KEY ISSUES FACING BOARDS OF DIRECTORS: NEW SEC ENFORCEMENT INITIATIVES AND CORPORATE GOVERNANCE RISKS

DIRECTORS ROUNDTABLE
OCTOBER 21, 2014

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H. R. 4173

EXCERPT: Pages 1, 487, 489-90, and 496
(with Sections 929P(b) and 929Y highlighted)

One Hundred Eleventh Congress of the United States of America

AT THE SECOND SESSION

Begun and held at the City of Washington on Tuesday, the fifth day of January, two thousand and ten

An Act

To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Dodd-Frank Wall Street Reform and Consumer Protection Act".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

violation of a provision of this Act, or of any rule or regulation issued under this Act, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.''.

SEC. 929N. AUTHORITY TO IMPOSE PENALTIES FOR AIDING AND ABETTING VIOLATIONS OF THE INVESTMENT ADVISERS ACT.

Section 209 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–9) is amended by inserting at the end the following new subsection:

''(f) AIDING AND ABETTING.—For purposes of any action brought by the Commission under subsection (e), any person that knowingly or recklessly has aided, abetted, counseled, commanded, induced, or procured a violation of any provision of this Act, or of any rule, regulation, or order hereunder, shall be deemed to be in violation of such provision, rule, regulation, or order to the same extent as the person that committed such violation.''.

SEC. 929O. AIDING AND ABETTING STANDARD OF KNOWLEDGE SATISFIED BY RECKLESSNESS.

Section 20(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78t(e)) is amended by inserting ''or recklessly'' after ''knowingly''.

SEC. 929P. STRENGTHENING ENFORCEMENT BY THE COMMISSION.

(a) AUTHORITY TO IMPOSE CIVIL PENALTIES IN CEASE AND DESIST PROCEEDINGS.—

(1) UNDER THE SECURITIES ACT OF 1933.—Section 8A of the Securities Act of 1933 (15 U.S.C. 77h–1) is amended by adding at the end the following new subsection:

''(g) AUTHORITY TO IMPOSE MONEY PENALTIES.—

''(1) GROUNDS.—In any cease-and-desist proceeding under subsection (a), the Commission may impose a civil penalty on a person if the Commission finds, on the record, after notice and opportunity for hearing, that—

''(A) such person—

''(i) is violating or has violated any provision of this title, or any rule or regulation issued under this title; or

''(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation thereunder; and

''(B) such penalty is in the public interest.

''(2) MAXIMUM AMOUNT OF PENALTY.—

''(A) FIRST TIER.—The maximum amount of a penalty for each act or omission described in paragraph (1) shall be $7,500 for a natural person or $75,000 for any other person.

''(B) SECOND TIER.—Notwithstanding subparagraph (A), the maximum amount of penalty for each such act or omission shall be $75,000 for a natural person or $375,000 for any other person, if the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

''(C) THIRD TIER.—Notwithstanding subparagraphs (A) and (B), the maximum amount of penalty for each such act or omission shall be $150,000 for a natural person or $725,000 for any other person, if—

"(A) IN GENERAL.—In any proceeding"; and

(E) by adding at the end the following:

"(B) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted pursuant to subsection (f) against any person, the Commission may impose a civil penalty if the Commission finds, on the record, after notice and opportunity for hearing, that such person—

"(i) is violating or has violated any provision of this title, or any rule or regulation issued under this title; or

"(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation issued under this title.".

(4) UNDER THE INVESTMENT ADVISERS ACT OF 1940.—Section 203(i)(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(i)(1)) is amended—

(A) by striking the matter following subparagraph (D);

(B) in the matter preceding subparagraph (A), by inserting after "opportunity for hearing," the following: "that such penalty is in the public interest and";

(C) by redesignating subparagraphs (A) through (D) as clauses (i) through (iv), respectively, and adjusting the margins accordingly;

(D) by striking "In any proceeding" and inserting the following:

"(A) IN GENERAL.—In any proceeding"; and

(E) by adding at the end the following new subparagraph:

"(B) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted pursuant to subsection (k) against any person, the Commission may impose a civil penalty if the Commission finds, on the record, after notice and opportunity for hearing, that such person—

"(i) is violating or has violated any provision of this title, or any rule or regulation issued under this title; or

"(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation issued under this title.".

(b) EXTRATERRITORIAL JURISDICTION OF THE ANTIFRAUD PROVISIONS OF THE FEDERAL SECURITIES LAWS.—

(1) UNDER THE SECURITIES ACT OF 1933.—Section 22 of the Securities Act of 1933 (15 U.S.C. 77v(a)) is amended by adding at the end the following new subsection:

"(c) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of section 17(a) involving—

"(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or

"(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.".

(2) UNDER THE SECURITIES EXCHANGE ACT OF 1934.—Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa) is amended—

(A) by striking "The district" and inserting the following:

"(a) IN GENERAL.—The district"; and

(B) by adding at the end the following new subsection:

"(b) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of the antifraud provisions of this title involving—

"(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or

"(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.".

(3) UNDER THE INVESTMENT ADVISERS ACT OF 1940.—Section 214 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–14) is amended—

(A) by striking "The district" and inserting the following:

"(a) IN GENERAL.—The district"; and

(B) by adding at the end the following new subsection:

"(b) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of section 206 involving—

"(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the violation is committed by a foreign adviser and involves only foreign investors; or

"(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.".

(c) CONTROL PERSON LIABILITY UNDER THE SECURITIES EXCHANGE ACT OF 1934.—Section 20(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78t(a)) is amended by inserting after "controlled person is liable" the following: "(including to the Commission in any action brought under paragraph (1) or (3) of section 21(d))".

SEC. 929Q. REVISION TO RECORDKEEPING RULE.

(a) INVESTMENT COMPANY ACT OF 1940 AMENDMENTS.—Section 31 of the Investment Company Act of 1940 (15 U.S.C. 80a–30) is amended—

(1) in subsection (a)(1), by adding at the end the following: "Each person having custody or use of the securities, deposits, or credits of a registered investment company shall maintain and preserve all records that relate to the custody or use by such person of the securities, deposits, or credits of the registered investment company for such period or periods as the Commission, by rule or regulation, may prescribe, as necessary or appropriate in the public interest or for the protection of investors."; and

(2) in subsection (b), by adding at the end the following:

"(4) RECORDS OF PERSONS WITH CUSTODY OR USE.—

of investors, may prescribe the form, content, time, and manner of delivery of any notice required under this paragraph.''.

SEC. 929Y. STUDY ON EXTRATERRITORIAL PRIVATE RIGHTS OF ACTION.

(a) IN GENERAL.—The Securities and Exchange Commission of the United States shall solicit public comment and thereafter conduct a study to determine the extent to which private rights of action under the antifraud provisions of the Securities and Exchange Act of 1934 (15 U.S.C. 78u-4) should be extended to cover—

(1) conduct within the United States that constitutes a significant step in the furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; and

(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

(b) CONTENTS.—The study shall consider and analyze, among other things—

(1) the scope of such a private right of action, including whether it should extend to all private actors or whether it should be more limited to extend just to institutional investors or otherwise;

(2) what implications such a private right of action would have on international comity;

(3) the economic costs and benefits of extending a private right of action for transnational securities frauds; and

(4) whether a narrower extraterritorial standard should be adopted.

(c) REPORT.—A report of the study shall be submitted and recommendations made to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House not later than 18 months after the date of enactment of this Act.

SEC. 929Z. GAO STUDY ON SECURITIES LITIGATION.

(a) STUDY.—The Comptroller General of the United States shall conduct a study on the impact of authorizing a private right of action against any person who aids or abets another person in violation of the securities laws. To the extent feasible, this study shall include—

(1) a review of the role of secondary actors in companies issuance of securities;

(2) the courts interpretation of the scope of liability for secondary actors under Federal securities laws after January 14, 2008; and

(3) the types of lawsuits decided under the Private Securities Litigation Act of 1995.

(b) REPORT.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report to Congress on the findings of the study required under subsection (a).

961 F.Supp.2d 905
United States District Court,
N.D. Illinois,
Eastern Division.

UNITED STATES SECURITIES and EXCHANGE COMMISSION, Plaintiff,
v.
A CHICAGO CONVENTION CENTER, LLC, Anshoo Sehti, and Intercontinental Regional Center Trust of Chicago, LLC, Defendants.

No. 13 C 982. | Aug. 6, 2013.

Synopsis

Background: Securities and Exchange Commission (SEC) brought securities fraud action against limited liability companies (LLCs) that allegedly fraudulently sold over $145 million in securities to Chinese investors who hoped to obtain United States citizenship by investing in target employment area under Immigration and Nationality Act's E13–5 Program. LLCs moved to dismiss.

Holdings: The District Court, Amy J. St. Eve, J., held that:

[1] SEC adequately alleged conduct by LLCs that occurred in United States, or had effect in United States, as required to state securities fraud claim under conducts and effects test, and

[2] SEC also adequately alleged domestic securities transaction, as required to state securities fraud claim under transactional test.

Motion denied.

West Headnotes (14)

[1] **Statutes**
Plain Language; Plain, Ordinary, or Common Meaning
Statutes
Relation to plain, literal, or clear meaning; ambiguity

When a statute's language is plain, the sole function of the courts, at least where the disposition required by the text is not absurd, is to enforce it according to its terms.

Cases that cite this headnote

[2] **Statutes**
Relation to plain, literal, or clear meaning; ambiguity

When interpreting a statute, court first and foremost gives words their plain meaning unless doing so would frustrate the overall purpose of the statutory scheme, lead to absurd results, or contravene clearly expressed legislative intent.

Cases that cite this headnote

[3] **Statutes**
Purpose and intent; determination thereof

When the plain meaning of a statutory term is unclear, outside considerations can be used in an attempt to glean the legislative intent behind the use of the term.

Cases that cite this headnote

[4] **Statutes**
Superfluousness

Statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.

Cases that cite this headnote

[5] **Statutes**
Superfluousness

Statutory canon against surplusage applies only where a competing interpretation gives effect to every clause and word of a statute.

Cases that cite this headnote

[6] **Statutes**

Departing from or varying language of statute

While a court should give words in a statute their plain meaning unless doing so would contravene clearly expressed legislative intent, a court, nonetheless, may not ignore the unambiguous language of the statute in order to further Congress's expressed purpose in enacting the statute.

Cases that cite this headnote

[7] Statutes

Plain, literal, or clear meaning; ambiguity

Where a statute's language is clear, court looks to the legislative history only to determine whether Congress expressed a clear intention to the contrary of the literal application of that language.

Cases that cite this headnote

[8] Statutes

Plain, literal, or clear meaning; ambiguity

Legislative history does not permit a judge to turn clear statutory text on its head.

Cases that cite this headnote

[9] Statutes

Plain Language; Plain, Ordinary, or Common Meaning

Court, in construing a statute, should not extend its analysis beyond its sole function of enforcing the statute according to its terms based on its plain language.

Cases that cite this headnote

[10] Statutes

Prior or existing law in general

Court must assume that Congress is aware of existing law when it passes legislation, and that Congress is knowledgeable about existing law pertinent to the legislation it enacts.

Cases that cite this headnote

[11] Statutes

Mistakes and errors; misnomer and misdescription

Courts should not correct drafting errors in statutes.

Cases that cite this headnote

[12] Statutes

Relation to plain, literal, or clear meaning; ambiguity

Court should avoid literal interpretation of a statute if such an interpretation would lead to absurd results.

Cases that cite this headnote

[13] Securities Regulation

Transactions with foreigners or in foreign countries

Securities and Exchange Commission (SEC) adequately alleged conduct by limited liability companies (LLCs) that occurred in United States, or had effect in United States, as required to state securities fraud claim under conducts and effects test in connection with LLCs' allegedly fraudulently sale of securities to Chinese investors who hoped to obtain United States citizenship by investing in target employment area under Immigration and Nationality Act's E13–5 Program; LLCs allegedly wanted investors to purchase securities in Illinois-based LLC that was formed to finance and develop convention center in Chicago. Securities Act of 1933, § 17(a)(1–3), 15 U.S.C.A. § 77q(a)(1–3); Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

1 Cases that cite this headnote

[14] Securities Regulation

Transactions with foreigners or in foreign countries

Securities and Exchange Commission (SEC) adequately alleged domestic securities transaction, as required to state securities fraud claim under transactional test in connection with limited liability companies' (LLCs') allegedly fraudulent sale of unlisted securities to Chinese investors who hoped to obtain United States citizenship by investing in target employment area under Immigration and Nationality Act's E13–5 Program; LLCs allegedly engaged in sale of securities in United States by instructing investors to execute subscription agreement and send it to LLCs in United States and to wire funds to United States-based escrow agent, which funds would only be released to LLCs upon approval of investors' United States visa applications. Securities Act of 1933, § 17(a)(1–3), 15 U.S.C.A. § 77q(a)(1–3); Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

Cases that cite this headnote

Attorneys and Law Firms

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MEMORANDUM OPINION AND ORDER

AMY J. ST. EVE, District Judge.

On February 26, 2013, the United States Securities and Exchange Commission ***907** ("SEC") filed a three-count Complaint against Defendants A Chicago Convention Center, LLC ("ACCC"), Anshoo Sethi ("Sethi"), and Intercontinental Regional Center Trust of Chicago, LLC ("IRCTC"), alleging violations of the Securities Act of 1933, 15 U.S.C § 77q(a)(1)-(a)(3) (the "Securities Act"), Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), and Exchange Act Rule 10b–5, 17 C.F.R. § 240.10b–5 ("Rule 10b–5"). (R. 3, Compl.) On April 29, 2013, A Chicago Convention Center, LLC and Intercontinental Regional Center Trust of Chicago, LLC (collectively, the "Corporate Defendants") filed a motion to dismiss the Complaint pursuant to Federal Rule of Civil Procedure ("Rule") 12(b)(6). (R. 77, Mot.) For the following reasons, the Court denies the Corporate Defendants' motion.

BACKGROUND

The SEC's allegations, which the Court must take as true at this stage, are as follows. For "over ... 18 months," Anshoo Sethi ("Mr. Sethi") and the Corporate Defendants (collectively, "Defendants") "have perpetrated a large scale investment scheme." (Compl. ¶ 1.) Specifically, Defendants "fraudulently sold over $145 million in securities and collected an additional $11 million in administrative fees from over 250 investors." (*Id.* ¶¶ 1, 7.) These investors were Chinese nationals who hoped to obtain United States citizenship through their investments as part of the E13–5 Program. (*Id.* ¶¶ 2–3.) The Immigration and Nationality Act of 1990 created the E13–5 Program, which allows foreign nationals to qualify for a green card "if the individuals invest $1,000,000 (or at least $500,000 in a "Target Employment Area"—*i.e.*, a high unemployment or rural area), creating or preserving at least 10 jobs for U.S. workers." (*Id.* ¶ 2.) Defendants, "[u]sing the lure" of the E13–5 program, "targeted" these foreign investors by selling securities in the form of an interest in ACCC, an Illinois limited liability company claiming to "finance and build the 'World's First Zero Carbon Emission Platinum LEED certified' hotel and conference center in the Chicago area." (*Id.* ¶¶ 3, 15, 20.) According to the SEC, ACCC and IRCTC were "alter egos for Sethi." (*Id.* ¶ 18.) Mr. Sethi "is the primary representative of each company in their business dealings with USCIS and investors," and he "controlled nearly every aspect of ACCC's and IRCTC's business, and asserted control over their actions." (*Id.*)

The SEC further alleges that Defendants made false claims to further this scheme. First, Defendants "used false and misleading information" to solicit investments in the project. (*Id.* ¶ 4.) Defendants, for example, have falsely claimed "that several major hotel chains have signed on to the Defendants' project, that Defendants have acquired all the necessary permits and approvals to construct the project, that the Defendants will contribute land valued at over $177 million to the project, and that the project is likely to generate over 8,000 jobs." (*Id.* ¶¶ 4, 21, 28–36, 40.) Defendants also made false claims and presented false documents to U.S. Citizenship and Immigration Services ("USCIS"), the agency that oversees the EB–5 program. (*Id.* ¶¶ 2, 5, 17, 37.) Specifically, Defendants provided false information to

USCIS in order to obtain the agency's "preliminary approval of the project," so that USCIS would grant "provisional visas" to the foreign investors. (*Id.* ¶¶ 5–6.) To do this, Defendants "provided a business plan and two economic studies to USCIS" to demonstrate that "the project will create or save enough U.S. jobs to qualify investors for green cards under the EB–5 program." (*Id.* ¶ 55.) The SEC ***908** contends that this "fraud upon USCIS is a necessary part of the scheme to defraud investors and misappropriate investment funds." (*Id.* ¶ 6.)

To date, Defendants "have convinced over 250 Chinese investors to wire a minimum of $500,000 apiece plus a $41,500 'administration fee' to the Defendants' U.S. bank accounts." (*Id.* ¶¶ 3, 20.) Defendants claimed that the "administrative fees" were fully refundable, but have in fact "already spent or dissipated *over 90%* of the administrative fees collected from investors." (*Id.* ¶ 7 (emphasis in original)); (*see also id.* ¶¶ 51–52.) In response to Defendants' alleged conduct, and in an effort "to protect the interests of current and future investors," the SEC brought this lawsuit, seeking various forms of injunctive relief. (*Id.* ¶ 8; R. at 23–26.)

LEGAL STANDARD

A Rule 12(b)(6) motion challenges the sufficiency of the complaint. *See Hallinan v. Fraternal Order of Police of Chi. Lodge No. 7,* 570 F.3d 811, 820 (7th Cir.2009). Under the federal notice pleading standards, a plaintiff's "factual allegations must be enough to raise a right to relief above the speculative level." *Twombly,* 550 U.S. at 555, 127 S.Ct. 1955. Put differently, a "complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v. Iqbal,* 556 U.S. 662, 678, 129 S.Ct. 1937, 1949, 173 L.Ed.2d 868 (2009) (quoting *Twombly,* 550 U.S. at 570, 127 S.Ct. 1955). "In evaluating the sufficiency of the complaint, [courts] view it in the light most favorable to the plaintiff, taking as true all well-pleaded factual allegations and making all possible inferences from the allegations in the plaintiff's favor." *AnchorBank, FSB v. Hofer,* 649 F.3d 610, 614 (7th Cir.2011); *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 322, 127 S.Ct. 2499, 168 L.Ed.2d 179 (2007) ("faced with a Rule 12(b)(6) motion to dismiss a § 10(b) action, courts must, as with any motion to dismiss for failure to plead a claim on which relief can be granted, accept all factual allegations in the complaint as true").

ANALYSIS

The Corporate Defendants argue that the Supreme Court's holding in *Morrison v. National Australia Bank Ltd.,* 561 U.S. 247, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010), governs this case and necessitates dismissal for failure to state a claim. (R. 89, Defs.' Mem. at 1.) Specifically, the Corporate Defendants argue that, under the "transactional" test set forth in *Morrison,* the SEC cannot assert a claim against them because the transactions at issue here were not "domestic transactions." (*Id.* (citing *Morrison,* 130 S.Ct. at 2883).) The SEC, however, contends that the "transactional" test is not the proper inquiry because the Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub.L. No. 111–203, 124 Stat. 1376 (2010) (the "Dodd–Frank Act") superseded *Morrison* and revived the previously applied "conducts and effects" test for SEC actions. (R. 89, Resp. at 1.) As explained below, the Court need not determine whether the "transactional" test or the "conducts and effects" test governs this suit—which is a complicated question—because the SEC has stated a claim under either inquiry.

I. The Supreme Court's Decision in *Morrison*

In *Morrison,* the Supreme Court considered the extraterritorial reach of Section 10(b) of the Exchange Act in the context of an action involving foreign investors making foreign transactions on foreign exchanges—a "foreign-cubed" action. Specifically, ***909** the foreign investors had filed a putative class action against an Australian banking corporation, alleging securities fraud relating to securities traded on foreign exchanges, but not on any exchange in the United States. *Morrison,* 130 S.Ct. at 2875–76, 2894 n. 11. The respondents had moved to dismiss for lack of subject-matter jurisdiction pursuant to Rule 12(b)(1) and for failure to state a claim under Rule 12(b)(6). *Id.* at 2876. The district court granted the motion under Rule 12(b)(1) finding no subject-matter jurisdiction. *Id.* The Second Circuit affirmed. *Id.* The Supreme Court concluded that the Second Circuit had erred in deeming the extraterritorial reach of Section 10(b) a matter of subject-matter jurisdiction. *Id.* at 2876–77. In doing so, the Supreme Court held that the issue of "what conduct Section 10(b) reaches ... is a merits question," rather than a matter of subject-matter jurisdiction. *Id.* 2877. The Supreme Court specifically noted that the "district court [ ] had jurisdiction under 15 U.S.C. § 78aa to adjudicate the question whether § 10(b) applies to [the defendants'] conduct." *Id.* at 2877. The Supreme Court, therefore, addressed whether the petitioner's allegations stated a claim to survive a motion to dismiss under Rule 12(b)(6). *Id.*

When analyzing the petitioner's allegations in *Morrison,* the Supreme Court applied a presumption against giving a statute extraterritorial effect "unless there is the affirmative intention of Congress clearly expressed" to give it such effect. *Morrison,* 130 S.Ct. at 2877. The Supreme Court explained that the Second Circuit jurisprudence had developed an "effects test" and a "conduct test" to determine whether to apply Section 10(b) extraterritorially. *Id.* at 2878–80. These tests, according to the Supreme Court, had no basis in the statutory text and led to unpredictable and inconsistent applications of Section 10(b) to transnational cases. *Id.* at 2879–81. It, therefore, concluded that courts must apply the presumption against extraterritoriality "in all cases." *Id.* at 2881. With that presumption in mind, the Supreme Court looked to the text of Section 10(b), and stated that, "[i]n short, there is no affirmative indication in the Exchange Act that § 10(b) applies, and we therefore conclude that it does not." *Id.* at 2883.

The analysis did not end there. The Supreme Court explained that the presumption against extraterritoriality often "is not self-evidently dispositive, but its application requires further analysis." *Morrison,* 130 S.Ct. at 2883. In a footnote, the Court explained that additional analysis is necessary—and consistent with its finding that Section 10(b) does not apply extraterritorially—because if Section 10(b) did apply abroad, then it would apply to all transnational funds. *Id.* at 2884 n. 9. Because Section 10(b) does not apply abroad, however, it needed to "determine which transnational funds it applied to." *Id.* The Supreme Court then developed its own test—the "transactional test"—to determine whether the petitioner had stated a claim under Section 10(b). *Id.* at 2886. Under this new test, a plaintiff may bring a cause of action for securities fraud when "the purchase or sale is made in the United States, or involves a security listed on a domestic exchange." *Id.* Because the allegations in the case before it "involve[d] no securities listed on a domestic exchange, and all aspects of the purchases ... occurred outside the United States," the Court dismissed the complaint for failure to state a claim. *Id.* at 2888.

II. The Effect of Section 929P(b) of the Dodd–Frank Act on *Morrison*

Shortly after the Supreme Court issued its decision in *Morrison,* Congress enacted ***910** the Dodd–Frank Act. The parties disagree about whether the Dodd–Frank Act superseded the portion of *Morrison*—as it relates to suits brought by the SEC or the Department of Justice—applying a presumption against extraterritoriality because the Exchange Act did not include language expressly indicating that it reached extraterritorial conduct. [1] Significantly, the parties highlight a tension created by Section 929P(b), namely that the plain language of the Section 929P(b) seems purely jurisdictional—particularly in light of its placement in the jurisdictional section of the Exchange Act—yet the Congressional intent behind that provision supports a conclusion that the provision is substantive. Specifically, the Corporate Defendants contend that the plain language of Section 929P(b)'s addition to the Exchange Act—which it believes is controlling here—unambiguously establishes that the provision relates only to subject-matter jurisdiction, and does not "even attempt to address" what constitutes a substantive cause of action. (Defs.' Mem. at 8–9.) The Corporate Defendants argue that the language is clear on its face, in part because the provision uses the word "jurisdiction." (*Id.*) They further argue that the location of this provision in the section of the Exchange Act entitled "Jurisdiction of offenses and suits" demonstrates that the provision is jurisdictional rather than substantive. (*Id.*) In response, the SEC asserts that the provision is not jurisdictional, but instead delineates the requirements for determining whether the SEC has stated a substantive claim under Section 10(b). (Resp. at 10.) According to the SEC, Section 929P(b) evidences Congress' intent to overcome the presumption against extraterritoriality expressed in *Morrison*—which stemmed from the fact that the Exchange Act lacked a "clear statement of extraterritorial effect"—and to revive the pre-*Morrison* "conducts and effects" test. *Morrison,* 130 S.Ct. at 2883.

*911 A. The Applicable Provisions of the Dodd–Frank Act

Section 929P of the Dodd–Frank Act amended several federal laws, including the Securities Act and the Exchange Act. Section 929P(b)—entitled "Extraterritorial Jurisdiction of the Antifraud Provisions of the Federal Securities Laws"—addressed the issue of transnational securities fraud actions brought by the SEC or the Department of Justice. The provision added the following language to both the Securities Act and Exchange Act:

> district courts ... shall have jurisdiction over an action or proceeding brought or instituted by the [SEC] ... involving:

(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or

(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

Section 929P(b) added this language to Section 27 of the Exchange Act, 15 U.S.C. § 78aa, entitled "Jurisdiction of offenses and suits," and Section 22 of the Securities Act, 15 U.S.C. § 77v, also entitled "Jurisdiction of offenses and suits."

B. Interpreting Section 929P(b)

In *Morrison,* the Supreme Court held that when a statute lacks explicit congressional intent to grant extraterritorial scope, a presumption against extraterritoriality applies. *Morrison,* 130 S.Ct. at 2883. The Supreme Court further concluded that the Exchange Act lacked such explicit language, and, therefore, applied a "transactional" test to determine if the Exchange Act reached the conduct at issue. *Id.* at 2883, 2885. Here, the crux of the issue is that Congress, in passing Section 929P(b), may have intended to fill the void noted by the Supreme Court in *Morrison,* and to rebut the presumption against extraterritoriality, by adding explicit extraterritorial language to the Exchange Act. The plain language of Section 929P(b), however, does not clearly express this potential intent. Instead, Section 929P(b), on its face, merely addresses subject-matter jurisdiction—a question which the Supreme Court previously resolved in *Morrison*—rather than the substantive reach of Section 10(b) of the Exchange Act. [2] The question becomes, therefore, ***912** how to interpret Section 929P(b) in light of this conflict between the language as drafted and Congress's possible intent in adopting this provision.

1. Statutory Interpretation Generally

[1] **[2]** **[3]** **[4]** "When a statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." *Sebelius v. Cloer,* ––– U.S. ––––, 133 S.Ct. 1886, 1889, 185 L.Ed.2d 1003 (2013) (citation omitted). Indeed, the Seventh Circuit approaches issues of statutory interpretation by assuming that the "ordinary meaning of the language accurately expresses the legislative purpose." *Commodity Futures Trading Com'n v. Worth Bullion Grp., Inc.,* 717 F.3d 545, 550 (7th Cir.2013) (internal citations omitted). When interpreting a statute, the Court "first and foremost [ ] give[s] words their plain meaning unless doing so would frustrate the overall purpose of the statutory scheme, lead to absurd results, or contravene clearly expressed legislative intent." *See United States v. Vallery,* 437 F.3d 626, 630 (7th Cir.2006); *see also Five Points Rd. Joint Venture v. Johanns,* 542 F.3d 1121, 1128 (7th Cir.2008). "When the plain meaning of a statutory term is unclear, outside considerations can be used in an attempt to glean the legislative intent behind the use of the term." *Emerg. Servs. Billing Corp., Inc. v. Allstate Ins. Co.,* 668 F.3d 459, 465 (7th Cir.2012); *see also McReynolds v. Merrill Lynch & Co., Inc.,* 694 F.3d 873, 882 (7th Cir.2012) ("Consulting legislative history may be an acceptable means of decoding an ambiguous statute"). Furthermore, "[i]t is a cardinal principle of statutory construction that a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." *Marx v. Gen'l Rev. Corp.,* –––U.S. ––––, 133 S.Ct. 1166, 1177, 185 L.Ed.2d 242 (2013).

2. The Plain Language of 929P(b)

Here, the plain language of Section 929P(b) seems clear on its face. Specifically, the provision uses the word "jurisdiction," [3] and it appears in the jurisdictional portions of the Exchange Act. *See Florida* ***913** *Dept. of Rev. v. Piccadilly Cafeterias, Inc.,* 554 U.S. 33, 47, 128 S.Ct. 2326, 171 L.Ed.2d 203 (2008) ("statutory titles and section headings are tools available for the resolution of a doubt about the meaning of a statute"); *INS v. Nat'l Ctr. for Immigrants' Rights,* 502 U.S. 183, 189–90, 112 S.Ct. 551, 116 L.Ed.2d 546 (1991) ("a title of a statute or section can aid in resolving any ambiguity in the legislation's text"); *Miller v. Herman,* 600 F.3d 726, 732 (7th Cir.2010) (holding that § 2301(d)(1) of the Magnuson–Moss Act "has the heading 'Jurisdiction' " and thus "clearly states" that the statute "grants 'appropriate district courts of the United States the ability to hear claims' ") (quoting *Arbaugh v. Y & H Corp.,* 546 U.S. 500, 516, 126 S.Ct. 1235, 1245, 163 L.Ed.2d 1097 (2006)). The plain meaning, when looked at in isolation, therefore, suggests that Section 929P(b) is a jurisdictional rather than substantive provision.

3. Interpreting Section 929P(b) to Avoid Superfluity

One concern with interpreting Section 929P(b) as purely jurisdictional based on its plain language is that such an interpretation may render the entire provision superfluous. Indeed, the Supreme Court in *Morrison* concluded that federal courts already had the power to hear SEC enforcement cases involving foreign transactions. *See Morrison,* 130 S.Ct. 2869, 2877 ("The District Court here had jurisdiction under 15 U.S.C. § 78aa to adjudicate the question whether § 10(b) applies to National's conduct."). Interpreting Section 929P(b) as jurisdictional would, therefore, mean that Congress gave the SEC no more power or enforcement capability than it had before *Morrison.* In other words, if Section 929P(b) is purely jurisdictional, it would be redundant and superfluous because other provisions in the "Jurisdiction of offenses and suits" section already granted federal courts extraterritorial jurisdiction.

Interpreting Section 929P(b) as jurisdictional, rather than as a partial refutation of *Morrison,* may, therefore, run contrary to a cardinal principle of statutory construction to avoid superfluous portions of statutes. *Marx,* 133 S.Ct. at 1177; *see also Corley v. United States,* 556 U.S. 303, 314–15, 129 S.Ct. 1558, 173 L.Ed.2d 443 (2009). In fact, the Supreme Court has acknowledged that a statute can "seem[ ] clear" on its face, but may not have a clear interpretation if a court considers "the absurd results of a literal reading" of the statute. *Corley,* 556 U.S. at 314 n. 5, 129 S.Ct. 1558 (stating that "the dissent's point that subsection (a) seems clear when read in isolation proves nothing, for the meaning—or ambiguity—of certain words or phrases may only become evident when placed in context.").

It is unclear, however, whether the Court should construe a provision that appears unambiguous on its face to avoid superfluity. *See Ortega v. Holder,* 592 F.3d 738, 743 (7th Cir.2010) ("If the plain wording of the statute is clear, our work is at an end") (citations omitted). The Seventh Circuit, for example, has applied this anti-superfluity principle "when interpreting ambiguous text." *River Road Hotel Partners, LLC v. Amalgamated Bank,* 651 F.3d 642, 651–52 (7th Cir.2011) (attempting to avoid superfluity when the statutory text "suggest[ed] more than one plausible understanding"); *see also Harrell v. United States Postal Service,* 445 F.3d 913, 925 (7th Cir.2006).

[5] The Supreme Court has also acknowledged that the "canon against surplusage is not an absolute rule." *Marx,* 133 S.Ct. at 1177; *see also Microsoft Corp. v. i4i Ltd. Partnership,* ––– U.S. ––––, 131 S.Ct. 2238, 2249, 180 L.Ed.2d 131 (2011) ("There are times when Congress enacts ***914** provisions that are superfluous"). The canon against surplusage applies, for example, "only where a competing interpretation gives effect to every clause and word of a statute." *Id.* (citation omitted). Also, the "canon against superfluity assists only where a competing interpretation gives effect to every clause and word of a statute." *i4i Ltd. Partnership,* 131 S.Ct. at 2248. Here, interpreting Section 929P(b) as substantive rather than jurisdictional, to avoid redundancy with the previously existing jurisdictional provision in the Exchange Act—15 U.S.C. § 78aa(a)—may render meaningless Congress's use of the word "jurisdiction" in Section 929P(b).

4. The Legislative History of Section 929P(b)

Another issue with interpreting Section 929P(b) as jurisdictional based on its language and placement in the jurisdictional section of the Exchange Act is that the legislative history supports a contradictory interpretation. Indeed, the legislative history seems to indicate that Congress intended Section 929P(b) to override *Morrison's* transactional test. Specifically, Representative Paul Kanjorski, the sponsor of Section 929P(b), indicated that Section 929P(b) directly addressed the Supreme Court's decision in *Morrison* by (1) rebutting the Supreme Court's presumption of extraterritoriality and (2) reviving the conducts and effects test which *Morrison* rejected. *See* 156 Cong. Rec. H5233, 5235–5239. In his remarks, Rep. Kanjorski stated that Section 929P(b) "creates a single national standard for protecting investors affected by transnational frauds by *codifying the authority to bring proceedings under both the conduct and the effects test regardless of the jurisdiction of the proceedings.*" *Id.* (emphasis added). Rep. Kanjorski noted that the bill's stated purpose was "to make clear that in actions and proceedings brought by the SEC ..., the specified provisions of the Securities Act, the Exchange Act, and the Investment Advisers Act may have extraterritorial application." *Id.* In addition, Rep. Kanjorski added that this extraterritorial application is "irrespective of whether the securities are traded on a domestic exchange or the transactions occur in the United States." 156 Cong. Rec. at 5237.

Rep. Kanjorski also discussed *Morrison,* including how the Supreme Court developed the transactional test in light of a presumption against extraterritoriality. To this end, he directly addressed the Supreme Court and explained that the provisions in 929P(b) are "intended to rebut that presumption by clearly indicating that Congress intends extraterritorial application in cases brought by the SEC or the Justice Department." 156 Cong. Rec. at 5237. Significantly, Rep. Kanjorski concluded this portion of his remarks by indicating that federal courts should use the conducts and effects test. Specifically, he stated that "the specified provisions of the Securities Act, the Exchange Act and the Investment Advisers Act may have extraterritorial application, and that extraterritorial application is appropriate ... when the conduct within the United States is significant or when conduct outside the United States has a foreseeable substantial effect within the United States." *Id.* at 5237.

