation; (iv) copies of procedures regarding automated trading malfunctions or system failures; (v) a description regarding the controls in place to monitor algorithms and to identify and take steps necessary to address a system

[31] In September 2012, the same group within FINRA announced that it was conducting a review of ATSs. It is unclear from the 2013 letter whether this is a continuation of that examination or a new review.

malfunction; (vi) a description of any automatic or other "kill switches"; (vii) copies of internal reviews focused on algorithms and/or software governance and control; and (viii) a description of any situations in which the firm had a malfunction with an algorithm or trading engine that had a material financial impact on the firm or any instances in which such a malfunction caused a disruption in the market.

Enforcement Developments

There were several FINRA enforcement developments of note last year.

First, in late 2013, FINRA publicly described its efforts to monitor certain "high-risk" brokers and the firms that hire such individuals. According to FINRA, two of the primary tools used in this area are its Broker Migration Model and Problem Broker Model.[32] The Broker Migration Model tracks the movement of certain registered representatives from firm to firm using a variety of risk metrics. The information developed is used by FINRA's Staff to prioritize its surveillance, examination, and enforcement resources, enabling it to conduct targeted examinations and enforcement actions. The Problem Broker Model identifies and monitors registered representatives who have significant regulatory disclosures. FINRA also uses the information derived from this model to target brokers in its surveillance, examination, and enforcement activities. FINRA has reported that, since February 2013, 42 brokers have been identified as "high-risk," leading to fast-tracked regulatory actions, including 16 completed cases (all of which resulted in bars from the industry). In its 2014 letter setting forth its regulatory and examination priorities, FINRA indicated that it will expand its "high-risk" program and establish a dedicated team within the Department of Enforcement to prosecute such cases.

Second, in December of 2013, FINRA issued Regulatory Notice 13-27 announcing amendments to Rule 8313, which governs the publicity of its disciplinary actions. Key changes include the elimination of the publicity thresholds in the rule, the establishment of general standards for the release of disciplinary information, and clarity on the scope of information subject to Rule 8313. Of particular note, the prior monetary sanction threshold of $10,000 for publication of disciplinary actions has been eliminated. Effective December 16, 2013, disciplinary complaints and decisions, independent of the sanction amount, will be shared with the public. Moreover, the amendments also changed the scope of the information FINRA will share with the public regarding many types of matters, including temporary cease-and-desist orders, statutory disqualification decisions, expedited proceedings, decisions, summary actions, membership application appeals and disciplinary decision appeals to the SEC. These disclosures are subject to limited, case-by-case exceptions at FINRA's discretion.

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[32] See FINRA's November 13, 2013 letter to United States Senator Edward J. Markey available at: http://www.markey.senate.gov/news/press-releases/markey-urges-finra-to-continue-enforcement-actions-improve-disclosures-on-rogue-brokers. This letter was written in response to an inquiry from Senator Markey regarding concerns about protecting investors from so-called "rogue brokers."

Third, last year, senior FINRA officials emphasized that the agency was focused on responding quickly to address fraudulent conduct. As examples of this effort, in at least two matters in 2013, FINRA filed for Temporary Cease-and-Desist Orders ("TCDOs") against firms when it learned of alleged fraudulent conduct. In a matter against Westor Capital Group, Inc. and its President, Chief Compliance Officer and Financial Operations Principal, Richard Hans Bach, FINRA filed a TCDO and a complaint in January 2013 alleging that the respondents misappropriated and misused customer funds. FINRA alleged that the respondents (i) misused customer securities to effect and cover short sales in other customer accounts without the customers' knowledge and (ii) failed to honor customer requests for withdrawals of funds and delivery of securities. In a separate matter against John Carris Investments, LLC, its Chief Executive Officer, George Carris, and five other firm principals, FINRA filed a TCDO and a complaint alleging that the respondents fraudulently solicited customers to buy a certain stock while, at the same time, the respondents were selling their shares in that security. FINRA alleged that respondents were fraudulently inflating the price of the stock through prearranged trading and unauthorized purchases in customers' accounts.

Current FINRA Enforcement Priorities

Based upon our review of currently available public information, we believe that the following list reflects some of FINRA's top enforcement priorities.[33]

- Structured and complex products sold to retail clients, including firm due diligence, the training provided to registered representatives and principals and the supervision of such sales;
- Single registered representative cases involving petty theft from firms or clients, dishonesty, cheating on expense reimbursements, unapproved private securities transactions, etc.;
- Fraudulent conduct by firms and/or individuals, including insider trading;
- Sales to senior investors;
- High-frequency and algorithmic trading;
- The use of social media to interact with retail investors;
- Excessive commissions and markups/markdowns;
- Cyber security and data breaches and losses;

[33] Several of these priorities are mentioned in FINRA's 2014 Annual Regulatory and Exam Priorities Letter posted to its website on January 2, 2014 and in an outline entitled "Enforcement Developments" presented at the 2013 FINRA Annual Conference, which included participants from senior FINRA Department of Enforcement Staff.

- Compliance with the Direct Market Access Rule;
- Anti-money laundering, including firms' policies and procedures;
- Systems and operations-related supervisory failures, including issues relating to firms' systems and procedures to identify and prevent firm and customer losses;
- Microcap and penny stock fraud, with a particular emphasis on schemes to defraud retail investors; and
- Audit trail integrity, including Large Options Positions Reporting and options order marking capacity.

FINRA Enforcement Actions[34]

Anti-Money Laundering

Anti-money laundering ("AML") cases are a steady part of FINRA's examination and enforcement efforts, and it regularly brings cases in this area. Last year FINRA announced the settlement of three cases (involving Firstrade Securities, Atlas One Financial Group and World Trade Financial Corp.) on the same day. Two other cases began as litigated actions, but were subsequently settled. Moreover, demonstrating its continued emphasis on AML, in its recently published 2014 regulatory and examination priorities letter, FINRA stated that it will focus on AML issues associated with institutional businesses this year.

A. *Firstrade Securities, Inc. ("Firstrade") (May 7, 2013)*

1. FINRA settled a matter with Firstrade in which it alleged that the firm engaged in certain AML, supervision, and order ticket recording violations.

2. Between May 2008 and July 2011, Firstrade, an online trading firm that catered to the Chinese community, failed to implement an adequate AML program to detect and report suspicious transactions, including potential manipulative trading. Specifically, FINRA alleged that Firstrade failed to investigate suspicious activity, including transactions involving certain types of securities, such as penny stocks, pre-arranged trades of Chinese issuer stock done in related accounts, and excessive journal entries between unrelated accounts, in accordance with the firm's procedures.

[34] Unless otherwise apparent from the context of the descriptions of the actions, the cases described herein are settlements in which respondents neither admitted nor denied the allegations against them.

3. In addition, FINRA alleged that Firstrade did not have any procedures for the detection, review, and reporting of suspicious activity related to the deposit of physical certificates and deposits/withdrawals at custodians.

4. FINRA also alleged that from May 2008 to March 2010, in a sampling of 30 order tickets for municipal securities, Firstrade failed to include a time of entry on all of the order tickets in the sample.

5. Firstrade consented to a censure and a $300,000 fine, $25,000 of which pertained to the municipal securities violations.

B. *Atlas One Financial Group, LLC ("Atlas One") (May 8, 2013)*

1. FINRA settled a matter with Atlas One in which it alleged that, between February 2007 and May 2011, Atlas One failed to establish and implement policies and procedures reasonably designed to detect and cause the reporting of suspicious transactions in accordance with AML rules, failed to maintain accurate books and records, and failed to timely report certain matters.

2. Specifically, FINRA alleged that Atlas One's AML program required the firm's chief compliance officer to monitor for potentially suspicious activity and AML red flags and investigate and report suspicious activity by filing a suspicious activity report when necessary, which he failed to do.

3. FINRA alleged that Atlas One failed to perform any additional scrutiny of accounts that shared the same contact information as six accounts that were frozen by the United States Department of Justice in connection with a conspiracy to launder hundreds of millions of dollars in a judicial bribery scheme in Italy and engaged in little or no securities activity but conducted approximately 125 wire transfers totaling over $10 million.

4. FINRA also alleged that certain customers' accounts engaged in a pattern of activity consisting of moving millions of dollars through customer accounts, which was inconsistent with the customer's stated annual income and liquid net worth (e.g., a customer whose annual income and liquid net worth were $500,000 and $850,000, respectively, later sent an outgoing wire in an amount in excess of $25 million).

5. FINRA also alleged that Atlas One opened an account for an Argentinean professional polo player who made very few securities transactions and engaged in a pattern of wire transfers in increments of less than $10,000 to and from Nigerian nationals.

This activity continued despite concerns from Atlas One's clearing firm.

6. In addition, FINRA alleged that Atlas One failed to timely report 16 of the 19 customer grievances it received between November 2008 and April 2012 and to timely update Forms U-4 and U-5 in 14 instances.

7. Atlas One consented to a censure and a $350,000 fine ($25,000 of which was joint and several with the chief compliance officer, who also received a three-month suspension from acting in a principal capacity).

C. *World Trade Financial Corp. ("WTF") (May 8, 2013)*

1. FINRA settled a matter with WTF in which it alleged that between March 2009 and August 2011, WTF bought and sold more than 27.5 billion shares of 12 penny stock issues on behalf of one customer, generating approximately $61 million in investor proceeds, which represented the majority of the firm's business and revenue.

2. FINRA alleged that WTF ignored red flags indicating that the customer was engaging in the unlawful distribution of securities.

3. FINRA also alleged that WTF traded securities that were not properly registered and were not eligible for an exemption to registration.

