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## **Minor Rule Violations Are on the SEC Enforcement Agenda**

Historically, the enforcement actions brought by the Securities and Exchange Commission (“SEC”) have focused more on fraud and misrepresentation, than on books and records violations or compliance professionals. Mary Jo White, Chairperson of the SEC appears to be expanding the enforcement focus of the SEC, which may significantly impact the compliance programs of federally registered investment advisers and broker-dealers.

In opening remarks given at the Securities Enforcement Forum on October 9, 2013, White set the stage for the future when she stated that “... one of our goals is to see that the SEC’s enforcement program is, and is perceived to be – everywhere, pursuing all types of violations of our federal securities laws, big and small.” She went on to state that “investors do not want someone who ignores minor violations, and waits for the big one that brings media attention, but instead, they want someone who understands that even the smallest infractions have victims, and that the smallest infractions are very often just the first step toward bigger ones down the road.”

In her discussion of the SEC’s enforcement mission, she utilized the Broken Windows Theory by analogy. The Broken Windows Theory was formulated in 1982 by George Kelling and James Q. Wilson. The theory simply states that like an abandoned building with a broken window signals a careless attitude toward the property, it also reflects an absence of respect for the law. Essentially the “broken window” is the first step in a neighborhood’s slow deterioration and as times goes on, there will be other show of abandonment and decay – such as “more broken windows, trash accumulation, graffiti and abandoned cars”. Thus, when a broken window is not fixed, it is a signal that no one cares, and so breaking more windows costs nothing. In the alternative, when a window is broken and someone fixes it – it is a signal that disorder will not be tolerated.

Ms. White then stated that “the same theory can be applied to our securities markets, minor violations that are overlooked or ignored can feed bigger ones, and, perhaps more importantly, can foster a culture where laws are increasingly treated as toothless guidelines. And so, I believe it is important to pursue even the smallest infractions.”

With that mindset, the Division of Enforcement of the SEC has been tasked to build upon the strength of the division by ensuring that SEC pursue not just the biggest frauds, but also violations such as control failures, negligence-based offenses, and even violations of prophylactic rules with no intent requirements. With this in mind, it is clear that broker-dealers and investment advisers will need to be mindful of the increased scrutiny that the exam program will bring to bear on their compliance programs.

While acknowledging the resource issues facing the SEC, Ms. White believes that the SEC can achieve this goal by: (i) expanding its field of vision and reach by leveraging the strength of its exam program, (ii) incentivizing individuals to step forward and collaborate with their regulatory colleagues, (iii) harnessing the power of its enhanced technological capabilities; (iv) focusing on deficient gatekeepers by pursuing those who should be serving as the neighborhood watch, but who fail to do their jobs; (v) looking for the “broken windows” in the markets by not overlooking the small violations to avoid breeding an environment of indifference to our rules; and (iv) continuing to prioritize the bigger cases.

While White’s focus was on financial auditors as gatekeepers, it is interesting to note that the primary “gatekeepers” in the financial industry are chief compliance officers. To this end, Ms. White stated “...Cases against delinquent gatekeepers remind them, and the industry, of the important responsibilities that gatekeepers share with us to protect investors.” This appears to be a significant shift by the SEC in that not only will they be bringing actions against firms for what have historically been “minor” books and records violations, they may also be bringing actions against the “gatekeepers” that allowed such violations to occur.

Ultimately, the ideological critics of the “broken windows theory” believe that the theory criminalizes poverty and hopes that the SEC’s new position doesn’t “criminalize” minor books and records violations and place additional pressure and exposure to sanctions on already beleaguered compliance professionals. While protection of the investing public is both a fundamental and important obligation of the SEC, hope remains that in the SEC’s zeal to enforce minor rule violations, they will maintain a focus on the true risks to the markets.

For the full text of Ms. White’s speech, please click the following link:

<http://www.sec.gov/News/Speech/Detail/Speech/1370539872100#.U11uXeIo4qI>

We hope that this information has been helpful to you. Should you have any additional questions or concerns, please feel free to contact Daniel E. LeGaye or Michael Schaps by e-mail or phone, at 281-367-2454, or consult with your legal counsel or compliance consultant.

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