[6] **[7]** **[8]** **[9]** It is unclear what weight the Court should give Rep. Kanjorski's remarks [4] in light of the language in Section ***915** 929P(b). Indeed, the law is not clear on how a court should interpret a statute when the legislative history and the language of a statute support contradictory interpretations. While "a court should give words their plain meaning unless doing so would ... contravene clearly expressed legislative intent," *Vallery,* 437 F.3d at 630, a court, nonetheless, "may not ignore the unambiguous language of the statute in order to further Congress's expressed purpose in enacting the statute." *Shlahtichman v. 1–800 Contacts, Inc.,* 615 F.3d 794, 802 (7th Cir.2010). Furthermore, "where a statute's language is clear, we look to the legislative history only to determine whether Congress expressed a clear intention to the contrary of the literal application of that language." *Middleton v. City of Chicago,* 578 F.3d 655, 660 (7th Cir.2009); *see also Emerg. Servs,* 668 F.3d at 465. Additionally, "[the Supreme Court's] cases have said that legislative history is irrelevant when the statutory text is clear." *Milavetz, Gallop & Milavetz, P.A. v. United States,* 559 U.S. 229, 254, 130 S.Ct. 1324, 1342, 176 L.Ed.2d 79 (2010) (Scalia, J., concurring.). It is unclear, therefore, how a court should weigh legislative history that expresses an intention directly contrary to the plain language of a statute that is potentially superfluous. It is clear, though, that legislative history "does not permit a judge to turn a clear text on its head." *Spivey v. Vertrue Inc.,* 528 F.3d 982, 985 (7th Cir.2008). It is also clear that a court should not extend its analysis beyond its "sole function" of enforcing the statute "according to its terms" based on its plain language. *Sebelius,* 133 S.Ct. at 1896.

[10] Furthermore, Rep. Kanjorski spoke just days after the Supreme Court issued its decision in *Morrison,* and Congress adopted the Dodd–Frank Act less than a month later. The language of Section 929P(b), however, was drafted prior to the *Morrison* decision. In fact, the House of Representatives passed a substantively identical bill in December of 2009. *See* Beyea, *supra* at 570 (citing Dodd–Frank Act, H.R. 4173, 111th Cong. § 7216 (2009)). A revision of that bill, which limited its application to actions brought by the SEC, became Section 929P(b). *Id.* This timeline complicates the Court's interpretation of Section 929P(b) for multiple reasons. First, because the language of Section 929P(b) was drafted prior to *Morrison* and did not materially change after *Morrison's* ground-breaking refutation of the "conducts and effects test" and proclamation that extraterritoriality was a merits, not jurisdictional, question, it may not have responded directly to *Morrison.* The Court must, however, "assume that Congress is aware of existing law when it passes legislation," *Miles v. Apex Marine Corp.,* 498 U.S. 19, 32, 111 S.Ct. 317, 112 L.Ed.2d 275 (1990), and "that Congress is knowledgeable about existing law pertinent to the legislation it enacts," *Goodyear Atomic Corp. v. Miller,* 486 U.S. 174, 184–85, 108 S.Ct. 1704, 100 L.Ed.2d 158 (1988). Second, because Rep. Kanjorski made his remarks just days after the Supreme Court issued *Morrison,* his comments may not have accurately represented the intent of Congress as a whole. Indeed, even the views of a bill's sponsor are not controlling when interpreting a statute. *See Mims v. Arrow Financial Services, LLC,* ––– U.S. ––––, 132 S.Ct. 740, 752, 181 L.Ed.2d 881 (2012).

[11] Moreover, even if Congress did not clearly articulate its intent in the language ***916** of Section 929P(b), or through its placement of Section 929P(b) in the jurisdictional section, courts should not correct drafting errors in statutes. [5] The Supreme Court has stated: "It is beyond our province to rescue Congress from its drafting errors, and to provide for what we might think ... is the preferred result." *Lamie v. U.S. Tr.,* 540 U.S. 526, 542, 124 S.Ct. 1023, 1034, 157 L.Ed.2d 1024 (2004); *see also United States v. Head,* 552 F.3d 640, 643 (7th Cir.2009) ("Judges do not read between the lines when a statute's text is clear and its structure is coherent."); *Jaskolski v. Daniels,* 427 F.3d 456, 461 (7th Cir.2005).

5. Avoiding Absurd Results

[12] The SEC also briefly argues that interpreting Section 929P(b) as merely jurisdictional would create an absurd result which the Court should avoid. Specifically, the SEC argues that it would be illogical to assume that Congress enacted Section 929P(b) to confer subject-matter "jurisdiction over SEC enforcement cases involving foreign securities transactions and foreign investors (jurisdiction it possessed *before* passage of the Dodd–Frank Act), only to dismiss all such enforcement cases for failure to state a claim under *Morrison's* domestic transaction requirement." (Resp. 7.) Although the Court should avoid literal interpretation of a statute if such an interpretation would lead to absurd results, it is not clear that such an absurd result would inevitably occur if Section 929P(b) were jurisdictional. *See Rennell v. Rowe,* 635 F.3d 1008, 1013 (7th Cir.2011) ("We will not follow a literal interpretation when to do so would lead to an unreasonable or absurd result.") (internal quotations omitted); *see also United States v. One Parcel of Real Estate Commonly Known as 916 Douglas Ave., Elgin, Ill.,* 903 F.2d 490, 492 (7th Cir.1990); *Castellon–Contreras v. I.N.S.,* 45 F.3d 149, 153 (7th Cir.1995); *United States v. Smairat,* No. 05 CR 168, 2006 WL 1554412 at *7 (N.D.Ill. June 1, 2006) (referring to the overall rule mentioned in *One Parcel* that "the court only looks beyond the express language of a statute where such language is ambiguous, or where a literal interpretation would lead to absurd results or thwart the goals of the statutory scheme."). Indeed, the SEC's argument presupposes that the *Morrison* "transactional" inquiry would be so narrow as to cause "all" actions encompassed by Section 929P(b) to be dismissed. The precise scope of a "domestic transaction" for purposes of the "transactional" inquiry, however, is unclear.

6. Conclusion

The plain language of Section 929P(b) and its placement in the jurisdictional section of the Exchange Act indicate that it may be jurisdictional. It is unclear, however, whether the Court's analysis should stop there because it is possible that this interpretation would create superfluity or contradict the legislative intent. The Court need not resolve this complex interpretation issue, however, because, as explained below, under either the *Morrison* "transactional" inquiry or the allegedly revived ***917** "conducts and effects test," the SEC's Complaint survives the present motion to dismiss.

III. Sufficiency of the Allegations

Here, viewing the facts in the light most favorable to the SEC, as must be done at this stage, the SEC's complaint passes muster under either the pre-*Morrison* "conducts and effects test," which the Dodd–Frank Act may have revived, or the "transactional" test set forth in *Morrison.*

A. Application of Conducts and Effects Test

[13] As the Supreme Court in *Morrison* describes, the "conduct test" is "whether the wrongful conduct occurred in the United States," while the "effects test" is "whether the wrongful conduct had a substantial effect in the United States or upon United States citizens." 130 S.Ct. at 2879 (quoting *SEC v. Berger,* 322 F.3d 187, 192–93 (2d Cir.2003)). Here, the SEC has alleged a variety of facts that, when viewed in the light most favorable to the SEC, place the Corporate Defendants' conduct—or the effects of this conduct—within the United States. The SEC alleges, for example, that the Corporate Defendants solicited investors "using the prospect of gaining U.S. residency through the EB–5 program," in which "foreign nationals may qualify to obtain a green card if they invest a minimum of $500,000 in the U.S. and that investment creates or preserves at least 10 jobs for U.S. workers." (Resp. at 4; Compl. ¶ 2). Specifically, Defendants wanted investors to "purchase securities in ... an Illinois-based limited liability company based in Chicago." (Resp. at 4; Compl. ¶¶ 3, 15). They formed this company to "financ[e] and develop[ ] ... a convention center and hotel complex in Chicago." (Resp. at 4). The Corporate Defendants do not contest that the SEC's allegations are sufficient to state a claim under the conduct and effects test—they only claim that the Court should not apply such a test.

B. Application of *Morrison*

[14] The SEC has also stated a claim under the *Morrison* "transactional" test. The Second Circuit has provided guidance on what constitutes a domestic purchase or sale for purposes of the *Morrison* transactional test. *See Absolute Activist Value Master Fund Ltd. v. Ficeto,* 677 F.3d 60, 67 (2d Cir.2012) ("While *Morrison* holds that § 10(b) can be applied to domestic purchases or sales, it provides little guidance as to what constitutes a domestic purchase or sale."). Specifically, after evaluating the definitions of the terms "buy," "purchase," "sale," and "sell" in the Exchange Act and jurisprudence regarding the time of a purchase or sale of securities, the Second Circuit held that, "to sufficiently allege a domestic securities transaction in securities not listed on a domestic exchange ... a plaintiff must allege facts suggesting that irrevocable liability was incurred or title was transferred within the United States." *Id.* at 68. Both parties accept the Second Circuit's interpretation of "domestic transaction" as the relevant standard here, if *Morrison* applies.

Here, the Complaint alleges that "Defendants have engaged in the sale of securities *in the United States.*" (Compl. ¶ 13 (emphasis added).) It further alleges the following to support the conclusion that the Corporate Defendants conducted a "domestic transaction":

- the terms of the offering instructed investors to "execute a subscription agreement ... and to send to Defendants in the U.S;" (Compl. ¶ 13a)

***918** • the offering instructed investors to wire funds to the Defendants' U.S.-based escrow agent; (Compl. ¶ 13c)

- the escrow agent would only release the investors' subscription amounts to Defendants upon approval of the investors' U.S. visa applications; and (Compl. ¶ 5)

- the investors were bound only "[i]f the subscription agreement [was] accepted" and countersigned by the Managing Member—an act which would occur in the United States. (Compl. Ex. B at 0000471, 0000481; Compl. ¶ 13e).

The Corporate Defendants argue, to the contrary, that "offer and acceptance—the requisite meeting of the minds—occurred abroad." (Mem. at 12.) According to the SEC, however, "it is not until the Managing Member signs that he 'hereby accepts' the investor's subscription that a contract is formed, let alone irrevocable liability is incurred." (Resp. at 12.) The parties' disagreement highlights factual disputes in the case—whether irrevocable liability attached and if so, where it attached—which the Court cannot resolve at this stage. *See, e.g., In re Optimal U.S. Litig.,* 813 F.Supp.2d 351, 373 (S.D.N.Y.2011) (finding that the defendants' argument—that the sale did not become final until the administrator accepted the subscription form, and therefore the transactions were not "domestic transactions"—was "promising" but "better-suited for a motion for summary judgment in the context of a more fully-developed factual record."). Rather, viewing the facts in the light most favorable to the SEC, the SEC has sufficiently alleged a "domestic transaction" under *Morrison. Id.* (concluding that the plaintiffs' allegations that the purchases "took place in the United States," coupled with contract notes indicating the purchase occurred in the United States, was sufficient to survive a motion to dismiss); *Anwar v. Fairfield Greenwich Ltd.,* 728 F.Supp.2d 372, 401 n. 8 (S.D.N.Y.2010) (concluding that the court needed a "more developed factual record ... to inform a proper determination as to whether Plaintiffs' purchase of the Offshore Funds' shares occurred in the United States" for purposes of *Morrison* 's transactional test).

CONCLUSION

For the foregoing reasons, the Court denies the Corporate Defendants' motion to dismiss.

Parallel Citations

Fed. Sec. L. Rep. P 97,594

Footnotes

1 This is a novel question. Some courts have, in dicta, assumed, without analysis, that Section 929P(b) superseded *Morrison. See, e.g., S.E.C. v. Tourre,* No. 10 Civ. 3229(KBF), 2013 WL 2407172, at *1 n. 4 (S.D.N.Y. June 4, 2013) ("Because the Dodd–Frank Act effectively reversed *Morrison* in the context of SEC enforcement actions, the primary holdings of this opinion affect only pre-Dodd Frank conduct."); *In re Optimal U.S. Litig.,* 865 F.Supp.2d 451, 456 n. 28 (S.D.N.Y.2012) ("To the extent that a broad reading of *Morrison* may raise policy concerns that parties will engage in foreign transactions to avoid the reach of the Exchange Act, Congress has attempted to remedy that problem by restoring the conducts and effects test for SEC enforcement actions"); *S.E.C. v. Gruss,* No. 11 Civ. 2420, 2012 WL 3306166, at *3 (S.D.N.Y. Aug. 13, 2012) ("Section 929P(b) of the Dodd–Frank Act allows the SEC to commence civil actions extraterritorially in certain cases."); *S.E.C. v. Compania Internacional Financiera S.A.,* No. 11 Civ. 4904(DLC), 2011 WL 3251813, at *6 n. 2 (S.D.N.Y. July 29, 2011) ("Section 929P of the [Dodd–Frank Act] may demonstrate the Congressional intent for the extraterritorial application of certain provisions of the federal securities laws that the *Morrison* court found lacking in prior versions of those laws. It may be that the Dodd–Frank Act was specifically designed to reinstate the Second Circuit's 'conduct and effects' test."); *Cornwell v. Credit Suisse Grp.,* 729 F.Supp.2d 620, 627 n. 3 (S.D.N.Y.2010) ("For whatever comfort it may bring to Plaintiffs and counsel, and however much restoration of the Second Circuit's pride and vindication of its venerable jurisprudence it is worth, the Court notes that in legislation recently enacted, Congress explicitly granted federal courts extraterritorial jurisdiction under the conduct or effect test for proceedings brought by the SEC"); *Asadi v. G.E. Energy (USA), LLC,* No. 4:12–345, 2012 WL 2522599, at *4 (S.D.Tex. June 28, 2012) ("Section 929P(b) gives the district courts extraterritorial jurisdiction, but only over certain enforcement actions brought by the SEC or the United States."). The parties have not, however, identified any cases where a court

has analyzed the interpretation of Section 929P(b) in an SEC enforcement action for conduct that occurred after *Morrison,* and the court found no such case.

2 Numerous commentators have acknowledged that the language of Section 929P(b) may not reflect the intent of Congress. *See, e.g.,* Meny Elgadeh, *Morrison v. National Australia Bank: Life After Dodd–Frank,* 16 Fordham J. Corp. & Fin. L. 573, 594 (2011) ("Significantly, the legislative text makes no mention of any change in the application of the securities laws. Rather it only speaks directly to a court's ability to hear a case, a power fully recognized by the majority in *Morrison*."); Stephen R. Smerek & Jason C. Hamilton, *Extraterritorial Application of United States Law After Morrison v. National Australia Bank,* 5 No. 1 Disp. Resol. Int'l 21, 23–24 (2011) ("While this language appears to express Congress's intent to extend the reach of the Securities and Exchange Act overseas, whether it succeeds in this purpose is less than certain"); John Chambers, *Note: Extraterritorial Private Rights of Action: Redefining the Transactional Test in Morrison v. National Australia Bank,* 31 Rev. Banking & Fin. L. 411, 429 (Fall 2011) ("Congress certainly intended to expand the substantive reach of Section 10(b) in SEC and Department of Justice [ ] suits, it did not do so."); Richard Painter, et al., *When Courts and Congress Don't Say What They Mean: Initial Reactions to Morrison v. National Australia Bank and to the Extraterritorial Jurisdiction Provisions of the Dodd–Frank Act,* 20 Minn. J. Int'l L. 1, 4 (Winter 2011) ("While the Congress's intent in passing the Dodd–Frank Act seems directed at empowering the SEC and DOJ to combat securities fraud, one can credibly argue that they failed to do so."); Andrew Rocks, *Notes: Whoops! The Imminent Reconciliation of U.S. Securities Laws with International Comity After Morrison v. National Australia Bank and the Drafting Error in the Dodd–Frank Act,* 56 Vill. L.Rev. 163, 192 (2011) ("[T]he ability of these agencies to enforce the antifraud provisions of the U.S. securities laws is no clearer than it was prior to the Dodd–Frank Act's enactment. Consequently, despite the drafters' intentions to the contrary, the presumption against extraterritorial application of the provision is not overcome by the Act's provisions."); A.C. Pritchard, *Securities Law in the Roberts Court: Agenda or Indifference?,* 37 J. Corp. L. 105, 142 (Fall 2011) ("The *Morrison* decision produced an immediate, if somewhat clumsy, reaction from Congress ... Unfortunately, Congress enacted language ensuring only that the courts would have jurisdiction to hear cases with extraterritorial application, not that Section 10(b) would have extraterritorial application. Thus, Congress repeated the Second Circuit's error of treating the scope of the law as jurisdictional, rather than a merits question."); Nidhi M. Geervarghese, *Note: A Shocking Loss of Investor Protection: The Implications of Morrison v. National Australia Bank,* 6 Brook. J. Corp. Fin. & Com. L. 235, 250 (Fall 2011) ("Congress may have erroneously addressed the power of the federal courts to hear a case, rather than the scope of the antifraud provisions of the Exchange Act.").

3 The Court is not persuaded by the SEC's citation to *Steel Co. v. Citizens for Better Env't,* 523 U.S. 83, 90, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998) for the proposition that jurisdiction "is a word of many, too many, meanings." (Resp. at 10.) In *Steel,* the Supreme Court considered that "jurisdiction" sometimes refers to the powers of the court "to enforce the violated requirement and to impose penalties" rather subject-matter jurisdiction. 523 U.S. at 90, 118 S.Ct. 1003. This alternative definition is not applicable here.

4 The only other mention of 929P(b) in the Congressional Record comes from Senator Jack Reed (D–RI) on July 15, 2010. 156 Cong. Rec. 105, S5915–16. He notes that 929P(b) added "extraterritoriality language that clarifies that in actions brought by the SEC or the Department of Justice, specified provisions in the securities laws apply if the conduct within the United States is significant, or the external U.S. conduct has a *foreseeable substantial effect* within our country, *whether or not the securities are traded on a domestic exchange or the transactions occur in the United States.*" *Id.* (emphasis added).

5 Many law review articles on the topic note the conundrum presented by the provision, and attribute the problem to unclear drafting. Description of the statutory language ranges from "less than meticulous" to "seemingly fails to capture the drafters' intent" to outright "drafting error." *See, e.g.,* Joshua L. Boehm, *Private Securities Fraud Litigation After Morrison v. National Australia Bank: Reconsidering A Reliance–Based Approach to Extraterritoriality,* 53 Harv. Int'l L.J. 249, 261 (2012) ("drafting error"); Beyea, *supra* at 573 ("less than meticulous"); Rocks, *supra* at 187 ("seemingly fails to capture the drafters' intent" and "drafting error").

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729 F.3d 62
United States Court of Appeals,
Second Circuit.

UNITED STATES, Appellee,
v.
Alberto VILAR and Gary Alan Tanaka, Defendants–Appellants.

Docket Nos. 10–521–cr(L), 10–580–cr(CON), 10–4639–cr(CON). | Argued: Aug. 21, 2012. | Decided: Aug. 30, 2013.

Synopsis
Background: Defendants were convicted in the United States District Court for the Southern District of New York, Richard J. Sullivan, J., of securities fraud, investment adviser fraud, and other offenses, and they appealed.

Holdings: The Court of Appeals, José A. Cabranes, Circuit Judge, held that:

[1] application of securities fraud prohibitions of Section 10(b) and Rule 10b–5 to extraterritorial conduct of defendants did not affect defendants' substantial rights;

[2] schemes involving two separate investments could be characterized in indictment as part of one conspiracy to defraud investors;

[3] evidence seized in partly unlawful search of defendants' New York office was admissible under the inevitable discovery doctrine; and

[4] instructions did not constructively amend mail fraud count of indictment.

Affirmed in part, and remanded with instructions to vacate both sentences.

West Headnotes (32)

[1] Criminal Law
Necessity of Objections in General

Federal court of appeals normally will not correct a legal error made in criminal trial court proceedings unless the defendant first brought the error to the trial court's attention; accordingly, where defendants present a claim on appeal that they did not give the district court an opportunity to consider, court limits its review to curing plain error.

Cases that cite this headnote

[2] Criminal Law
Necessity of Objections in General

Plain error standard is met when (1) there is an error; (2) the error is clear or obvious, rather than subject to reasonable dispute; (3) the error affected the appellant's substantial rights, which in the ordinary case means it affected the outcome of the district court proceedings; and (4) the error seriously affects the fairness, integrity or public reputation of judicial proceedings.

1 Cases that cite this headnote

[3] Criminal Law
Necessity of Objections in General

Plain error review applies where the defendant did not object before the trial court because he failed to recognize an error, and where the defendant did not object because the trial court's decision was correct at the time but assertedly became erroneous due to a supervening legal decision; in all cases, court looks not to the law at the time of the trial court's decision to assess whether the error was plain, but rather, to the law as it exists at the time of review.

Cases that cite this headnote

[4] Criminal Law
Extraterritorial operation

Congress has the authority to enforce its criminal laws beyond the territorial boundaries of the United States.

Cases that cite this headnote

[5] Criminal Law

Extraterritorial operation

When a criminal statute gives no clear indication of an extraterritorial application, it has none.

2 Cases that cite this headnote

[6] Securities Regulation

Transactions with foreigners or in foreign countries

Securities fraud prohibitions of Section 10(b) and Rule 10b–5 do not apply extraterritorially in criminal cases. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

6 Cases that cite this headnote

[7] Statutes

Extraterritorial operation

Presumption against extraterritoriality is not a rule to be applied to the specific facts of each case; a statute either applies extraterritorially or it does not, and once it is determined that a statute does not apply extraterritorially, the only question court must answer in the individual case is whether the relevant conduct occurred in the territory of a foreign sovereign.

2 Cases that cite this headnote

[8] Securities Regulation

Transactions with foreigners or in foreign countries

Although securities sold were not listed on an American exchange, application of securities fraud prohibitions of Section 10(b) and Rule 10b–5 to defendants did not affect their substantial rights; jury would have found that defendants engaged in fraud in connection with a domestic purchase or sale of securities since one set of investors entered into and renewed their agreement in Puerto Rico, and another investor executed the documents necessary to invest in her own New York apartment and handed those documents to a New York messenger. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

5 Cases that cite this headnote

[9] Indictment and Information

Conspiracy

Allegation in a single count of a conspiracy to commit several crimes is not duplicitous, for the conspiracy is the crime, and that is one, however diverse its objects. Fed.Rules Cr.Proc.Rule 7, 18 U.S.C.A.

Cases that cite this headnote

[10] Conspiracy

Conspiracy to defraud in general

Schemes involving two separate investments could be characterized in indictment as part of one conspiracy to defraud investors by lying about the nature of their investments and continuing to mislead them into believing that their money was safe and invested in accordance with the representations they had received from defendants. Fed.Rules Cr.Proc.Rule 7, 18 U.S.C.A.

Cases that cite this headnote

[11] Indictment and Information

Informing accused of nature of charge

Indictment and Information

Protection against subsequent prosecution

Indictment and Information

Sufficiency in general

Indictment and Information

Sufficiency of averments in general

Indictment and Information

Sufficiency of indictment in language of statute in general

An indictment is sufficient when it charges a crime with sufficient precision to inform the defendant of the charges he must meet and with enough detail that he may plead double jeopardy in a future prosecution based on the same set of events; moreover, an indictment need do little more than to track the language of the statute charged and state the time and place in approximate terms of the alleged crime.

Cases that cite this headnote

[12] **Indictment and Information**
Indictment
Where a generally framed indictment encompasses the specific legal theory or evidence used at trial, there is no constructive amendment.

Cases that cite this headnote

[13] **Criminal Law**
Review De Novo
Criminal Law
Reception of evidence
Criminal Law
Evidence wrongfully obtained
Appellate court reviews suppression court's factual findings for clear error, viewing the evidence in the light most favorable to the government, and reviews its legal conclusions de novo.

3 Cases that cite this headnote

[14] **Criminal Law**
Good Faith or Objectively Reasonable Conduct Doctrine
Pursuant to the "good faith" exception to the exclusionary rule, when police act under a warrant that is invalid for lack of probable cause, the exclusionary rule does not apply if the police acted in objectively reasonable reliance on the subsequently invalidated search warrant.

Cases that cite this headnote

[15] **Criminal Law**
Causal nexus; independent discovery or basis or source
"Independent source" rule permits the admission of evidence seized pursuant to an unlawful search if that evidence would have been obtained through separate, lawful means.

Cases that cite this headnote

[16] **Criminal Law**
Admission of evidence
Government was not required to assert the inevitable discovery doctrine before judge in opposition to defendants' motion to suppress evidence obtained by search warrant; government explained its position on the admissibility of the documents to judge, who permitted the government to move forward with the subpoena, recognizing that the admissibility of the documents might be subject to challenge at a future date, and thus government did not waive its "inevitable discovery" argument in the proceedings before judge.

Cases that cite this headnote

[17] **Criminal Law**
Inevitable discovery
Criminal Law
Degree of proof
"Inevitable discovery" rule permits unlawfully obtained evidence to be admitted at trial if the government can establish by a preponderance of the evidence that the information ultimately or inevitably would have been discovered by lawful means; to prevail under the inevitable discovery doctrine, the government must prove by a preponderance of the evidence that the evidence inevitably would have been discovered.

2 Cases that cite this headnote

[18] **Criminal Law**
Inevitable discovery
Criminal Law
Degree of proof
To prevail under the inevitable discovery doctrine, government must prove that each event leading to the discovery of the evidence would have occurred with a sufficiently high degree of confidence for the district judge to conclude, by a preponderance of the evidence, that the evidence would inevitably have been discovered.

Cases that cite this headnote

[19] Criminal Law

Inevitable discovery

Although subpoena was sought after the government initiated its partly unlawful search of defendants' New York office, evidence seized in search was admissible under the inevitable discovery doctrine since government would have validly discovered the documents produced pursuant to grand jury subpoena "but for" the over-breadth of the warrant.

Cases that cite this headnote

[20] Searches and Seizures

Foreign states or officers

Search of United States' company's United Kingdom (U.K.) warehouse was reasonable within meaning of Fourth Amendment where search warrant was obtained in accordance with U.K. law, authority to determine what documents could validly be seized under U.K. law remained at all times with the U.K. authorities, and American investigators attended the search and offered their opinions on the relevance of various documents. U.S.C.A. Const.Amend. 4.

Cases that cite this headnote

[21] Criminal Law

Plain or fundamental error

Where a defendant fails to make a specific and timely objection to a district court's jury charge, those instructions are subject to review only for plain error.

Cases that cite this headnote

[22] Securities Regulation

Fraudulent transactions

Reliance is not an element of a criminal case brought by the government under Section 10(b) or Rule 10b–5. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

2 Cases that cite this headnote

[23] Securities Regulation

Materiality

Securities Regulation

Scienter, Intent, Knowledge, Negligence or Recklessness

Securities Regulation

Materiality of violation

When the government brings a civil or criminal action under Section 10(b) and Rule 10b–5, it need only prove, in addition to scienter, materiality, meaning a substantial likelihood that a reasonable investor would find the omission or misrepresentation important in making an investment decision, and not actual reliance. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

1 Cases that cite this headnote

[24] Criminal Law

Elements and incidents of offense in general

Indictment and Information

Accusation in general

Instructions, which permitted jury to convict based on an accurate account statement sent in support of a scheme to defraud rather than a specific false account statement charged in indictment, did not constructively amend mail fraud count of indictment or improperly broaden the basis for defendant's conviction on that count; mail fraud count, which incorporated the previous allegations in the indictment, made clear that the scheme to defraud consisted of inducing victim to transfer funds to defendant's company by misrepresenting the nature and quality of the investment, and it was those false statements that defendant knowingly made, and his mailing in support of that scheme that constituted the essential element of the mail fraud, and thus it was entirely unnecessary for the government to also prove that the account statement itself was false. 18 U.S.C.A. § 1341.

2 Cases that cite this headnote

[25] Securities Regulation

Fraudulent transactions

To convict defendant of securities fraud, government was under no obligation to prove that he wanted to steal victim's money, only that he intended to defraud her in connection with his sale of an investment. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

3 Cases that cite this headnote

[26] Securities Regulation

Weight and sufficiency

Even if government did not introduce evidence from which a reasonable juror could infer that the investors received the offering memoranda and circulars, evidence was sufficient to support defendants' securities fraud convictions; government introduced other documents that unmistakably conveyed to the investors specific, false representations concerning the investment mix backing the guaranteed fixed rate deposit accounts (GFRDAs) sold to investors by defendants. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

2 Cases that cite this headnote

[27] Postal Service

Nature and elements of offense in general

Telecommunications

Nature and elements of offense in general

A scheme to defraud is not complete until the proceeds have been received and use of the mail or wires to obtain the proceeds satisfies the jurisdictional element; jurisdictional element is fulfilled when the defendant uses the mail or wires to convert the money to his own use. 18 U.S.C.A. §§ 1341, 1343.

Cases that cite this headnote

[28] Telecommunications

Effectiveness of communication to further fraud

Inasmuch as defendant used wire transfers to send defrauded investor's money to his own account, wire transfers were in furtherance of the scheme to defraud, and could constitute basis for wire fraud conviction. 18 U.S.C.A. § 1343.

Cases that cite this headnote

[29] United States

Mints, assay offices, coinage, and money

Evidence, which demonstrated that defendant knowingly and willfully defrauded investor of millions of dollars by lying to her about the nature of investment opportunity, that, based on those misrepresentations, investor transferred her money to an account with defendant's company that was previously empty, and that immediately thereafter, hundreds of thousands of those dollars were transferred to defendant's own account, was sufficient to support defendant's money laundering conviction. 18 U.S.C.A. § 1957(a).

Cases that cite this headnote

[30] Criminal Law

Restitution

Restitution orders under the Mandatory Victim Restitution Act (MVRA) are reviewed for abuse of discretion, which occurs when the decision rests on an error of law, clearly erroneous finding of fact, or otherwise cannot be located within the range of permissible decisions. 18 U.S.C.A. §§ 3663A, 3664.

2 Cases that cite this headnote

[31] Sentencing and Punishment

Nexus to offense of conviction

Restitution is not permitted for loss caused by “relevant conduct,” even though such conduct may be properly included in offense level calculation under the Sentencing Guidelines. 18 U.S.C.A. § 3663A(a)(2).

Cases that cite this headnote

[32] Criminal Law

Effective assistance

Appellate court has three options for dealing with a claim for ineffective assistance of counsel raised on direct appeal: it may (1) decline to hear the claim, permitting the appellant to raise the issue as part of a subsequent motion to vacate, set aside or correct sentence, (2) remand the claim to the district court for necessary factfinding, or (3) decide the claim on the record before it. U.S.C.A. Const.Amend. 6; 28 U.S.C.A. § 2255.

Cases that cite this headnote

Attorneys and Law Firms

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Before: NEWMAN, CABRANES, and STRAUB, Circuit Judges.

Opinion

JOSÉ A. CABRANES, Circuit Judge.

Alberto Vilar and Gary Alan Tanaka appeal their judgments of conviction, entered on February 8, 2010, and February 10, 2010, respectively, in the United States District Court for the Southern District of New York (Richard J. Sullivan, *Judge.*) In simple terms, a jury found that Vilar and Tanaka lied to clients about the nature and quality of certain investments. This appeal raises a number of substantial issues, including a question left open after the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.,* 561 U.S. 247, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010): whether *criminal* liability under Section 10(b) of the Securities Exchange Act of 1934 ("Section 10(b)") extends to conduct in connection with an extraterritorial purchase or sale of securities.

We conclude as follows. First, Section 10(b) and its implementing regulation, Rule 10b–5, do not apply to extraterritorial conduct, regardless of whether liability is sought criminally or civilly. [1] Accordingly, a defendant may be convicted of securities fraud under Section 10(b) and Rule 10b–5 only if he has engaged in fraud in connection with (1) a security listed on a U.S. exchange, or (2) a security purchased or sold in the United States. Although the District Court did not require proof of domestic securities transactions in this case, this error was not "plain" since it did not affect the outcome of the proceedings, and therefore did not affect Vilar and Tanaka's substantial rights.

Second, when proceeding criminally or civilly under Section 10(b) or Rule 10b–5, the government need not prove that the victims of a fraudulent scheme actually relied on the alleged material misrepresentations or omissions. Because reliance is not an element of a Section 10(b) offense, the District Court did not err by not instructing the jury on the issue of reliance.

Third, although the mail fraud charge in the indictment specified that the mailing itself was false or fraudulent, the District Court's instruction permitting the jury to convict the defendants based on a mailing that itself contained no false or fraudulent statement did not "constructively amend" the indictment.

Fourth, on remand, the District Court must decide what acts constitute the offense conduct for the purposes of calculating the appropriate loss amount at sentencing, and re-determine the amount of money subject to forfeiture. Further, the District Court must, in accordance with the Mandatory Victim Restitution Act, limit its restitution order to victims of the scheme who purchased securities domestically.

Fifth, with the exception of Vilar's ineffective assistance of counsel claim, which we do not reach, Vilar and Tanaka's remaining claims are without merit.

*68 BACKGROUND [2]

It is fair to say that, from the mid–1980s until their arrest in 2005, Vilar and Tanaka were prominent investment managers and advisers. Prior to the technology market crash of 2000–2001, they were responsible for managing approximately $9 billion in investments for their clients.

Vilar and Tanaka managed their clients' assets through a number of different funds and entities. In 1986, they founded and became the sole shareholders of Amerindo Investment Advisors Inc. ("Amerindo U.S."), an investment adviser registered with the Securities and Exchange Commission ("SEC"). Amerindo U.S. was a California corporation with principal offices in San Francisco and New York City. Vilar and Tanaka also founded and were the sole shareholders of (1) Amerindo Investment Advisors, Inc. ("Amerindo Panama"), a corporation organized under the laws of the Republic of Panama that managed an off-shore investment fund offered to U.S. investors, and (2) Amerindo Investment Advisors (UK) Ltd. ("Amerindo U.K."), a United Kingdom corporation, which managed portfolios of U.S. emerging growth stocks for U.K.-based clients. [3]

From at least July 1986 until May 2005, Vilar and Tanaka offered clients the opportunity to invest in "Guaranteed Fixed Rate Deposit Accounts" ("GFRDAs"). The GFRDA program was made available only to a select group of individual clients, who were generally close friends or family members of Vilar or Tanaka. Vilar and Tanaka promised investors in the GFRDA program that they would receive a high, fixed rate of interest over a set term, and that the overwhelming majority of the GFRDA funds would be invested in high-quality, short-term deposits, including U.S. Treasury bills. The balance of the capital in the GFRDAs —generally no more than twenty-five percent—was to be invested in publicly traded emerging growth stocks.

Despite Vilar and Tanaka's description of the GFRDA program, they invested all of the funds in technology and biotechnology stocks, presumably in the hopes of meeting or even exceeding the high "guaranteed" rates of return. The downside of this scheme, of course, was that the GFRDAs were volatile and not safe investments at all. And so, when the so-called dot-com bubble "burst" in the fall of 2000, the value of the investments held by the GFRDAs dropped precipitously. Accordingly, Vilar and Tanaka could not pay the promised rates of return and, as a consequence, several GFRDA investors lost millions of dollars.

In June 2002, as the GFRDA scheme was falling apart, Vilar and Tanaka approached a long-standing client, Lily Cates, with the opportunity to invest in a type of venture known as a Small Business Investment Company ("SBIC"). Vilar told Cates that he and Tanaka had been approved for an SBIC license, which would allow the SBIC to obtain matching funds from the federal government's Small Business Administration ("SBA") for the SBIC's investments. In fact, Vilar and Tanaka had never received an SBIC license and, indeed, had been denied such a license multiple times.