4. FINRA also alleged that WTF failed to have a program reasonably designed to monitor for and detect and report suspicious activity, which would be considered AML red flags.

5. WTF consented to a censure, a $250,000 fine, and a temporary ban from certain activities.

6. The firm's president and owner, chief executive officer, and trading desk supervisor were fined from $5,000 to $40,000 and suspended from three to nine months for failure to supervise.

7. In setting the sanctions, FINRA noted that the respondents had previously been sanctioned by FINRA for the sale of unregistered securities and that the SEC had affirmed the sanctions.

D. *Oppenheimer & Co., Inc. ("Oppenheimer") (Aug. 5, 2013)*

1. FINRA settled a matter with Oppenheimer related to sales of over 1 billion shares of unregistered penny stocks and a failure to have in place adequate systems and policies to detect and investigate that the securities were unregistered and that activity in them was suspicious.

2. This settlement resolved a complaint initiated against the firm by FINRA in May 2013.

3. According to FINRA, the sales took place between August 19, 2008 and September 20, 2010, in accounts opened by 13 customers at five branch offices throughout the United States. In many instances, the customers, some of whom appeared to be affiliated with issuers, deposited share certificates for recently-issued stock, or for amounts of stock that represented a large percentage of the float for the stock. Shortly thereafter, the customers sold the stock and wired out the proceeds.

4. FINRA alleged that Oppenheimer had no system or procedure to determine whether stocks were restricted or freely tradable and failed to conduct adequate supervisory reviews to determine whether the securities were registered, notwithstanding the presence of one or more "red flags" known to the firm's branch administration, surveillance or compliance staff.

5. FINRA also alleged that Oppenheimer's AML program failed to identify suspicious activity in penny stocks and that Oppenheimer failed to investigate the suspicious activity. The Firm's AML policy focused on asset movements instead of securities transactions and thus did not systematically review trading in penny stocks for suspicious activity. In addition, the Firm failed to monitor compliance with those aspects of its AML policy applicable to one of the customer accounts, held by a foreign financial institution ("FFI"). In particular, the Firm failed to assess the customer's risk as an FFI and did not enforce its own restrictions on that customer's trading activity.

6. The Firm consented to a censure, a fine of $1,425,000, and an undertaking to retain an independent consultant to conduct a comprehensive review of the adequacy of its policies, systems, procedures and training related to the purchase and sale of penny stocks, the supervision of FFIs, and AML.

7. In announcing the settlement of this matter, FINRA stated that "[t]his is the second time Oppenheimer has been found to have violated its AML obligations." According to the Offer of Settlement

resolving the case, the firm was fined $2.8 million in 2005 for allegations relating to failure to supervise in the AML area.

E. *Legent Clearing LLC (n/k/a COR Clearing LLC) ("COR Clearing") (Dec. 16, 2013)*

1. FINRA settled a matter in which it alleged that COR Clearing failed to comply with AML, financial reporting and supervisory obligations. This matter resulted from various FINRA examinations of the firm from 2009 through 2013.

2. Like the Oppenheimer case, this case began as a litigated matter. However, the firm and FINRA agreed to resolve the matter late last year. The settlement covered not only the original charges but also additional violations identified by FINRA in recent examinations of the firm.

3. COR Clearing provides clearing services for approximately 86 correspondent firms. The introducing firms it serviced had significant numbers of accounts that conducted activity in low-priced securities and engaged in third-party wire activity. According to FINRA, COR Clearing's types of accounts present a high risk of money laundering and other fraudulent activity.

4. FINRA alleged certain AML-related violations, including the following:

    a. During 2009 to 2013, COR Clearing's AML surveillance program was not reasonably designed to detect and cause reporting of transactions required under the Bank Secrecy Act ("BSA"). The firm failed to implement a reasonable program to detect and evaluate AML "red flags," and it failed to ensure that its employees were aware of criteria for identifying red flags.

    b. COR Clearing's AML program relied in part on the introducing firms for surveillance of suspicious activity, even though it did not conduct any review of the introducing firm's AML programs.

    c. COR Clearing's procedures relied on manual reports for monitoring suspicious activity, and had inadequate staff and resources devoted to this monitoring.

    d. In 2009, COR Clearing implemented a "Defensive SARS" program, which the firm used to file suspicious activity reports without first completing the investigation necessary to support filing the report.

e. For several months in 2012, COR Clearing's AML surveillance system failed altogether, resulting in the firm's failure to conduct any systematic reviews to identify and investigate suspicious activity.

f. In 2007, the firm failed to file a Foreign Bank and Financial Accounts Report ("FBAR"), which is required for foreign bank accounts with a balance over $10,000. The firm failed to establish adequate written procedures and controls regarding FBARs.

5. FINRA alleged various additional violations including the firm's (i) repeated erroneous computations of customer reserve and net capital computations; (ii) failure to maintain the physical possession and control of fully paid securities; (iii) failure to properly classify securities in its custody and control; (iv) failure to have written procedures for the solicitation and acceptance of checks from customers made payable to correspondents; and (v) failure to have the firm's insurance coverage include a required provision for notification to FINRA in the event the coverage is materially modified.

6. FINRA alleged multiple supervisory violations, including (i) failing to establish adequate supervisory systems relating to Reg SHO; (ii) filing an incorrect FOCUS report; (iii) failure to maintain adequate supervision of control stocks; (iv) the improper outsourcing of back-office functions; (v) inadequate due diligence of microcap securities; (vi) inadequate supervision of National Securities Clearing Corporation illiquid charges; (vii) inadequate retention and review of e-mails of one executive; (viii) inadequate controls for the fixed income trading desk; (ix) inadequate controls over funding and liquidity; (x) inadequate supervision of RVP/DVP accounts; and (xi) failure to ensure that its president was properly registered as a principal.

7. COR Clearing consented to a censure and a fine of $1 million. COR Clearing also agreed to retain a consultant to review its policies, systems procedures and training. The firm also agreed to submit proposed new clearing agreements to FINRA for its approval for a period of time. Finally, COF Clearing undertook to submit certifications by two senior officers stating that each individual had reviewed the firm's customer reserve and net capital computations for accuracy prior to filing with FINRA.

Arbitration Agreements

Below is a litigated case in which FINRA brought charges alleging that certain language included in a broker-dealer's customer agreements conflicted with FINRA Rules.

A. *Charles Schwab & Co., Inc. ("Schwab") (Feb. 21, 2013)*

1. In a litigated matter, FINRA enforcement alleged three causes of action related to language Schwab included in its customer agreements regarding waiver of a customer's ability to assert claims through class actions and limits to consolidation of claims in arbitration.

2. The first two causes of action charged that provisions in Schwab's customer agreements by which a customer waived any ability to assert a claim by means of a judicial class action conflicts with FINRA Arbitration Rule 12204, and violated FINRA Rules 2268(d)(1) and (d)(3) and NASD Rules 3110(f)(4)(A) and (4)(C), which preserve judicial class actions as an alternative to arbitration, even when there is a pre-dispute arbitration agreement between a FINRA member firm and its customer.

3. The Hearing Panel dismissed the first two causes of action, concluding that, while Schwab's language conflicted with FINRA Arbitration Rules, FINRA Enforcement could not enforce the rules. Under the Federal Arbitration Act ("FAA"), as construed by the Supreme Court in *AT&T Mobility v. Concepcion, 131 S.Ct. 1740 (2011),* and other decisions, adjudicators must enforce arbitration agreements to resolve disputes and must reject any public policy exception that disfavors arbitration, unless Congress itself has indicated an exception to the FAA. As such, the Hearing Panel dismissed the Department of Enforcement's first two claims.

4. The third cause of action charged that other language in Schwab's customer agreements requiring customers to agree that arbitrators have no power to consolidate more than one party's claims in arbitration violated FINRA Rule 2268(d)(1) and NASD Rule 3110(f)(4)(A) by attempting to "limit" and "contradict" FINRA Arbitration Rule 12312. FINRA Arbitration Rule 12312 specifies circumstances in which arbitrators may arbitrate consolidated claims.

5. The Hearing Panel concluded that the language purporting to limit the powers of FINRA arbitrators violated FINRA Rule 2268(d)(1) and NASD Rule 3110(f)(4)(A) in two respects: (i) the consolidation language undermined the fundamental operation of FINRA Arbitration Rule 12312 and, in fact, the overall operation of FINRA

Arbitration Rules generally, by depriving FINRA of its authority to grant and circumscribe the powers of arbitrators in FINRA's forum; and (ii) the consolidation language contravened the specific authority given to the arbitrators to join individual claims in specified circumstances.

6. The Hearing Panel further concluded that the FAA did not bar enforcement of the FINRA Arbitration Rules in this instance, because the FAA did not dictate how an arbitration forum should be governed and operated or prohibit the consolidation of individual claims.

7. For the violations found as to the third cause of action, Schwab was ordered to pay a fine of $500,000 and the hearing costs.

8. Additionally, Schwab was ordered to remove the language at issue from customer agreements and send a notice to customers indicating that the prior limitation on the powers of FINRA arbitrators is not effective. The notice must reiterate that Schwab agrees to arbitrate in accordance with FINRA Arbitration Rules, and indicate that consolidation is available in arbitration pursuant to those rules.

9. This decision is on appeal.

Auction Rate Securities

Since the summer of 2008, regulators have brought numerous cases against broker-dealers arising out of the auction rate securities ("ARS") freeze that occurred earlier that year. The below case is an example of a case that was litigated through to a decision by FINRA's National Adjudicatory Council ("NAC").