***69** On June 20, 2002, Cates invested $5 million in the SBIC formed by Amerindo, and her funds were deposited into an Amerindo bank account at Bear, Stearns & Co., in the name of a Panamanian corporation called "Amerindo Management Inc." ("AMI"). Vilar and Tanaka quickly drew on these funds in order to meet various personal and corporate obligations. Notably, Vilar and Tanaka made the following transactions: (1) on June 25, 2002, Tanaka transferred $1 million to a personal bank account held by Vilar, and Vilar immediately used that money for a variety of personal expenses, including a substantial donation to his alma mater; and (2) on July 9, 2002, Vilar and Tanaka wired approximately $2.85 million of Cates's money from the AMI account to an account in Luxembourg, as part of a settlement agreement with a former GFRDA investor. Over the next two years—during which Vilar repeatedly assured Cates that her funds were safely in escrow—Vilar and Tanaka continued to use Cates's SBIC investment account for their own needs. For example, in 2003, Tanaka forged Cates's signature to authorize a $250,000 transfer from her SBIC account to one of Vilar's personal accounts. More than $50,000 of that transfer was used by Vilar to make a personal mortgage payment.

In early 2005, Cates requested that Vilar return her money and close her account. Vilar responded that she would have to make her request of Amerindo Panama—an organization with which she had never previously interacted. With her suspicions raised, Cates reported Vilar and Tanaka to the SEC. Vilar made several false statements in response to the SEC's inquiries, hoping to obscure the SBIC scheme.

On August 15, 2006, the Department of Justice indicted Vilar and Tanaka, charging them in twelve counts with: (1) conspiracy to commit securities fraud, investment adviser fraud, mail fraud, wire fraud, and money laundering, in violation of 18 U.S.C. § 371 (Count One); (2) securities fraud, in violation of 15 U.S.C. §§ 78j(b), 78ff and 17 C.F.R. § 240.10b–5 (Counts Two and Three); (3) investment adviser fraud, in violation of 15 U.S.C. §§ 80b–6 and 80b–7 (Count Four); (4) mail fraud, in violation of 18 U.S.C. § 1341 (Count Five); (5) wire fraud, in violation of 18 U.S.C. § 1343 (Counts Six and Seven); (6) money laundering, in violation of 18 U.S.C. § 1957 (Counts Eight through Eleven); and (7) the making of false statements to the SEC, in violation of 18 U.S.C. § 1001(a) (Count Twelve). [4]

Trial began before Judge Sullivan and a jury on September 22, 2008. On November 19, 2008, after a nine-week trial, the jury convicted Vilar on all twelve counts and convicted Tanaka on Counts One (conspiracy), Three (securities fraud relating to the GFRDA scheme), and Four (investment adviser fraud). Tanaka was acquitted on the other nine counts. On February 8, 2010, the District Court sentenced Vilar principally to a term of 108 months' imprisonment. Two days later, Tanaka was sentenced to a term of sixty months' imprisonment. On April 5, 2010, the District Court ordered both defendants to pay almost $35 million in restitution, including a 9% compounding interest rate, and to forfeit more than $54 million.

Vilar and Tanaka now appeal.

DISCUSSION

Vilar and Tanaka raise what can only be described as a host of challenges to their ***70** convictions and sentences. For ease of comprehension, we address, first, Vilar and Tanaka's claim that the conduct underlying their convictions for securities fraud was "extraterritorial," and therefore not criminal under Section 10(b) or Rule 10b–5; second, their challenges to the indictment; third, their various challenges to the admission of evidence introduced by the government at trial; fourth, their challenges to the District Court's jury instructions; fifth, their challenges to the sufficiency of the evidence supporting their convictions; sixth, their challenges to their sentences; and, finally, seventh, their claims of ineffective assistance of counsel.

I. "Extraterritoriality"

Vilar and Tanaka contend that their respective convictions for securities fraud must be reversed because their conduct was extraterritorial, meaning that it "occurr[ed] in the territory of [a] sovereign [other than the United States]," *Kiobel v. Royal Dutch Petroleum Co.,* ––– U.S. ––––, 133 S.Ct. 1659, 1669, 185 L.Ed.2d 671 (2013), and therefore was not proscribed by Section 10(b) or Rule 10b–5. They rely on the Supreme Court's holding in *Morrison,* which was decided after Vilar and Tanaka were convicted, and which limited Section 10(b) and Rule 10b–5 to prohibiting fraud committed in connection with "transactions in securities listed on domestic exchanges, and domestic transactions in other securities." *Morrison,* 130 S.Ct. at 2884. Observing that *Morrison* was a civil lawsuit, the government responds that *Morrison*' s geographic limit on the reach of Section 10(b) and Rule 10b–5 applies only in the civil context and therefore is no bar to Vilar and Tanaka's criminal convictions. In the alternative, the government argues that Vilar and Tanaka's illegal conduct was "territorial" within the meaning of *Morrison,* inasmuch as at least some of the transactions were "domestic transactions in other securities." *Id.* Although we conclude that *Morrison* does apply to criminal cases brought pursuant to Section 10(b) and Rule 10b–5, we agree that the record in this case confirms that Vilar and Tanaka did perpetrate fraud in connection with domestic securities transactions, and we therefore affirm their convictions.

A. Standard of Review

[1] **[2]** It is an axiom of appellate review that "[a] federal court of appeals normally will not correct a legal error made in criminal trial court proceedings unless the defendant first brought the error to the trial court's attention." *Henderson v. United States,* ––– U.S. ––––, 133 S.Ct. 1121, 1124, 185 L.Ed.2d 85 (2013). Accordingly, where, as here, defendants present us with a claim that they did not give the district court an opportunity to consider, we limit our review to curing "plain error." *United States v. James,* 712 F.3d 79, 96 (2d Cir.2013). This standard is met when "(1) there is an error; (2) the error is clear or obvious, rather than subject to reasonable dispute; (3) the error affected the appellant's substantial rights, which in the ordinary case means it affected the outcome of the district court proceedings; and (4) the error seriously affects the fairness, integrity or public reputation of judicial proceedings." *United States v. Marcus,* 560 U.S. 258, 130 S.Ct. 2159, 2164, 176 L.Ed.2d 1012 (2010) (internal quotation marks and brackets omitted).

[3] Plain error review applies equally where the defendant did not object before the trial court because he failed to recognize an error, and where the defendant did not object because the trial court's decision was correct at the time but assertedly became erroneous due to a supervening legal decision. *See* ***71** *Johnson v. United States,* 520 U.S. 461, 466–67, 117 S.Ct. 1544, 137 L.Ed.2d 718 (1997). In all cases, we look not to the law at the time of the trial court's decision to assess whether the error was plain, but rather, to the law as it exists at the time of review. *See Henderson,* 133 S.Ct. at 1129–30. In other words, a decision of the trial court that was perfectly proper when issued may nonetheless be considered "plainly erroneous" on appeal due to a supervening change in the law. [5]

B. Analysis

1. "Clear or Obvious Error"

The question presented here requires us to consider yet another issue created by the Supreme Court's far-reaching holding in *Morrison.* Section 10(b) and Rule 10b–5 together proscribe the use of fraudulent schemes "in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered...." 15 U.S.C. § 78j (b). [6] Prior to the Supreme Court's decision in *Morrison,* "[i]n determining whether § 10(b) and Rule 10b–5 could apply extraterritorially, this Court had ... applied the so-called conduct and effects test, which focused on: (1) whether the wrongful conduct occurred in the United States, and (2) whether the wrongful conduct had a substantial effect in the United States or upon United States citizens." *Absolute Activist Value Master Fund Ltd. v. Ficeto,* 677 F.3d 60, 65 (2d Cir.2012) (internal ***72** quotation marks omitted). *Morrison* did away with this test. Relying on the "longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States," *Morrison,* 130 S.Ct at 2877 (internal quotation marks omitted), the Supreme Court rejected any extraterritorial application of Section 10(b) and 10b–5, and instructed that "Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States." *Id.* at 2888.

Despite the supposed bright-line nature of *Morrison*'s holding, there has been no shortage of questions raised in its wake. This appeal requires us to decide whether *Morrison*'s limit on the scope of Section 10(b) liability extends to criminal prosecutions brought under that provision. Although we have not yet addressed this specific issue, we have no problem concluding that *Morrison*'s holding applies equally to criminal actions brought under Section 10(b), and that this result is "clear or obvious" for the purposes of plain error review. We reach this result for two reasons: (1) the presumption against extraterritoriality applies to criminal statutes, and (2) the presumption against extraterritoriality applies to Section 10(b).

i. Criminal Statutes

[4] **[5]** First, the government is incorrect when it asserts that "the presumption against extraterritoriality for civil statutes ... simply does not apply in the criminal context." Gov't Br. 96. As we have observed, "[i]t is beyond doubt that, as a general proposition, Congress has the authority to 'enforce its laws beyond the territorial boundaries of the United States.' " *United States v. Yousef,* 327 F.3d 56, 86 (2d Cir.2003) (quoting *EEOC v. Arabian Am. Oil Co.,* 499 U.S. 244, 248, 111 S.Ct. 1227, 113 L.Ed.2d 274 (1991)). But the courts have also recognized the "commonsense notion that Congress generally legislates with domestic concerns in mind," *Smith v. United States,* 507 U.S. 197, 204 n. 5, 113 S.Ct. 1178, 122 L.Ed.2d 548 (1993), and "the presumption that United States law governs domestically but does not rule the world," *Kiobel,* 133 S.Ct. at 1664 (internal quotation marks omitted). For these reasons, "[w]hen a statute gives no clear indication of an extraterritorial application, it has none." *Morrison,* 130 S.Ct. at 2878.

The government contends, relying on *United States v. Bowman,* 260 U.S. 94, 43 S.Ct. 39, 67 L.Ed. 149 (1922), that the presumption against extraterritoriality has no place in our reading of criminal statutes. To the contrary, no plausible interpretation of *Bowman* supports this broad proposition; fairly read, *Bowman* stands for quite the opposite. In *Bowman,* the Supreme Court was asked to consider criminal charges brought against sailors who, while at sea, conspired to defraud a company owned by the United States. *See id.* at 95–96, 43 S.Ct. 39. The Court explained:

> Crimes against private individuals or their property, like assaults, murder, burglary, larceny, robbery, arson, embezzlement and frauds of all kinds, which affect the peace and good order of the community, must of course be committed within the territorial jurisdiction of the government where it may properly exercise it. If punishment of them is to be extended to include those committed outside of the strict territorial jurisdiction, it is natural for Congress to say so in

> the statute, and failure to do so will negative the purpose of Congress in this regard.

***73** *Id.* at 98, 43 S.Ct. 39. The Court nonetheless concluded that charges could be brought in district court in that case, because "the same rule of interpretation should not be applied to criminal statutes which are, as a class, not logically dependent on their locality for the Government's jurisdiction, *but are enacted because of the right of the Government to defend itself against obstruction, or fraud wherever perpetrated, especially if committed by its own citizens, officers, or agents.*" *Id.* (emphasis supplied). In other words, the presumption against extraterritoriality *does* apply to criminal statutes, except in situations where the law at issue is aimed at protecting "the right of the government to defend itself." *Id.*

Indeed, we have repeatedly observed that *Bowman* makes precisely this distinction. For example, in *United States v. Gatlin,* 216 F.3d 207 (2d Cir.2000), we observed that "[s]tatutes prohibiting crimes *against the United States government* may be applied extraterritorially even in the absence of 'clear evidence' that Congress so intended," but that "the *Bowman* Court explicitly stated that the presumption against extraterritoriality *does* apply to '[c]rimes against private individuals or their property....' " *Id.* at 211 n. 5 (quoting *Bowman,* 260 U.S. at 98, 43 S.Ct. 39) (emphases in *Gatlin*); *see also Yousef,* 327 F.3d at 87–88. And, we have explicitly recognized that "although there is no general bar against the extraterritorial application of our criminal laws to American citizens, the Supreme Court has long recognized a presumption against such applications." *United States v. Kim,* 246 F.3d 186, 188–89 (2d Cir.2001); *see also Small v. United States,* 544 U.S. 385, 388–89, 125 S.Ct. 1752, 161 L.Ed.2d 651 (2005) (using the presumption against extraterritoriality as guidance in the criminal context); *United States v. Ayesh,* 702 F.3d 162, 166 (4th Cir.2012) ("Whether Congress has exercised that authority is a matter of statutory construction and, generally, statutes enacted by Congress, including criminal statutes, apply only within the territorial jurisdiction of the United States.").

The government nonetheless argues that we have previously interpreted *Bowman* as limiting the presumption against extraterritoriality to civil statutes. The government draws our attention to *United States v. Siddiqui,* 699 F.3d 690 (2d Cir.2012), where we stated that "[t]he ordinary presumption that laws do not apply extraterritorially has no application to criminal statutes," *id.* at 700, and *United States v. Al Kassar,* 660 F.3d 108 (2d Cir.2011), where we similarly wrote that "[t]he presumption that ordinary acts of Congress do not apply extraterritorially ... does not apply to criminal statutes," *id.* at 118.

However broadly worded, these statements must be understood in their context. In *Al Kassar,* we considered the extraterritorial application of four counts of conviction that relied on statutes with "explicit provisions applying them extraterritorially," and one count for "conspiracy to kill U.S. officers or employees," which we held applies extraterritorially in light of "the nature of the offense—protecting U.S. personnel from harm when acting in their official capacity." *Al Kassar,* 660 F.3d at 118. *Siddiqui* also addressed statutes designed to protect U.S. personnel engaged in the performance of their duties from assault or interference. *Siddiqui,* 699 F.3d at 701. In other words, *Al Kassar* and *Siddiqui* both followed *Bowman* 's rule precisely—they required that the relevant statutes either contain a clear indication of Congress's intent to provide for extraterritorial application or relate to crimes against the United States government. Inasmuch as these cases relied upon *Bowman* to reach this result, they surely do not require that the presumption ***74** against extraterritoriality be laid aside in *all* criminal cases. They are simply applications of *Bowman*'s holding.

Further, the government provides little reason, beyond its misplaced reliance on *Bowman,* for why the presumption against extraterritoriality should not apply to criminal statutes. The government argues that criminal statutes "are concerned with prohibiting individuals ... from defrauding American investors and from using the infrastructure of American commerce to defraud investors" and that applying the presumption against extraterritoriality to criminal statutes "would create a broad immunity for criminal conduct simply because the fraudulent scheme culminates in a purchase or sale abroad." Gov't Br. 98–99. But much the same could be said of civil fraud statutes: Applying the presumption against extraterritoriality immunizes thieves and swindlers from civil liability for defrauding Americans abroad.

More to the point, the distinction the government attempts to draw between civil and criminal laws is no response to the fundamental purposes of the presumption. The Supreme Court has emphasized that we apply this rule of statutory interpretation because we understand that "Congress generally legislates with domestic concerns in mind," *Smith,* 507 U.S. at 204 n. 5, 113 S.Ct. 1178, and because the presumption "serves to protect against unintended clashes between our laws and those of other nations which could result in international discord," *Kiobel,* 133 S.Ct. at 1664 (internal quotation marks omitted). We discern no reason that these concerns are less pertinent in the criminal context.

[6] Finally, the government argues, that Section 10(b) belongs to the "class [of statutes that are] not logically dependent on their locality for the Government's jurisdiction, but are enacted because of the right of the Government to defend itself against obstruction, or fraud wherever perpetrated, especially if committed by its own citizens, officers or agents." *Bowman,* 260 U.S. at 98, 43 S.Ct. 39. We are not persuaded. Although Section 10(b) clearly forbids a variety of fraud, its purpose is to prohibit "[c]rimes against private individuals or their property," which *Bowman* teaches is exactly the sort of statutory provision for which the presumption against extraterritoriality does apply. *Id.* In sum, the general rule is that the presumption against extraterritoriality applies to criminal statutes, and Section 10(b) is no exception.

ii. Section 10(b)

[7] Second, even if it were the case that we do not generally apply the presumption against extraterritoriality to criminal statutes, Section 10(b) would still not apply extraterritorially in criminal cases. The reason is simple: The presumption against extraterritoriality is a method of interpreting a statute, which has the same meaning in every case. The presumption against extraterritoriality is not a rule to be applied to the specific facts of each case. *See Morrison,* 130 S.Ct. at 2877. A statute either applies extraterritorially or it does not, and once it is determined that a statute does not apply extraterritorially, the only question we must answer in the individual case is whether the relevant conduct occurred in the territory of a foreign sovereign.

The Supreme Court has already interpreted Section 10(b), and it has done so in unmistakable terms: "Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States." *Id.* at 2888. To permit the government to punish extraterritorial ***75** conduct when bringing criminal charges under Section 10(b) "would establish ... the dangerous principle that judges can give the same statutory text different meanings in different cases." *Clark v. Martinez,* 543 U.S. 371, 386, 125 S.Ct. 716, 160 L.Ed.2d 734 (2005).

The government nonetheless insists that Section 10(b) is interpreted differently in the criminal and civil contexts because different elements are required to prevail in each. More specifically, the government observes that only private plaintiffs must prove reliance, economic loss, and loss causation, whereas only the government (in criminal cases) must prove that the fraud was committed willfully. Critically, however, none of these differences relate to the *conduct* proscribed by Section 10(b).

Reliance, economic loss, and loss causation relate to who (other than the government) may bring suit and not to the conduct prohibited by Section 10(b). The Supreme Court has made this distinction clear, explaining that

> [i]n our cases addressing § 10(b) and Rule 10b–5, we have confronted two main issues. First, we have determined the scope of conduct prohibited by § 10(b). Second, in cases where the defendant has committed a violation of § 10(b), we have decided questions about the elements of the 10b–5 private liability scheme: for example, whether there is a right to contribution, what the statute of limitations is, whether there is a reliance requirement, and whether there is an *in pari delicto* defense.
>
> The latter issue, determining the elements of the 10b–5 private liability scheme, has posed difficulty because Congress did not create a private § 10(b) cause of action and had no occasion to provide guidance about the elements of a private liability scheme.

Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 172–73, 114 S.Ct. 1439, 128 L.Ed.2d 119 (1994) (internal brackets and citations omitted). Accordingly, "when it comes to 'the scope of the conduct prohibited by Rule 10b–5 and § 10(b), the text of the statute controls our decision' " and "[i]t is only with respect to the additional 'elements of the 10b–5 private liability scheme' that we 'have had to infer how the 1934 Congress would have addressed the issues had the [civil] 10b–5 action been included as an express provision in the 1934 Act.' " *Morrison,* 130 S.Ct. at 2881 n. 5 (quoting *Cent. Bank of Denver,* 511 U.S. at 173, 114 S.Ct. 1439) (brackets omitted).

As for the element of willfulness in criminal cases, it comes directly from Section 32 of the Securities Exchange Act of 1934, which permits criminal liability to attach to a violation of Section 10(b), only when the violation is willful.[7] 15 U.S.C. § 78ff(a). But like the elements relevant only to private plaintiffs, the requirement of proving willfulness has nothing to do with the text or interpretation of Section 10(b). In other words, Section 32 provides no basis for *expanding* the conduct for which a defendant may be held criminally liable under Section 10(b).

Nor, for that matter, can Rule 10b–5 provide for the extraterritorial reach that ***76** its underlying statute lacks. Although the Supreme Court has approved the delegation of authority to the SEC to create rules with criminal penalties, *see* *United States v. O'Hagan,* 521 U.S. 642, 650–51, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997), "criminal liability under SEC regulations for insider trading may not extend beyond the conduct that Congress intended to encompass in § 10(b) of the 1934 Act," *United States v. Gansman,* 657 F.3d 85, 90 n. 5 (2d Cir.2011).

2. "Substantial Rights"

[8] Having concluded that it would be clear or obvious error to apply Section 10(b) and Rule 10b–5 to extraterritorial criminal conduct in light of *Morrison,* we now turn, in our analysis of the asserted "plain error," to whether "the error affected the appellant's substantial rights, which in the ordinary case means it affected the outcome of the district court proceedings." *Marcus,* 130 S.Ct. at 2164 (internal quotation marks omitted).

Under *Morrison,* a defendant may be convicted of securities fraud under Section 10(b) and Rule 10b–5 if he has engaged in fraud with respect to either (1) a security listed on an American exchange, or (2) a security purchased or sold in the United States. *Morrison,* 130 S.Ct. at 2888. There is no claim that any of the securities sold in this case were listed on an American exchange.[8] We ask, therefore, whether the jury would have found, beyond a reasonable doubt, that Vilar and Tanaka engaged in fraud in connection with a *domestic* purchase or sale of securities, in violation of Section 10(b) and Rule 10b–5. *Cf. Needham,* 604 F.3d at 679–80 (explaining that a defendant has not demonstrated plain error where, absent the asserted error, the government still would have proved its case beyond a reasonable doubt.).

On this issue, we are guided by our test, recently enunciated in the aftermath of *Morrison,* for determining whether a security not listed on an American exchange was purchased or sold in the United States: "[A] securities transaction is domestic when the parties incur irrevocable liability to carry out the transaction within the United States or when title is passed within the United States." *Absolute Activist,* 677 F.3d at 69. More specifically, a domestic transaction has occurred when "the purchaser [has] incurred irrevocable liability within the United States to take and pay for a security, *or* ... the seller [has] incurred irrevocable liability within the United States to deliver a security." *Id.* at 68 (emphasis supplied).

As to the GFRDA fraud (Counts One and Three), the government contends that one set of victims, the Mayer family, entered into and renewed their agreement in Puerto Rico,[9] and another victim, Graciela ***77** Lecube–Chavez, did so in New York. *See* Gov't Br. 101. As to the SBIC scheme (Count Two), the government points to evidence that Lily Cates "executed the documents necessary to invest in the SBIC in her own New York apartment and handed those documents to a New York messenger." Gov't Sur–Reply 12. In light of these domestic transactions, we are persuaded that, based on the record evidence, a jury would have found that Vilar and Tanaka engaged in fraud in connection with a *domestic* purchase or sale of securities pursuant to Section 10(b) and Rule 10b–5.[10]

In particular, the record contains correspondence between Vilar and the Mayer family, indicating that they met in Puerto Rico, where the Mayers lived, to discuss the GFRDA program and that the Mayers committed to the investment while in Puerto Rico. *See* Gov't Supp. App'x 876–79; *see also* Trial Tr. 849 (explaining that all of the Mayers' meetings with Vilar to discuss the GFRDA investment occurred in Puerto Rico). Indeed, the Mayers' GFRDA application lists their address as Santurce, Puerto Rico, and Vilar and Tanaka sent a letter confirming the Mayers' investment to that address.[11] *See* Tanaka ***78** App'x 534–37. The evidence similarly shows that Lisa Mayer was in Puerto Rico when she re-invested her family's money in the GFRDA program, once the original investment had expired. *See* Gov't Supp. App'x at 753–54.

Much the same can be said of the evidence demonstrating that Lecube–Chavez irrevocably committed herself to her GFRDA investment while in New York. A series of letters sent by Vilar to Lecube–Chavez demonstrate that Lecube–Chavez was in New York when she received and signed the commitment forms for her GFRDA and sent the money required for opening her account. *See* Tanaka App'x 465–69, 520–24; Gov't App'x 772; *see also* Trial Tr. 306–09 (testimony confirming that Lecube–Chavez sent a check to Amerindo after receiving these letters).

In sum, with respect to the purchases of GFRDAs by the Mayers and Lecube–Chavez, the record contains facts "concerning the formation of the contracts" and "the exchange of money," which are precisely the sort that we indicated may suffice to prove that irrevocable liability was incurred in the United States.[12] *See Absolute Activist,* 677 F.3d at 70.

Despite this evidence of domestic securities transactions with the Mayers and Lecube–Chavez, our analysis of whether the change in law created by *Morrison* would have affected the outcome of this case as to Counts One and Three is complicated by the fact that the jury rendered a general verdict covering all victims of the GFRDA scheme. In other words, it is possible that, in responding to a carefully drawn special verdict form, the jury would have found Vilar and Tanaka guilty only of defrauding victims outside of the United States, and not of defrauding the Mayers or Lecube–Chavez. Nonetheless, upon a review of the record, we have no doubt that the jury would have found Vilar and Tanaka guilty of violating Section 10(b) and Rule 10b–5 with respect to the Mayers and Lecube–Chavez specifically. The record contains evidence in the form of offering materials and prospectuses, as well as testimony by Lisa Mayer and Lecube–Chavez confirming beyond a reasonable doubt that Vilar and Tanaka, willfully, and with the intent to defraud, made material misrepresentations as to the nature of the GFRDA program in connection with their purchases of GFRDAs. *See, e.g.,* Tanaka App'x 447–48 (offering circular); Gov't Supp. App'x 878 (letter from Vilar to Dr. Herbert Mayer); Trial Tr. 301–04 (testimony of Graciela Lecube–Chavez); *id.* at 831–38 (testimony of Lisa Mayer). We therefore conclude that, notwithstanding the fact that the jury returned general verdicts as to Counts One and Three, the error made manifest by *Morrison*'s change in law would not have altered the outcome of the jury's determinations as to Counts ***79** One or Three, and therefore did not affect Vilar and Tanaka's substantial rights. *Cf. Hedgpeth v. Pulido,* 555 U.S. 57, 61, 129 S.Ct. 530, 172 L.Ed.2d 388 (2008) (harmless error analysis applied where a jury returned a general verdict after being instructed on alternative theories of guilt, one of which was erroneous).

Count Two presents no such difficulties inasmuch as the jury convicted Vilar of defrauding Cates, and the record makes clear that Cates made her investment in the SBIC scheme while in the United States. Cates testified that she met with Vilar at his apartment in New York in June 2002 to discuss the investment opportunity, and shortly thereafter signed the commitment papers. *See* Trial Tr. 2098–104. We do not doubt that, on this record, the jury would have found that Cates incurred irrevocable liability to purchase her SBIC investment while in the United States.

* * *

In sum, there was no plain error in Vilar and Tanaka's convictions on Counts One, Two, or Three with respect to the territoriality of their conduct.

II. Sufficiency of the Indictment

Vilar and Tanaka challenge the indictment on two grounds. First, they claim that Count One (Conspiracy) was "duplicitous," by which they mean that the indictment alleged one conspiracy where, in fact, there were two smaller conspiracies. Second, they claim that Count Four (Investment Adviser Fraud) was not sufficiently definite, and was later constructively amended at trial. We review *de novo* the denial of a motion to dismiss the indictment. *United States v. Daley,* 702 F.3d 96, 99–100 (2d Cir.2012). Neither claim has merit.

[9] As for the "duplicity" of Count One, Vilar and Tanaka argue that the GFRDA frauds and SBIC frauds were separate conspiracies, and should have been charged as such. The District Court rejected this argument, *see United States v. Vilar,* No. 05 Cr. 621(RJS), 2008 WL 4298545, at *1 (S.D.N.Y. Sept. 5, 2008), and we do so as well. We have held that "[a]n indictment is impermissibly duplicitous where: 1) it combines two or more distinct crimes into one count in contravention of Fed.R.Crim.P. 8(a)'s requirement that there be a separate count for each offense, and 2) the defendant is prejudiced thereby."[13] *United States v. Sturdivant,* 244 F.3d 71, 75 (2d Cir.2001) (internal quotation marks omitted). However, "this [C]ourt has long held that acts that could be charged as separate counts of an indictment may instead be charged in a single count if those acts could be characterized as part of a single continuing scheme." *United States v. Olmeda,* 461 F.3d 271, 281 (2d Cir.2006) (internal quotation marks omitted). It has been established for at least seventy years that " '[t]he allegation in a single count of a conspiracy to commit several crimes is not duplicitous, for [t]he conspiracy is the crime, and that is one, however diverse its objects.' " *United States v. Williams,* 705 F.2d 603, 624

(2d Cir.1983) (quoting *Braverman v. United States,* 317 U.S. 49, 54, 63 S.Ct. 99, 87 L.Ed. 23 (1942)).

***80 [10]** The record leaves no doubt that the GFRDA and SBIC schemes can be characterized as part of one conspiracy to defraud investors by (1) lying about the nature of their investments and (2) continuing to mislead them into believing that their money was safe and invested in accordance with the representations they had received from Vilar and Tanaka. [14] *See, e.g., United States v. Tutino,* 883 F.2d 1125, 1141 (2d Cir.1989) ("As long as the essence of the alleged crime is carrying out a single scheme to defraud, then aggregation is permissible.").

[11] As for the definiteness of Count Four (Investment Adviser Fraud), Vilar and Tanaka argue that the indictment was not sufficient because it did not specify that the SBIC fraud, as opposed to the GFRDA fraud, formed the basis of Count Four. [15] Pursuant to Federal Rule of Criminal Procedure 7, "[t]he indictment or information must be a plain, concise, and definite written statement of the essential facts constituting the offense charged...." Fed.R.Crim.P. 7(c)(1). [16] As we have explained, "[a]n indictment is sufficient when it charges a crime with sufficient precision to inform the defendant of the charges he must meet and with enough detail that he may plead double jeopardy in a future prosecution based on the same set of events." *United States v. Yannotti,* 541 F.3d 112, 127 (2d Cir.2008) (internal quotation marks omitted). "Moreover, an indictment need do little more than to track the language of the statute charged and state the time and place (in approximate terms) of the alleged crime." *Id.* (internal quotation marks omitted).

***81** The indictment in this case sufficiently sets out the time and circumstances of the conspiracy and tracks the language of the statute charged. *See* Tanaka App'x 116. While it is true that the indictment does not explicitly refer to the SBIC scheme, we have little trouble concluding that it contained "sufficient precision" to inform Vilar and Tanaka of the charges to be met and to enable them to plead double jeopardy in the future. *Yannotti,* 541 F.3d at 127.

Vilar and Tanaka nonetheless argue that the indictment was constructively amended by the government when it narrowed Count Four to the SBIC scheme because the indictment was worded more generally and could have encompassed broader conduct. We have only recently had occasion to recall that, "[t]o prevail on a constructive amendment claim, a defendant must demonstrate that the terms of the indictment are in effect altered by the presentation of evidence and jury instructions which so modify *essential elements* of the offense charged that there is a substantial likelihood that the defendant may have been convicted of an offense other than that charged in the indictment." *United States v. D'Amelio,* 683 F.3d 412, 416 (2d Cir.2012) (internal quotation marks omitted; emphasis in original). Although "a constructive amendment is a per se violation of the Grand Jury Clause," we have "consistently permitted significant flexibility in proof, provided that the defendant was given *notice* of the *core* of criminality to be proven at trial." *United States v. Banki,* 685 F.3d 99, 118 (2d Cir.2012) (internal quotation marks and citation omitted; emphasis in *Banki*).

[12] We have little doubt that Vilar and Tanaka were on notice of the "core of criminality" alleged in Count Four—namely that, between 2002 and 2005, Vilar and Tanaka defrauded Lily Cates, to whom they were investment advisers, as part of the SBIC scheme. Even if it were true that Count Four of the indictment originally contemplated both the GFRDA and SBIC schemes, rather than the latter scheme alone, "where a generally framed indictment encompasses the specific legal theory or evidence used at trial, there is no constructive amendment." *Id.* (internal quotation marks and brackets omitted); *see also United States v. Miller,* 471 U.S. 130, 136, 105 S.Ct. 1811, 85 L.Ed.2d 99 (1985) ("As long as the crime and the elements of the offense that sustain the conviction are fully and clearly set out in the indictment, the right to a grand jury is not normally violated by the fact that the indictment alleges more crimes or other means of committing the same crime."). Indeed, in contrast to the alleged narrowing of Count 4 here, we have specifically noted that a constructive amendment occurs "when the trial evidence or the jury charge operates to *broaden* the possible bases for conviction from that which appeared in the indictment." *Banki,* 685 F.3d at 118 (internal quotation marks omitted; emphasis supplied).

In sum, Vilar and Tanaka have established no error based on the sufficiency of the indictment.

III. Evidentiary Challenges

[13] Vilar and Tanaka claim that at trial the District Court erred by not suppressing (1) evidence obtained pursuant to an overbroad warrant to search Amerindo's New York office; (2) evidence seized in a search of Amerindo's London storage facility; and (3) testimony concerning statements made by

Renata Tanaka, Tanaka's wife, who worked in Amerindo's London office. When considering a district court's order denying a motion to suppress evidence, "we review the district court's factual findings for clear error, viewing the ***82** evidence in the light most favorable to the government," and review its legal conclusions *de novo. United States v. Moreno,* 701 F.3d 64, 72 (2d Cir.2012) (internal quotation marks and brackets omitted). We review a district court's rulings about the admissibility of trial evidence for "abuse of discretion," *United States v. Coplan,* 703 F.3d 46, 80 (2d Cir.2012), which means that we set aside its decision if "it based its ruling on an erroneous view of the law or on a clearly erroneous assessment of the evidence, or rendered a decision that cannot be located within the range of permissible decisions," *In re Sims,* 534 F.3d 117, 132 (2d Cir.2008) (internal quotation marks and citation omitted) (explaining term of art "abuse of discretion").

A. The U.S. Search

1. Background

On May 25, 2005, Magistrate Judge Frank Maas signed a search warrant for Amerindo's office in New York City. The warrant permitted authorities to seize broad categories of documents, including all corporate records and client files, without any temporal limitation. The next day, investigators executed the warrant and seized approximately 170 boxes of documents, as well as 30 computers. Several hours into the search, counsel to Amerindo arrived at the office and indicated that he would cooperate with the government's investigation. He offered to put into place a preservation policy for Amerindo's documents and suggested that, because it appeared that the search would not be completed in a day, Amerindo would agree to accept service of a grand jury subpoena for the documents; Amerindo could then, in his view, disclose the requested documents in an orderly fashion. By early afternoon, the government had faxed the grand jury subpoena and Amerindo's attorney had accepted service. In return for this acceptance, the investigators stopped their search.

[14] But Amerindo did not comply with the subpoena. Instead, Vilar and Tanaka filed a motion to quash the subpoena and suppress any evidence obtained during the search. In a thorough and well-reasoned Opinion and Order, Judge Kenneth M. Karas, who was then the presiding judge, determined that, although there was probable cause to search the New York office, certain portions of the warrant were not supported by probable cause and lacked sufficient particularity. *See United States v. Vilar,* No. S3 05–CR–621(KMK), 2007 WL 1075041, at *19–23 (S.D.N.Y. Apr. 4, 2007) ("*Warrant Decision* "). Judge Karas went on to conclude that the evidence obtained could not be rescued from suppression by the good faith of the executing officers, [17] but that certain valid portions of the warrant could be severed, and evidence seized pursuant to those valid portions would be admissible. *Id.* at *23–24, *31–34. Finally, Judge Karas found that the grand jury subpoena was not an improper extension of the search and, after modifying the subpoena to address certain areas that were overbroad, insufficiently particular, or overly burdensome, he denied the motion to quash. *Id.* at *39–50. In practical terms, the government was permitted to obtain the documents from ***83** Amerindo's New York office through its grand jury subpoena.

[15] The saga of the evidence obtained from Amerindo's New York office did not end there, however. Prior to trial, Vilar and Tanaka moved to exclude the documents produced pursuant to the grand jury subpoena on the ground that these documents represented so-called fruits of the unlawful search. Judge Sullivan, who by then had taken over the case, disagreed and held that both the "inevitable discovery" [18] and "independent source" [19] doctrines permitted the admission of the documents obtained through the grand jury subpoena. *See United States v. Vilar,* 530 F.Supp.2d 616, 626–34 (S.D.N.Y.2008) ("*Subpoena Decision* ").

2. Analysis

Vilar and Tanaka now argue that Judge Karas erred in severing the valid portions of the warrant and that Judge Sullivan erred in admitting the evidence obtained pursuant to the grand jury subpoena. We need not address Judge Karas's invalidation of parts of the warrant, nor the independent source doctrine, because it is clear that Judge Sullivan properly admitted all of the evidence pursuant to the inevitable discovery doctrine.

[16] As a preliminary matter, Vilar and Tanaka contend, as they did before Judge Sullivan, that the government forfeited its claim that the materials obtained under the subpoena were admissible pursuant to the inevitable discovery doctrine. In particular, they argue that the documents admitted pursuant to the subpoena were the same ones suppressed pursuant to the overbroad warrant and, therefore, the government was required to assert the inevitable discovery doctrine before Judge Karas in opposition to Vilar and Tanaka's motion to suppress evidence obtained by the warrant. This argument neglects the fact that the government explained its position on the admissibility of the documents to Judge Karas, *see Subpoena Decision,* 530 F.Supp.2d at 622; indeed, Judge Karas permitted the government to move forward with the subpoena, recognizing that the admissibility of the documents might be subject to challenge at a future date, *see id.* at 622–23. Even if the government did not incant the phrase "inevitable discovery" when defending before Judge Karas the admissibility of the documents seized pursuant to the warrant, Vilar and Tanaka have advanced no plausible authority for the notion that it was not perfectly appropriate to reserve those arguments for the time when Vilar and Tanaka challenged the admissibility of the subpoenaed evidence itself. In short, the government did not waive its "inevitable discovery" argument in the proceedings before Judge Karas.

[17] Vilar and Tanaka's substantive arguments fare no better. It is correct, of course, that the so-called exclusionary rule, "when applicable, forbids the use of improperly obtained evidence at trial." *Herring v. United States,* 555 U.S. 135, 139, 129 S.Ct. 695, 172 L.Ed.2d 496 (2009). But "[u]nder the 'inevitable discovery' doctrine, ***84** evidence obtained during the course of an unreasonable search and seizure should not be excluded 'if the government can prove that the evidence would have been obtained inevitably' without the constitutional violation." *United States v. Heath,* 455 F.3d 52, 55 (2d Cir.2006) (quoting *Nix v. Williams,* 467 U.S. 431, 447, 104 S.Ct. 2501, 81 L.Ed.2d 377 (1984)). Put another way, whether this exception to the exclusionary rule applies depends on whether "the disputed evidence inevitably [would] have been found through legal means 'but for' the constitutional violation[.]" *Id.*

[18] To prevail under the inevitable discovery doctrine, the government must prove "by a preponderance of the evidence" presented to the district judge that the evidence inevitably would have been discovered. *Nix,* 467 U.S. at 444, 104 S.Ct. 2501. In *United States v. Cabassa,* 62 F.3d 470 (2d Cir.1995), we acknowledged that using the preponderance-of-the-evidence standard to prove inevitability creates a problem of probabilities, and observed that even if each event in a series is individually more likely than not to happen, it still may be less than probable that the final event will occur. *Id.* at 474. For this reason, we subsequently explained "that illegally-obtained evidence will be admissible under the inevitable discovery exception to the exclusionary rule only where a court can find, with a high level of confidence, that each of the contingencies necessary to the legal discovery of the contested evidence would be resolved in the government's favor." *Heath,* 455 F.3d at 60. In other words, the government must prove that each event leading to the discovery of the evidence would have occurred with a sufficiently high degree of confidence for the district judge to conclude, by a preponderance of the evidence, that the evidence would inevitably have been discovered.

[19] Judge Sullivan, in a careful and clear Memorandum and Order of January 17, 2008, found that (1) the subpoena was not issued on the basis of any information unlawfully seized from Amerindo's New York office; (2) the government was actively investigating Amerindo and inevitably would have conducted a substantial search of the New York office; (3) Amerindo's attorney inevitably would have raised the alternative of a grand jury subpoena; (4) the government inevitably would have issued the grand jury subpoena; and (5) Vilar and Tanaka inevitably would have produced the documents requested by the subpoena (which they, in fact, did). *See Subpoena Decision,* 530 F.Supp.2d at 627–32. We identify no error in these findings, let alone clear error. *See Moreno,* 701 F.3d at 72.

Indeed, we can be confident that this sequence is what would have happened, because it *did* happen. This case presents the unusual scenario where the actual events played out exactly as they would have "but for" the over-breadth of the warrant, because the government actually obtained the evidence through alternative means that did not depend on any invalidity of the warrant. As Judge Sullivan noted, "it is beyond doubt that the Government had a lawful basis to be present in Amerindo's office on the date of the search in order to execute the lawful portions of the Warrant," *Subpoena Decision,* 530 F.Supp.2d at 627, because, as Judge Karas found—and Vilar and Tanaka do not contest—there was "[c]learly" probable cause to conduct a search of Amerindo's New York office, *Warrant Decision,* 2007 WL 1075041, at *20. Further, the offer of Amerindo's counsel to accept a grand jury subpoena had nothing to do with any illegality in the warrant; at the time, he ***85** thought the warrant was valid. The record, therefore, confirms that the government would have validly discovered the documents produced pursuant to the subpoena "but for" the over-breadth of the warrant.

Vilar and Tanaka nonetheless insist that this material should have been excluded because the subpoena was issued after the government began its search pursuant to the (partly) invalidated warrant. They rely on our decision in *United States v. Eng,* 971 F.2d 854 (2d Cir.1992), in which we cautioned that, "[p]articular care is appropriate where ... subpoenas are issued after or at the time of the unlawful search," and "subpoenas must not serve as an after the fact insurance policy to validate an unlawful search under the inevitable discovery doctrine." *Id.* at 860–61 (internal quotation marks omitted). Put simply, Vilar and Tanaka assert that the inevitable discovery doctrine cannot apply where the subpoena was sought after the government initiated its partly unlawful search. We cannot agree.

First, *Eng* created no such rule and, in fact, it rejected a *per se* rule "that the subpoena power *never* may be relied upon by the government to meet the inevitable discovery burden of proof." *Id.* at 860. Indeed, we explained quite clearly that we could find "no reason why the government may not rely upon the subpoena power as one way it might meet the burden of proving inevitable discovery by a preponderance of the evidence." *Id.*

Second, based on the facts of this case, the temporal or causal relationship between the search of Amerindo's New York office and the issuance of the subpoena has no bearing on whether "the disputed evidence inevitably [would] have been found through legal means 'but for' the constitutional violation [.]" *Heath,* 455 F.3d at 55. And, as we have explained, there is no doubt that the government would have discovered the evidence through the grand jury subpoena, irrespective of the invalidity of parts of the warrant.

Accordingly, we identify no error in the admission of the documents from Amerindo's New York office.

B. The Search in the United Kingdom

1. Background

On October 13 and 14, 2005, British and American authorities searched the Cadogan Tate warehouse in London for documents stored by Amerindo U.K. *Warrant Decision,* 2007 WL 1075041, at *17. In order to gain access to Amerindo's documents in the United Kingdom, American authorities first filed a "Mutual Legal Assistance Treaty" ("MLAT") [20] request, in which they sought the assistance of U.K. law enforcement. *Id.* at *12.

After receiving the request, a U.K. detective conducted his own investigation to ensure that any warrant application would comport with U.K. law and that it would be based on sufficient information to justify the issuance of a warrant. *Id.* at *11–13. Once these prerequisites had been satisfied, the detective sought and obtained a valid warrant from a magistrate. *Id.* at *16. As part of his normal procedure, the detective requested that American officials attend the search to provide advice on what materials were relevant. *Id.* at *13. Although American investigators did attend ***86** the search and offered their opinions on the relevance of various documents, Judge Karas found—and we have no reason to doubt—that the authority to determine what documents could validly be seized under U.K. law remained at all times with the U.K. authorities. *Id.* at *16–17.

Vilar and Tanaka subsequently sought to suppress the evidence obtained at the Cadogan Tate warehouse. Judge Karas, then presiding, denied their motion, holding (1) that the Fourth Amendment's warrant requirement did not apply because the search was executed abroad, and (2) that the evidence did not have to be suppressed because the search was valid under U.K. law and was reasonable. *See id.* at *51–58. Vilar and Tanaka now renew their challenge to the admission of the evidence obtained in the United Kingdom.

2. Analysis

After Judge Karas issued his opinion, we clarified the law applicable to searches of United States citizens conducted abroad by United States authorities, [21] holding "that the Fourth Amendment's warrant requirement does not govern searches conducted abroad by U.S. agents; such searches of U.S. citizens need only satisfy the Fourth Amendment's requirement of reasonableness." *In re Terrorist Bombings of U.S. Embassies in E. Africa,* 552 F.3d 157, 167 (2d Cir.2008) ("*In re Terrorist Bombings* "). "To determine whether a search is reasonable under the Fourth Amendment, we examine the 'totality of the circumstances' to balance 'on the one hand, the degree to which it intrudes upon an individual's privacy and, on the other, the degree to which it is needed for the promotion of legitimate governmental interests.' " *Id.* at 172 (quoting *Samson v. California,* 547 U.S. 843, 848, 126 S.Ct. 2193, 165 L.Ed.2d 250 (2006)).

[20] Judge Karas's undisputed factual findings provide ample support for the conclusion that the U.K. search was reasonable, and that the Cadogan Tate materials were therefore properly admitted. Indeed, Vilar and Tanaka's only substantive challenge to this determination is a misguided effort to confine *In re Terrorist Bombings* to its facts. They contend that "[t]he interest in obtaining evidence of possible white collar crimes—particularly involving only a handful of investors—cannot compare to the national security interest in preventing murderous, terrorist attacks, the interest at stake in *Terrorist Bombings.*" Tanaka Br. 86–87. *In re Terrorist Bombings* was not limited to cases of suspected terrorism or instances of similarly horrific crime. We could not have been clearer in stating that "the Fourth Amendment's warrant requirement does not govern searches conducted abroad by U.S. agents." *In re Terrorist Bombings,* 552 F.3d at 167. The government has demonstrated that the U.K. search was reasonable; it need do no more. For this reason, the District Court properly admitted the evidence obtained in the U.K.

C. Statements of Renata Tanaka

The final evidentiary claim of Vilar and Tanaka may also be disposed of readily. They protest the admission of statements made by Renata Tanaka, the wife of defendant Tanaka, who worked at Amerindo ***87** U.K., to Stephen Gray, the attorney for several GFRDA clients. Judge Sullivan permitted Gray to relate the statements pursuant to Federal Rule of Evidence 801(d)(2)(D), which excludes from the definition of hearsay any statement "offered against an opposing party" that "was made by the party's agent or employee on a matter within the scope of that relationship and while it existed." Vilar and Tanaka each argue that Renata Tanaka was not his agent and that the statements were not made within the scope of any agency relationship. However, after a lengthy colloquy, Judge Sullivan found, by a preponderance of the evidence, that Renata Tanaka was, in fact, an agent of both Vilar and Tanaka, and that the challenged statements were made within the scope of that relationship. *See* Tanaka App'x 345–61. We identify no error, let alone clear error, in Judge Sullivan's findings, *see Coplan,* 703 F.3d at 80, nor in his conclusion that these findings satisfied the requirements of Rule 801(d)(2)(D), *see United States v. Lauersen,* 348 F.3d 329, 340 (2d Cir.2003).

IV. Jury Instructions

Defendants charge two main errors in the District Court's jury instructions. [22] First, they both argue that the District Court erroneously omitted a reliance element from the charges for securities fraud (Counts Two and Three). Second, Vilar (only) claims that the District Court improperly permitted the jury to convict him of mail fraud (Count Five) without proving ***88** that the mailing contained false or fraudulent material.

[21] As we recently explained,

> we review a properly preserved claim of error regarding jury instructions *de novo,* reversing only where, viewing the charge as a whole, there was a prejudicial error. The trial court enjoys broad discretion in crafting its instructions, which is only circumscribed by the requirement that the charge be fair to both sides. A defendant challenging a district court's refusal to give a requested jury instruction carries the heavy burden of showing that his proposed charge accurately represented the law in every respect, and that the charge actually given, viewed as a whole, prejudiced him.

Coplan, 703 F.3d at 87 (internal quotation marks, brackets, ellipses, and citations omitted). By contrast, where a defendant fails to make a specific and timely objection to a district court's jury charge, those instructions are subject to review only for plain error. *See United States v. Nouri,* 711 F.3d 129, 138 (2d Cir.2013); *see also Marcus,* 130 S.Ct. at 2164 (explaining plain error standard); Part I.A., *ante* (same).

A. Securities Fraud (Counts Two and Three)

[22] First, Vilar and Tanaka protest the District Court's refusal to instruct the jury that, to prove a violation of Section 10(b) and Rule 10b–5, "the government must prove beyond all reasonable doubt that the alleged victim did in fact rely upon the alleged device, scheme, or practice in purchasing or selling shares of the alleged listed securities." Gov't Supp. App'x 53. Reliance, however, is not an element of a criminal case brought by the government under Section 10(b) or Rule 10b–5. Accordingly, the District Court did not err in deciding not to issue this charge.

To prevail in a civil case under Section 10(b) and Rule 10b–5, the government must "prove that in connection with the purchase or sale of a security the defendant, acting with scienter, made a material misrepresentation (or a material omission if the defendant had a duty to speak) or used a fraudulent device." *VanCook v. SEC,* 653 F.3d 130, 138 (2d Cir.2011). In order to impose criminal liability, the government must also prove that the defendant willfully violated the law. 15 U.S.C. § 78ff(a); *see also O'Hagan,* 521 U.S. at 665–66, 117 S.Ct. 2199; note 7, *ante.*

Conspicuously absent from this list of elements is "reliance." Indeed, it has long been the law that the government, as opposed to a private plaintiff, need prove only materiality, meaning that "there is a substantial likelihood that a reasonable investor would find [the omission or misrepresentation] important in making an investment decision," *United States v. Contorinis,* 692 F.3d 136, 143 (2d Cir.2012), and not that a victim did, in fact, rely on it. *See SEC v. Apuzzo,* 689 F.3d 204, 213 (2d Cir.2012) ("Thus, while a plaintiff must prove reliance ... in a private securities fraud suit, there is no such requirement in an SEC enforcement action.") (internal citation omitted); *United States v. Gleason,* 616 F.2d 2, 28 (2d Cir.1979) (relying on *SEC v. Texas Gulf Sulphur Co.,* 401 F.2d 833, 860 (2d Cir.1968)). That is because, as explained earlier, *see* Part I.B.1.ii, *ante,* reliance is relevant only to the identification of the private persons entitled to bring suit. *See Cent. Bank of Denver, N.A.,* 511 U.S. at 173, 114 S.Ct. 1439; *see also United States v. Marino,* 654 F.3d 310, 320 (2d Cir.2011) (noting that reliance is "required in a *private* Rule 10b–5 action" (emphasis supplied)).

[23] Despite Vilar and Tanaka's argument to the contrary—which is based on ***89** language from a non-precedential summary order, *see United States v. Schlisser,* 168 Fed.Appx. 483, 486 (2d Cir.2006)—the long-established law of our Circuit, and nearly every other circuit, [23] is that, when the government (as opposed to a private plaintiff) brings a civil or criminal action under Section 10(b) and Rule 10b–5, it need only prove, in addition to scienter, materiality, meaning a substantial likelihood that a reasonable investor would find the omission or misrepresentation important in making an investment decision, and not actual reliance.

The explanation for this discrepancy, as the Supreme Court explained in the context of mail fraud, is that because the statute prohibits "the 'scheme to defraud,' rather than the completed fraud, [inferring] the elements of reliance and damage would clearly be inconsistent with the statutes Congress enacted." *Neder v. United States,* 527 U.S. 1, 24–25, 119 S.Ct. 1827, 144 L.Ed.2d 35 (1999); *see also SEC v. N. Am. Research & Dev. Corp.,* 424 F.2d 63, 84–85 (2d Cir.1970). Accordingly, we find no error in the District Court's refusal to instruct the jury on reliance.

B. Mail Fraud (Count Five)

Second, Vilar alone [24] argues that the District Court's instructions concerning mail fraud "lowered the government's burden of proof," and were therefore erroneous. Vilar Br. 150. The indictment alleged a single act giving rise to the mail fraud count: that Vilar and Tanaka "sent and caused to be sent and delivered via a private and commercial interstate carrier a false and fraudulent account statement from London, England," to Lily Cates in New York. Tanaka App'x 117. When instructing the jury, the District Court repeated this allegation verbatim, Trial Tr. 5589, but went on to state that, "[i]ncidentally, the mailed letter need not itself be fraudulent[; f]or example, the mailed matter need not contain any fraudulent representations, and indeed may be completely innocent," *id.* at 5594.

[24] The government responds that this instruction contains no error because it is accurate—the mailing itself need not contain false information for a defendant to commit fraud by mail. *See, e.g., Schmuck v. United States,* 489 U.S. 705, 715, 109 S.Ct. 1443, 103 L.Ed.2d 734 (1989) (explaining that " 'innocent' mailings—ones that contain no false information—may supply the mailing element"). Though correct as to the law, the government's answer misunderstands the nature of Vilar's objection. In substance, Vilar claims that the jury charge constructively amended the indictment because the indictment charged that Vilar sent a specific false account statement, but the District Court's instruction permitted the jury to convict based on an accurate account statement sent in support of a scheme to defraud.

As stated earlier, *see* Part II, *ante,* an indictment is constructively amended when "the terms of the indictment are in effect altered by the presentation of evidence and jury instructions which so modify *essential elements* of the offense charged that there is a substantial likelihood that the defendant may have been convicted of an offense other than that charged in the ***90** indictment." *D'Amelio,* 683 F.3d at 416 (internal quotation marks omitted; emphasis in original). "Although constructive amendment is viewed as a *per se* violation of the Grand Jury Clause, sufficient to secure relief without any showing of prejudice, this court has proceeded cautiously in identifying such error, consistently permitting significant flexibility in proof, provided that the defendant was given *notice* of the *core of criminality* to be proven at trial." *United States v. Agrawal,* 726 F.3d 235, 259–60 (2d Cir.2013) (internal quotation marks and brackets omitted). [25]

The dispositive question is whether the District Court's instruction affected the "core of criminality." We recently tried to clarify this phrase in *United States v. D'Amelio,* where we described it as "the essence of a crime," not "the particulars of how a defendant effected the crime." 683 F.3d at 418. Relying on *Stirone v. United States,* 361 U.S. 212, 80 S.Ct. 270, 4 L.Ed.2d 252 (1960), and our prior holdings, we explained that the distinction between a constructive amendment and a permissible variation in the government's proof "lies in whether the jury convicted based on a complex of facts distinctly different from that which the grand jury set forth in the indictment, or whether the indictment charged a single set of discrete facts from which the government's proof was at most a non-prejudicial variance." *D'Amelio,* 683 F.3d at 419 (internal quotation marks and citation omitted).

In *D'Amelio,* the government charged the defendant with enticing a minor using a computer and the Internet. *Id.* at 414. The core of his criminality was his enticement of a minor, which "did not encompass a specific facility and a specific means of interstate commerce employed by [the defendant] in connection with the crime." *Id.* at 421. Accordingly, we held that the indictment was not constructively amended when the district court instructed the jurors that they could convict if the defendant used the Internet or telephone. *See id.* at 421–22. We explained that the government's proof and the jury instructions did not "support[ ] a theory ... that was distinctly different from the one charged," because the variance from the indictment would not have caused the defendant to be surprised by the introduction "of different and unrelated proof adduced at trial," and because the differences between the indictment and proof were not "extreme." *Id.* at 421. Put another way, the defendant in *D'Amelio* was convicted of the very enticement of a minor he was charged with, even if the district court permitted the jury to find that the means of enticement was a telephone instead of a computer.

Guided by these principles, we conclude that the jury instructions of Judge Sullivan did not impermissibly amend the mail fraud count or improperly broaden the basis for Vilar's conviction on that count. In cases where the crime charged concerns the making of false statements, we have described the "core of criminality" as "knowingly making false statements." *United States v. Bernstein,* 533 F.2d 775, 787 (2d Cir.1976); *see also* ***91** *United States v. Sindona,* 636 F.2d 792, 797 (2d Cir.1980). A fair reading of the mail fraud count, which incorporated the previous allegations in the indictment, makes clear that the scheme to defraud consisted of inducing Cates to transfer funds to Amerindo by misrepresenting the nature and quality of the SBIC investment. These were the false statements that Vilar knowingly made, and it was his mailing in support of this scheme that constituted the essential element of the mail fraud. [26] It was, therefore, entirely unnecessary for the government also to prove that the account statement itself was false, and it has long been held that it is no constructive amendment "to drop from an indictment those allegations that are unnecessary to an offense that is clearly contained within it...." *Miller,* 471 U.S. at 144, 105 S.Ct. 1811; *see also* *United States v. Rosenthal,* 9 F.3d 1016, 1023 (2d Cir.1993) ("While it is the Government's burden to prove the essential elements of a charged crime, allegations in an indictment that go beyond the essential elements which are required for conviction do not increase the Government's burden.").

Accordingly, we do not understand the jury instructions as "support [ing] a theory ... that was distinctly different from the one charged," nor do we think that Vilar would have been surprised by the introduction "of different and unrelated proof adduced at trial." *D'Amelio,* 683 F.3d at 421. Indeed, the mailing specified in the indictment was the very mailing for which Vilar was convicted. In other words, the indictment informed the defendant as to the specific time and place of the criminal conduct for which he could be held liable, such that the "core of criminality" was clear. *See, e.g., United States v. Danielson,* 199 F.3d 666, 670 (2d Cir.1999); *United States v. Knuckles,* 581 F.2d 305, 312 (2d Cir.1978). For these reasons, the indictment "fairly inform[ed the] defendant of the charge against which he [had to] defend," and was not constructively amended. *United States v. Resendiz–Ponce,* 549 U.S. 102, 108, 127 S.Ct. 782, 166 L.Ed.2d 591 (2007).

V. Sufficiency of the Evidence

The defendants advance a legion of challenges to the sufficiency of the evidence marshaled against them at trial. Although we review sufficiency challenges *de novo*, *United States v. Desposito,* 704 F.3d 221, 226 (2d Cir.2013), we "must view the evidence in the light most favorable to the government, crediting every inference that could have been drawn in the government's favor, and deferring to the jury's assessment of witness credibility, and its assessment of the weight of the evidence," *United States v. Chavez,* 549 F.3d 119, 124 (2d Cir.2008) (internal citations, alterations and quotation marks omitted). "[A] defendant challenging the sufficiency of the evidence that led to his conviction at trial bears a heavy burden," *Coplan,* 703 F.3d at 62 (internal quotation marks omitted), because we must uphold the judgment of conviction if "*any* rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt," *Jackson v. Virginia,* 443 U.S. 307, 319, 99 S.Ct. 2781, 61 L.Ed.2d 560 (1979). We consider in turn the claims of insufficiency as to each count of conviction.

A. Conspiracy (Count One)

Count One charged the defendants with conspiring to (1) carry out the GFRDA ***92** scheme, and (2) cover up the collapse of the GFRDAs by paying off GFRDA investors with money taken from Lily Cates through the SBIC scheme. Vilar and Tanaka contend that the evidence introduced at trial was insufficient to support a finding of a single conspiracy. Instead, according to Vilar and Tanaka, the evidence at most proved the existence of two smaller conspiracies to defraud—one to sell the GFRDAs and a *separate* conspiracy to conceal the earlier fraud.

Vilar and Tanaka's argument was not persuasive for "duplicity" purposes, *see* Part II, *ante,* and it is not persuasive from a sufficiency-of-the-evidence standpoint either. In short, sufficient evidence supports the jury's finding that a single conspiracy existed here. *See United States v. Eppolito,* 543 F.3d 25, 48 (2d Cir.2008) ("[A] single conspiracy is not transformed into multiple conspiracies merely by virtue of the fact that it may involve two or more phases or spheres of operation, so long as there is sufficient proof of mutual dependence and assistance."). Most notably, the evidence demonstrates that Cates's money was transferred at the same time that Vilar and Tanaka settled debts arising from the GFRDA scheme. *See* Trial Tr. 4129–35; Gov't Supp. App'x 742–52, 883. Based on the evidence put forth at trial, a rational juror could have found that Vilar and Tanaka entered into a conspiracy in 1986 with the objective of defrauding customers by causing them to believe that GFRDAs were safe and liquid investments. The specific methods they used may have evolved, but the objective of the conspiracy remained the same.

B. Securities Fraud (Counts Two and Three)

As set out at length above, *see* Part IV.A, to convict a defendant of securities fraud under Section 10(b) and Rule 10b–5, the government must prove that in connection with a domestic purchase or sale of a security the defendant willfully made a material misrepresentation (or a material omission if the defendant had a duty to speak) or used a fraudulent device. *See* 15 U.S.C. §§ 78j (b), 78ff(a); 17 C.F.R. § 240.10b–5;[27] *see also O'Hagan,* 521 U.S. at 665–66, 117 S.Ct. 2199; *VanCook,* 653 F.3d at 138.[28] A misrepresentation or omission is material "when there is a substantial likelihood that a reasonable investor would find [the omission or misrepresentation] important in making an investment decision." *Contorinis,* 692 F.3d at 143.

1. The SBIC Fraud (Count Two)

Vilar alone[29] contends that the evidence is insufficient to support his conviction relating to the SBIC fraud because there is inadequate evidence (1) that he conveyed any misrepresentation to Lily Cates; (2) that he intended to steal from Lily Cates; and (3) that he used the mails or instrumentalities of interstate commerce in connection with Cates's SBIC purchase. We need not dwell long on these claims.

The record contains more than enough evidence for a reasonable juror to find, beyond a reasonable doubt, that Vilar lied to Cates about the nature of her SBIC investment, and in particular about the status of the SBIC license. Most notably, Cates testified to these exact facts. *See* Trial Tr. 2100–02. Although Vilar attempts ***93** to discredit her testimony as "unclear," Vilar Br. 76, and "disjointed," *id.* at 80, her testimony was clear enough to permit the jury to credit it and rely on her account of what happened.

[25] Vilar next declares that his conviction is invalid because the evidence does not demonstrate that he intended to "steal" from Cates. *Id.* at 83. This argument misses the mark because the government was under no obligation to prove that he wanted to steal Cates's money, only that he intended to defraud her in connection with his sale of the SBIC investment. *See United States v. Kelley,* 551 F.3d 171, 175–76 (2d Cir.2009); *cf. SEC v. Obus,* 693 F.3d 276, 286 (2d Cir.2012) (explaining that scienter under Section 10(b) is "defined as 'a mental state embracing intent to deceive, manipulate, or defraud' " (quoting *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 193 & n. 12, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976))). There is no doubt that there was sufficient evidence of this intent to support the jury's verdict. *See, e.g.,* Trial Tr. 2101 (testimony of Lily Cates indicated that Vilar told her that the SBIC license was "already done").

Finally, Vilar contends that the evidence of his use of the mails or an instrumentality of interstate commerce was insufficient to support his conviction. He claims that Cates's transfer of $5 million to purchase her SBIC investment "was made *not* by wire or mailing a check, but via a journal entry, a back-office accounting maneuver executed by the Bear Stearns' New York Office...." Vilar Br. 90–91. Even if Vilar were correct that Cates did not use the mails or an instrumentality of interstate commerce to transfer the money, that would have little bearing on the numerous other occasions that Vilar did use the mails and wire transfers to carry out his scheme. *See, e.g.,* Gov't Supp. App'x 615–17 (letter faxed to Lily Cates stating, *inter alia,* that Vilar was "very proud of securing" funds from the Small Business Administration and that "we can all go on to make a killing in the SBA Fund"). The jury's verdict as to Count Two was therefore fully supported by the evidence.

2. The GFRDA Fraud (Count Three)

Vilar and Tanaka argue that the government did not prove that the GFRDA victims invested based on the fraudulent terms contained in the offering memoranda and circulars because it failed to prove that those documents were in fact sent to GFRDA investors. [30] Vilar and Tanaka suggest that any misrepresentations contained in the offering memoranda and circulars could not, therefore, have been material, inasmuch as no investor could find information of which they were not aware to be important to their investment decision.

[26] This argument fails because it ignores all of the documents containing the same misrepresentations that clearly *were* received by the Mayers and Lecube–Chavez. Even if we assume that the government did not introduce evidence from which a reasonable juror could infer that the investors received the offering memoranda and circulars, the government introduced ***94** other documents that unmistakably conveyed to the investors specific, false representations concerning the investment mix backing the GFRDAs. *See, e.g.,* Gov't Supp. App'x 878 (1987 letter to Mayer family setting out GFRDA investment ratios). Vilar and Tanaka's argument also ignores the direct testimony of Lisa Mayer and Graciela Lecube–Chavez. As described at length above, *see* Part I.B.2, the government offered sufficient evidence for a rational juror to find beyond a reasonable doubt that the defendants made material misrepresentations in connection with the sale of the GFRDAs.

C. Investment Adviser Fraud (Count Four)

The defendants challenge the sufficiency of the government's evidence on the investment adviser fraud [31] count on two grounds: first, that Amerindo was not an investment adviser within the meaning of the statute because it did not charge fees for its services; and second, that there was insufficient proof of a mailing or use of an instrumentality of interstate commerce. These claims are wholly without merit. First, a letter from Vilar to Cates's attorney in 2004 discussed fees that would be due to Amerindo. *See* Gov't Supp. App'x 708–09. Although the letter did not specify that the fees were for Amerindo's investment advisory services, the jury could reasonably have inferred that fact. [32] Second, it is clear from the record that numerous communications with Cates, including the solicitation of her investment into the fraudulent SBIC account, were conducted using the mails and telephones. *See, e.g., id.* at 755–57. The evidence therefore was sufficient to support the jury's verdict as to the investment adviser fraud count.

D. Wire Fraud (Counts Six and Seven)

In order to prove wire fraud, "the government must establish the existence of a scheme to defraud, that money or property were the object of the scheme, and that ***95** defendant used interstate wires in furtherance of that scheme." *United States v. Guadagna,* 183 F.3d 122, 129 (2d Cir.1999). Vilar challenges his wire fraud convictions on the basis that the wire transfers at issue, by which Cates's money was transferred from Amerindo's account to Vilar's account, occurred after Cates had transferred her $5 million to the SBIC fund. Vilar argues that these wire transfers cannot satisfy the "in furtherance" requirement because the scheme was complete once Amerindo obtained the funds.

[27] **[28]** The fact that the wire transactions at issue occurred after Cates had transferred the funds to the SBIC account is irrelevant. As we have explained, "[a] scheme to defraud is not complete until the proceeds have been received and use of the mail or wires to obtain the proceeds satisfies the jurisdictional element," which is to say that the jurisdictional element is fulfilled when the defendant uses the mail or wires to convert the money to his own use. *Sindona,* 636 F.2d at 802 (relying on *Pereira v. United States,* 347 U.S. 1, 7–9, 74 S.Ct. 358, 98 L.Ed. 435 (1954)). Inasmuch as Vilar used the wire transfers to send the money to his own account, the wire transfers were undoubtedly in furtherance of the scheme to defraud.

E. Money Laundering (Counts Eight, Nine, Ten, and Eleven)

[29] In order to prove that a defendant has committed the crime of money laundering under 18 U.S.C. § 1957(a), [33] the government must "present evidence that the defendant knowingly engaged or attempted to engage in a monetary transaction in unlawful funds." *United States v. Ness,* 565 F.3d 73, 78 (2d Cir.2009). Vilar argues that the government has proved neither that he knowingly initiated or agreed to the transfers of Cates's money from Amerindo's account to his own account, nor that he knew that the funds were unlawful.

Both of these claims are belied by the sequence of events in this case. As we have already confirmed, the evidence at trial demonstrated that Vilar knowingly and willfully defrauded Cates of millions of dollars by lying to her about the nature of the SBIC investment opportunity. Based on these misrepresentations, Cates transferred her money to an Amerindo account that was previously empty. Immediately thereafter, hundreds of thousands of these dollars were transferred to Vilar's own account. Based on the evidence of these transfers and their timing, a rational juror could conclude that Vilar knew of the criminal scheme and of the origin of the funds. Accordingly, Vilar's insufficiency claims as to money laundering are meritless.

VI. Sentencing

[30] Vilar and Tanaka argue that their sentences must be vacated due to errors in the calculation of (1) loss caused by the offense, (2) restitution, and (3) forfeiture. As with any sentencing claim, when considering a challenge to the calculation of loss amount, "[w]e review legal conclusions, such as interpretations of the Guidelines, de novo and findings of fact for clear error." *United States v. Lacey,* 699 F.3d 710, 717 (2d Cir.2012). Accordingly, we are "obliged to determine whether the trial court's method of calculating the amount of loss was legally acceptable," but we will not disturb a district court's "reasonable estimate of the loss, given the available ***96** information." *United States v. Turk,* 626 F.3d 743, 748 (2d Cir.2010) (internal quotation marks and ellipsis omitted). The same standard applies to review of forfeiture determinations. *See United States v. Gaskin,* 364 F.3d 438, 461–62 (2d Cir.2004). Restitution orders under the Mandatory Victim Restitution Act ("MVRA"), 18 U.S.C. §§ 3663A–3664, are reviewed for "abuse of discretion," which occurs when the decision rests on an error of law, clearly erroneous finding of fact, or otherwise cannot be located within the range of permissible decisions. *See United States v. Zangari,* 677 F.3d 86, 91 (2d Cir.2012); *see also In re Sims,* 534 F.3d at 132. For the following reasons, we agree with Vilar and Tanaka that the cause must be remanded for resentencing.

First, the calculation of the applicable sentencing guidelines must derive from the losses resulting from or intended to result from the criminal "offense." United States Sentencing Guidelines Manual ("U.S.S.G.") § 2B1.1 cmt. n.3(A). The District Court calculated the loss caused by Vilar and Tanaka's scheme to be between $20 million and $50 million, resulting in a twenty-two-level sentencing enhancement. [34] Tanaka App'x 805–06. This finding was based on the losses suffered by Lily Cates, the Mayer family, and Lecube–Chavez, as well as other victims who may have purchased GFRDAs abroad. *See id.*

As we explained in Part I, *ante,* conduct in connection with extraterritorial transactions in securities does not constitute an offense under Section 10(b) or Rule 10b–5. However, the parties have not briefed, and the District Court has not had an opportunity to consider, the question of whether losses suffered by victims who purchased GFRDAs abroad may constitute "relevant conduct" under U.S.S.G. §§ 1B1.3(a)(1), 2B1.1(b). Accordingly, we leave it to the District Court to consider this question in the first instance on remand.

Second, the District Court must recalculate restitution. The MVRA requires district courts to order defendants to make restitutions to their victims. 18 U.S.C. § 3663A(a)(1). [35] A "victim" refers to a "person directly and proximately harmed as a result of the commission of an offense for which restitution may be ordered including, in the case of an offense that involves as an element a scheme, conspiracy, or pattern of criminal activity, any person directly harmed by the defendant's ***97** criminal conduct in the course of the scheme, conspiracy, or pattern." *Id.* § 3663A(a)(2).