A. *Thomas Weisel Partners LLC ("Weisel") and Stephen H. Brinck, Jr. (Feb. 15, 2013)*

1. FINRA's NAC affirmed a previous Hearing Panel decision dated November 8, 2011, which dismissed three causes of action in a contested matter brought by FINRA Enforcement against Weisel and Stephen H. Brinck, Jr., the firm's former head of fixed income and corporate cash management, on May 18, 2010 in connection with the firm's sales of ARS.

2. FINRA alleged that: (1) Brinck, facing pressure from senior Weisel managers to raise $25 million that would be used to pay employee bonuses, fraudulently sold $15.7 million of ARS from a firm proprietary account into three customer accounts the firm managed without the customers' approval, even though, at the time of the sales, the firm was concerned about the ARS market, which

crashed weeks later, and Brinck had recommended that all corporate cash clients sell their ARS; (2) the firm made false and misleading statements to two of the customers to induce them to provide retroactive consent; (3) the firm made false statements in a letter to FINRA concerning the transactions; and (4) the firm failed to maintain and implement adequate supervisory procedures and an adequate supervisory system.

3. The Hearing Panel dismissed the first three charges after determining that FINRA failed to prove that Brinck's decision to sell the ARS was inconsistent with his earlier decision to gradually divest from ARS or motivated by concerns about the safety or liquidity of the ARS or the firm's intention to use the cash proceeds to pay bonuses. Instead, the Hearing Panel found that the firm and Brinck were not worried about the safety or liquidity of the ARS when they sold them from the firm proprietary account into the customers' accounts. Specifically, the firm's and Brinck's confidence in the soundness of the ARS was bolstered by ongoing communications between Brinck and the broker-dealers that underwrote the ARS. The firm also continued to purchase over $5 million in ARS for accounts of firm employees and their family members, including Thomas Weisel's personal investment account. Additionally, Brinck was never informed that the proceeds from the ARS sales would be used to pay bonuses and Brinck himself was not eligible to receive a bonus.

4. FINRA Enforcement appealed the dismissal of the first three charges and the NAC affirmed the Hearing Panel's dismissal. The NAC found that the preponderance of the evidence did ***not*** demonstrate that: (i) that Brinck acted with scienter; (ii) Weisel made false or misleading statements to clients; or (iii) Weisel falsely responded to FINRA requests for information.

5. In the November 8, 2011 decision, the Hearing Panel determined that Weisel failed to have adequate supervisory systems and procedures surrounding its principal transactions. Weisel was fined $200,000 and was ordered to pay $11,030 for the costs of the hearing. These findings and sanctions regarding the firm were not appealed to the NAC.

Best Execution and Markups/Markdowns

FINRA continues to "aggressively pursue" best execution and markup/markdown cases.[35] As a demonstration of its efforts in this area, below are four cases in this area involving various securities, including non-convertible preferred securities, corporate, agency, and municipal bonds. In two actions, FINRA sanctioned both the firm and an individual.

A. *Merrill Lynch, Pierce, Fenner & Smith Inc. ("Merrill Lynch") (Apr. 16, 2013)*

1. FINRA settled a matter in which it alleged that Merrill Lynch failed to provide best execution in a number of transactions of non-convertible preferred securities executed through the firm's proprietary order execution system, and lacked supervisory systems and written supervisory procedures related to best execution.

2. Between April 1, 2006 and December 31, 2010, the firm's propriety order execution system, ML BondMarket, utilized pricing logic that executed based on quotations from only the two primary exchanges where non-convertible securities were listed. In some instances, better prices were available on a non-primary market, and orders were executed at prices that were inferior to the National Best Bid and Offer.

3. FINRA alleged that, as a result of the pricing logic of the ML BondMarket system, the firm failed to provide best execution in 12,259 transactions.

4. FINRA further alleged that Merrill Lynch failed to establish and maintain a reasonably designed supervisory system to address the firm's best execution duties for non-convertible preferred securities executed on ML BondMarket in that the firm failed to conduct post-execution reviews. FINRA also found that the firm's written supervisory procedures were inadequate.

5. FINRA noted that there were red flags during the relevant period. First, Merrill Lynch received inquiries from FINRA staff regarding the relevant conduct, and although Merrill Lynch took certain remedial steps intended to address the issues raised by the staff, the firm failed to indentify the flawed pricing logic until December 2010. Second, FINRA's best execution report cards that were available to the firm from February 2008 through June 2011

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[35] In announcing the StateTrust Investments case described below, Thomas Gira, FINRA's Executive Vice President and Head of Market Regulation, stated that "FINRA will continue to aggressively pursue firms and individuals who charge customers excessive markups and markdowns."

included approximately 2,200 of the transactions identified in the AWC.

6. Merrill Lynch consented to a censure, a fine of $1,050,000 ($650,000 for best execution violations and $400,000 for supervisory violations), restitution of $329,950 plus interest in connection with the 12,259 transactions, and an undertaking to revise its written supervisory procedures related to best execution of non-convertible preferred securities.

B. *StateTrust Investments, Inc. ("StateTrust") and Joseph Luis Turnes ("Turnes") (June 11, 2013)*

1. FINRA settled a matter with StateTrust and Turnes, the firm's head trader, in which it alleged that StateTrust (i) through Turnes, charged unfair prices in corporate bond transactions; (ii) failed to adequately supervise Turnes; (iii) failed to properly report transactions in TRACE-eligible securities; and (iv) distributed prospectuses with material misstatements of fact.

2. According to FINRA, StateTrust charged unfair prices to customers in 563 corporate bond transactions between March 2007 and June 2010. For example, in 324 of the transactions, StateTrust bought bonds from a customer at an unfair price and then sold them to one of its bank or insurance affiliates, or vice versa. The markups/markdowns were 5% or more in 227 of the 563 transactions, for which excessive charges totaled $336,472.

3. In 85 of the 563 transactions, between September 2008 and September 2009, StateTrust charged markups/markdowns ranging from 8.03% to 23.58%, accounting for excessive charges of $124,644. Trade confirmations and account statements sent by mail did not disclose the excessive markups/ markdowns. FINRA used these facts as a basis for alleging that the firm acted contrary to certain fraud provisions of the federal securities laws and thus violated its rules regarding just and equitable principles of trade.

4. According to FINRA, Turnes determined the prices at which StateTrust bought and sold the bonds, and his failure to properly price the bonds caused StateTrust to charge excessive prices. During the review period, Turnes was (indirectly) the largest shareholder of StateTrust and its bank and insurance affiliates; he also served as Chairman of those affiliates.

5. FINRA also alleged that, despite having written supervisory procedures regarding determining appropriate markups/ markdowns, as well as surveillance tools to detect excessive markups/markdowns, the firm failed to detect or identify the

excessive markups/markdowns for the 563 bond transactions and failed to supervise Turnes in a manner reasonably designed to prevent the excessive pricing.

6. FINRA also alleged that, between September 2008 and March 2009, StateTrust failed to properly report 64 bond transactions in TRACE-eligible securities after initial submissions were rejected because the executed prices were outside the price ranges of other executed transactions in the same bonds.

7. Finally, FINRA alleged that, from 2006 to 2009, StateTrust sold shares of affiliated mutual funds to customers and provided prospectuses containing material misstatements of fact related to the affiliation of StateTrust with the funds' investment managers.

8. StateTrust made the following statements of corrective action: (i) StateTrust now documents its price discovery efforts in order to demonstrate the reasonableness of its pricing; (ii) StateTrust no longer crosses trades between its retail customers and its affiliates; and (iii) StateTrust has strengthened its relevant written supervisory procedures.

9. StateTrust consented to a censure, a fine of $1,045,000 and restitution of $353,319 plus interest. Turnes consented to a fine of $75,000 and a six-month suspension from association with any FINRA member in any capacity.

10. According to FINRA, in a related case resolved in 2012, StateTrust's chief compliance officer was fined $20,000 and suspended for five months from acting in any principal capacity.

C. *Morgan Stanley & Co. LLC ("MSCO") and Morgan Stanley Smith Barney LLC ("MSSB," and together with MSCO, the "firm") (Aug. 22, 2013)*

1. FINRA settled a matter with the firm in relation to 281 corporate, agency, and municipal bond transactions between January 2008 and September 2011.

2. According to FINRA, the firm failed to provide best execution for certain customer corporate and agency bond transactions in violation of FINRA Rule 2010 and NASD 2320. In addition, FINRA alleged that the firm violated MSRB Rules G17 and G-30(a) by purchasing municipal securities from customers for its own account (and/or selling municipal securities to customers from its own account) at aggregate prices, including mark-ups and mark-downs, which were not fair and reasonable.

3. Of particular note, in consideration of enhancements that the firm made in 2012 to its supervision of mark-ups, mark-downs, and execution prices for bond transactions, FINRA elected not to bring formal supervision charges against the firm. Those enhancements were implemented in accordance with an undertaking by the firm in a prior FINRA matter concerning mark-ups and mark-downs in corporate and municipal securities.

4. The firm consented to a censure, a fine of $1 million, of which $560,000 was allocated to MSRB, and restitution in the amount of $452,280.90, of which $255,829.12 arose from MSRB violations.

D. *Oppenheimer & Co., Inc., ("Oppenheimer") and David P. Sirianni (Dec. 9, 2013)*

1. FINRA settled a matter in which it alleged that Oppenheimer charged unfair and unreasonable mark-ups in municipal securities transactions and failed to adequately supervise municipal securities transactions.

2. FINRA alleged that, in 89 customer transactions between July 2008 and June 2009, Oppenheimer, through its head municipal securities trader, David P. Sirianni, charged mark-ups from 5.01 percent to 15.57 percent. In 54 of those transactions, the mark-ups exceeded 9.4 percent. The mark-ups were not disclosed to customers.