[31] The MVRA's definition of "victim" reflects an important limiting principle for restitution awards—namely, that Congress has "authorize[d] an award of restitution only for the loss caused by the specific conduct that is the basis of the offense of conviction." *Hughey v. United States,* 495 U.S. 411, 413, 110 S.Ct. 1979, 109 L.Ed.2d 408 (1990). [36] As we have previously explained, restitution is not permitted for loss caused by "relevant conduct," even though such conduct may be "properly included in offense level calculation" under the Sentencing Guidelines. *United States v. Lussier,* 104 F.3d 32, 33 (2d Cir.1997). It follows, therefore, that the District Court cannot order restitution for investors who purchased GFRDAs abroad, since those investors are not victims of the offense. [37] Accordingly, the District Court must vacate the restitution award and proceed to recalculate restitution with respect to victims who have been "directly harmed by the defendant's criminal conduct." [38] 18 U.S.C. § 3663A(a)(2).

Third, we must remand with instructions to vacate the forfeiture order because, as the government concedes and the District Court itself has confessed, due to arithmetical mistakes, the calculation of the final forfeiture amount was clearly erroneous. [39]

In sum, we remand the cause to the District Court with directions to vacate the sentences of Vilar and Tanaka, and to proceed to resentence the defendants in terms consistent with this opinion.

VII. Ineffective Assistance of Counsel

Finally, Vilar contends that his trial counsel was constitutionally ineffective, laying an extensive list of missteps and failures at the feet of his former attorney. Among other things, Vilar charges his trial counsel with (1) inadequate review of discovery; (2) inadequate development of defenses; (3) failure to cross-examine witnesses; (4) failure to advocate for his client in his summation; and (5) failure to challenge the forfeiture order.

***98** **[32]** We have three options for dealing with a claim for ineffective assistance of counsel raised on direct appeal: We may "(1) decline to hear the claim, permitting the appellant to raise the issue as part of a subsequent petition for writ of habeas corpus pursuant to 28 U.S.C. § 2255; (2) remand the claim to the district court for necessary factfinding; or (3) decide the claim on the record before us." *United States v. Ramos,* 677 F.3d 124, 129 (2d Cir.2012) (internal quotation marks omitted). The Supreme Court has indicated that "in most cases a motion brought under § 2255 is preferable to direct appeal for deciding claims of ineffective assistance," *Massaro v. United States,* 538 U.S. 500, 504, 123 S.Ct. 1690, 155 L.Ed.2d 714 (2003), and we have expressed our own "baseline aversion to resolving ineffectiveness claims on direct review," *Ramos,* 677 F.3d at 130 (internal quotation marks omitted). Particularly in view of the complexity of this case and the absence of any comment from Vilar's attorney, *see Sparman v. Edwards,* 154 F.3d 51, 52 (2d Cir.1998), we think it unwise to consider an ineffective assistance claim on direct review. Vilar may pursue this claim, if he chooses, in a subsequent § 2255 petition.

CONCLUSION

To summarize, we hold that:

(1) Section 10(b) and Rule 10b–5 do not apply to extraterritorial conduct, regardless of whether liability is sought criminally or civilly. Accordingly, a defendant may be convicted of securities fraud under Section 10(b) and Rule 10b–5 only if he has engaged in fraud in connection with (1) a security listed on an American exchange, or (2) a security purchased or sold in the United States.

(2) Although the District Court erred by failing to require proof of domestic securities transactions, that error was not "plain," because the evidence in the record demonstrated that Vilar and Tanaka engaged in fraud in connection with a *domestic* purchase or sale of securities, and therefore, the error did not affect the outcome of the proceedings or affect Vilar and Tanaka's substantial rights.

(3) The indictment was sufficient. In particular, Count One of the indictment was not "duplicitous" because it charged a single scheme to defraud, and Count Four of the indictment was sufficiently pleaded, insofar as it

informed Vilar and Tanaka of the charges to be met and enabled them to plead double jeopardy in the future.

(4) The District Court properly admitted evidence obtained during the U.S. and U.K. searches. First, the District Court correctly concluded that documents obtained from defendants' office in the United States were admissible pursuant to the "inevitable discovery" doctrine. Second, the U.K. search was reasonable, and therefore, the evidence obtained was properly admitted because evidence obtained in a search by the U.S. government in another country is admissible so long as the search was "reasonable" under the Fourth Amendment.

(5) In a prosecution brought by the government for securities fraud under Section 10(b) or Rule 10b–5, the government does not need to prove that the victims of a scheme to defraud actually relied on the material misrepresentation or omission. Accordingly, the District Court did not err by not instructing the jury on reliance.

***99** (6) Although the mail fraud charge in the indictment specified that the mailing itself was false or fraudulent, the District Court's instruction permitting the jury to convict based on a mailing that contained no false or fraudulent statement did not "constructively amend" the indictment.

(7) Under the Mandatory Victim Restitution Act, restitution is not permitted for investors who purchased securities abroad, inasmuch as those investors are not victims of an offense under Section 10(b) or 10b–5.

(8) The District Court must, on remand, determine what acts constitute offense conduct for the purposes of calculating loss amount at sentencing, as well as the amount subject to forfeiture.

(9) With the exception of Vilar's ineffective assistance of counsel claim, which we do not reach, Vilar and Tanaka's remaining claims are without merit.

The February 8, 2010, and February 10, 2010 judgments of conviction of the District Court are **AFFIRMED** in all respects, except for the sentences; and the cause is **REMANDED** to the District Court with instructions to vacate both sentences and proceed to a *de novo* resentencing consistent with this opinion. [40]

Parallel Citations

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Footnotes

1 The text of Section 10(b), 15 U.S.C. § 78j(b), and of Rule 10b–5, 17 C.F.R. § 240.10b–5, may be found at Note 6, *post.*

2 Because Vilar and Tanaka appeal from judgments of conviction entered after a jury trial, we draw the facts from the evidence presented at trial, viewed in the light most favorable to the government. *See, e.g., Parker v. Matthews,* ––– U.S. ––––, 132 S.Ct. 2148, 2152, 183 L.Ed.2d 32 (2012); *United States v. Rosen,* 716 F.3d 691, 694 (2d Cir.2013).

3 Throughout this opinion we refer generically to Vilar and Tanaka's various joint ventures as "Amerindo."

4 The SEC also proceeded against Vilar and Tanaka in a separate civil action. *See SEC v. Amerindo Inv. Advisors, Inc.,* No. 05 Civ. 5231(RJS) (S.D.N.Y. filed June 1, 2005).

5 We note, as we have many times before, that, prior to the Supreme Court's decision in *Johnson,* we employed a "modified" plain error analysis when addressing a claimed error that resulted from a supervening legal decision. In those cases, we placed the burden on the government to demonstrate that the error did not affect the defendant's substantial rights, rather than requiring the defendant to show that it did. *See United States v. Needham,* 604 F.3d 673, 678 (2d Cir.2010). We have also observed that "it is unclear whether this standard remains in force following the Supreme Court's decision in *Johnson,*" *id.,* but on at least twenty-two occasions in published decisions, which we refrain from citing on grounds of tedium, we have declined to resolve this question because its answer has never affected the result in any case, *see, e.g., United States v. Botti,* 711 F.3d 299, 308–10 (2d Cir.2013). Not surprisingly, we have no reason to address the parties' arguments on this issue in this case, as it would have no effect on our decision. Indeed, we cannot help but be skeptical that the allocation of the burden of demonstrating harm will ever be dispositive in this context. We simply add our voice to the chorus of those who warn of this snare in our jurisprudence.

6 Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange.... [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap

agreement[,] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b). Rule 10b–5, which was promulgated pursuant to Section 10(b), provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b–5.

7 Specifically, Section 32 provides that "[a]ny person who willfully violates any provision of this chapter ..., or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter" may, upon conviction, be subject to a fine and sentence of imprisonment. 15 U.S.C. § 78ff(a). However, "no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation." *Id.*

8 Although the government does observe that "[t]he GFRDA purported to invest in and, in fact, did invest in numerous securities traded in the U.S. markets," Gov't Br. 101–02, it provides no legal argument whatsoever for why this fact would render the GFRDA a domestic security within the meaning of *Morrison.* Accordingly, we deem this claim waived. *See, e.g., Viacom Int'l, Inc. v. YouTube, Inc.,* 676 F.3d 19, 40 n. 14 (2d Cir.2012) (holding that a "one-sentence argument is insufficient to raise [an] issue for review before this Court" because " '[i]ssues not sufficiently argued in the briefs are considered waived and normally will not be addressed on appeal' ") (quoting *Norton v. Sam's Club,* 145 F.3d 114, 117 (2d Cir.1998)).

9 Although we presume that Congress did not intend to apply Section 10(b) to extraterritorial conduct, we also presume that Congress did intend to apply Section 10(b) to security transactions occurring in Puerto Rico, since, as the First Circuit has explained, "the default rule presumes the applicability of federal laws to Puerto Rico." *United States v. Acosta–Martinez,* 252 F.3d 13, 20 (1st Cir.2001). By statute, the First Circuit reviewed decisions of the Supreme Court of Puerto Rico from 1915 until 1961 and was, absent appeal to the Supreme Court, the final arbiter of the law of Puerto Rico for fifty-six years. *See* Act of Jan. 28, 1915, Pub.L. No. 63–241, 38 Stat. 803, 803–04 (1915) (providing for appellate jurisdiction in the First Circuit to review final judgments of the Supreme Court of Puerto Rico); Act of Aug. 30, 1961, Pub.L. No. 87–189, 75 Stat. 417, 417 (1961) (withdrawing the same jurisdiction). In light of this historical relationship, the law of the First Circuit has an especially compelling persuasiveness when it comes to the interplay between federal law and the law of Puerto Rico. *See United States v. Laboy–Torres,* 553 F.3d 715, 719 n. 3 (3d Cir.2009) (according the First Circuit's decisions "great weight" due to its "expertise with Puerto Rican law").

10 The government also contends that the relevant securities transaction were domestic because (1) "the GFRDA was marketed and sold to customers based in the United States," and (2) "[i]nvestors were directed to wire funds to a New York bank, and the custodian of the fund was a New York securities firm." Gov't Br. 101. However, we have already held that, assuming such facts to be true, they are insufficient to demonstrate a purchase or sale of a security in the United States for the purposes of Section 10(b). *See Absolute Activist,* 677 F.3d at 70.

11 We are aware that in his recent Memorandum and Order granting summary judgment in part to the SEC in the parallel civil action against Vilar and Tanaka, Judge Sullivan declined to grant summary judgment to the SEC on its claim for securities fraud upon the Mayers. Judge Sullivan held that there was a genuine issue of material fact as to whether the Mayers became irrevocably bound in the United States because Vilar may have sent an offer letter from abroad and, arguably, under Puerto Rico law, a contract agreed to by mail " 'is presumed as executed at the place where the offer was made.' " *SEC v. Amerindo Inv. Advisors, Inc.,* No. 05 Civ. 5231(RJS), 2013 WL 1385013, at *7 (S.D.N.Y. Mar. 11, 2013) (quoting 31 L.P.R.A. § 3401). We are not persuaded by Judge Sullivan's reasoning in the parallel civil action because we do not see how the law of a state or territory governing the place of contract bears on the question, under federal law, of whether "a manipulative or deceptive device or contrivance" was employed "in connection with ... the purchase or sale of any ... security in the United States." *Morrison,* 130 S.Ct. at 2888. That question is answered by determining whether "the purchaser incurred irrevocable liability within the United States to take and pay for a security, or ... the seller incurred irrevocable liability within the United States to deliver a security." *Absolute Activist,* 677 F.3d at 68. In other words, territoriality under *Morrison* concerns where, physically, the purchaser or seller committed him or herself, not where, as a matter of law, a contract is said to have been executed. *See Morrison,* 130 S.Ct. at 2885 (noting that "it is the foreign location of the *transaction* that establishes (or reflects the presumption of) the Act's inapplicability" (emphasis in original)).

We also observe, in passing, that Judge Sullivan did grant summary judgment to the SEC as to the security fraud claims relating to Lecube–Chavez and several other investors in the GFRDA program, as well as Lily Cates, holding that the undisputed facts demonstrated that those investors incurred irrevocable liability in the United States. *See Amerindo Inv. Advisors,* 2013 WL 1385013, at *6–8.

12 Vilar and Tanaka argue that, even if some victims purchased securities within the United States, "evidence showed that purchases and sales of GFRDA were deliberately and carefully structured to occur outside the United States." Vilar Reply 6. In other words, Vilar and Tanaka argue that their very intention to evade U.S. law is evidence of their innocence. We see no reason to rescue fraudsters when they complain that their perfect scheme to avoid getting caught has failed. *Morrison* is straightforward: When a securities transaction takes place in the United States, it is subject to regulation under Section 10(b), and when a securities transaction takes place abroad, it is not. The parties' intention to engage in foreign transactions is entirely irrelevant.

13 Federal Rule of Criminal Procedure 8(a) provides:

> **Joinder of Offenses.** The indictment or information may charge a defendant in separate counts with 2 or more offenses if the offenses charged—whether felonies or misdemeanors or both—are of the same or similar character, or are based on the same act or transaction, or are connected with or constitute parts of a common scheme or plan.

14 In a related vein, there was no error in the District Court's decision not to use a multiple conspiracy jury instruction. It is true that "[i]f the evidence at trial supports an inference that there was more than one conspiracy, then, whether multiple conspiracies existed is a question of fact for the jury." *United States v. Vazquez,* 113 F.3d 383, 386 (2d Cir.1997). However, "[i]n order to secure a reversal on the ground that the court failed to give a multiple conspiracy charge, a defendant must prove there were two or more groups operating separately from one another, although membership in the groups might overlap, and that failure to give the requested charge prejudiced defendant." *Id.* (internal citation omitted). Vilar and Tanaka have shown neither that there were two or more groups operating separately from one another, nor that they were prejudiced by the lack of a multiple conspiracy instruction, since "there was ample proof before the jury for it to find beyond a reasonable doubt that defendant was a member of the conspiracy charged in the indictment." *Id.*

15 We note that Vilar and Tanaka did not challenge the sufficiency of the Indictment with regard to Count Four until trial had begun. Where the sufficiency of the indictment is not challenged until trial, "the sufficiency of an indictment should be interpreted liberally in favor of sufficiency." *United States v. Sabbeth,* 262 F.3d 207, 218 (2d Cir.2001).

16 In full, Rule 7(c)(1) provides:

> **In General.** The indictment or information must be a plain, concise, and definite written statement of the essential facts constituting the offense charged and must be signed by an attorney for the government. It need not contain a formal introduction or conclusion. A count may incorporate by reference an allegation made in another count. A count may allege that the means by which the defendant committed the offense are unknown or that the defendant committed it by one or more specified means. For each count, the indictment or information must give the official or customary citation of the statute, rule, regulation, or other provision of law that the defendant is alleged to have violated. For purposes of an indictment referred to in section 3282 of title 18, United States Code, for which the identity of the defendant is unknown, it shall be sufficient for the indictment to describe the defendant as an individual whose name is unknown, but who has a particular DNA profile, as that term is defined in that section 3282.

17 Pursuant to the "good faith" exception to the exclusionary rule, "[w]hen police act under a warrant that is invalid for lack of probable cause, the exclusionary rule does not apply if the police acted 'in objectively reasonable reliance' on the subsequently invalidated search warrant." *Herring v. United States,* 555 U.S. 135, 142, 129 S.Ct. 695, 172 L.Ed.2d 496 (2009) (quoting *United States v. Leon,* 468 U.S. 897, 922, 104 S.Ct. 3405, 82 L.Ed.2d 677 (1984)).

18 The "inevitable discovery" rule permits unlawfully obtained evidence to be admitted at trial if the government can "establish by a preponderance of the evidence that the information ultimately or inevitably would have been discovered by lawful means." *Nix v. Williams,* 467 U.S. 431, 444, 104 S.Ct. 2501, 81 L.Ed.2d 377 (1984).

19 The "independent source" rule permits the admission of evidence seized pursuant to an unlawful search if that evidence would have been obtained through separate, lawful means. *See Murray v. United States,* 487 U.S. 533, 537, 108 S.Ct. 2529, 101 L.Ed.2d 472 (1988).

20 The Mutual Legal Assistance Treaty Between the United States of America and the United Kingdom of Great Britain and Northern Ireland was signed on January 6, 1994. S. Treaty Doc. No. 104–2, 1994 WL 855115. The Treaty provides that the U.S. and U.K. will assist each other in the investigation and prosecution of criminal offenses, including by "executing requests for search and seizures." *Id.* at *7.

21 We note that the government does not contest that the search of the Cadogan Tate warehouse constituted a search by American authorities. If the search was not conducted by the U.S., evidence found would not need to be excluded even if the search was not reasonable because it is "well-established that the Fourth Amendment's exclusionary rule ... generally does not apply to evidence obtained by searches abroad conducted by foreign officials." *United States v. Lee,* 723 F.3d 134, 139 (2d Cir.2013).

22 Vilar and Tanaka identify three additional supposed errors in the jury instructions: (1) the failure to issue a multiple conspiracies instruction; (2) the failure to require a finding that the events giving rise to the convictions for securities fraud transpired within the statute of limitations; and (3) the failure to require a unanimous finding as to the use of the mails or instrumentality of interstate commerce in furtherance of the securities fraud (Counts Two and Three) and Investment Adviser Fraud (Count Four). We may dispatch these claims in short order.

First, we have already explained that Vilar and Tanaka have failed to establish that they were entitled to a multiple conspiracies instruction or that the omission of one prejudiced them. *See* note 14, *ante.* Second, Vilar and Tanaka did not assert their statute-of-limitations claim before the District Court, and we therefore review it for "plain error." *See United States v. Nouri,* 711 F.3d 129, 138 (2d Cir.2013). Even if the omissions described by Vilar and Tanaka were in error—a conclusion we do not reach—they were certainly not plain errors, nor did they affect a substantial right. *See Marcus,* 130 S.Ct. at 2164. The record contains ample evidence that both the Mayers, *see, e.g.,* Gov't Supp. App'x 791–92, and Lecube–Chavez, *see, e.g., id.* at 767–68, invested money in GFRDAs, and that Vilar and Tanaka continued to engage in conduct aimed to reassure investors and prevent them from redeeming their investments within the five-year limitations period, *cf. United States v. Scop,* 846 F.2d 135, 139 (2d Cir.1988) (holding that "evidence of continued stock purchases and sales at prices affected (or so the jury might find) by the earlier artificial trades, of the mailings of stock certificates, and of the reassurances to customers ... was sufficient to permit a rational jury to conclude that the conspiracy and substantive scheme to defraud continued" into the limitations period). Third, Vilar and Tanaka not only failed to raise an objection to the failure explicitly to require a unanimous finding as to the use of the mails or instrumentality of interstate commerce, but they invited such an error (if it was indeed, an error) by proposing jury instructions that required unanimity on certain elements but not on the mail or instrumentality of interstate commerce element. *See* Gov't Supp. App'x 49–63 (defendants' proposed jury instructions). Accordingly, we reject this claim on appeal. *See United States v. Cherif,* 943 F.2d 692, 701 (7th Cir.1991). The same conclusion applies to Tanaka's contention that the government somehow failed, through the jury instructions as to Count Four, to "mitigate a grave risk" that the jury could have convicted Tanaka for investment adviser fraud for his role in the GFRDA scheme, which was not the conduct underlying that count. Tanaka Br. 57; *see also* Part II, *ante.*

23 *See, e.g., SEC v. Goble,* 682 F.3d 934, 942 (11th Cir.2012); *McCann v. Hy–Vee, Inc.,* 663 F.3d 926, 931–32 (7th Cir.2011); *United States v. Jenkins,* 633 F.3d 788, 802 (9th Cir.2011); *SEC v. Tambone,* 597 F.3d 436, 447 n. 9 (1st Cir.2010); *SEC v. Pirate Investor LLC,* 580 F.3d 233, 239 n. 10 (4th Cir.2009); *SEC v. Wolfson,* 539 F.3d 1249, 1256 (10th Cir.2008); *United States v. Haddy,* 134 F.3d 542, 544, 549–51 (3d Cir.1998); *SEC v. Blavin,* 760 F.2d 706, 711 (6th Cir.1985).

24 Tanaka was not convicted of mail fraud.

25 Whether an unpreserved claim of constructive amendment is amenable to plain error review is subject to some debate. *See D'Amelio,* 683 F.3d at 417 n. 2 (declining to decide whether a constructive amendment determination is subject to plain error review); *see also United States v. Vebeliunas,* 76 F.3d 1283, 1291 (2d Cir.1996) (applying plain error review to a constructive amendment claim after the defendant conceded that such standard applied). We need not resolve that issue here, however, inasmuch as we conclude that the mail fraud count was not constructively amended by the District Court's jury instructions.

26 The essential elements of a mail fraud charge are "(1) a scheme to defraud, (2) money or property as the object of the scheme, and (3) use of the mails to further the scheme." *United States v. Litwok,* 678 F.3d 208, 213 (2d Cir.2012) (internal quotation marks and ellipsis omitted).

27 For the text of these provisions, see notes 6 and 7, *ante.*

28 For additional background on the meaning of "willfully" in Section 32, see *United States v. Kaiser,* 609 F.3d 556, 568–69 (2d Cir.2010); *United States v. Dixon,* 536 F.2d 1388, 1396–97 (2d Cir.1976).

29 Tanaka was not convicted on Count Two.

30 Vilar and Tanaka also contend that the evidence was insufficient to demonstrate that the GFRDA funds were actually invested in risky technology stocks, and Tanaka argues that the evidence was insufficient to prove his intent to defraud. To the contrary, both of these facts were amply supported by direct testimony or documentary evidence. *See, e.g.,* Gov't Supp. App'x 538–40 (testimony of Amerindo employee who booked trades indicating that Tanaka chose which trades to execute and that Amerindo only traded in stocks); *id.* at 786–87 (GFRDA subscription agreement, signed by Tanaka, specifying that 50–75% of funds would be invested in non-stock, high-quality, short-term investments).

31 Title 15 U.S.C. § 80b–6 provides:

> It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—
>
> **(1)** to employ any device, scheme, or artifice to defraud any client or prospective client;
>
> **(2)** to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

> **(3)** acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction; or
> **(4)** to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

An "investment adviser" is defined as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities." *Id.* § 80b–2(a)(11).

32 Indeed, the letter specifically refers to "The Investment Management Agreement." Gov't Supp. App'x 708.

33 In relevant part, 18 U.S.C. § 1957(a) provides: "Whoever ... knowingly engages or attempts to engage in a monetary transaction in criminally derived property of a value greater than $10,000 and is derived from specified unlawful activity, shall be punished as provided in subsection (b)."

34 Vilar and Tanaka argue that the amount of actual loss should be zero, because (1) the victims received profits from Amerindo during the course of the scheme, and therefore did not actually lose money; and (2) there is enough money in frozen Amerindo accounts to repay each victim. We disagree because defendants should not benefit from attempting to ensure the continuation of their scheme, *see United States v. Carrozzella,* 105 F.3d 796, 805 (2d Cir.1997), or from inducing investors to reinvest certain interest payments received, *see United States v. Hsu,* 669 F.3d 112, 122 (2d Cir.2012).

Nor should defendants' liability be reduced by the amount of money available in Amerindo's bank accounts, because the relevant sentencing guideline permits a sentencing court to credit a defendant with available funds only when those funds are designated as collateral for the debt owed the victim. *See* U.S.S.G. § 2B1.1, cmt. n.3(E)(ii) ("In a case involving collateral pledged or otherwise provided by the defendant," the loss shall be reduced by "the fair market value of the collateral....").

35 In relevant part, the MVRA provides:

> **(a)(1)** Notwithstanding any other provision of law, when sentencing a defendant convicted of an offense described in subsection (c), the court shall order, in addition to, or in the case of a misdemeanor, in addition to or in lieu of, any other penalty authorized by law, that the defendant make restitution to the victim of the offense or, if the victim is deceased, to the victim's estate.

18 U.S.C. § 3663A(a)(1).

36 Although *Hughey* interpreted the provisions of the earlier Victim Witness Protection Act ("VWPA"), the relevant language in the VWPA is nearly identical to the MVRA's provisions, and we have therefore applied *Hughey* in cases addressing restitution under the MVRA. *See Marino,* 654 F.3d at 319 n. 7.

37 Our decision in *Marino* is not to the contrary. In that case, we held that a defrauded investor may be a "victim" for restitution purposes, even if he would not have a private right of action to seek damages in a civil suit. 654 F.3d at 321. The question in this case, however, is whether the investors that purchased GFRDAs abroad were victims of Vilar and Tanaka's *criminal* conduct, which, for the reasons spelled out above, they surely were not. *See* Part I, *ante.*

38 We expect that on remand Vilar and Tanaka will renew, and the District Court will consider, their arguments concerning the propriety of calculating restitution awards to include a compounding 9% rate of prejudgment interest. Vilar and Tanaka contend, persuasively, that this rate, which is based on New York State's statutory rate, *see* N.Y. C.P.L.R. § 5004, will have the effect of benefitting victims of the GFRDA scheme at the expense of innocent investors in non-fraudulent securities. In fact, there is some doubt as to whether it is ever appropriate to award interest at the state rate on federal claims. *Cf. Thomas v. iStar Fin., Inc.,* 629 F.3d 276, 280 (2d Cir.2010) (holding that "judgments that are based on both state and federal law with respect to which no distinction is drawn shall have applicable interest calculated at the federal interest rate").

39 We also leave it for the District Court to consider on remand whether the forfeiture amount is affected by the extraterritorial limitations imposed on Section 10(b) by *Morrison. See* Part I, *ante.*

40 We leave it to the District Court to consider in the first instance the question of whether bail should be granted pending any petition for certiorari. In the interest of judicial economy, jurisdiction may be restored to this Court for an appeal of the District Court's bail decision, or of the sentences imposed on remand, by letter to the Clerk of this Court. Any such proceedings will be assigned to this panel.

End of Document

15 U.S.C.A. § 78u-6

§ 78u-6. Securities whistleblower incentives and protection

Effective: July 22, 2010
Currentness

(a) Definitions

In this section the following definitions shall apply:

(1) Covered judicial or administrative action

The term "covered judicial or administrative action" means any judicial or administrative action brought by the Commission under the securities laws that results in monetary sanctions exceeding $1,000,000.

(2) Fund

The term "Fund" means the Securities and Exchange Commission Investor Protection Fund.

(3) Original information

The term "original information" means information that--

(A) is derived from the independent knowledge or analysis of a whistleblower;

(B) is not known to the Commission from any other source, unless the whistleblower is the original source of the information; and

(C) is not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless the whistleblower is a source of the information.

(4) Monetary sanctions

The term "monetary sanctions", when used with respect to any judicial or administrative action, means--

(A) any monies, including penalties, disgorgement, and interest, ordered to be paid; and

(B) any monies deposited into a disgorgement fund or other fund pursuant to section 308(b) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246(b)), as a result of such action or any settlement of such action.

(5) Related action

The term "related action", when used with respect to any judicial or administrative action brought by the Commission under the securities laws, means any judicial or administrative action brought by an entity described in subclauses (I) through (IV) of subsection (h)(2)(D)(i) that is based upon the original information provided by a whistleblower pursuant to subsection (a) that led to the successful enforcement of the Commission action.

(6) Whistleblower

The term "whistleblower" means any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission.

(b) Awards

(1) In general

In any covered judicial or administrative action, or related action, the Commission, under regulations prescribed by the Commission and subject to subsection (c), shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information to the Commission that led to the successful enforcement of the covered judicial or administrative action, or related action, in an aggregate amount equal to--

(A) not less than 10 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions; and

(B) not more than 30 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions.

(2) Payment of awards

Any amount paid under paragraph (1) shall be paid from the Fund.

(c) Determination of amount of award; denial of award

(1) Determination of amount of award

(A) Discretion

The determination of the amount of an award made under subsection (b) shall be in the discretion of the Commission.

(B) Criteria

In determining the amount of an award made under subsection (b), the Commission--

(i) shall take into consideration--

(I) the significance of the information provided by the whistleblower to the success of the covered judicial or administrative action;

(II) the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in a covered judicial or administrative action;

(III) the programmatic interest of the Commission in deterring violations of the securities laws by making awards to whistleblowers who provide information that lead to the successful enforcement of such laws; and

(IV) such additional relevant factors as the Commission may establish by rule or regulation; and

(ii) shall not take into consideration the balance of the Fund.

(2) Denial of award

No award under subsection (b) shall be made--

(A) to any whistleblower who is, or was at the time the whistleblower acquired the original information submitted to the commission, a member, officer, or employee of--

(i) an appropriate regulatory agency;

(ii) the Department of Justice;

(iii) a self-regulatory organization;

(iv) the Public Company Accounting Oversight Board; or

(v) a law enforcement organization;

(B) to any whistleblower who is convicted of a criminal violation related to the judicial or administrative action for which the whistleblower otherwise could receive an award under this section;

(C) to any whistleblower who gains the information through the performance of an audit of financial statements required under the securities laws and for whom such submission would be contrary to the requirements of section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1); or

(D) to any whistleblower who fails to submit information to the Commission in such form as the Commission may, by rule, require.

(d) Representation

(1) Permitted representation

Any whistleblower who makes a claim for an award under subsection (b) may be represented by counsel.

(2) Required representation

(A) In general

Any whistleblower who anonymously makes a claim for an award under subsection (b) shall be represented by counsel if the whistleblower anonymously submits the information upon which the claim is based.

(B) Disclosure of identity

Prior to the payment of an award, a whistleblower shall disclose the identity of the whistleblower and provide such other information as the Commission may require, directly or through counsel for the whistleblower.

(e) No contract necessary

No contract with the Commission is necessary for any whistleblower to receive an award under subsection (b), unless otherwise required by the Commission by rule or regulation.

(f) Appeals

Any determination made under this section, including whether, to whom, or in what amount to make awards, shall be in the discretion of the Commission. Any such determination, except the determination of the amount of an award if the award was made in accordance with subsection (b), may be appealed to the appropriate court of appeals of the United States not more than 30 days after the determination is issued by the Commission. The court shall review the determination made by the Commission in accordance with section 706 of Title 5.

(g) Investor Protection Fund

(1) Fund established

There is established in the Treasury of the United States a fund to be known as the "Securities and Exchange Commission Investor Protection Fund".

(2) Use of Fund

The Fund shall be available to the Commission, without further appropriation or fiscal year limitation, for--

(A) paying awards to whistleblowers as provided in subsection (b); and

(B) funding the activities of the Inspector General of the Commission under section 4(i).

(3) Deposits and credits

(A) In general

There shall be deposited into or credited to the Fund an amount equal to--

(i) any monetary sanction collected by the Commission in any judicial or administrative action brought by the Commission under the securities laws that is not added to a disgorgement fund or other fund under section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246) or otherwise distributed to victims of a violation of the securities laws, or the rules and regulations thereunder, underlying such action, unless the balance of the Fund at the time the monetary sanction is collected exceeds $300,000,000;

(ii) any monetary sanction added to a disgorgement fund or other fund under section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246) that is not distributed to the victims for whom the Fund was established, unless the balance of the disgorgement fund at the time the determination is made not to distribute the monetary sanction to such victims exceeds $200,000,000; and

(iii) all income from investments made under paragraph (4).

(B) Additional amounts

If the amounts deposited into or credited to the Fund under subparagraph (A) are not sufficient to satisfy an award made under subsection (b), there shall be deposited into or credited to the Fund an amount equal to the unsatisfied portion of the award from any monetary sanction collected by the Commission in the covered judicial or administrative action on which the award is based.

(4) Investments

(A) Amounts in Fund may be invested

The Commission may request the Secretary of the Treasury to invest the portion of the Fund that is not, in the discretion of the Commission, required to meet the current needs of the Fund.

(B) Eligible investments

Investments shall be made by the Secretary of the Treasury in obligations of the United States or obligations that are guaranteed as to principal and interest by the United States, with maturities suitable to the needs of the Fund as determined by the Commission on the record.

(C) Interest and proceeds credited

The interest on, and the proceeds from the sale or redemption of, any obligations held in the Fund shall be credited to the Fund.

(5) Reports to Congress

Not later than October 30 of each fiscal year beginning after July 21, 2010, the Commission shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives a report on--

(A) the whistleblower award program, established under this section, including--

(i) a description of the number of awards granted; and

(ii) the types of cases in which awards were granted during the preceding fiscal year;

(B) the balance of the Fund at the beginning of the preceding fiscal year;

(C) the amounts deposited into or credited to the Fund during the preceding fiscal year;

(D) the amount of earnings on investments made under paragraph (4) during the preceding fiscal year;

(E) the amount paid from the Fund during the preceding fiscal year to whistleblowers pursuant to subsection (b);

(F) the balance of the Fund at the end of the preceding fiscal year; and

(G) a complete set of audited financial statements, including--

(i) a balance sheet;

(ii) income statement; and

(iii) cash flow analysis.

(h) Protection of whistleblowers

(1) Prohibition against retaliation

(A) In general

No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower--

(i) in providing information to the Commission in accordance with this section;

(ii) in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information; or

(iii) in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 et seq.), this chapter, including section 78j-1(m) of this title, section 1513(e) of Title 18, and any other law, rule, or regulation subject to the jurisdiction of the Commission.

(B) Enforcement

(i) Cause of action

An individual who alleges discharge or other discrimination in violation of subparagraph (A) may bring an action under this subsection in the appropriate district court of the United States for the relief provided in subparagraph (C).

(ii) Subpoenas

A subpoena requiring the attendance of a witness at a trial or hearing conducted under this section may be served at any place in the United States.

(iii) Statute of limitations

(I) In general

An action under this subsection may not be brought--

(aa) more than 6 years after the date on which the violation of subparagraph (A) occurred; or

(bb) more than 3 years after the date when facts material to the right of action are known or reasonably should have been known by the employee alleging a violation of subparagraph (A).

(II) Required action within 10 years

Notwithstanding subclause (I), an action under this subsection may not in any circumstance be brought more than 10 years after the date on which the violation occurs.

(C) Relief

Relief for an individual prevailing in an action brought under subparagraph (B) shall include--

(i) reinstatement with the same seniority status that the individual would have had, but for the discrimination;

(ii) 2 times the amount of back pay otherwise owed to the individual, with interest; and

(iii) compensation for litigation costs, expert witness fees, and reasonable attorneys' fees.

(2) Confidentiality

(A) In general

Except as provided in subparagraphs (B) and (C), the Commission and any officer or employee of the Commission shall not disclose any information, including information provided by a whistleblower to the Commission, which could reasonably be expected to reveal the identity of a whistleblower, except in accordance with the provisions of section 552a of Title 5, unless and until required to be disclosed to a defendant or respondent in connection with a public proceeding instituted by the Commission or any entity described in subparagraph (C). For purposes of section 552 of Title 5, this paragraph shall be considered a statute described in subsection (b)(3)(B) of such section.

(B) Exempted statute

For purposes of section 552 of Title 5, this paragraph shall be considered a statute described in subsection (b)(3)(B) of such section 552.

(C) Rule of construction

Nothing in this section is intended to limit, or shall be construed to limit, the ability of the Attorney General to present such evidence to a grand jury or to share such evidence with potential witnesses or defendants in the course of an ongoing criminal investigation.

(D) Availability to Government agencies

(i) In general

Without the loss of its status as confidential in the hands of the Commission, all information referred to in subparagraph (A) may, in the discretion of the Commission, when determined by the Commission to be necessary to accomplish the purposes of this chapter and to protect investors, be made available to--

(I) the Attorney General of the United States;

(II) an appropriate regulatory authority;

(III) a self-regulatory organization;

(IV) a State attorney general in connection with any criminal investigation;

(V) any appropriate State regulatory authority;

(VI) the Public Company Accounting Oversight Board;

(VII) a foreign securities authority; and

(VIII) a foreign law enforcement authority.

(ii) Confidentiality

(I) In general

Each of the entities described in subclauses (I) through (VI) of clause (i) shall maintain such information as confidential in accordance with the requirements established under subparagraph (A).

(II) Foreign authorities

Each of the entities described in subclauses (VII) and (VIII) of clause (i) shall maintain such information in accordance with such assurances of confidentiality as the Commission determines appropriate.

(3) Rights retained

Nothing in this section shall be deemed to diminish the rights, privileges, or remedies of any whistleblower under any Federal or State law, or under any collective bargaining agreement.

(i) Provision of false information

A whistleblower shall not be entitled to an award under this section if the whistleblower--

(1) knowingly and willfully makes any false, fictitious, or fraudulent statement or representation; or

(2) uses any false writing or document knowing the writing or document contains any false, fictitious, or fraudulent statement or entry.

(j) Rulemaking authority

The Commission shall have the authority to issue such rules and regulations as may be necessary or appropriate to implement the provisions of this section consistent with the purposes of this section.

CREDIT(S)

(June 6, 1934, c. 404, Title I, § 21F, as added July 21, 2010, Pub.L. 111-203, Title IX, § 922(a), 124 Stat. 1841.)

Notes of Decisions (19)

15 U.S.C.A. § 78u-6, 15 USCA § 78u-6
Current through P.L. 113-163 (excluding P.L. 113-128) approved 8-8-14

End of Document

15 U.S.C.A. § 78u-7

§ 78u-7. Implementation and transition provisions for whistleblower protection

Effective: July 22, 2010
Currentness

(a) Implementing rules

The Commission shall issue final regulations implementing the provisions of section 78u-6 of this title, as added by this subtitle, not later than 270 days after July 21, 2010.

(b) Original information

Information provided to the Commission in writing by a whistleblower shall not lose the status of original information (as defined in section 78u-6(a)(3) of this title, as added by this subtitle) solely because the whistleblower provided the information prior to the effective date of the regulations, if the information is provided by the whistleblower after July 21, 2010.

(c) Awards

A whistleblower may receive an award pursuant to section 78u-6 of this title, as added by this subtitle, regardless of whether any violation of a provision of the securities laws, or a rule or regulation thereunder, underlying the judicial or administrative action upon which the award is based, occurred prior to July 21, 2010.

(d) Administration and enforcement

The Securities and Exchange Commission shall establish a separate office within the Commission to administer and enforce the provisions of section 78u-6 of this title (as add [1] by this section 922(a)). Such office shall report annually to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on its activities, whistleblower complaints, and the response of the Commission to such complaints.

CREDIT(S)

(July 21, 2010, Pub.L. 111-203, Title IX, § 924, 124 Stat. 1850.)

Notes of Decisions (1)

Footnotes

1 So in original. Probably should be "added".

15 U.S.C.A. § 78u-7, 15 USCA § 78u-7

Current through P.L. 113-163 (excluding P.L. 113-128) approved 8-8-14

Sec.

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§ 240.21F-1 General.

Section 21F of the Securities Exchange Act of 1934 ("Exchange Act") (15 U.S.C. 78u-6), entitled "Securities Whistleblower Incentives and Protection," requires the Securities and Exchange Commission ("Commission") to pay awards, subject to certain limitations and conditions, to whistleblowers who provide the Commission with original information about violations of the federal securities laws. These rules describe the whistleblower program that the Commission has established to implement the provisions of Section 21F, and explain the procedures you will need to follow in order to be eligible for an award. You should read these procedures carefully because the failure to take certain required steps within the time frames described in these rules may disqualify you from receiving an award for which you otherwise may be eligible. Unless expressly provided for in these rules, no person is authorized to make any offer or promise, or otherwise to bind the Commission with respect to the payment of any award or the amount thereof. The Securities and Exchange Commission's Office of the Whistleblower administers our whistleblower program. Questions about the program or these rules should be directed to the SEC Office of the Whistleblower, 100 F Street, N.E., Washington, DC 20549-5631.

§ 240.21F-2 Whistleblower status and retaliation protection.

(a) Definition of a whistleblower. (1) You are a whistleblower if, alone or jointly with others, you provide the Commission with information pursuant to the procedures set forth in § 240.21F-9(a) of this chapter, and the information relates to a possible violation of the federal securities laws (including any rules or regulations thereunder) that has occurred, is ongoing, or is about to occur. A whistleblower must be an individual. A company or another entity is not eligible to be a whistleblower.

(2) To be eligible for an award, you must submit original information to the Commission in accordance with the procedures and conditions described in §§240.21F-4, 240.21F-8, and 240.21F-9 of this chapter.

(b) Prohibition against retaliation: (1) For purposes of the anti-retaliation protections afforded by Section 21F(h)(1) of the Exchange Act (15 U.S.C. 78u-6(h)(1)), you are a whistleblower if:

(i) You possess a reasonable belief that the information you are providing relates to a possible securities law violation (or, where applicable, to a possible violation of the provisions set forth in 18 U.S.C. 1514A(a)) that has occurred, is ongoing, or is about to occur, and;

(ii) You provide that information in a manner described in Section 21F(h)(1)(A) of the Exchange Act (15 U.S.C. 78u-6(h)(1)(A)).

The anti-retaliation protections apply whether or not you satisfy the requirements, procedures and conditions to qualify for an award.

(2) Section 21F(h)(1) of the Exchange Act (15 U.S.C. 78u-6(h)(1)), including any rules promulgated thereunder, shall be enforceable in an action or proceeding brought by the Commission.

§ 240.21F-3 Payment of awards.

(a) Commission actions: Subject to the eligibility requirements described in §§240.21F-2, 240.21F-8, and 240.21F-16 of this chapter, the Commission will pay an award or awards to one or more whistleblowers who:

(1) Voluntarily provide the Commission

(2) With original information

(3) That leads to the successful enforcement by the Commission of a federal court or administrative action

(4) In which the Commission obtains monetary sanctions totaling more than $1,000,000.

The terms voluntarily, original information, leads to successful enforcement, action, and monetary sanctions are defined in § 240.21F-4 of this chapter.

(b) Related actions: The Commission will also pay an award based on amounts collected in certain related actions.

(1) A related action is a judicial or administrative action that is brought by:

(i) The Attorney General of the United States;

(ii) An appropriate regulatory authority;

(iii) A self-regulatory organization; or

(iv) A state attorney general in a criminal case, and is based on the same original information that the whistleblower voluntarily provided to the Commission, and that led the Commission to obtain monetary sanctions totaling more than $1,000,000.

The terms appropriate regulatory authority and self-regulatory organization are defined in § 240.21F-4 of this chapter.

(2) In order for the Commission to make an award in connection with a related action, the Commission must determine that the same original information that the whistleblower gave to the Commission also led to the successful enforcement of the related action under the same criteria described in these rules for awards made in connection with Commission actions. The Commission may seek assistance and confirmation from the authority bringing the related action in making this determination. The Commission will deny an award in connection with the related action if:

(i) The Commission determines that the criteria for an award are not satisfied; or

(ii) The Commission is unable to make a determination because the Office of the Whistleblower could not obtain sufficient and reliable information that could be used as the basis for an award determination pursuant to § 240.21F-12(a) of this chapter. Additional procedures apply to the payment of awards in related actions. These procedures are described in §§ 240.21F-11 and 240.21F-14 of this chapter.

(3) The Commission will not make an award to you for a related action if you have already been granted an award by the Commodity Futures Trading Commission ("CFTC") for that same action pursuant to its whistleblower award program under Section 23 of the Commodity Exchange Act (7 U.S.C. 26). Similarly, if the CFTC has previously denied an award to you in a related action, you will be precluded from relitigating any issues before the Commission that the CFTC resolved against you as part of the award denial.

§ 240.21F-4 Other definitions.

(a) Voluntary submission of information. (1) Your submission of information is made voluntarily within the meaning of §§ 240.21F-1 through 240.21F-17 of this chapter if you provide your submission before a request, inquiry, or demand that relates to the subject matter of your submission is directed to you or anyone representing you (such as an attorney):

(i) By the Commission;

(ii) In connection with an investigation, inspection, or examination by the Public Company Accounting Oversight Board, or any self-regulatory organization; or

(iii) In connection with an investigation by the Congress, any other authority of the federal government, or a state Attorney General or securities regulatory authority.

(2) If the Commission or any of these other authorities direct a request, inquiry, or demand as described in paragraph (1) of this section to you or your representative first, your submission will not be considered voluntary, and you will not be eligible for an award, even if your response is not compelled by subpoena or other applicable law. However, your submission of information to the Commission will be considered voluntary if you voluntarily provided the same information to one of the other authorities identified above prior to receiving a request, inquiry, or demand from the Commission.

(3) In addition, your submission will not be considered voluntary if you are required to report your original information to the Commission as a result of a pre-existing legal duty, a contractual duty that is owed to the Commission or to one of the other authorities set forth in paragraph (1) of this section, or a duty that arises out of a judicial or administrative order.

(b) *Original information*. (1) In order for your whistleblower submission to be considered original information, it must be:

(i) Derived from your independent knowledge or independent analysis;

(ii) Not already known to the Commission from any other source, unless you are the original source of the information;

(iii) Not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless you are a source of the information; and

(iv) Provided to the Commission for the first time after July 21, 2010 (the date of enactment of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*).

(2) Independent knowledge means factual information in your possession that is not derived from publicly available sources. You may gain independent knowledge from your experiences, communications and observations in your business or social interactions.

(3) Independent analysis means your own analysis, whether done alone or in combination with others. Analysis means your examination and evaluation of information that may be publicly available, but which reveals information that is not generally known or available to the public.

(4) The Commission will not consider information to be derived from your independent knowledge or independent analysis in any of the following circumstances:

(i) If you obtained the information through a communication that was subject to the attorney-client privilege, unless disclosure of that information would otherwise be permitted by an attorney pursuant to § 205.3(d)(2) of this chapter, the applicable state attorney conduct rules, or otherwise;

(ii) If you obtained the information in connection with the legal representation of a client on whose behalf you or your employer or firm are providing services, and you seek to use the information to make a whistleblower submission for your own benefit, unless disclosure would otherwise be permitted by an attorney pursuant to § 205.3(d)(2) of this chapter, the applicable state attorney conduct rules, or otherwise; or

(iii) In circumstances not covered by paragraphs (b)(4)(i) or (b)(4)(ii) of this section, if you obtained the information because you were:

(A) An officer, director, trustee, or partner of an entity and another person informed you of allegations of misconduct, or you learned the information in connection with the entity's processes for identifying, reporting, and addressing possible violations of law;

(B) An employee whose principal duties involve compliance or internal audit responsibilities, or you were employed by or otherwise associated with a firm retained to perform compliance or internal audit functions for an entity;

(C) Employed by or otherwise associated with a firm retained to conduct an inquiry or investigation into possible violations of law; or

(D) An employee of, or other person associated with, a public accounting firm, if you obtained the information through the performance of an engagement required of an independent public accountant under the federal securities laws (other than an audit subject to §240.21F-8(c)(4) of this chapter), and that information related to a violation by the engagement client or the client's directors, officers or other employees.

(iv) If you obtained the information by a means or in a manner that is determined by a United States court to violate applicable federal or state criminal law; or

(v) Exceptions. Paragraph (b)(4)(iii) of this section shall not apply if:

(A) You have a reasonable basis to believe that disclosure of the information to the Commission is necessary to prevent the relevant entity from engaging in conduct that is likely to cause substantial injury to the financial interest or property of the entity or investors;

(B) You have a reasonable basis to believe that the relevant entity is engaging in conduct that will impede an investigation of the misconduct; or

(C) At least 120 days have elapsed since you provided the information to the relevant entity's audit committee, chief legal officer, chief compliance officer (or their equivalents), or your supervisor, or since you received the information, if you received it under circumstances indicating that the entity's audit committee, chief legal officer, chief compliance officer (or their equivalents), or your supervisor was already aware of the information.

(vi) If you obtained the information from a person who is subject to this section, unless the information is not excluded from that person's use pursuant to this section, or you are providing the Commission with information about possible violations involving that person.

(5) The Commission will consider you to be an <u>original source</u> of the same information that we obtain from another source if the information satisfies the definition of original information and the other source obtained the information from you or your representative. In order to be considered an original source of information that the Commission receives from Congress, any other authority of the federal government, a state Attorney General or securities regulatory authority, any self-regulatory organization, or the Public Company Accounting Oversight Board, you must

have voluntarily given such authorities the information within the meaning of these rules. You must establish your status as the original source of information to the Commission's satisfaction. In determining whether you are the original source of information, the Commission may seek assistance and confirmation from one of the other authorities described above, or from another entity (including your employer), in the event that you claim to be the original source of information that an authority or another entity provided to the Commission.

(6) If the Commission already knows some information about a matter from other sources at the time you make your submission, and you are not an original source of that information under paragraph (b)(5) of this section, the Commission will consider you an original source of any information you provide that is derived from your independent knowledge or analysis and that materially adds to the information that the Commission already possesses.

(7) If you provide information to the Congress, any other authority of the federal government, a state Attorney General or securities regulatory authority, any self-regulatory organization, or the Public Company Accounting Oversight Board, or to an entity's internal whistleblower, legal, or compliance procedures for reporting allegations of possible violations of law, and you, within 120 days, submit the same information to the Commission pursuant to § 240.21F-9 of this chapter, as you must do in order for you to be eligible to be considered for an award, then, for purposes of evaluating your claim to an award under §§ 240.21F-10 and 240.21F-11 of this chapter, the Commission will consider that you provided information as of the date of your original disclosure, report or submission to one of these other authorities or persons. You must establish the effective date of any prior disclosure, report, or submission, to the Commission's satisfaction. The Commission may seek assistance and confirmation from the other authority or person in making this determination.

(c) Information that leads to successful enforcement. The Commission will consider that you provided original information that led to the successful enforcement of a judicial or administrative action in any of the following circumstances:

(1) You gave the Commission original information that was sufficiently specific, credible, and timely to cause the staff to commence an examination, open an investigation, reopen an investigation that the Commission had closed, or to inquire

concerning different conduct as part of a current examination or investigation, and the Commission brought a successful judicial or administrative action based in whole or in part on conduct that was the subject of your original information; or

(2) You gave the Commission original information about conduct that was already under examination or investigation by the Commission, the Congress, any other authority of the federal government, a state Attorney General or securities regulatory authority, any self-regulatory organization, or the PCAOB (except in cases where you were an original source of this information as defined in paragraph (b)(4) of this section), and your submission significantly contributed to the success of the action.

(3) You reported original information through an entity's internal whistleblower, legal, or compliance procedures for reporting allegations of possible violations of law before or at the same time you reported them to the Commission; the entity later provided your information to the Commission, or provided results of an audit or investigation initiated in whole or in part in response to information you reported to the entity; and the information the entity provided to the Commission satisfies either paragraph (c)(1) or (c)(2) of this section. Under this paragraph (c)(3), you must also submit the same information to the Commission in accordance with the procedures set forth in §240.21F-9 within 120 days of providing it to the entity.

(d) An <u>action</u> generally means a single captioned judicial or administrative proceeding brought by the Commission. Notwithstanding the foregoing:

(1) For purposes of making an award under § 240.21F-10 of this chapter, the Commission will treat as a Commission action two or more administrative or judicial proceedings brought by the Commission if these proceedings arise out of the same nucleus of operative facts; or

(2) For purposes of determining the payment on an award under § 240.21F-14 of this chapter, the Commission will deem as part of the Commission action upon which the award was based any subsequent Commission proceeding that, individually, results in a monetary sanction of $1,000,000 or less, and that arises out of the same nucleus of operative facts.

(e) <u>Monetary sanctions</u> means any money, including penalties, disgorgement, and interest, ordered to be paid and any money deposited into a disgorgement fund or other fund pursuant to Section 308(b) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246(b)) as a result of a Commission action or a related action.

(f) Appropriate regulatory agency means the Commission, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and any other agencies that may be defined as appropriate regulatory agencies under Section 3(a)(34) of the Exchange Act (15 U.S.C. 78c(a)(34)).

(g) Appropriate regulatory authority means an appropriate regulatory agency other than the Commission.

(h) Self-regulatory organization means any national securities exchange, registered securities association, registered clearing agency, the Municipal Securities Rulemaking Board, and any other organizations that may be defined as self-regulatory organizations under Section 3(a)(26) of the Exchange Act (15 U.S.C. 78c(a)(26)).

§ 240.21F-5 Amount of award.

(a) The determination of the amount of an award is in the discretion of the Commission.

(b) If all of the conditions are met for a whistleblower award in connection with a Commission action or a related action, the Commission will then decide the percentage amount of the award applying the criteria set forth in § 240.21F-6 of this chapter and pursuant to the procedures set forth in §§ 240.21F-10 and 240.21F-11 of this chapter. The amount will be at least 10 percent and no more than 30 percent of the monetary sanctions that the Commission and the other authorities are able to collect. The percentage awarded in connection with a Commission action may differ from the percentage awarded in connection with a related action.

(c) If the Commission makes awards to more than one whistleblower in connection with the same action or related action, the Commission will determine an individual percentage award for each whistleblower, but in no event will the total amount awarded to all whistleblowers in the aggregate be less than 10 percent or greater than 30 percent of the amount the Commission or the other authorities collect.

§ 240.21F-6 Criteria for determining amount of award.

In exercising its discretion to determine the appropriate award percentage, the Commission may consider the following factors in relation to the unique facts and circumstances of each case, and may increase or decrease the award percentage based on its analysis of these factors. In the event that awards are determined for multiple whistleblowers in connection an action, these factors will be used to determine the relative allocation of awards among the whistleblowers.

(a) <u>Factors that may increase the amount of a whistleblower's award</u>. In determining whether to increase the amount of an award, the Commission will consider the following factors, which are not listed in order of importance.

(1) <u>Significance of the information provided by the whistleblower</u>. The Commission will assess the significance of the information provided by a whistleblower to the success of the Commission action or related action. In considering this factor, the Commission may take into account, among other things:

(i) The nature of the information provided by the whistleblower and how it related to the successful enforcement action, including whether the reliability and completeness of the information provided to the Commission by the whistleblower resulted in the conservation of Commission resources;

(ii) The degree to which the information provided by the whistleblower supported one or more successful claims brought in the Commission or related action.

(2) <u>Assistance provided by the whistleblower</u>. The Commission will assess the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in the Commission action or related action. In considering this factor, the Commission may take into account, among other things:

(i) Whether the whistleblower provided ongoing, extensive, and timely cooperation and assistance by, for example, helping to explain complex transactions, interpreting key evidence, or identifying new and productive lines of inquiry;

(ii) The timeliness of the whistleblower's initial report to the Commission or to an internal compliance or reporting system of business organizations committing, or impacted by, the securities violations, where appropriate;

(iii) The resources conserved as a result of the whistleblower's assistance;

(iv) Whether the whistleblower appropriately encouraged or authorized others to assist the staff of the Commission who might otherwise not have participated in the investigation or related action;

(v) The efforts undertaken by the whistleblower to remediate the harm caused by the violations, including assisting the authorities in the recovery of the fruits and instrumentalities of the violations; and

(vi) Any unique hardships experienced by the whistleblower as a result of his or her reporting and assisting in the enforcement action.

(3) Law enforcement interest. The Commission will assess its programmatic interest in deterring violations of the securities laws by making awards to whistleblowers who provide information that leads to the successful enforcement of such laws. In considering this factor, the Commission may take into account, among other things:

(i) The degree to which an award enhances the Commission's ability to enforce the federal securities laws and protect investors; and

(ii) The degree to which an award encourages the submission of high quality information from whistleblowers by appropriately rewarding whistleblowers' submission of significant information and assistance, even in cases where the monetary sanctions available for collection are limited or potential monetary sanctions were reduced or eliminated by the Commission because an entity self-reported a securities violation following the whistleblower's related internal disclosure, report, or submission.

(iii) Whether the subject matter of the action is a Commission priority, whether the reported misconduct involves regulated entities or fiduciaries, whether the whistleblower exposed an industry-wide practice, the type and severity of the securities violations, the age and duration of misconduct, the number of violations, and the isolated, repetitive, or ongoing nature of the violations; and

(iv) The dangers to investors or others presented by the underlying violations involved in the enforcement action, including the amount of harm or potential harm caused by the underlying violations, the type of harm resulting from or threatened by the underlying violations, and the number of individuals or entities harmed.

(4) Participation in internal compliance systems. The Commission will assess whether, and the extent to which, the whistleblower and any legal representative of the whistleblower participated in internal compliance systems. In considering this factor, the Commission may take into account, among other things:

(i) Whether, and the extent to which, a whistleblower reported the possible securities violations through internal whistleblower, legal or compliance procedures before, or at the same time as, reporting them to the Commission; and

(ii) Whether, and the extent to which, a whistleblower assisted any internal investigation or inquiry concerning the reported securities violations.

(b) Factors that may decrease the amount of a whistleblower's award. In determining whether to decrease the amount of an award, the Commission will consider the following factors, which are not listed in order of importance.

(1) Culpability. The Commission will assess the culpability or involvement of the whistleblower in matters associated with the Commission's action or related actions. In considering this factor, the Commission may take into account, among other things:

(i) The whistleblower's role in the securities violations;

(ii) The whistleblower's education, training, experience, and position of responsibility at the time the violations occurred;

(iii) Whether the whistleblower acted with scienter, both generally and in relation to others who participated in the violations;

(iv) Whether the whistleblower financially benefitted from the violations;

(v) Whether the whistleblower is a recidivist;

(vi) The egregiousness of the underlying fraud committed by the whistleblower; and

(vii) Whether the whistleblower knowingly interfered with the Commission's investigation of the violations or related enforcement actions.

(2) Unreasonable reporting delay. The Commission will assess whether the whistleblower unreasonably delayed reporting the securities violations. In considering this factor, the Commission may take into account, among other things:

(i) Whether the whistleblower was aware of the relevant facts but failed to take reasonable steps to report or prevent the violations from occurring or continuing;

(ii) Whether the whistleblower was aware of the relevant facts but only reported them after learning about a related inquiry, investigation, or enforcement action; and

(iii) Whether there was a legitimate reason for the whistleblower to delay reporting the violations.

(3) Interference with internal compliance and reporting systems. The Commission will assess, in cases where the whistleblower interacted with his or her entity's internal compliance or reporting system, whether the whistleblower undermined the integrity of such system. In considering this factor, the Commission will take into account whether there is evidence provided to the Commission that the whistleblower knowingly:

(i) Interfered with an entity's established legal, compliance, or audit procedures to prevent or delay detection of the reported securities violation;

(ii) Made any material false, fictitious, or fraudulent statements or representations that hindered an entity's efforts to detect, investigate, or remediate the reported securities violations; and

(iii) Provided any false writing or document knowing the writing or document contained any false, fictitious or fraudulent statements or entries that hindered an entity's efforts to detect, investigate, or remediate the reported securities violations.

§ 240.21F-7 Confidentiality of submissions.

(a) Section 21F(h)(2) of the Exchange Act (15 U.S.C. 78u-6(h)(2)) requires that the Commission not disclose information that could reasonably be expected to reveal the identity of a whistleblower, except that the Commission may disclose such information in the following circumstances:

(1) When disclosure is required to a defendant or respondent in connection with a federal court or administrative action that the Commission files or in another public action or proceeding that is filed by an authority to which we provide the information, as described below;

(2) When the Commission determines that it is necessary to accomplish the purposes of the Exchange Act (15 U.S.C. 78a) and to protect investors, it may provide your information to the Department of Justice, an appropriate regulatory authority, a self regulatory organization, a state attorney general in connection with a criminal

investigation, any appropriate state regulatory authority, the Public Company Accounting Oversight Board, or foreign securities and law enforcement authorities. Each of these entities other than foreign securities and law enforcement authorities is subject to the confidentiality requirements set forth in Section 21F(h) of the Exchange Act (15 U.S.C. 78u-6(h)). The Commission will determine what assurances of confidentiality it deems appropriate in providing such information to foreign securities and law enforcement authorities.

(3) The Commission may make disclosures in accordance with the Privacy Act of 1974 (5 U.S.C. 552a).

(b) You may submit information to the Commission anonymously. If you do so, however, you must also do the following:

(1) You must have an attorney represent you in connection with both your submission of information and your claim for an award, and your attorney's name and contact information must be provided to the Commission at the time you submit your information;

(2) You and your attorney must follow the procedures set forth in § 240.21F-9 of this chapter for submitting original information anonymously; and

(3) Before the Commission will pay any award to you, you must disclose your identity to the Commission and your identity must be verified by the Commission as set forth in § 240.21F-10 of this chapter.

§ 240.21F-8 Eligibility.

(a) To be eligible for a whistleblower award, you must give the Commission information in the form and manner that the Commission requires. The procedures for submitting information and making a claim for an award are described in § 240.21F-9 through § 240.21F-11 of this chapter. You should read these procedures carefully because you need to follow them in order to be eligible for an award, except that the Commission may, in its sole discretion, waive any of these procedures based upon a showing of extraordinary circumstances.

(b) In addition to any forms required by these rules, the Commission may also require that you provide certain additional information. You may be required to:

(1) Provide explanations and other assistance in order that the staff may evaluate and use the information that you submitted;

(2) Provide all additional information in your possession that is related to the subject matter of your submission in a complete and truthful manner, through follow-up meetings, or in other forms that our staff may agree to;

(3) Provide testimony or other evidence acceptable to the staff relating to whether you are eligible, or otherwise satisfy any of the conditions, for an award; and

(4) Enter into a confidentiality agreement in a form acceptable to the Office of the Whistleblower, covering any non-public information that the Commission provides to you, and including a provision that a violation of the agreement may lead to your ineligibility to receive an award.

(c) You are not eligible to be considered for an award if you do not satisfy the requirements of paragraphs (a) and (b) of this section. In addition, you are not eligible if:

(1) You are, or were at the time you acquired the original information provided to the Commission, a member, officer, or employee of the Commission, the Department of Justice, an appropriate regulatory agency, a self-regulatory organization, the Public Company Accounting Oversight Board, or any law enforcement organization;

(2) You are, or were at the time you acquired the original information provided to the Commission, a member, officer, or employee of a foreign government, any political subdivision, department, agency, or instrumentality of a foreign government, or any other foreign financial regulatory authority as that term is defined in Section 3(a)(52) of the Exchange Act (15 U.S.C. 78c(a)(52));

(3) You are convicted of a criminal violation that is related to the Commission action or to a related action (as defined in § 240.21F-4 of this chapter) for which you otherwise could receive an award;

(4) You obtained the original information that you gave the Commission through an audit of a company's financial statements, and making a whistleblower submission would be contrary to requirements of Section 10A of the Exchange Act (15 U.S.C. 78j-a).

(5) You are the spouse, parent, child, or sibling of a member or employee of the Commission, or you reside in the same household as a member or employee of the Commission;

(6) You acquired the original information you gave the Commission from a person:

(i) Who is subject to paragraph (c)(4) of this section, unless the information is not excluded from that person's use, or you are providing the Commission with information about possible violations involving that person; or

(ii) With the intent to evade any provision of these rules; or

(7) In your whistleblower submission, your other dealings with the Commission, or your dealings with another authority in connection with a related action, you knowingly and willfully make any false, fictitious, or fraudulent statement or representation, or use any false writing or document knowing that it contains any false, fictitious, or fraudulent statement or entry with intent to mislead or otherwise hinder the Commission or another authority.

§ 240.21F-9Procedures for submitting original information.

(a) To be considered a whistleblower under Section 21F of the Exchange Act (15 U.S.C. 78u-6(h)), you must submit your information about a possible securities law violation by either of these methods:

(1) Online, through the Commission's website located at www.sec.gov; or

(2) By mailing or faxing a Form TCR (Tip, Complaint or Referral) (referenced in § 249.1800 of this chapter) to the SEC Office of the Whistleblower, 100 F Street NE, Washington, DC 20549-5631, Fax (703) 813-9322.

(b) Further, to be eligible for an award, you must declare under penalty of perjury at the time you submit your information pursuant to paragraph (a)(1) or (2) of this section that your information is true and correct to the best of your knowledge and belief.

(c) Notwithstanding paragraphs (a) and (b) of this section, if you are providing your original information to the Commission anonymously, then your attorney must submit your information on your behalf pursuant to the procedures specified in paragraph (a) of this section. Prior to your attorney's submission, you must provide your attorney with a completed Form TCR (referenced in §249.1800 of this chapter) that you have signed under penalty of perjury. When your attorney makes her submission on your behalf, your attorney will be required to certify that he or she:

(1) Has verified your identity;

(2) Has reviewed your completed and signed Form TCR (referenced in §249.1800 of this chapter) for completeness and accuracy and that the information contained therein is true, correct and complete to the best of the attorney's knowledge, information and belief;

(3) Has obtained your non-waivable consent to provide the Commission with your original completed and signed Form TCR (referenced in §249.1800 of this chapter) in the event that the Commission requests it due to concerns that you may have knowingly and willfully made false, fictitious, or fraudulent statements or representations, or used any false writing or document knowing that the writing or document contains any false fictitious or fraudulent statement or entry; and

(4) Consents to be legally obligated to provide the signed Form TCR (referenced in §249.1800 of this chapter) within seven (7) calendar days of receiving such request from the Commission.

(d) If you submitted original information in writing to the Commission after July 21, 2010 (the date of enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act) but before the effective date of these rules, your submission will be deemed to satisfy the requirements set forth in paragraphs (a) and (b) of this section. If you were an anonymous whistleblower, however, you must provide your attorney with a completed and signed copy of Form TCR (referenced in §249.1800 of this chapter) within 60 days of the effective date of these rules, your attorney must retain the signed form in his or her records, and you must provide of copy of the signed form to the Commission staff upon request by Commission staff prior to any payment of an award to you in connection with your submission. Notwithstanding the foregoing, you must follow the procedures and conditions for making a claim for a whistleblower award described in §§ 240.21F-10 and 240.21F-11 of this chapter.

§ 240.21F-10 Procedures for making a claim for a whistleblower award in SEC actions that result in monetary sanctions in excess of $1,000,000.

(a) Whenever a Commission action results in monetary sanctions totaling more than $1,000,000, the Office of the Whistleblower will cause to be published on the Commission's website a "Notice of Covered Action." Such Notice will be published subsequent to the entry of a final judgment or order that alone, or collectively with other judgments or orders previously entered in the Commission action, exceeds $1,000,000; or, in the absence of such judgment or order subsequent to the deposit of monetary sanctions exceeding $1,000,000 into a disgorgement or other fund pursuant to Section 308(b) of the Sarbanes-Oxley Act of 2002. A claimant will have ninety (90) days from the date of the Notice of Covered Action to file a claim for an award based on that action, or the claim will be barred.

(b) To file a claim for a whistleblower award, you must file Form WB-APP, *Application for Award for Original Information Provided Pursuant to Section 21F of the Securities Exchange Act of 1934* (referenced in § 249.1801 of this chapter). You must sign this form as the claimant and submit it to the Office of the Whistleblower by mail or fax. All claim forms, including any attachments, must be received by the Office of the Whistleblower within ninety (90) calendar days of the date of the Notice of Covered Action in order to be considered for an award.

(c) If you provided your original information to the Commission anonymously, you must disclose your identity on the Form WB-APP (referenced in § 249.1801 of this chapter), and your identity must be verified in a form and manner that is acceptable to the Office of the Whistleblower prior to the payment of any award.

(d) Once the time for filing any appeals of the Commission's judicial or administrative action has expired, or where an appeal has been filed, after all appeals in the action have been concluded, the staff designated by the Director of the Division of Enforcement ("Claims Review Staff") will evaluate all timely whistleblower award claims submitted on Form WB-APP (referenced in § 249.1801 of this chapter) in accordance with the criteria set forth in these rules. In connection with this process, the Office of the Whistleblower may require that you provide additional information relating to your eligibility for an award or satisfaction of any of the conditions for an award, as set forth in § 240.21F-(8)(b) of this chapter. Following that evaluation, the Office of the Whistleblower will send you a Preliminary Determination setting forth a preliminary assessment as to whether the claim should be allowed or denied and, if allowed, setting forth the proposed award percentage amount.

(e) You may contest the Preliminary Determination made by the Claims Review Staff by submitting a written response to the Office of the Whistleblower setting forth the grounds for your objection to either the denial of an award or the proposed amount of an award. The response must be in the form and manner that the Office of the Whistleblower shall require. You may also include documentation or other evidentiary support for the grounds advanced in your response.

(1) Before determining whether to contest a Preliminary Determination, you may:

(i) Within thirty (30) days of the date of the Preliminary Determination, request that the Office of the Whistleblower make available for your review the materials from among those set forth in § 240.21F-12(a) of this chapter that formed the basis of the Claims Review Staff's Preliminary Determination.

(ii) Within thirty (30) calendar days of the date of the Preliminary Determination, request a meeting with the Office of the Whistleblower; however, such meetings are not required and the office may in its sole discretion decline the request.

(2) If you decide to contest the Preliminary Determination, you must submit your written response and supporting materials within sixty (60) calendar days of the date of the Preliminary Determination, or if a request to review materials is made pursuant to paragraph (e)(1) of this section, then within sixty (60) calendar days of the Office of the Whistleblower making those materials available for your review.

(f) If you fail to submit a timely response pursuant to paragraph (e) of this section, then the Preliminary Determination will become the Final Order of the Commission (except where the Preliminary Determination recommended an award, in which case the Preliminary Determination will be deemed a Proposed Final Determination for purposes of paragraph (h) of this section). Your failure to submit a timely response contesting a Preliminary Determination will constitute a failure to exhaust administrative remedies, and you will be prohibited from pursuing an appeal pursuant to § 240.21F-13 of this chapter.

(g) If you submit a timely response pursuant to paragraph (e) of this section, then the Claims Review Staff will consider the issues and grounds advanced in your response, along with any supporting documentation you provided, and will make its Proposed Final Determination.

(h) The Office of the Whistleblower will then notify the Commission of each Proposed Final Determination. Within thirty 30 days thereafter, any Commissioner may request that the Proposed Final Determination be reviewed by the Commission. If no Commissioner requests such a review within the 30-day period, then the Proposed Final Determination will become the Final Order of the Commission. In the event a Commissioner requests a review, the Commission will review the record that the staff relied upon in making its determinations, including your previous submissions to the Office of the Whistleblower, and issue its Final Order.

(i) The Office of the Whistleblower will provide you with the Final Order of the Commission.

§ 240.21F-11 Procedures for determining awards based upon a related action. (a) If you are eligible to receive an award following a Commission action that results in monetary sanctions totaling more than $1,000,000, you also may be eligible to receive an award based on the monetary sanctions that are collected from a related action (as defined in § 240.21F-3 of this chapter).

(b) You must also use Form WB-APP (referenced in § 249.1801 of this chapter) to submit a claim for an award in a related action. You must sign this form as the claimant and submit it to the Office of the Whistleblower by mail or fax as follows:

(1) If a final order imposing monetary sanctions has been entered in a related action at the time you submit your claim for an award in connection with a Commission action, you must submit your claim for an award in that related action on the same Form WB-APP (referenced in § 249.1801 of this chapter) that you use for the Commission action.