3. FINRA alleged that Mr. Sirianni purchased the securities from a broker-dealer on Oppenheimer's behalf, held the bonds in inventory overnight, and then resold the bonds to the firm's customers at excessive mark-ups.

4. FINRA alleged that Oppenheimer failed to detect the unfair mark-ups and that the firm's supervisory system was deficient because supervisors relied solely on a surveillance report that only captured intra-day transactions. The firm's report did not reflect instances in which bonds were held in inventory overnight before being sold to customers.

5. Additionally, FINRA alleged that, in 15 other transactions, the firm sold municipal securities for its own account to a customer at unfair and unreasonable prices.

6. Oppenheimer consented to a censure, a fine of $675,000 (comprised of $500,000 for the pricing violations and $175,000 for the supervision violations), and an order to pay more than $246,000 in restitution. Oppenheimer also consented to an undertaking to report to FINRA regarding the effectiveness of the firm's written supervisory procedures for pricing of municipal bonds.

7. Additionally, FINRA fined Mr. Sirianni $100,000 and suspended him for 60 days.

Collateralized Debt Obligations

The below case is an example of a case involving trading in complex structured and derivative products, such as collateralized debt obligations ("CDOs").

A. *Citigroup Global Markets, Inc. ("Citigroup") (Dec. 21, 2012)*

1. FINRA settled a matter with Citigroup in which FINRA alleged that between April 1, 2009 and March 30, 2010, Citigroup incurred trading losses of $464 million when it purchased distressed assets during certain blind auctions held in connection with the liquidation of CDOs.

2. FINRA alleged that the purchases benefited Citigroup's banking affiliate, Citibank, N.A. ("CBNA"), which was the holder of the super senior notes of the CDOs.

3. In addition, FINRA alleged that Citigroup's written supervisory procedures required all inter-affiliate transactions, such as the liquidations, be on market terms, unless there was prior written approval from the legal department.

4. FINRA alleged that Citigroup's affiliates submitted par bids without prior written permission and subsequently shifted the losses from CBNA to Citigroup.

5. Citigroup investigated and identified the par bids, subsequently self-reported the foregoing issue to FINRA, and took remedial actions, including recording a one-time capital contribution of $464 million to an affiliate, reversing a $184 million tax loss benefit, and correcting its records.

6. Citigroup consented to a censure and a $575,000 fine.

Direct Market Access and Sponsored Access Trading

Direct market access and sponsored access trading are hot regulatory topics as can be seen from FINRA's mention of those issues in its 2014 regulatory and examination priorities letter and in the significant action described below.

A. *Newedge USA, LLC ("Newedge") (July 11, 2013)*

1. FINRA joined with BATS Exchange, Inc., New York Stock Exchange LLC, NYSE Arca, and The NASDAQ Stock Market LLC (excluding FINRA, the "Exchanges"), to censure and fine Newedge

for failing to supervise direct market access ("DMA") and sponsored access ("SA") trading by clients on its routing platform.

2. FINRA and the Exchanges alleged that, between January 2008 to December 2011, Newedge failed to establish sufficient supervisory systems and procedures to monitor trading by DMA and SA clients, including addressing anti-money laundering and other potentially suspicious activity such as spoofing, marking the close, excessive repetitive order entry and wash sale transactions. FINRA also referenced a report by an outside consultant retained by the firm in May 2008, and an e-mail in May 2008 from a high ranking employee, both of which pointed out gaps in the firm's supervision of its DMA trading activity. FINRA noted that the firm's compliance department had also raised numerous warnings about red flags.

3. FINRA and the Exchanges alleged that Newedge failed to establish adequate supervisory systems and procedures to ensure compliance with the requirements of Reg SHO (including the failure to have an adequate post-trade locate review system), and failed to establish adequate supervisory procedures to ensure compliance with the SEC Emergency Orders from July and September 2008 regarding short sales.

4. FINRA and the Exchanges further alleged that Newedge failed to maintain certain records, such as opening account documents, order data, attachments to e-mails, "bcc" e-mail information, text messages, and certain required documents related to DMA and SA client accounts.

5. Newedge consented to a censure and a fine of $9.5 million, of which $4 million would be paid to FINRA and the remainder to the Exchanges. The firm also consented to hire a consultant to carry out a comprehensive review of the adequacy of its policies, systems, and procedures concerning the areas covered in the settlement.

6. In announcing this case, FINRA trumpeted the fact that the action stemmed from referrals and information provided to it by the various Exchanges and stated that this matter "illustrates how FINRA and the exchanges can effectively pursue activity that spans multiple markets."

Financial and Operational Issues

Financial and operational issues continued to be a focus of FINRA's enforcement efforts last year. Below is an example of a significant case brought at the end of 2013.

A. *Deutsche Bank Securities, Inc. ("Deutsche Bank") (Dec. 19, 2013)*

1. FINRA settled a matter with Deutsche Bank involving financial and operational deficiencies primarily related to the firm's enhanced lending program. The matter also involved allegations that the firm lacked transparency in its financial records, and overstated capitalization and had inadequate customer reserves due to inaccurate calculations. This case arose out of issues identified during a FINRA examination.

2. Under Deutsche Bank's enhanced lending program, the firm arranged for its London affiliate to lend cash and securities to Deutsche Bank's hedge fund customers.

3. FINRA alleged that the firm's books reflected that Deutsche Bank owed its affiliate $9.4 billion, but the books were not clear regarding what portions of the debt were attributable to the lending program, and what portions were attributable to the London affiliate's proprietary trading. In addition, in calculating this payable balance, the firm improperly netted non-securities related transactions with securities-related transactions, causing it to over-report net capital by $239 million.

4. FINRA also alleged that, in certain instances, Deutsche Bank made errors in its net capital calculations. For example, due to a correction of a previous error and reclassification of $31 billion as stock loans under the enhanced lending program, the firm's London affiliate was obligated to pay a margin call of $3.1 billion. Deutsche Bank then improperly calculated the payable balance, causing a reduction to the firm's reported liabilities and an overstatement of the firm's net capital.

5. Additionally, FINRA alleged that, in March 2010, Deutsche Bank incorrectly calculated its customer reserve formula by including a debit for margin deposits with respect to certain pledge securities and failing to include an offsetting credit. This error caused a deficiency in its customer reserve fund of between $700 million and $1.6 billion.

6. FINRA also alleged that Deutsche Bank failed to establish, maintain and enforce an adequate supervisory system and procedures to detect and prevent these violations. The firm also failed to

establish written supervisory policies and procedures regarding its independent price verification process for mortgage-backed securities inventory positions.

7. Deutsche Bank consented to a censure and a fine of $6.5 million.

Large Option Position Reporting

Last year, FINRA brought several cases involving Large Options Position Reporting ("LOPR"). Moreover, FINRA recently stated in its 2014 regulatory and exam priorities letter that it has "observed significant, prolonged and wide-scale [LOPR] deficiencies with some firms" and that it will continue to pursue cases in this area.

A. *Goldman Sachs Execution & Clearing, LP ("GSEC") (Mar. 19, 2013)*

1. On behalf of NYSE Regulation, Inc., FINRA settled a matter under NYSE Amex Options rules in which FINRA alleged that GSEC: (1) failed to report certain reportable options positions to the LOPR system; (2) failed to report to LOPR correct effective dates for certain reportable options positions; and (3) failed to reasonably supervise and implement adequate controls to comply with LOPR reporting requirements.

2. FINRA identified these violations during its investigation of the firm for reporting failures during two periods, January 2004 through October 2011 ("First Relevant Period") and January 2010 through May 2012 ("Second Relevant Period").

3. FINRA alleged that during the First Relevant Period, GSEC failed to accurately report its end of day LOPR positions for approximately 450,000 reportable option positions. Specifically, GSEC failed to report the following two types of options positions: (1) expiring in the money option positions that were exercised or assigned; and (2) expiring out of the money option positions that were exercised or assigned.

4. FINRA further alleged that during the Second Relevant Period, GSEC incorrectly reported approximately 38,080 reportable options positions to the LOPR system with an effective date reflecting when GSEC processed and/or allocated the positions, instead of the actual trade date.

5. FINRA also alleged that the firm failed to reasonably supervise and implement adequate controls, including a failure to implement a system of follow-up reviews to achieve compliance with LOPR reporting.

6. GSEC consented to a censure and a fine of $475,000.

7. In settling this matter, FINRA took into consideration the fact that GSEC self-identified and self-reported the LOPR reporting issues that occurred during the Second Relevant Period and promptly changed its reporting system upon recognizing the issues.

B. *TD Ameritrade Clearing, Inc. ("TD Ameritrade") (Nov. 6, 2013)*

1. FINRA settled a matter in which it alleged that TD Ameritrade failed to accurately report certain large options positions.

2. FINRA alleged that, from May 2007 to January 2010, TD Ameritrade failed to use the proper code to aggregate certain reportable positions as acting-in-concert. This resulted in the firm failing to report approximately 1.4 million positions in 4,099 accounts.

3. FINRA also alleged that TD Ameritrade failed to establish and maintain reasonable supervisory procedures and supervisory systems, including written supervisory procedures, to ensure compliance with large options position reporting rules.

4. This matter arose in connection with a LOPR sweep review of the firm's compliance with the options reporting requirements.

5. TD Ameritrade consented to a censure and a $1,150,000 fine. In settling this matter, FINRA took into consideration remedial steps taken by the firm, including supervisory systems enhancements, retention of an independent consultant and a plan to implement the consultant's recommendations.

6. The TD Ameritrade case was announced by FINRA on the same day that it publicized the SG Americas Securities case described immediately below.