(2) If a final order imposing monetary sanctions in a related action has not been entered at the time you submit your claim for an award in connection with a

Commission action, you must submit your claim on Form WB-APP (referenced in § 249.1801 of this chapter) within ninety (90) days of the issuance of a final order imposing sanctions in the related action.

(c) The Office of the Whistleblower may request additional information from you in connection with your claim for an award in a related action to demonstrate that you directly (or through the Commission) voluntarily provided the governmental agency, regulatory authority or self-regulatory organization the same original information that led to the Commission's successful covered action, and that this information led to the successful enforcement of the related action. The Office of the Whistleblower may, in its discretion, seek assistance and confirmation from the other agency in making this determination.

(d) Once the time for filing any appeals of the final judgment or order in a related action has expired, or if an appeal has been filed, after all appeals in the action have been concluded, the Claims Review Staff will evaluate all timely whistleblower award claims submitted on Form WB-APP (referenced in § 249.1801 of this chapter) in connection with the related action. The evaluation will be undertaken pursuant to the criteria set forth in these rules. In connection with this process, the Office of the Whistleblower may require that you provide additional information relating to your eligibility for an award or satisfaction of any of the conditions for an award, as set forth in § 240.21F-(8)(b) of this chapter. Following this evaluation, the Office of the Whistleblower will send you a Preliminary Determination setting forth a preliminary assessment as to whether the claim should be allowed or denied and, if allowed, setting forth the proposed award percentage amount.

(e) You may contest the Preliminary Determination made by the Claims Review Staff by submitting a written response to the Office of the Whistleblower setting forth the grounds for your objection to either the denial of an award or the proposed amount of an award. The response must be in the form and manner that the Office of the Whistleblower shall require. You may also include documentation or other evidentiary support for the grounds advanced in your response.

(1) Before determining whether to contest a Preliminary Determination, you may:

(i) Within thirty (30) days of the date of the Preliminary Determination, request that the Office of the Whistleblower make available for your review the materials from among those set forth in § 240.21F-12(a) of this chapter that formed the basis of the Claims Review Staff's Preliminary Determination.

(ii) Within thirty (30) days of the date of the Preliminary Determination, request a meeting with the Office of the Whistleblower; however, such meetings are not required and the office may in its sole discretion decline the request.

(2) If you decide to contest the Preliminary Determination, you must submit your written response and supporting materials within sixty (60) calendar days of the date of the Preliminary Determination, or if a request to review materials is made pursuant to paragraph (e)(1)(i) of this section, then within sixty (60) calendar days of the Office of the Whistleblower making those materials available for your review.

(f) If you fail to submit a timely response pursuant to paragraph (e) of this section, then the Preliminary Determination will become the Final Order of the Commission (except where the Preliminary Determination recommended an award, in which case the Preliminary Determination will be deemed a Proposed Final Determination for purposes of paragraph (h) of this section). Your failure to submit a timely response contesting a Preliminary Determination will constitute a failure to exhaust administrative remedies, and you will be prohibited from pursuing an appeal pursuant to § 240.21F-13 of this chapter.

(g) If you submit a timely response pursuant to paragraph (e) of this section, then the Claims Review Staff will consider the issues and grounds that you advanced in your response, along with any supporting documentation you provided, and will make its Proposed Final Determination.

(h) The Office of the Whistleblower will notify the Commission of each Proposed Final Determination. Within thirty 30 days thereafter, any Commissioner may request that the Proposed Final Determination be reviewed by the Commission. If no Commissioner requests such a review within the 30-day period, then the Proposed Final Determination will become the Final Order of the Commission. In the event a Commissioner requests a review, the Commission will review the record that the staff relied upon in making its determinations, including your previous submissions to the Office of the Whistleblower, and issue its Final Order.

(i) The Office of the Whistleblower will provide you with the Final Order of the Commission.

§ 240.21F-12 Materials that may form the basis of an award determination and that may comprise the record on appeal.

(a) The following items constitute the materials that the Commission and the Claims Review Staff may rely upon to make an award determination pursuant to §§ 240.21F-10 and 240.21F-11 of this chapter:

(1) Any publicly available materials from the covered action or related action, including:

(i) The complaint, notice of hearing, answers and any amendments thereto;

(ii) The final judgment, consent order, or final administrative order;

(iii) Any transcripts of the proceedings, including any exhibits;

(iv) Any items that appear on the docket; and

(v) Any appellate decisions or orders.

(2) The whistleblower's Form TCR (referenced in §249.1800 of this chapter), including attachments, and other related materials provided by the whistleblower to assist the Commission with the investigation or examination;

(3) The whistleblower's Form WB-APP (referenced in §249.1800 of this chapter), including attachments, and any other filings or submissions from the whistleblower in support of the award application;

(4) Sworn declarations (including attachments) from the Commission staff regarding any matters relevant to the award determination;

(5) With respect to an award claim involving a related action, any statements or other information that the entity provides or identifies in connection with an award determination, provided the entity has authorized the Commission to share the information with the claimant. (Neither the Commission nor the Claims Review Staff may rely upon information that the entity has not authorized the Commission to share with the claimant); and

(6) Any other documents or materials including sworn declarations from third-parties that are received or obtained by the Office of the Whistleblower to assist the Commission resolve the claimant's award application, including information related to

the claimant's eligibility. (Neither the Commission nor the Claims Review Staff may rely upon information that the entity has not authorized the Commission to share with the claimant).

(b) These rules do not entitle claimants to obtain from the Commission any materials (including any pre-decisional or internal deliberative process materials that are prepared exclusively to assist the Commission in deciding the claim) other than those listed in paragraph (a) of this section. Moreover, the Office of the Whistleblower may make redactions as necessary to comply with any statutory restrictions, to protect the Commission's law enforcement and regulatory functions, and to comply with requests for confidential treatment from other law enforcement and regulatory authorities. The Office of the Whistleblower may also require you to sign a confidentiality agreement, as set forth in § 240.21F-(8)(b)(4) of this chapter, before providing these materials.

§ 240.21F-13 Appeals.

(a) Section 21F of the Exchange Act (15 U.S.C. 78u-6) commits determinations of whether, to whom, and in what amount to make awards to the Commission's discretion. A determination of whether or to whom to make an award may be appealed within 30 days after the Commission issues its final decision to the United States Court of Appeals for the District of Columbia Circuit, or to the circuit where the aggrieved person resides or has his principal place of business. Where the Commission makes an award based on the factors set forth in § 240.21F-6 of this chapter of not less than 10 percent and not more than 30 percent of the monetary sanctions collected in the Commission or related action, the Commission's determination regarding the amount of an award (including the allocation of an award as between multiple whistleblowers, and any factual findings, legal conclusions, policy judgments, or discretionary assessments involving the Commission's consideration of the factors in § 240.21F-6 of this chapter) is not appealable.

(b) The record on appeal shall consist of the Preliminary Determination, the Final Order of the Commission, and any other items from those set forth in § 240.21F-12(a) of this chapter that either the claimant or the Commission identifies for inclusion in the record. The record on appeal shall not include any pre-decisional or internal deliberative process materials that are prepared exclusively to assist the Commission in deciding the claim (including the staff's Draft Final Determination in the event that the Commissioners reviewed the claim and issued the Final Order).

§ 240.21F- 14 Procedures applicable to the payment of awards.

(a) Any award made pursuant to these rules will be paid from the Securities and Exchange Commission Investor Protection Fund (the "Fund").

(b) A recipient of a whistleblower award is entitled to payment on the award only to the extent that a monetary sanction is collected in the Commission action or in a related action upon which the award is based.

(c) Payment of a whistleblower award for a monetary sanction collected in a Commission action or related action shall be made following the later of:

(1) The date on which the monetary sanction is collected; or

(2) The completion of the appeals process for all whistleblower award claims arising from:

(i) The Notice of Covered Action, in the case of any payment of an award for a monetary sanction collected in a Commission action; or

(ii) The related action, in the case of any payment of an award for a monetary sanction collected in a related action.

(d) If there are insufficient amounts available in the Fund to pay the entire amount of an award payment within a reasonable period of time from the time for payment specified by paragraph (c) of this section, then subject to the following terms, the balance of the payment shall be paid when amounts become available in the Fund, as follows:

(1) Where multiple whistleblowers are owed payments from the Fund based on awards that do not arise from the same Notice of Covered Action (or related action), priority in making these payments will be determined based upon the date that the collections for which the whistleblowers are owed payments occurred. If two or more of these collections occur on the same date, those whistleblowers owed payments based on these collections will be paid on a pro rata basis until sufficient amounts become available in the Fund to pay their entire payments.

(2) Where multiple whistleblowers are owed payments from the Fund based on awards that arise from the same Notice of Covered Action (or related action), they will share the same payment priority and will be paid on a pro rata basis until sufficient amounts become available in the Fund to pay their entire payments.

§ 240.21F-15 No amnesty.

The Securities Whistleblower Incentives and Protection provisions do not provide amnesty to individuals who provide information to the Commission. The fact that you may become a whistleblower and assist in Commission investigations and enforcement actions does not preclude the Commission from bringing an action against you based upon your own conduct in connection with violations of the federal securities laws. If such an action is determined to be appropriate, however, the Commission will take your cooperation into consideration in accordance with its Policy Statement Concerning Cooperation by Individuals in Investigations and Related Enforcement Actions (17 CFR § 202.12).

§ 240.21F-16 Awards to whistleblowers who engage in culpable conduct.

In determining whether the required $1,000,000 threshold has been satisfied (this threshold is further explained in § 240.21F-10 of this chapter) for purposes of making any award, the Commission will not take into account any monetary sanctions that the whistleblower is ordered to pay, or that are ordered against any entity whose liability is based substantially on conduct that the whistleblower directed, planned, or initiated. Similarly, if the Commission determines that a whistleblower is eligible for an award, any amounts that the whistleblower or such an entity pay in sanctions as a result of the action or related actions will not be included within the calculation of the amounts collected for purposes of making payments.

§ 240.21F-17 Staff communications with individuals reporting possible securities law violations.

(a) No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement (other than agreements dealing with information covered by § 240.21F-4(b)(4)(i) and § 240.21F-4(b)(4)(ii) of this chapter related to the legal representation of a client) with respect to such communications.

(b) If you are a director, officer, member, agent, or employee of an entity that has counsel, and you have initiated communication with the Commission relating to a possible securities law violation, the staff is authorized to communicate directly with you regarding the possible securities law violation without seeking the consent of the entity's counsel.

U.S. SECURITIES AND EXCHANGE COMMISSION

2013 ANNUAL REPORT TO CONGRESS ON THE

Dodd-Frank Whistleblower Program

DISCLAIMER

This is a report of the Staff of the U.S. Securities and Exchange Commission. The Commission has expressed no view regarding the analysis, findings, or conclusions contained herein.

CONTENTS

Report available on the Web at:
http://www.sec.gov/about/offices/owb/annual-report-2013.pdf

MESSAGE FROM THE CHIEF OF THE OFFICE OF THE WHISTLEBLOWER

Fiscal Year 2013 was a historic one for the Securities and Exchange Commission's Office of the Whistleblower ("OWB" or the "Office"). During the year, the Office paid whistleblowers a total of over $14 million in recognition of their contributions to the success of enforcement actions pursuant to which ongoing frauds were stopped in their tracks. While the amounts paid are significant, the bigger story is the untold numbers of current and future investors who were shielded from harm thanks to the information and cooperation provided by whistleblowers. At the end of the day, protecting investors is what the whistleblower program is all about.

"At the end of the day, protecting investors is what the whistleblower program is all about."

The program, which is administered through OWB, is now in its third year of operation. The program was designed to incentivize individuals to provide the U.S. Securities and Exchange Commission ("Commission" or "SEC") with specific, credible, and timely information about possible securities law violations, and thereby enhance the Commission's ability to act swiftly to protect investors from harm and bring violators to justice. Under the program, individuals who voluntarily provide the Commission with original information that leads to a successful enforcement action resulting in monetary sanctions of over $1,000,000, may be eligible to receive an award equal to 10-30% of the monies collected by the Commission or in a related action.

The Commission's goal continues to be the receipt of high-quality information concerning potential securities law violations. The number of whistleblower tips and complaints the Commission receives annually increased from 3,001 in the 2012 fiscal year to 3,238 in the 2013 fiscal year. From the establishment of the whistleblower program in August 2011 until the end of Fiscal Year 2013, the Commission has received 6,573 tips and complaints from whistleblowers.

Fiscal Year 2013 saw the Commission make its largest whistleblower award to date. On September 30, 2013, the Commission awarded over $14 million to a whistleblower whose information led to an SEC enforcement action that recovered substantial investor funds. In less than six months after receiving the whistleblower's tip, the Commission was able to bring an enforcement action against the perpetrators and secure investor monies. OWB hopes that award payments like this one will encourage individuals to come forward and assist the Commission in stopping securities fraud.

As mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Dodd-Frank Act"), the Commission's Office of the Inspector General ("OIG") conducted an audit of the Commission's whistleblower program and released its report on January 18, 2013. OIG concluded that overall the Commission's whistleblower program was effective and operated appropriately. Specifically, OIG found that the Commission's final rules implementing the whistleblower provisions of the Dodd-Frank Act to be clearly defined and user-friendly for those with a basic knowledge of securities laws, rules and regulations. OIG also concluded that OWB's outreach efforts had been strong and that in general OWB was prompt in responding to information received from whistleblowers and in communicating with interested parties. To further strengthen its internal controls, OIG recommended that OWB adopt key performance measures and metrics where appropriate. In response, the Office developed key performance measures and metrics in 28 different areas.

One of the most crucial tenets by which OWB operates is the protection of a whistleblower's identifying information. OWB works with SEC Enforcement Division staff to protect whistleblower identities against disclosure. The Commission also allows individuals who prefer to remain anonymous to the Commission to be eligible under the whistleblower program if they submit their whistleblower tip through an attorney. Although they must disclose their identity to the Commission before they can be paid an award, the Commission does not publicly disclose whistleblower identities when it announces awards.

The Dodd-Frank Act extended anti-retaliation protections to Commission whistleblowers, which the Commission can enforce through civil enforcement actions in federal court or administrative proceedings. The protection of whistleblowers from retaliation by their employers is important to the success of the whistleblower program. Furthermore, the Commission's rules prohibit any person from taking action to impede an individual from reporting a securities law violation to the Commission, including through the use of a confidentiality agreement. OWB is coordinating actively with Enforcement Division staff to identify matters where employers may have taken retaliatory measures against individuals who reported potential securities law violations or have utilized confidentiality, severance, or other agreements in an effort to prohibit their employees from voicing concerns about potential wrongdoing.

"The protection of whistleblowers from retaliation by their employers is important to the success of the whistleblower program."

Finally, OWB encourages anyone who believes they have information concerning a potential securities law violation to submit the tip via the online portal on OWB's webpage (http://www.sec.gov/whistleblower) or by submitting a Form TCR by mail or fax, also located on OWB's webpage. If a whistleblower or his or her counsel has any question about how or whether to submit a tip to the Commission, or any other questions about the program, the individual should call the whistleblower hotline at (202) 551-4790.

OWB looks forward to the continued growth of the Commission's whistleblower program. OWB is poised to carry out the Commission's mission of motivating whistleblowers to submit high-quality information that will lead to successful securities enforcement actions and better protect investors from financial fraud.

Sean X. McKessy
Chief, Office of the Whistleblower

HISTORY AND PURPOSE

The Dodd-Frank Act[1] amended the Securities Exchange Act of 1934 (the "Exchange Act")[2] by, among other things, adding Section 21F[3], entitled "Securities Whistleblower Incentives and Protection." Section 21F directs the Commission to make monetary awards to eligible individuals who voluntarily provide original information that leads to successful Commission enforcement actions resulting in monetary sanctions over $1,000,000, and successful related actions.

Awards are required to be made in the amount equal to 10 to 30% of the monetary sanctions collected. To ensure that whistleblower payments would not diminish the amount of recovery for victims of securities law violations, Congress established a separate fund, called the Investor Protection Fund ("Fund"), out of which eligible whistleblowers would be paid.

The Commission established OWB, a separate office within the Commission's Division of Enforcement ("Enforcement"), to administer and effectuate the whistleblower program. It is OWB's mission to administer a vigorous whistleblower program that will help the Commission identify and halt frauds early and quickly to minimize investor losses.

In addition to establishing an awards program to encourage the submission of high quality information, the Dodd-Frank Act and the Commission's implementing regulations ("the Final Rules")[4] prohibit retaliation against whistleblowers who report possible wrongdoing based on a reasonable belief that a possible securities violation has occurred, is in progress or is about to occur.[5]

The whistleblower program was designed to complement, rather than replace, existing corporate compliance programs. While it provides incentives for insiders and others with information about unlawful conduct to come forward, it also encourages them to work within their company's own compliance structure.

Section 924(d) of the Dodd-Frank Act requires OWB to report annually to Congress on OWB's activities, whistleblower complaints, and the response of the Commission to such complaints. In addition, Section 21F(g)(5) of the Exchange Act requires the Commission to submit an annual report to Congress that addresses the following subjects:

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[1] Pub. L. No. 111-203, § 922(a), 124 Stat 1841(2010).
[2] 15 U.S.C. § 78a *et seq*.
[3] 15 U.S.C. § 78u-6.
[4] 240 C.F.R. §§ 21F-1 through 21F-17.
[5] 15 U.S.C. § 78u-6(h)(1); 240 C.F.R. § 21F-2(b).

- The whistleblower award program, including a description of the number of awards granted and the type of cases in which awards were granted during the preceding fiscal year;
- The balance of the Fund at the beginning of the preceding fiscal year;
- The amounts deposited into or credited to the Fund during the preceding fiscal year;
- The amount of earnings on investments made under Section 21F(g)(4) during the preceding fiscal year;
- The amount paid from the Fund during the preceding fiscal year to whistleblowers pursuant to Section 21F(b);
- The balance of the Fund at the end of the preceding fiscal year; and
- A complete set of audited financial statements, including a balance sheet, income statement and cash flow analysis.[6]

This report has been prepared by OWB to satisfy the reporting obligations of Section 924(d) of the Dodd-Frank Act and Section 21F(g)(5) of the Exchange Act. The sections in this report addressing the activities of OWB, the whistleblower tips received during Fiscal Year 2013, and the processing of those whistleblower tips primarily address the requirements of Section 924(d) of the Dodd-Frank Act. The sections in this report addressing the whistleblower incentive awards made during Fiscal Year 2013 and the Fund primarily address the requirements of Section 21F(g)(5) of the Exchange Act.

[6] In Fiscal Years 2011 and 2012, OWB submitted its report on the Dodd-Frank whistleblower program to Congress on November 15th to coincide with the submission of the Commission's annual Agency Financial Report to Congress, which included audited financial information on the Fund. However, because of the recent partial government shutdown, the annual Agency Financial Report will be submitted to Congress at a later date. Therefore, the financial information contained in this report concerning the Fund (see page 16) is unaudited, and Congress will receive the audited financial information on the Fund when the Commission submits its 2013 Agency Financial Report.

OVERVIEW OF THE OFFICE OF THE WHISTLEBLOWER

Organization

Section 924(d) of the Dodd-Frank Act directed the Commission to establish a separate office within the Commission to administer and to enforce the provisions of Section 21F of the Exchange Act. On February 18, 2011, the Commission announced the appointment of Sean X. McKessy to head the Office. On January 17, 2012, the Commission named Jane A. Norberg as the Office's Deputy Chief.

In addition to Mr. McKessy and Ms. Norberg, OWB currently is staffed by nine attorneys and three paralegals.

Activities

Since its establishment, OWB has focused primarily on establishing the office and implementing the whistleblower program pursuant to the Dodd-Frank Act and the Commission's Final Rules, which became effective on August 12, 2011.

During Fiscal Year 2013, the Office's activities included the following:

- Communicating with whistleblowers who have submitted tips, additional information, claims for awards, and other correspondence to OWB. The Office also met with whistleblowers, potential whistleblowers and their counsel, and consulted Enforcement staff to provide guidance to whistleblowers and their counsel.

- Staffing a publicly-available whistleblower hotline for members of the public to call with questions about the program. The hotline was established in May 2011. OWB attorneys return all calls within 24 business hours. During the 2013 fiscal year, the Office returned over 2,810 phone calls from members of the public.

- Reviewing and entering whistleblower tips received by mail and fax into the Commission's Tips, Complaints, and Referrals System (the "TCR System").

- Working with Enforcement staff to identify and track all enforcement cases potentially involving a whistleblower to assist in the documentation of the whistleblower's information and cooperation in anticipation of a potential claim for award.

- Posting on the OWB website a notice of every Commission action that resulted in monetary sanctions over $1,000,000, called a Notice of Covered Action ("NoCA"), for which a whistleblower who provided original information that led to the success of that enforcement action may seek an award.

"During the 2013 fiscal year, the Office returned over 2,810 phone calls from members of the public."

- Reviewing and analyzing applications for whistleblower awards submitted in response to each posted NoCA. OWB attorneys confer with Enforcement staff on the relevant covered action to determine the applicant's assistance or contribution on the matter. OWB attorneys then prepare a written recommendation concerning whether the Commission should issue an award to the applicant in that matter.

- Responding to requests by claimants to reconsider a preliminary determination of the Claims Review Staff to deny their application for an award. This includes compiling and providing copies of the record which formed the basis of the preliminary determination to grant or deny an award, upon timely request by the claimant.

- Working with the Commission's Office of Financial Management ("OFM") to execute on the Commission's approved awards and get payments to qualified whistleblowers promptly following the Commission's Final Order.

- Maintaining and updating the OWB website to better inform the public about the whistleblower program (www.sec.gov/whistleblower). The website includes two videos by Mr. McKessy providing an overview of the program and information about how tips, complaints and referrals are handled. The website also contains detailed information about the program, copies of the forms required to submit a tip or claim an award, a listing of current and past NoCAs, links to helpful resources, and answers to frequently asked questions.

- Identifying and monitoring whistleblower complaints alleging retaliation by employers or former employers for reporting possible securities law violations internally or to the Commission. The Commission has the authority to enforce the provisions of the Exchange Act, including the anti-retaliation provisions of Section 21F(h)(1). OWB works with Enforcement staff on potential anti-retaliation enforcement actions where appropriate. OWB also monitors federal court cases addressing the anti-retaliation provisions of the Dodd-Frank Act and the Sarbanes-Oxley Act of 2002.[7] In addition, OWB reviews employee confidentiality and other agreements provided by whistleblowers for potential concerns arising under Rule 21F-17 of the Exchange Act.[8]

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[7] 18 U.S.C. § 1514A. On July 17, 2013, the United States Court of Appeals for the Fifth Circuit in *Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620 (5th Cir. 2013) held that the anti-retaliation provisions of the Dodd-Frank Act provide a private cause of action only for those employees who provide allegations of possible securities law violations directly to the Commission. The Fifth Circuit's decision in *Asadi* is contrary to several district court decisions and may contradict a Commission regulation that provides protection for employees from retaliation where they report possible securities violations to persons or authorities other than the Commission, including reporting internally. District courts in both Colorado and California, however, have agreed with the *Asadi* holding.

[8] Rule 21F-17(a) provides that "No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing or threatening to enforce, a confidentiality agreement . . . with respect to such communications." 240 C.F.R. § 21F-17(a).

- Working together with the Commission's Office of the Inspector General ("OIG") in connection with the audit required of the Commission's whistleblower program by Section 922 of the Dodd-Frank Act. OIG issued a final report on January 18, 2013. (See pages 17-18 for a detailed discussion of the OIG's findings.)

- Developing and implementing key performance measures related to OWB's internal controls to strengthen the whistleblower process in response to OIG's evaluation of the whistleblower program.

- Providing training on the Dodd-Frank Act and the Commission's implementing rules to Commission staff. This included the posting of guidance on Commission intranet sites regarding whistleblower issues and rules. OWB anticipates it will provide additional training to groups likely to be involved in whistleblower matters in the SEC's Home Office, specialty units, and all eleven Regional Offices in the upcoming fiscal year.

- Providing guidance to Commission staff regarding the handling of confidential whistleblower-identifying information and the handling of potentially privileged information provided by whistleblowers.

- Coordinating with Commission staff in making external referrals to other government agencies consistent with the Dodd-Frank Act's and the Final Rules' confidentiality provisions.

- Conferring with regulators from other agencies' whistleblower offices, including the Internal Revenue Service and the Commodity Futures Trading Commission, to discuss best practices and experiences.

- Actively publicizing the program through participation in webinars, media interviews, presentations, press releases, and other public communications. For Fiscal Year 2013, OWB participated in seventeen public engagements and conducted several media interviews aimed at promoting and educating the public concerning the Commission's whistleblower program.

- Working with the Commission's Office of Information and Technology to develop a software solution that will assist and streamline OWB's daily work flow and track the progress of whistleblower complaints synchronized with various Enforcement data systems.

WHISTLEBLOWER TIPS RECEIVED DURING FISCAL YEAR 2013

The Final Rules specify that individuals who would like to be considered for a whistleblower award must submit their tip via the Commission's online TCR questionnaire portal or by mailing or faxing their tip on Form TCR to OWB.[9] OWB sends an acknowledgement or deficiency letter to whistleblowers for all complaints that are received by mail or fax, which includes a TCR submission number. Whistleblowers who use the online portal to submit a complaint receive a computer-generated confirmation receipt and a TCR submission number. All whistleblower tips received by the Commission are entered into the TCR System, the Commission's centralized database for prioritization, assignment, and tracking.

Subject of Whistleblower Complaints

In Fiscal Year 2013, 3,238 whistleblower TCRs were received.[10] By comparison, for Fiscal Year 2012, the Commission received 3,001 whistleblower TCRs. The table below shows the number of whistleblower tips received by the Commission on a yearly basis since the inception of the whistleblower program:

FY2011[11]	FY2012	FY2013
334	3,001	3,238

The most common complaint categories reported by whistleblowers in the 2013 fiscal year were Corporate Disclosures and Financials (17.2%), Offering Fraud (17.1%), and Manipulation (16.2%). By comparison, in Fiscal Year 2012, the most common complaint categories reported by whistleblowers also were Corporate Disclosures and Financials (18.2%), Offering Fraud (15.5%), and Manipulation (15.2%).

This is the first year for which the Commission has year-over-year data concerning the nature of the tips and complaints the Commission receives through its whistleblower program. Appendix A shows the number of whistleblower tips, by allegation type and quarter, received during the 2013 fiscal year. Appendix B provides a comparison between the number of whistleblower tips by allegation type that the Commission received during the 2012 and 2013 fiscal years. As demonstrated by Appendix B, the most common complaint categories reported by whistleblowers have remained consistent between the prior and current fiscal years.

[9] 240 C.F.R. § 21F-9(a).

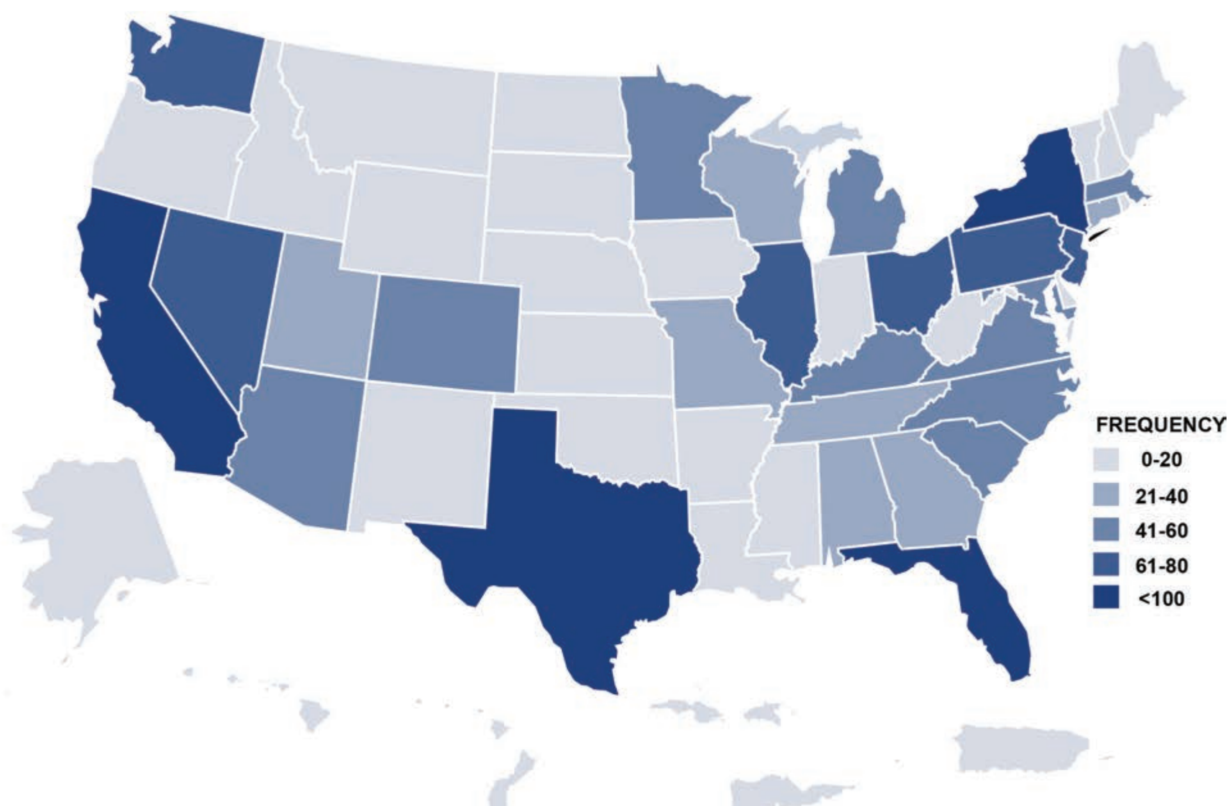
[10] The Commission also receives TCRs from individuals who do not wish or are not eligible to be considered for an award under the whistleblower program. The data in this report is limited to those TCRs that include the required whistleblower declaration and does not reflect all TCRs received by the Commission during the fiscal year.

[11] Because the Final Rules became effective August 12, 2011, only 7 weeks of whistleblower data is available for Fiscal Year 2011.

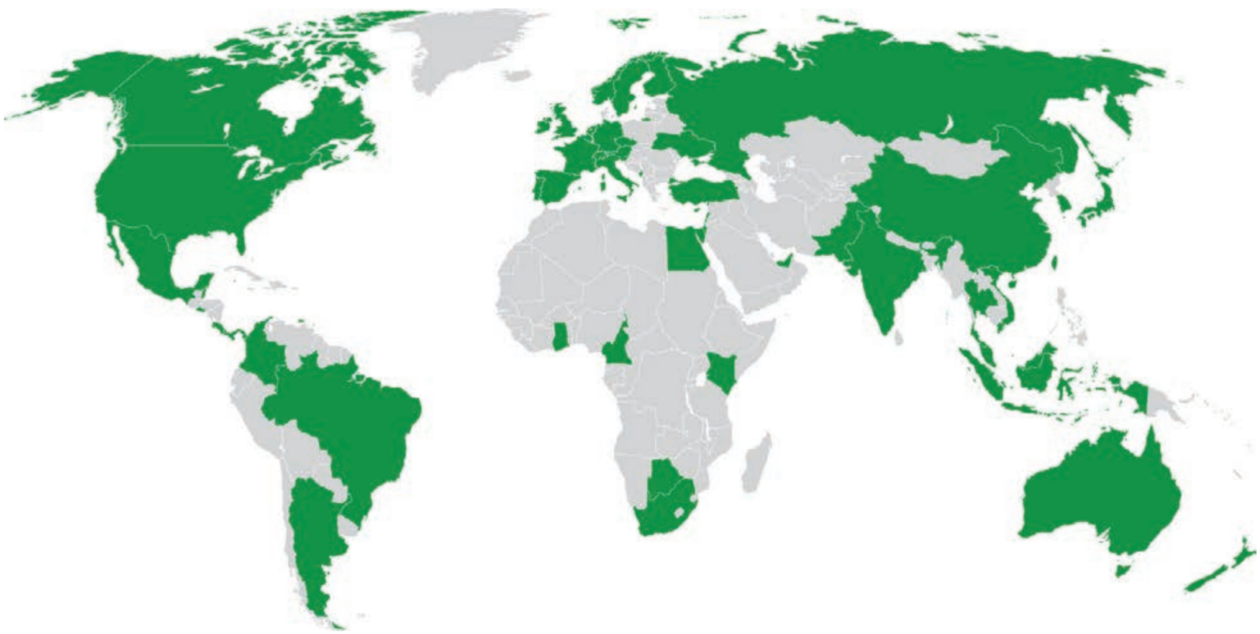
Origin of Whistleblower Complaints

OWB publicizes and promotes the Commission's whistleblower program through external speaking engagements, participation in panels, and discussions with the media. OWB educates the public about the whistleblower program by having an accessible website and manning a whistleblower hotline. As a result, the Commission receives whistleblower submissions from individuals throughout the United States as well as from individuals residing in foreign countries.

During Fiscal Year 2013, the Commission received whistleblower submissions from individuals in all fifty (50) states, as well as from the District of Columbia, and the U.S. territories of Puerto Rico, Guam, and the U.S. Virgin Islands, as reflected in the map below. California, New York and Florida were the three states from which the highest number of whistleblower tips originated in the 2013 fiscal year.



Since the beginning of the whistleblower program, the Commission has received whistleblower tips from individuals in sixty-eight (68) countries outside the United States. In Fiscal Year 2013 alone, the Commission received whistleblower submissions from individuals in fifty-five (55) foreign countries. The map below reflects all countries in which whistleblower tips originated during Fiscal Year 2013.



Appendices C and D, which accompany this report, provide more specific information concerning the sources of domestic and foreign whistleblower tips that the Commission received during the 2013 fiscal year.

PROCESSING OF WHISTLEBLOWER TIPS DURING FISCAL YEAR 2013

The Commission's Office of Market Intelligence ("OMI") within Enforcement evaluates incoming whistleblower TCRs and assigns specific, credible, and timely TCRs to members of Commission staff for further investigation or analysis.

TCR Evaluation

OMI reviews every TCR submitted by a whistleblower to the Commission. During the evaluation process, OMI staff examines each tip to identify those that are sufficiently specific, credible, and timely to warrant the additional allocation of Commission resources. When OMI determines a complaint warrants deeper investigation, OMI staff assigns the complaint to one of the Commission's 11 regional offices, a specialty unit, or to an Enforcement Associate Director in the Home Office. Complaints that relate to an existing investigation are forwarded to the staff working on the existing matter. Tips that could benefit from the specific expertise of another Division or Office within the Commission generally are forwarded to staff in that Division or Office for further analysis.

The Commission may use information from whistleblower tips and complaints in several different ways. For example, the Commission may initiate an enforcement investigation based on the whistleblower's tip or complaint. Even if a whistleblower's tip does not cause an investigation to be opened, it may still help lead to a successful enforcement action if the whistleblower provides additional information that substantially contributes to an ongoing or active investigation. Tips may also provide information that prompts the Commission to commence an examination of a regulated entity or a review of securities filings, which may lead to an enforcement action.