C. *SG Americas Securities, LLC ("SG Americas") (Nov. 6, 2013)*

1. FINRA settled a matter in which it alleged that, from December 2007 to January 2013, SG Americas (i) failed to report approximately 500,000 over-the-counter (OTC) end-of-day conventional options positions; (ii) failed to report, or incorrectly reported, the counter-party for 518,964 OTC options positions; and (iii) failed to report its customers' conventional options positions on the same side of the market as the firm's positions in 100,212 instances. The firm also self-reported to FINRA that it had incorrectly netted the long and short legs of certain put/call spread transactions involving conventional index options, and as a result,

the firm failed to report or misreported 919,325 conventional options positions.

2. FINRA also alleged that SG Americas failed to implement and maintain an adequate system of follow-up and review designed to ensure complete and accurate reporting of large options positions.

3. SG Americas consented to a censure and a $675,000 fine.

Leveraged and Inverse Exchange-Traded Funds

In 2012, FINRA brought several enforcement actions involving leveraged and inverse exchange-traded funds ("ETFs"). Those efforts continued last year with the below case. Moreover, FINRA has recently stated that it will continue to focus on the marketing, sale and suitability of these and other complex structured products.

A. *J.P. Turner & Company, LLC ("J.P. Turner") (Dec. 5, 2013)*

1. FINRA settled a matter in which it alleged that J.P. Turner sold unsuitable leveraged and inverse exchange-traded funds ("Non-Traditional ETFs") and effected excessive mutual fund switches in customer accounts.

2. According to FINRA, Non-Traditional ETFs have certain risks that increase over time and in volatile markets, such risks associated with daily "reset," leverage and compounding. Non-Traditional ETFs are designed to achieve their stated objectives on a daily basis, and therefore their performance can quickly diverge from the performance of the underlying index or benchmark. This effect can be exaggerated in volatile markets.

3. FINRA alleged that, from January 2008 to August 2009, J.P. Turner failed to establish and maintain reasonable supervisory systems, including written procedures, to monitor Non-Traditional ETFs, and failed to provide adequate training regarding these products. J.P. Turner supervised Non-Traditional ETFs in the same manner it did traditional ETFs, and its supervisory system was not tailored to address the unique risks associated with Non-Traditional ETFs.

4. Representatives recommended Non-Traditional ETFs to retail brokerage customers without conducting a reasonable suitability analysis, without having an adequate understanding of the risks of Non-Traditional ETFs, and without performing reasonable due diligence. As a result, representatives made unsuitable recommendations of Non-Traditional ETFs to 27 customers, who collectively lost more than $200,000 in the investments.

Additionally, in some cases, customers held Non-Traditional ETFs for extended periods of time.

5. FINRA also alleged that, from February 2008 to April 2010, J.P. Turner representatives engaged in a pattern of unsuitable mutual fund switching. For example, on 537 occasions, one representative recommended that customers sell mutual funds within one to 12 months after purchase.

6. The firm failed to establish reasonable supervisory systems, including written procedures, to monitor for trends or patterns and prevent unsuitable mutual fund switching.

7. Despite several red flags, including the fact that the transactions appeared on exception reports, the firm failed to reject more than 2,800 mutual fund switches. As a result, 66 customers paid $502,654 in commissions and sales charges for unsuitable mutual fund switches.

8. J.P. Turner consented to a censure and an order to pay $707,559 in restitution to 84 customers.

9. Interestingly, in setting the sanction in this matter FINRA stated that "[i]n the interests of providing full restitution to customers, FINRA imposed no fine after considering, among other things, the Firm's revenue and financial resources."

Market-on-Close Orders

Below is an example of cases FINRA and other regulators have brought regarding Market-on-Close ("MOC") orders.

A. *Raven Securities Corp. ("Raven"), Richard S. Cohen and Brian C. Gilgan (June 14, 2013)*

1. In a Hearing Board Decision on behalf of NYSE Regulation, Inc., FINRA alleged that, between July 2009 and October 2009, Raven engaged in daily market-on-close orders ("MOC") in approximately 100 to 150 different securities in a single customer's (the "Customer") account.

2. FINRA alleged that the activity generally involved, first, the Customer entering large MOC orders on the opposite side of the preliminary NYSE closing imbalance through a clearing firm's order entry system, which led to the creation of misleading closing imbalance information that would be published via the NYSE in the securities the Customer traded.

3. Second, the Customer would enter equal-sized orders via Raven on the contra side of his MOC orders, which resulted in prearranged trades and/or wash sales.

4. Finally, the Customer entered orders (short-selling) to obtain positions leading into the NYSE close. His short sells had the effect of influencing the price of the securities to go lower. The Customer would receive favorable average prices on the short positions he obtained, which he often profitably liquidated/covered at the NYSE closing price.

5. FINRA alleged that Raven failed to use due diligence to learn the essential facts relative to every order it accepted from the Customer, which resulted in Raven's floor brokers executing certain orders that the Customer had entered on both sides of a transaction, buying and selling the same security on the same day, at the same time and price, which involved no change in beneficial ownership, and thereby resulted in wash trades.

6. FINRA alleged that on numerous occasions, Raven violated Reg SHO by accepting sell orders on behalf of the customer that had been improperly marked as long when the Customer did not own the security being sold at the time the order was entered.

7. In addition, FINRA alleged that Raven failed to produce certain electronic communications that were requested, claiming that it was unable to retrieve such records.

8. FINRA also alleged that, during the investigation, Raven made material omissions of fact on submissions filed with the NYSE, such as logs purporting to evidence certain supervisory reviews, which were not actually completed on the dates indicated.

9. In connection with the above activities, FINRA alleged that Raven failed to reasonably supervise and implement adequate written supervisory policies and procedures, including a separate system of follow-up and review.

10. Raven consented to a censure, a $1,150,000 fine, and certain other undertakings.

11. In addition, the chief executive officer (Cohen) and the chief operating officer (Gilgan) were censured and suspended in all supervisory capacities for one year.

Private Placements

Over the last several years, FINRA has brought a number of enforcement actions relating to alleged abuses in the sale and marketing of private placement securities. Below is a 2013 case in this area.

A. *G. Research, Inc. formerly Gabelli & Company, Inc. ("G. Research") (June 5, 2013)*

1. FINRA settled a matter in which it alleged that G. Research failed to adequately supervise the formation, operation, marketing and sales of private investment partnerships by the firm's registered representatives.

2. FINRA stated that from as early as 2001 and through November 2008, the firm was aware of its registered representatives' plans to form private partnerships in which they would act as general partners and that would provide access, at lower minimum investment thresholds, to the firm's affiliated adviser and the range of investment styles offered by the affiliated adviser. As a result, FINRA alleged that the firm was obligated to supervise its representatives' participation in those partnerships and to adopt related supervisory systems and procedures.

3. Although, the firm implemented written supervisory procedures ("WSPs"), FINRA alleged the WSPs were not reasonably designed or enforced to supervise the advertising, sales materials, and sales of the partnerships, due diligence with respect to the partnerships' investments in hedge funds and funds of hedge funds, and the relative fees charged to customers by the partnerships.

4. FINRA alleged that the firm failed to take steps to ensure mandated reviews of sales materials prior to distribution. As a result, the private partnerships prepared advertising and sales materials that violated NASD advertising rules and lacked risk, leverage, management fees, lack of liquidity, and conflicts of interest disclosures.

5. FINRA also alleged that between 2001 and 2008, the private partnerships raised approximately $36 million from approximately 106 investors without evaluating the fees charged to at least 34 of the investors.

6. G. Research consented to a censure and a fine of $1 million.

Prospectus, Trade Confirmation, and Account Statement Delivery

For years, regulators have brought cases involving firms' deficiencies regarding delivery of prospectuses and various client account records. Two examples from last year and one brought on December 31, 2012 but announced in early 2013 follow:

A. *Ameriprise Financial Services, Inc. ("AFSI") (Apr. 18, 2013)*

1. FINRA settled a matter with AFSI in which it alleged that in approximately 580,000 instances between January 1, 2009 and June 30, 2011, AFSI failed to timely deliver mutual fund prospectuses to its customers within the required time period, and failed to maintain and enforce an adequate supervisory system or written procedures to supervise this delivery requirement.

2. AFSI contracted with two third-party service providers for the delivery of mutual fund prospectuses and provided the service providers with daily information regarding the mutual fund transactions that required delivery of a prospectus.

3. FINRA alleged that AFSI's written supervisory procedures did not require an adequate review of the service providers' performance. According to FINRA, AFSI had no systems or procedures related to daily or weekly review of the service providers' performance. Also, while AFSI's procedures did require a monthly sample review of the service providers' performance, they did not specifically describe what reviewers should look for or what action to take if a deficiency was identified. Rather, AFSI's supervision of the service providers involved substantial reliance on the service providers themselves. FINRA also alleged that the sample size reviewed by AFSI was likely too small.

4. FINRA noted that the primary cause of the late deliveries was an insufficient supply of paper copies of prospectuses provided by certain mutual fund companies. While the primary service provider contracted by AFSI did make a "print on demand" service available, AFSI did not utilize the service and did not implement any alternative for the first 26 months of the review period; AFSI utilized the print on demand service beginning in March 2011.

5. AFSI consented to a censure and a fine of $525,000.

B. *UBS Securities LLC ("UBS") (Sept. 9, 2013)*

1. FINRA settled a matter in which it alleged that, from 2003 to June 2011, UBS failed to deliver certain trade confirmations and account statements, and in certain instances failed to disclose required

transaction information to institutional customers who executed trades in foreign securities through non-registered foreign affiliates.

2. UBS used its non-registered foreign affiliates to execute trades in non-U.S. securities for U.S. institutional customers. UBS, however, was still required to send trade confirmations and account statements to the clients including all required disclosure language.

3. In June 2011, UBS discovered through self-testing that it had failed to send trade confirmations and account statements to U.S. institutional clients who executed trades in non-U.S. securities in certain European, Middle Eastern, Asian and African markets. UBS discovered that the issues stemmed from improper coding of certain accounts and missing or incorrect data in the firm's main systems used to generate trade confirmations and account statements.

4. FINRA alleged that, from June 2010 to June 2011, UBS failed to send trade confirmations to institutional customers for 28,332 transactions. Additionally, UBS sent trade confirmations to institutional customers for 60,290 transactions, but those confirmations did not include certain required transaction disclosure language. Further, trade confirmations for OTC equity derivative transactions did not include certain required disclosure language.

5. FINRA alleged that, from May 2011 to June 2011, UBS failed to deliver 1,728 account statements due to missing or invalid customer address information or other missing data. The firm did not have a process to monitor for missing customer addresses.

6. FINRA alleged that UBS failed to have adequate procedures to supervise and monitor the systems for delivery of trade confirmations and account statements. The firm reviewed a sample of confirmations periodically, but because none of the affected confirmations were included in the sample, the issue was not detected timely. Further, the sample review was not designed to detect missing codes.

7. In settling the matter, FINRA acknowledged that UBS discovered the violations after internal testing, investigated the conduct and proactively remediated the problems prior to self-reporting the issues. FINRA also acknowledged the firm's substantial assistance during its investigation. Accordingly, FINRA noted that the sanctions imposed on the firm reflected these mitigating factors.

8. UBS consented to a censure and a fine of $575,000.

C. *LPL Financial, LLC ("LPL") (Dec. 31, 2012)*

1. FINRA settled a matter in which it alleged that LPL failed to establish and maintain an adequate supervisory system and written procedures reasonably designed to ensure timely delivery of mutual fund prospectuses.

2. From January 2009 through June 2011, LPL executed approximately 16 million mutual fund purchases or exchange transactions. Approximately 3.4 million of those required LPL to deliver a mutual fund prospectus to the customer within three business days.

3. FINRA alleged that, during the relevant time period, LPL relied on its registered representatives to deliver prospectuses and to obtain confirmation from the customer that they received the prospectus. FINRA further alleged that the firm did not adequately supervise to determine whether the confirmations were received, or whether the prospectuses were delivered.

4. FINRA alleged two inadequacies in LPL's supervisory procedures. First, LPL relied on representations from its registered representatives in an annual compliance questionnaire as confirmation that the prospectuses had been delivered and the required confirmations of receipt had been received from clients. Second, LPL conducted inadequate branch audits in that (i) there was no requirement that mutual fund transactions be included in the sample for the purpose of testing whether prospectuses were delivered; (ii) where gaps were found in prospectus delivery, they were not cited in the branch deficiency letter; and (iii) there was no procedure to determine whether prospectuses were delivered late.

5. FINRA further alleged that the firm was aware that its procedures were failing and that representatives were failing to consistently obtain delivery confirmations from clients, however the firm did not take any corrective action.

6. In settling the matter, the firm consented to a censure and a fine of $400,000.

Record Retention

Over the years, regulators have brought numerous cases involving the failure to retain and/or supervise e-mail communications. Below are two examples of cases from 2013. In addition, a third case opened a new front in the record retention area: a firm was sanctioned for failure to keep certain business records in the required format.

A. *Direct Services, LLC, ING America Equities, Inc., ING Financial Advisers, LLC, ING Financial Partners, Inc. and ING Investment Advisers, LLC (collectively "firms") (Feb. 19, 2013)*

1. FINRA settled a matter in which it alleged that these five affiliated firms failed to retain and review, or timely review, millions of e-mail communications affecting hundreds of the firms' employees.

2. FINRA stated that the firms' e-mail retention system worked by journaling or copying of e-mails from the firms' exchange server, where they were initially kept, to an e-mail archive, which was designed to maintain the e-mails for the required time periods.

3. FINRA alleged that two of the firms failed to journal e-mails to the archive between 2008 and 2010 that were sent or received by nearly 1,000 registered representatives who were either hired as independent contractors by the two firms or whose accounts were hosted on external servers.

4. FINRA also alleged that four of the firms failed to configure secondary e-mail addresses of 332 registered representatives and associated persons at the firms between February 2008 and September 2010 in a manner that would ensure the messages were journaled and archived.

5. In addition, FINRA alleged that four of the firms also failed to journal e-mails sent to distribution lists, e-mails sent as blind carbon copies, encrypted e-mails and e-mails sent from a third party software provider's application.

6. Lastly, FINRA alleged that the firms failed to review nearly 6 million e-mails that were retained and flagged for supervisory review.

7. The firms consented to a censure and a joint and several fine of $1.2 million. The firms also agreed to an undertaking to review their procedures regarding the capturing, retention and review of e-mails, and to ensure that reasonable policies and procedures are in place to address and correct the violations.

8. In setting the fine, FINRA acknowledged that the firms self-reported the e-mail issues and undertook an internal review of their relevant supervisory policies and procedures, and the substantial assistance the firms provided to FINRA during its investigation.

B. *LPL Financial LLC ("LPL") (May 21, 2013)*

1. FINRA settled a matter in which it alleged that LPL had significant e-mail system failures that prevented it from accessing hundreds of millions of e-mails and reviewing tens of millions of other messages. FINRA also alleged that LPL made material misstatements to FINRA during its investigation.

2. FINRA alleged that, from 2007 to 2013, LPL's e-mail review and retention systems failed at least 35 times, preventing LPL from capturing e-mail, supervising its representatives and responding to regulatory requests. As a result of its deficiencies, LPL failed to produce e-mails to certain federal and state regulators, as well as certain private litigants and customers in arbitration proceedings.

3. Some examples of the e-mail retention and review failures alleged by FINRA include:

   a. During a four-year period, LPL failed to supervise 28 million "doing business as" ("DBA") e-mails sent and received by thousands of representatives who acted as independent contractors. Approximately 2,500 e-mail addresses used by LPL independent contractors were not linked to LPL's supervisory system;

   b. During a transition to a less costly e-mail archive provider in March 2009, the firm failed to retain access to hundreds of millions of e-mails. For a five-month period in 2009, the firm had limited access to certain e-mails. Additionally, from October 2009 through March 2010, LPL had no access to 280 million archived e-mails, and it made little effort to regain access. When the archived e-mails were finally restored, approximately 80 million e-mails had become corrupted;

   c. Over a seven-year period, LPL failed to retain, review or archive 3.5 million Bloomberg messages;

   d. Prior to 2011, the firm failed to supervise e-mails of any of its registered employees, other than its independent advisors;

   e. From 2008 to 2011, LPL identified 1,029 instances of advisors using unauthorized DBA e-mail addresses, but it

failed to discipline the advisors, prohibit advisors from using unauthorized DBA addresses, or archive and review the e-mails sent through the unauthorized e-mail addresses;

f. LPL failed to archive e-mails sent to customers through third-party e-mail-based advertising platforms; and

g. In 2011, three financial institutions were unable to transfer approximately 700,000 e-mails to LPL's system for supervisory review. Additionally, over 200 e-mail addresses from these institutions were not reported to the firm, resulting in those accounts not being supervised.

4. FINRA also alleged that LPL made material misstatements to FINRA during its investigation of LPL's e-mail failures. Specifically, FINRA alleged that, in a letter, LPL inaccurately stated that the firm discovered the DBA e-mail issue in June 2011 and that there were no "red flags" suggesting an issue, when in fact there were numerous red flags and certain LPL personnel had information that would have uncovered the issue in 2008.

5. LPL consented to a censure and a fine in the amount of $7.5 million. Additionally, LPL was ordered to establish a $1.5 million fund to compensate customer claimants who were potentially affected by LPL's failure to produce e-mail.

6. The firm also undertook to certify to FINRA that it had established policies and procedures reasonably designed to achieve compliance with the rules regarding e-mail retention and supervision. LPL also agreed to notify regulators who may have received incomplete e-mail productions.

C. *Barclays Capital Inc. ("Barclays") (Dec. 26, 2013)*

1. FINRA settled a matter in which it alleged that Barclays failed to preserve electronic business records and certain e-mails and instant messages ("IMs") in the required "Write-Once, Read Many" ("WORM") format for a period of at least 10 years.

2. FINRA alleged that, between 2002 and 2012, the firm failed to maintain certain business-related records in WORM format, including order and trade ticket data, trade confirmations, blotters, settlements, account records and ledgers, exception reports, and records supporting FOCUS reports and annual financial statements and schedules. According to FINRA, the WORM issues affected various electronic books and records related to many of the firm's business units, including Equities, Futures, Commodities, Securitized Products, and Finance.

3. Although Barclays performed certain testing to confirm that its records were properly retained, FINRA alleged that the testing did not focus on the format in which the firm's records were stored, including whether they were maintained in a WORM compliant format.

4. FINRA alleged that, between May 2007 and May 2010, the firm failed to properly ingest into its archive certain Bloomberg attachments. Specifically, due to an error in the ingestion script, the firm did not properly ingest attachments that were associated with more than one Bloomberg e-mail. Once an attachment was ingested in connection with one Bloomberg e-mail, the attachment failed to be associated with subsequently processed Bloomberg e-mails that contained the same attachment. The firm was not able to determine the number of Bloomberg e-mails affected, but FINRA noted that the firm generates approximately 500,000 Bloomberg e-mails per day (18% of the firm's electronic communications).

5. FINRA further alleged that, between October 2008 and May 2010, the firm failed to retain approximately 3.3 million Bloomberg IMs. Specifically, the ingestion script stopped processing all Bloomberg IMs for the day if it attempted to process an attachment that had already been processed as an attachment to a Bloomberg IM that same day. FINRA alleged that these Bloomberg-related issues impacted the firm's ability to respond to requests in regulatory and civil matters.

6. FINRA alleged that, for both the electronic document retention issues and the Bloomberg-related issues, the firm did not have an adequate supervisory system or written procedures in place to comply with relevant rules and to timely detect and remedy deficiencies.

7. Barclays consented to a censure and a fine of $3.75 million. In determining the sanction imposed, FINRA acknowledged that the firm self-reported the issues, undertook an internal review, and hired an independent consultant to review its supervisory systems related to these issues.

Suitability

FINRA routinely brings cases involving suitability. Below are descriptions of two 2013 settlements.

A. *Wells Fargo Advisors, LLC ("Wells Fargo"), as successor in interest to Wells Fargo Investments, LLC and Merrill Lynch, Fenner & Smith Inc., as successor in interest to Banc of America Investment Services, Inc. ("BAI") (collectively the "firms") (June 4, 2013)*

1. FINRA settled separate matters with Wells Fargo and BAI in which it alleged that the firms made unsuitable recommendations of floating-rate bank loan funds, failed to train their sales forces regarding characteristics of the funds and failed to reasonably supervise sales of the funds.

2. FINRA stated that between January 1, 2007 and December 31, 2008, the firms' respective registered representatives recommended floating-rate bank loan funds to customers without conducting adequate suitability assessments. In particular, representatives recommended the funds, which are subject to high credit risk and can be illiquid, to customers looking to preserve principal and with a conservative risk tolerance. Unsuitable transactions in the funds resulted in losses of approximately $1.9 million to 214 Wells Fargo customers and losses of approximately $1.1 million to 214 BAI customers.

3. FINRA also alleged that the firms failed to reasonably supervise fund sales and train their personnel regarding the risks and features of the funds or the customers for whom the funds were a suitable investment.

4. With respect to Wells Fargo, FINRA alleged that, in response to potential concerns raised internally, the firm had conducted a review and prepared guidance to its sales force regarding the sale of floating rate loan fund sales but failed to distribute that information adequately.

5. With respect to BAI, FINRA alleged that the firm did not respond adequately to developments in the market for floating rates loan funds that affected the risks associated with them, for example by providing alerts to its sales force or adapting its supervision of fund sales.

6. Wells Fargo consented to a censure, a fine of $1,250,000.00, and restitution to customers in the amount of $1,981,561.70.

7. BAI consented to a censure, a fine of $900,000.00, and restitution to customers in the amount of $1,095,680.83.

B. *VSR Financial Services, Inc. (“VSR”) and Donald J. Beary (“Beary”) (May 15, 2013)*

1. FINRA settled a matter with VSR and Beary, who is VSR’s co-founder, executive vice president, chairman of its board of directors and direct participation principal, in which it alleged: (i) supervisory failures by VSR related to customer account concentration levels in alternative investments and review and approval of the use of consolidated financial account reports; and (ii) unsuitable sales of high-risk private placements and related supervisory failures.

2. According to FINRA, from July 28, 2005 through August 19, 2010 there were numerous instances of customer account concentrations in alternative investments exceeding limits set in VSR’s policies, which provided that no more than 40%-50% of a client’s “exclusive net worth” – total net worth minus home, automobiles and furnishings – could be invested in alternative investments unless there was a well-documented, substantial reason to exceed such threshold.

3. A “discount program” was used that artificially reduced the amount of customer positions for concentration purposes, which the firm and Beary continued to implement despite warnings from the SEC in 2006 and 2008 regarding the lack of related supervisory procedures. VSR also reduced the risk ratings on many investments from the levels assigned by the alternative investment program sponsors and also lowered its own internal risk ratings after the firm’s acceptance of several products.

4. Despite the discount program and risk level adjustments, there were numerous instances of customers’ investments exceeding the 40% concentration guideline VSR established, with several exceeding 50%, yet there was no documentation supporting a “substantial reason” for the concentration, as required by the firm’s policies.

5. FINRA also alleged that, between January 1, 2006 and January 1, 2012, VSR failed to require pre-approval of the use of consolidated customer financial reports, did not determine whether accurate pricing and disclosures were being used, and had no system to promptly review consolidated reports after transmission to customers. VSR had limited procedures related to the use of consolidated reports and provided limited guidance during the time period, all of which preceded a FINRA notice to members

reminding firms of their obligations related to consolidated reports and emphasizing firms' supervisory responsibilities.

6. FINRA also alleged that, between March 1, 2005 and December 12, 2008, VSR recommended and sold high-risk private placements to customers for whom the investments were unsuitable given their financial circumstances and the risk tolerances, resulting in millions in customer losses. VSR earned commissions totaling $62,182 for these transactions sold by one particular registered representative, who was barred for his related conduct, among other things. VSR earned an additional $483,077 in commissions for these transactions sold by a separate registered representative.

7. According to FINRA, VSR failed to supervise the registered representatives responsible for the unsuitable sales. FINRA noted that the transactions were each reviewed and approved by one of the firm's principals, but that the principals failed to detect or investigate red flags, which included falsification of customer net worth and risk tolerance information, and that the "discount program" and risk level adjustments described above may have contributed to the alleged misconduct.

8. VSR consented to a censure and a fine of $550,000. Beary consented to a fine of $10,000 and a 45-day suspension from association with any FINRA member firm.

Supervision

FINRA has indicated that, in every investigation, it evaluates the supervision of the underlying conduct. Below are two cases from 2013 involving firms' failure to supervise certain activity.

A. *Ameriprise Financial Services, Inc. ("AFSI") and American Enterprise Investment Services Inc. ("AEIS") (Mar. 4, 2013)*

1. FINRA settled a matter in which it alleged that AFSI and its affiliated clearing firm AEIS lacked supervisory systems that were reasonably designed to review and monitor wire transfer requests and the transmittal of customer monies to third-party accounts.

2. According to FINRA, between December 2006 and October 2010, an AFSI-registered representative misappropriated approximately $790,000 from two customers by submitting approximately 85 falsified wire requests, ranging from $1,000 to $95,000, for transfers to bank accounts the registered representative controlled. (This representative was barred by FINRA in 2011.)

3. FINRA alleged that both firms failed to identify the registered representative's misconduct for nearly four years, despite red flags.

4. For example, three of the wire requests appeared to go to an account controlled by the registered representative. At least three forged wire transfers were initially rejected, with one wire transfer rejected for a signature discrepancy. In addition, two more forged wire transfers were processed and disbursed after the firms discovered the registered representative's misconduct, and one request was processed after the registered representative was terminated.

5. FINRA also alleged that the firms' supervisory systems were inadequate to detect or prevent multiple transmittals of funds to third-party accounts in that the systems lacked a centralized system for compiling information about wire requests. The firms relied on a manual review of wire requests without exception reports, which prevented the firms from being able to detect patterns of misconduct.

6. FINRA also alleged that AFSI failed to promptly discontinue terminated employees' access to company computer systems, thereby failing to protect customer records and information. Although AFSI implemented procedures in January 2010 requiring that terminated employees' access be cut within one hour of termination, FINRA alleged that between February and June 2010, AFSI failed to timely halt computer access for 100 of 200 terminated employees.

7. The firms consented to a censure and a joint and several fine of $750,000.

8. FINRA noted that AFSI paid full restitution to the two customers affected by the registered representative's conduct.

B. *Lincoln Financial Securities Corporation ("LFS") (Dec. 10, 2012)*

1. FINRA settled a matter with LFS related to alleged supervisory failures in the areas of variable annuity redemptions, licensing of representatives, e-mail retention, anti-money laundering ("AML"), and producing managers.

2. FINRA alleged that, between January 2008 and April 2009, LFS failed to enforce its policy related to variable annuity redemptions, which required, among other things, LFS registered representatives to document an economic analysis demonstrating that the redemption was beneficial to the customer. This policy was

designed to assist supervisors reviewing the transactions to ensure that the transactions were suitable.

3. FINRA also alleged that, between January 2009 and December 2009, LFS failed to enforce its policy that prohibited its registered representatives from receiving commissions unless the representative was licensed in both the state of solicitation and the customer's state of residence at the time of the transaction. As a result, approximately 2,500 transactions occurred in customer accounts despite representatives not being licensed in the customer's state of residence at the time of the commission payment. Approximately 90 representatives received commissions as a result of these transactions.

4. According to FINRA, LFS also failed to have adequate AML procedures for monitoring for suspicious transactions in client accounts held directly with the product manufacturer following the initial investment. FINRA noted that two independently-conducted audits in 2008 and 2009 revealed that direct business accounts were not being reviewed by LFS, and LFS did not confirm that the product manufacturers were conducting the reviews. FINRA also alleged that, from 2005 to 2008, LFS's AML training program was inadequate by failing to adequately specify the time frame for training and the employees that required training.

5. FINRA also alleged that, from March 2007 to June 2009, LFS failed to reasonably enforce its supervisory procedures to ensure that all of its representatives' securities-related e-mails were captured, reviewed and retained. LFS permitted its representatives to use non-LFS e-mail accounts that were not linked to the firm's e-mail system, but any securities-related e-mails were required to be forwarded to LFS's e-mail system. An outside auditor employed by LFS during this time period notified the firm of securities-related e-mails in representatives' non-firm e-mail accounts that were not forwarded to the firm's e-mail system. However, LFS did not employ a systematic and consistent method to confirm that such e-mails were forwarded and retained. Similarly, FINRA alleged that, from January 2009 through June 2009, LFS failed to have an adequate system in place to confirm whether e-mails related to the outside business activities of its representatives involved securities-related correspondence and whether such e-mails were retained.

6. Finally, FINRA alleged that, from March 2007 through May 2008, LFS failed to reasonably supervise customer account activity and customer files for producing managers. FINRA noted that LFS procedures permitted its office of supervisory jurisdiction ("OSJ") managers to review their own securities transactions on behalf of customers. Additionally, LFS branch office inspection reports did

not ensure that a sufficient sample of customer files serviced by OSJ managers was reviewed during branch audits. Finally, during calendar year 2008 LFS failed to complete an adequate Rule 3012 report; the report failed to address certain deficiencies that LFS had been aware of during the previous year.

7. LFS consented to a censure and a fine of $525,000.

Trade Reporting

Firms' electronic transaction reporting has been the subject of regulatory interest for a number of years. The following three cases involve various trade reporting issues.

A. *Citigroup Global Markets Inc. ("Citigroup") (May 30, 2013)*

1. FINRA settled a matter in which it alleged that, at certain times between February 2002 and August 2011, Citigroup failed to accurately transmit last sale reports to the FINRA/Nasdaq Trade Reporting Facility ("FNTRF") and the OTC Reporting Facility ("OTCRF").

2. Specifically, regarding last trade reports required to be transmitted to FNTRF, FINRA alleged that Citigroup (i) failed to transmit or timely transmit last sale reports and failed to designate some of the reports as late; (ii) failed to report the correct time of execution; (iii) improperly designated some reports as ".PRP"; (iv) failed to mark transactions as riskless principal transactions; and (v) incorrectly reported the second leg of riskless principal transactions.

3. With respect to last trade reports required to be reported to OTCRF, FINRA alleged that Citigroup (i) failed to timely report last-sale reports of transactions in OTC equity securities and failed to designate some of the reports as late; (ii) failed to report correct execution times for reportable securities; (iii) failed to accept or decline trade reports in reportable securities within 20 minutes after execution; and (iv) erroneously reported to OTCRF foreign equity securities transactions that were executed and reported in foreign countries.

4. The violations affected over 600,000 last sale reports in designated securities.

5. FINRA alleged that Citigroup did not provide for adequate supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and rules concerning trade reporting.

6. FINRA also alleged that, from January 2009 to March 2009 and from January 2010 to March 2010, Citigroup transmitted approximately 150 reports to Order Audit Trail System ("OATS") that contained inaccurate, incomplete, or improperly formatted data or that failed to show the time of order receipt.

7. In addition, FINRA alleged that, between January 2007 and June 2007, Citigroup (i) effected 16 transactions in seven securities while a trading halt was in effect; (ii) effected four transactions in one security after the securities registration was revoked; and (iii) failed to fully and promptly execute a customer market order in 78 instances.

8. Citigroup consented to a censure, a fine of $800,000, restitution to certain customers in the amount of $1,055, and certain other undertakings. In settling the matter, FINRA also noted three previous matters wherein Citigroup had been sanctioned for trade reporting violations.

B. *Barclays Capital Inc. ("Barclays") (June 7, 2013)*

1. FINRA settled a matter in which it alleged that, between September 2008 and July 2011, Barclays failed to timely transmit accurate and complete submissions to OATS.

2. Specifically, FINRA alleged that, from September 2008 to December 2009, Barclays failed to transmit 630 Reportable Order Events ("ROEs") to OATS. This represented 100% of the ROEs that Barclays was required to submit during that time period. In a separate review period of nine months, the firm again failed to transmit over 100 million ROEs to OATS, representing 6% of all ROEs that the firm was required to transmit to OATS, for a period of nine months.

3. FINRA alleged that for a period of 12 nonconsecutive months, Barclays transmitted reports to OATS that contained inaccurate, incomplete, or improperly formatted data, or that were not timely filed. Barclays' reports represented 4% of all reports transmitted to OATS.

4. FINRA also alleged that for a period of over two years, Barclays improperly reported almost six million Execution Reports to OATS, representing 5% of all the Executions Reports submitted by Barclays.

5. FINRA alleged that between September 2008 and July 2011, Barclays disclosed inaccurate information on customer confirmations on 33 occasions.

6. In addition, FINRA alleged that Barclays' supervisory system failed to achieve compliance with applicable securities laws, regulations, and rules to ensure that Barclays' submissions to OATS were timely, accurate, and complete.

7. Barclays consented to a censure, a $550,000 fine, and an undertaking to revise the firm's written supervisory procedures.

C. *Wedbush Securities, Inc. ("Wedbush") (June 25, 2013)*

1. In May 2012, FINRA's Department of Market Regulation filed a complaint against Wedbush alleging several billion violations of the OATS rules. After a hearing on the merits, a FINRA Hearing Panel issued an order accepting an Offer of Settlement of the action, which alleged that Wedbush failed to (i) meet OATS reporting obligations for over one billion reportable order events ("ROEs"); (ii) have in place a supervisory system reasonably designed to achieve compliance with the OATS reporting rules; (iii) conduct supervisory reviews required by its written supervisory procedures; and (iv) properly register the supervisor of personnel responsible for OATS reporting.

2. FINRA alleged that between January 1, 2005 and July 7, 2006, the firm failed to send to OATS approximately 1.6 billion ROEs, a number representing 99.92% of the firm's overall reporting obligation for that time period. FINRA also alleged that between 2006 and 2010, Wedbush submitted 270 million ROEs late, which made the firm's late reporting violation rates significantly higher than its peer group and industry averages.

3. FINRA further alleged that 12.7 million ROEs submitted by the firm were rejected due to context or syntax errors, and 45 million order reports submitted by the firm contained inaccurate, incomplete or improperly formatted data that prevented OATS from linking to the related order.

4. FINRA noted that Wedbush continued to have OATS reporting violations subsequent to the review periods that were the subject of its complaint. For example, Wedbush submitted 607 million late ROEs in four months in 2012.

5. Wedbush consented to a censure and a fine of $750,000, which included $500,000 for OATS reporting violations, $225,000 for supervisory violations and $25,000 for failure to register its principal. The Firm also agreed to an undertaking to retain an independent consultant to conduct a comprehensive review of its policies, systems, controls, procedures and training relating to OATS reporting and its supervision of OATS reporting.

Chicago		
Merri Jo Gillette	312.324.1134	mgillette@morganlewis.com
Michael M. Philipp	312.324.1905	mphilipp@morganlewis.com
Irvine		
Scott B. Garner	949.399.7182	sgarner@morganlewis.com
Robert E. Gooding, Jr.	949.399.7181	rgooding@morganlewis.com
Los Angeles		
John F. Hartigan	213.612.2630	jhartigan@morganlewis.com
Miami		
Ivan P. Harris	305.415.3398	iharris@morganlewis.com
Ethan W. Johnson	305.415.3394	ejohnson@morganlewis.com
New York		
P. Georgia Bullitt	212.309.6683	gbullitt@morganlewis.com
Michèle A. Coffey	212.309.6917	mcoffey@morganlewis.com
Anne C. Flannery	212.309.6370	aflannery@morganlewis.com
Bernard J. Garbutt III	212.309.6084	bgarbutt@morganlewis.com
Brian A. Herman	212.309.6909	bherman@morganlewis.com
Ben A. Indek	212.309.6109	bindek@morganlewis.com
Jennifer L. Klass	212.309.7105	jklass@morganlewis.com
Michael S. Kraut	212.309.6927	mkraut@morganlewis.com
Robert C. Mendelson	212.309.6303	rmendelson@morganlewis.com
Kelly A. Moore	212.309.6612	kelly.moore@morganlewis.com
Richard F. Morris	212.309.6650	richard.morris@morganlewis.com
Robert M. Romano	212.309.7083	rromano@morganlewis.com
Kevin T. Rover	212.309.6244	krover@morganlewis.com
Martha B. Stolley	212.309.6858	mstolley@morganlewis.com
John M. Vassos	212.309.6158	jvassos@morganlewis.com
Philadelphia		
Elizabeth Hoop Fay	215.963.5712	efay@morganlewis.com
Timothy W. Levin	215.963.5037	tlevin@morganlewis.com
Sean Graber	215.963.5598	sgraber@morganlewis.com
Marc J. Sonnenfeld	215.963.5572	msonnenfeld@morganlewis.com
San Francisco		
Joseph E. Floren	415.442.1391	jfloren@morganlewis.com
Elizabeth A. Frohlich	415.442.1352	efrohlich@morganlewis.com
Susan D. Resley	415.442.1351	sresley@morgnlewis.com

Washington, D.C.

John V. Ayanian	202.739.5946	jayanian@morganlewis.com
Patrick D. Conner	202.739.5594	pconner@morganlewis.com
Mary M. Dunbar	202.739.5358	mdunbar@morganlewis.com
Mark D. Fitterman	202.739.5019	mfitterman@morganlewis.com
Melissa Hall	202.739.5883	melissa.hall@morganlewis.com
Charles M. Horn	202.739.5951	chorn@morganlewis.com
Daniel R. Kleinman	202.739.5143	dkleinman@morganlewis.com
Christian J. Mixter	202.739.5575	cmixter@morganlewis.com
Michael Richman	202.739.5036	mrichman@morganlewis.com
Steven W. Stone	202.739.5453	sstone@morganlewis.com
E. Andrew Southerling	202.739.5062	asoutherling@morganlewis.com

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