In certain instances, OMI may determine it is more appropriate that a whistleblower's tip be investigated by another regulatory or law enforcement agency. When this occurs, the Commission will forward the tip to the Commission point of contact for that agency, consistent with the confidentiality requirements of Section 21F(h)(2) of the Exchange Act. Additionally, tips that relate to the financial affairs of an individual investor or a discrete investor group, usually are forwarded to the Commission's Office of Investor Education and Advocacy ("OIEA") for resolution. Comments or questions about agency practice or the federal securities laws also are forwarded to OIEA.

Assistance by OWB

OWB supports the tip allocation and investigative processes in several ways. When whistleblowers submit tips on a Form TCR in hard copy via mail or fax, OWB enters this information into the TCR System so it can be evaluated by OMI.[12] During the evaluation process, OWB may assist by contacting the whistleblower to obtain additional information to assist in the triage process.

During an investigation, OWB serves as a liaison as necessary between the whistleblower (and his or her counsel) and SEC investigative staff. On occasion, OWB arranges meetings between whistleblowers and the subject matter experts on the Enforcement staff to assist in better understanding the whistleblower's submissions and developing the facts of specific cases.

OWB staff also communicates frequently with Enforcement staff with respect to the timely documentation of information regarding the staff's interactions with whistleblowers, the value of the information provided by whistleblowers, and the assistance provided by whistleblowers as the potential securities law violation is being investigated.

[12]Tips submitted by whistleblowers through the Commission's online Tips, Complaints and Referrals questionnaire are automatically forwarded to OMI for evaluation.

WHISTLEBLOWER AWARDS MADE DURING FISCAL YEAR 2013

Process for Reviewing Applications for Awards

The Office posts on its website a Notice of Covered Action ("NoCA") for each Commission enforcement action where a final judgment or order, by itself or together with other prior judgments or orders in the same action issued after July 21, 2010, results in monetary sanctions exceeding $1,000,000. OWB also announces on Twitter each time a new group of NoCAs is posted to its website, and sends email alerts to GovDelivery when its website is updated.[13] In addition, whistleblowers may sign up to receive an update via email every time the list of NoCAs on OWB's website is updated. Once a NoCA is posted, individuals have 90 calendar days to apply for an award by submitting a completed Form WB-APP to OWB by the claim due date listed for that action.[14]

During Fiscal Year 2013, OWB posted 118 Notices of Covered Action for enforcement judgments and orders issued during the applicable period that included the imposition of sanctions exceeding the statutory threshold of $1,000,000.[15] Since the program's inception, OWB has posted 431 NoCAs to its website.

OWB analyzes each application for a whistleblower award, working with Enforcement staff responsible for the relevant action to understand the contribution or involvement the applicant had in the matter. OWB then prepares a written recommendation as to whether the applicant should receive an award, and if so, the percentage of the award.

The Claims Review Staff, designated by the Co-Directors of Enforcement, reviews OWB's recommendation in accordance with the criteria set forth in the Dodd-Frank Act and the Final Rules. The Claims Review Staff currently is comprised of three senior officers in Enforcement, including one of the Co-Directors. The Claims Review Staff then issues a Preliminary Determination setting forth its assessment as to whether the claim should be allowed or denied and, if allowed, setting forth the proposed award percentage amount.[16]

If a claim is denied and the applicant does not object within the statutory time period, then the Preliminary Determination of the Claims Review Staff becomes the Final Order of the Commission. However, an applicant can request reconsideration and has 30 calendar days to request a copy of the record that

"Since the program's inception, OWB has posted 431 NoCAs to its website."

[13]GovDelivery is a vendor that provides communications for public sector clients.

[14]240 C.F.R. §§ 21F-10(a), (b).

[15]By posting a Notice of Covered Action for a particular case, the Commission is not making a determination either that (i) a whistleblower tip, complaint or referral led to the Commission opening an investigation or filing an action with respect to the case or (ii) an award to a whistleblower will be paid in connection with the case.

[16]240 C.F.R. § 21F-10(d).

"Since the inception of the Commission's whistleblower program in August 2011, the Commission has granted awards to six whistleblowers..."

formed the basis of the Claims Review Staff's decision or to request a meeting with OWB. Whistleblowers can seek reconsideration with OWB by submitting a written response within 60 calendar days of the later of (i) the date of the Preliminary Determination, or (ii) the date when OWB made materials available for the whistleblower's review.[17] OWB considers the issues and grounds advanced in the applicant's response, along with any supporting documentation provided, and makes its recommendation to the Claims Review Staff. After this additional review, the Claims Review Staff issues a Proposed Final Determination, and the matter is forwarded to the Commission for its decision.[18]

All Preliminary Determinations of the Claims Review Staff that involve an award of money also are forwarded to the Commission for consideration as Proposed Final Determinations irrespective of whether the applicant objected to the Preliminary Determination.[19] These procedures ensure that the Commission makes the final decision for all claims in which (1) a monetary award is recommended or (2) there is a preliminary denial of claims to which the applicant objects.

Within 30 days of receiving notice of the Proposed Final Determination, any Commissioner may request that the Proposed Final Determination be reviewed by the Commission. If no Commissioner requests such a review within the 30-day period, then the Proposed Final Determination becomes the Final Order of the Commission. In the event a Commissioner requests a review, the Commission reviews the record that the Claims Review Staff relied upon in making its determination and issues its Final Order.[20]

Whistleblower Awards

Since the inception of the Commission's whistleblower program in August 2011, the Commission has granted awards to six whistleblowers, with four whistleblowers receiving awards in Fiscal Year 2013. In each instance, the whistleblower provided high-quality original information that allowed the Commission to more quickly unearth and investigate the securities law violation, thereby better protecting investors from further financial injury and helping to conserve limited agency resources.

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[17] 240 C.F.R. § 21F-10(e).
[18] 240 C.F.R. §§ 21F-10(g), (h).
[19] 240 C.F.R. §§ 21F-10(f), (h).
[20] 240 C.F.R. § 21F-10(h). A whistleblower's rights of appeal from a Commission Final Order are set forth in Section 21F(f) of the Exchange Act, 15 U.S.C. § 78u-6(f), and Rule 21F-13(a) of the Final Rules, 240 C.F.R. § 21F-13(a).

On August 21, 2012, the Commission announced its first whistleblower[21] award. In that instance, the whistleblower helped the Commission stop a multi-million dollar fraud. The whistleblower provided documents and other significant information that allowed the investigation to move at an accelerated pace and prevent the fraud from ensnaring additional victims. During Fiscal Year 2013, the Commission made three more payments to this whistleblower in connection with additional amounts that had been collected by the Commission in the underlying enforcement action.

On June 12, 2013, the Commission announced it had issued an award to three whistleblowers who helped the Commission shut down a sham hedge fund. Two of the whistleblowers provided information that prompted the Commission to open the investigation and stop the scheme before more investors were harmed. The third whistleblower provided independent corroborating information and identified key witnesses. On August 30, 2013, the Commission announced it had approved payouts to each of the three whistleblowers in connection with money that had been collected in a related criminal proceeding.[22]

On October 1, 2013, the Commission announced it had made the largest whistleblower award to date, awarding over $14 million to a whistleblower whose information led to a Commission enforcement action that recovered substantial investor funds. Less than six months after receiving the whistleblower's tip, the Commission was able to bring an enforcement action against the perpetrators and secure investor funds.

On October 30, 2013, the Commission announced it made another award payment to a whistleblower whose information and continued cooperation enabled the Commission to detect and halt an ongoing fraudulent scheme. Because the payment was made after the end of Fiscal Year 2013, this award payment is not reflected in the Fund or in the Commission's financial statements for the 2013 fiscal year.

In sum, during Fiscal Year 2013, the Commission made $14,831,965.64 in award payments to whistleblowers under the Commission's whistleblower program.

[21] By law, the Commission must protect the confidentiality of whistleblowers and cannot disclose any information that might directly or indirectly reveal a whistleblower's identity. Therefore, the information herein concerning the awards the Commission has issued does not include information regarding the whistleblower's identity or other information that could indirectly reveal the whistleblower's identity.

[22] In cases where there are related criminal proceedings in which money is collected by another regulator, a provision in the whistleblower rules allows whistleblowers to then additionally apply for an award based off the other regulator's collections in what qualifies as a "related action." 240 C.F.R. § 21F-3(b).

SECURITIES AND EXCHANGE COMMISSION INVESTOR PROTECTION FUND

Section 922 of the Dodd-Frank Act established the Fund to provide funding for the Commission's whistleblower award program, including the payment of awards in related actions.[23] In addition, the Fund is used to finance the operations of the SEC's OIG's suggestion program.[24] The suggestion program is intended for the receipt of suggestions from Commission employees for improvements in work efficiency, effectiveness, productivity, and the use of resources at the Commission, as well as allegations by Commission employees of waste, abuse, misconduct, or mismanagement within the Commission.[25]

Section 21F(g)(5) of the Exchange Act requires certain Fund information to be reported to Congress on an annual basis. Below is a chart containing Fund-related information for Fiscal Year 2013[26]:

Balance of Fund at beginning of fiscal year	$453,429,825.58
Amounts deposited into or credited to Fund during fiscal year	$0.00[27]
Amount of earnings on investments during fiscal year	$650,206.56
Amount paid from Fund during fiscal year to whistleblowers	($14,831,965.64)
Amount disbursed to Office of the Inspector General during fiscal year	($51,457.14)
Balance of Fund at end of the fiscal year	$439,196,609.36

In addition, Section 21F(g)(5) of the Exchange Act requires a complete set of audited financial statements for the Fund, including a balance sheet, income sheet, income statement, and cash flow analysis. That information is included in the Commission's Agency Financial Report, which is being submitted separately to Congress.

[23]Section 21F(g)(2)(A) of the Exchange Act, 15 U.S.C. § 78u-6(g)(2)(A).

[24]Section 21F(g)(2)(B) of the Exchange Act provides that the Fund shall be available to the Commission for "funding the activities of the Inspector General of the Commission under section 4(i)." 15 U.S.C. § 78u-6(g)(2)(B). The Office of the General Counsel has interpreted Section 21F(g)(2)(B) to refer to Section 4D of the Exchange Act, which establishes the Inspector General's suggestion program. Subsection (e) of that section provides that the "activities of the Inspector General under this subsection shall be funded by the Securities and Exchange Commission Investor Protection Fund established under Section 21F." 15 U.S.C. § 78d-4(e).

[25]Section 4D(a) of the Exchange Act, 15 U.S.C. § 78d-4(a).

[26]As referenced above, the financial information on the Fund contained in this report is unaudited, and Congress will receive the audited financial information on the Fund when the Commission submits its 2013 Agency Financial Report.

[27]Pursuant to Section 21F(g)(3) of the Exchange Act, no monetary sanctions are deposited into or credited to the Fund if the balance of the Fund exceeds certain thresholds at the time the monetary sanctions are collected.

EVALUATION OF THE WHISTLEBLOWER PROGRAM BY THE INSPECTOR GENERAL

Section 922 of the Dodd-Frank Act mandated that OIG conduct a review of the Commission's whistleblower program and submit a report of findings not later than 30 months after the Dodd-Frank Act's enactment to the (1) Senate Committee on Banking, Housing and Urban Affairs, and (2) House Committee on Financial Services. During Fiscal Year 2013, OWB worked closely with OIG in providing information and materials to enable OIG to perform its evaluation of the Commission's whistleblower program. On January 18, 2013, OIG issued its final report, a copy of which may be found on OWB's webpage.[28]

OIG concluded that implementation of the final rules made the Commission's whistleblower program clearly defined and user-friendly for those who have basic knowledge of securities laws, rules and regulations.[29] OIG also found that the Commission's whistleblower program is promoted on the Commission's website, and that the public can easily access OWB's homepage to learn about the whistleblower program and how to submit a tip.[30] OIG determined that OWB's outreach efforts have been strong and that "[b]ecause of the accessibility of OWB's website from the SEC's website, the program's promotion through various social media methods, prominent presence on major internet search engines, and OWB's internal and external outreach efforts . . . the SEC's whistleblower program is effectively promoted on its website and is widely publicized."[31]

In its report, OIG concluded that OWB is generally prompt in responding to information that is provided by whistleblowers, applications for whistleblower awards, and in communicating with interested parties.[32] However, OIG recommended that the whistleblower program's internal controls be strengthened by adding performance metrics.[33]

Enforcement agreed that performance metrics related to OWB's internal controls may be of value to the whistleblower process.[34] As a result, OWB developed performance metrics in 28 key areas and added those metrics to its internal control plan. For instance, on a quarterly basis, OWB will evaluate the percentage of whistleblower tips received by fax or through mail that are entered into the TCR System within three business days of receipt; the percentage of calls returned by OWB to messages left on the hotline within 24 business hours; and the percentage of initial reviews and acknowledgement or deficiency letters that are completed

[28] *Evaluation of the SEC's Whistleblower Program*, Office of Inspector General, January 18, 2013, Report No. 511, available at http://www.sec.gov/about/offices/oig/reports/audits/2013/511.pdf.
[29] *Id.* at v.
[30] *Id.*
[31] *Id.* at 14.
[32] *Id.* at v, 14.
[33] *Id.* at v, 20-22.
[34] *Id.* at 42, Appendix VI.

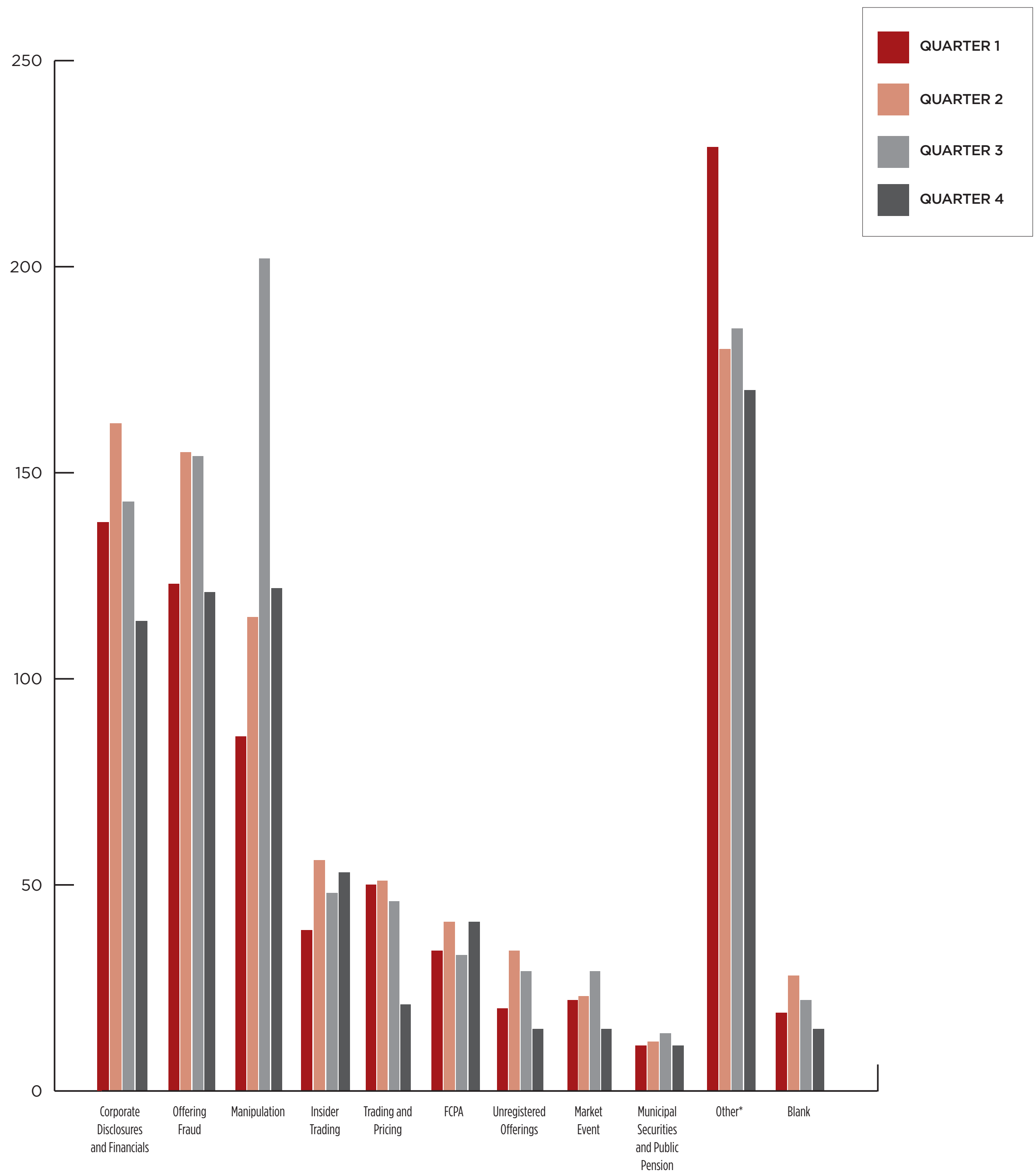
within thirty business days of receipt of an application for a whistleblower award. OWB also adopted additional performance measures that it will evaluate on an annual basis.

OWB's adoption of these performance metrics related to its internal controls was designed to strengthen and enhance the Commission's whistleblower program. OWB began utilizing the newly-adopted performance metrics in the last quarter of Fiscal Year 2013.

Finally, OIG did not find any programmatic changes to the Commission's whistleblower program to be necessary at this time. For instance, OIG observed that the Commission's whistleblower award levels are comparable to the award levels of other federal government whistleblower programs and that the whistleblower appeals process and funding mechanism via the Fund are appropriate.[35] OIG also determined that it was premature to introduce a private right of action into the Commission's whistleblower program and concluded that the Freedom of Information Act exemption added by the Dodd-Frank Act aids whistleblowers in disclosing information to the Commission.[36]

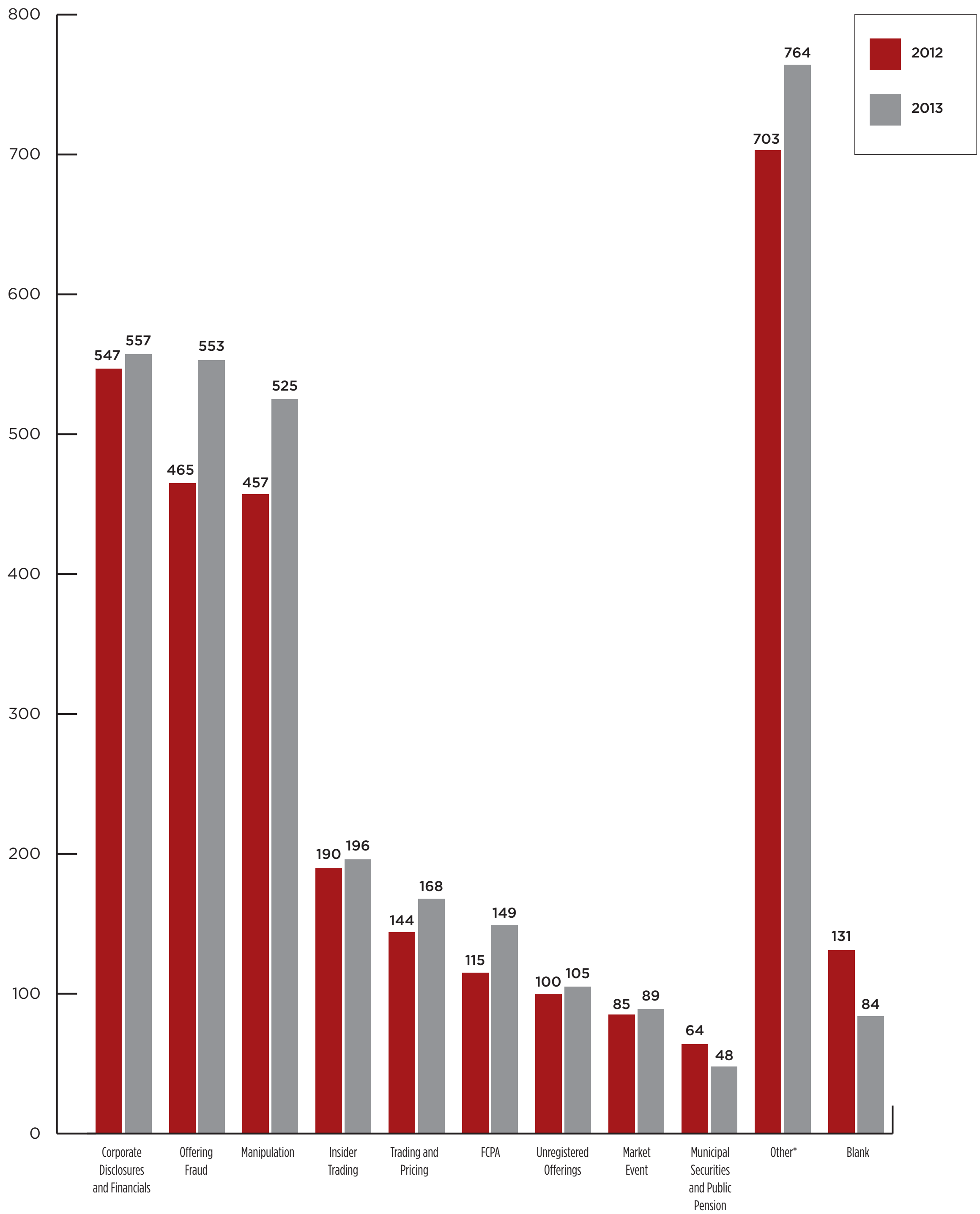
[35] *Id.* at vi, 24, 26.
[36] *Id.* at vi, 30.

APPENDIX A
WHISTLEBLOWER TIPS BY ALLEGATION TYPE
FISCAL YEAR 2013



* "Other" indicates that the submitter has identified their WB TCR as not fitting into any allegation category that is listed on the online questionnaire.

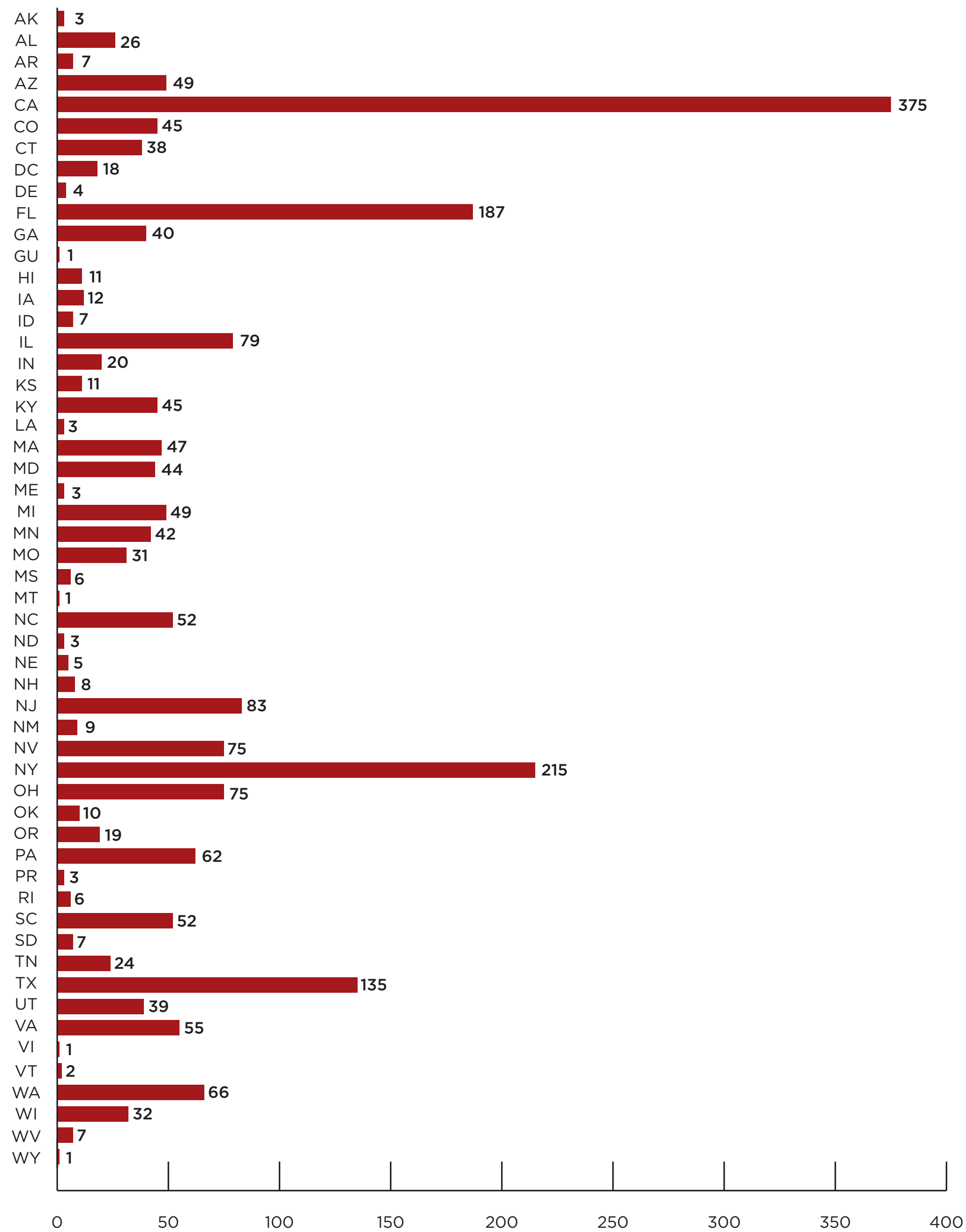
APPENDIX B
WHISTLEBLOWER TIPS BY ALLEGATION TYPE
COMPARISON OF FISCAL YEARS 2012 AND 2013



* "Other" indicates that the submitter has identified their WB TCR as not fitting into any allegation category that is listed on the online questionnaire.

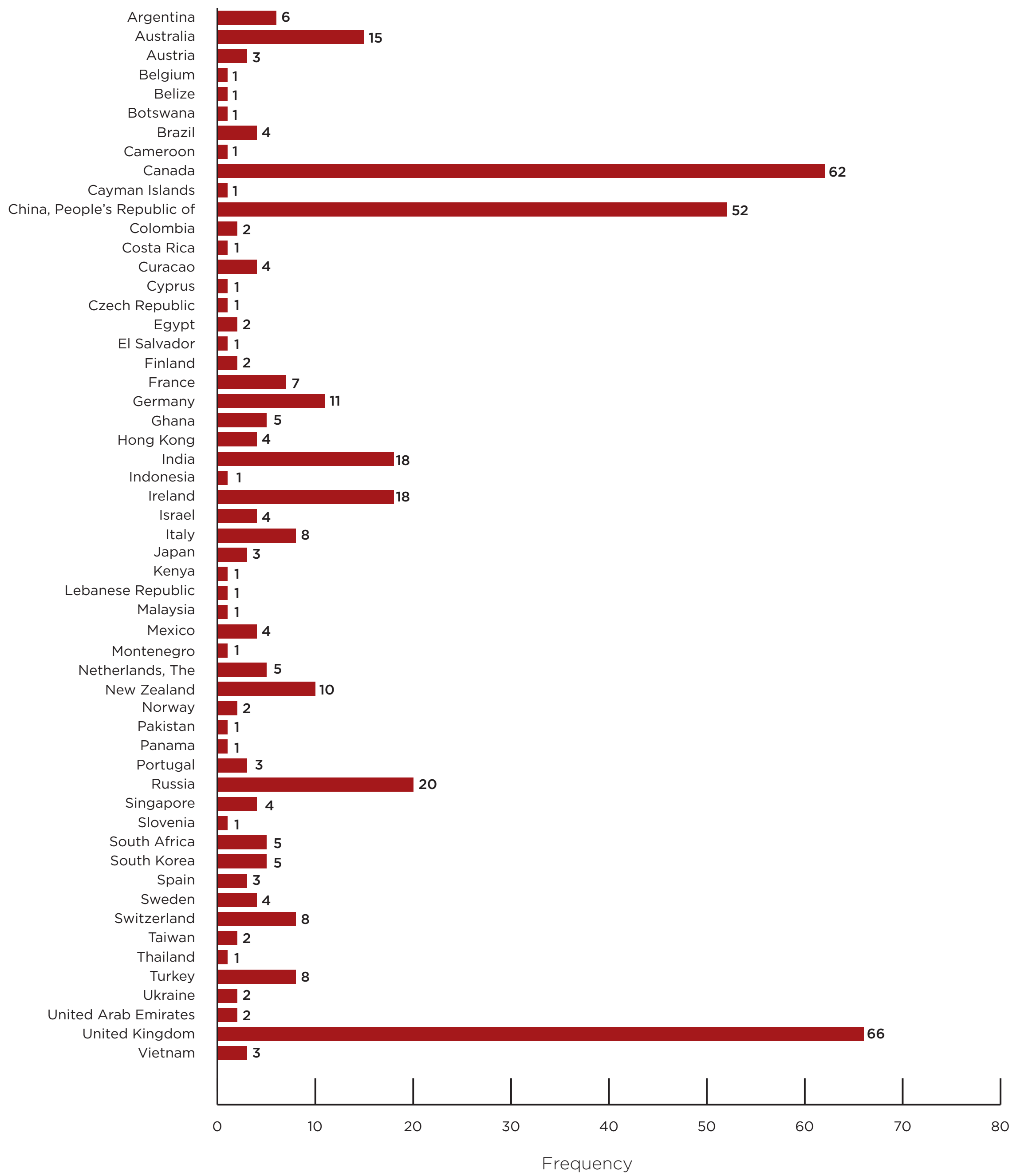
APPENDIX C

WHISTLEBLOWER TIPS RECEIVED BY GEOGRAPHIC LOCATION
UNITED STATES AND ITS TERRITORIES
FISCAL YEAR 2013*



*Multiple individuals may jointly submit a TCR under the Commission's whistleblower program. Appendix C reflects the number of individuals submitting WB TCRs to the Commission within the United States or one of its territories, and not the total number of domestic WB TCRs received by the Commission during Fiscal Year 2013. For example, a WB TCR that is jointly submitted by two individuals in New York and New Jersey would be reflected on Appendix C as a submission from both New York and New Jersey. The total number of persons submitting WB TCRs in the United States or one of its territories during Fiscal Year 2013 was 2250, which constitutes approximately 65.54% of the individuals participating in the Commission's whistleblower program for this period. Additionally, 779 individuals constituting 22.69% of the total number of persons participating in the Commission's whistleblower program for Fiscal Year 2013 submitted WB TCRs without any foreign or domestic geographical categorization or submitted them anonymously through counsel.

APPENDIX D
WHISTLEBLOWER TIPS RECEIVED BY GEOGRAPHIC LOCATION INTERNATIONAL FISCAL YEAR 2013*



*As with domestic WB TCRs, multiple individuals from abroad may jointly submit a TCR under the Commission's whistleblower program. Appendix D reflects the number of individuals submitting WB TCRs to the Commission from abroad, and not the total number of foreign WB TCRs received by the Commission during Fiscal Year 2013. The total number of persons submitting WB TCRs from abroad during Fiscal Year 2013 was 404, which constitutes approximately 11.77% of the individuals participating in the Commission's whistleblower program for this period.

OFFICE OF THE WHISTLEBLOWER

Washington, DC

SEC SETTLEMENTS INVOLVING ADMISSIONS OF WRONGDOING (JUNE 2013 – OCTOBER 2014)

Matter	Date of Settlement	Substance of Admission	Settlement Amount
SEC v. *Falcone* (SDNY); *SEC* v. *Harbinger Capital Partners* (SDNY)	Aug. 2013	Falcone admitted to bilking $113 million in funds from his firm, Harbinger Capital Partners, to pay his personal tax obligation; to granting favorable terms to certain investors; and to retaliating against a financial services firm for shorting bonds of a particular manufacturer by using his fund to purchase the manufacturer's outstanding bonds, thereby causing the price of the bonds to increase.	~$18 million total (~$10.5 m penalty; ~$6.5 m disgorgement; ~$1 m pre-judgment interest)
In re JP Morgan Chase & Co. (SEC Admin.) ("London Whale" Controversy)	Sept. 2013	JP Morgan admitted, among other things, that its trading losses occurred "against a backdrop of woefully deficient accounting controls in the [firm's chief investment office]," that "[s]enior management failed to adequately update the audit committee on these and other important facts concerning the CIO before the firm filed its first quarter report for 2012," and that "[d]eprived of access to these facts, the audit committee was hindered in its ability to discharge its obligations to oversee management on behalf of shareholders and to ensure the accuracy of the firm's financial statements."	$200 million
In re G-Trade Services LLC (SEC Admin.) ("ConvergEx Subsidiaries")	Dec. 2013	Certain subsidiaries of ConvergEx Group admitted to "represent[ing] to customers that they charge explicit commissions to execute equity trading orders," where in reality they "they routinely routed orders, including orders for U.S. equities, to an offshore affiliate in Bermuda that executed them on a riskless basis and opportunistically boosted their profits by adding a mark-up or mark-down on the price of a security," causing many customers "to unknowingly pay more than double what they understood they were paying to have their orders executed. "	$107 million

Matter	Date of Settlement	Substance of Admission	Settlement Amount
In re Scottrade, Inc. (SEC Admin.)	Jan. 2014	Scottrade admitted to violating recordkeeping provisions of the securities laws. Due to a computer coding error, Scottrade failed to provide, at the SEC's request, "blue sheet" information on over 1000 occasions over a 6 year period.	$2.5 million
In re Credit Suisse Group AG (SEC Admin.)	Feb. 2014	Credit Suisse admitted that it "provided cross-border securities services to thousands of U.S. clients and collected fees totaling approximately $82 million," whereby Credit Suisse relationship managers who were not registered brokers travelled to and communicated with U.S. clients.	$196 million
In re Lions Gate Entertainment Corp. (SEC Admin.)	Mar. 2014	"According to the SEC's order instituting settled administrative proceedings, Lions Gate's management participated in a set of extraordinary corporate transactions in 2010 that put millions of newly issued company shares in the hands of a management-friendly director. . . . Lions Gate failed to reveal that the move was part of a defensive strategy to solidify incumbent management's control, instead stating in SEC filings that the transactions were part of a previously announced plan to reduce debt. In fact, the company had made no such prior announcement." Lions Gate admitted, among other things, that it "amended its insider trading policy at the midnight board meeting to allow the friendly director to immediately convert the notes to stock," "approved the friendly director's last-minute request to change the conversion price," and "allowed the friendly director to review the new note terms, term sheet, and exchange agreement before they were provided to the note holder."	$7.5 million
SEC v. Harbinger Capital Partners LLC (SDNY)	July 2014	Peter Jenson, Harbinger's former COO, admitted that he know of Falcone and Harbinger's violations, and failed ensure	$200,000

Matter	Date of Settlement	Substance of Admission	Settlement Amount
		"that the lender had separate counsel," "that the loan was consistent with Falcone's fiduciary obligations," and "that Falcone paid an above market interest rate on the loan." Jenson also admitted that he failed to "timely disclose the loan to investors" and to "take actions to cause the lender to accelerate Falcone's payment on the loan once investors in the [fund] were permitted to begin redeeming their investments."	
In re Michael Horowitz and Moshe Marc Cohen (SEC Admin.)	July 2014	Horowitz admitted to perpetrating a scheme to sell investors variable annuities contracts with death benefit and bonus features, designating a terminally ill patient as annuitants whose death with trigger a payment. These annuities were marketed as "short-term investment vehicles." Horowitz also admitted to knowing that "if the "stranger annuitants" did not die within a matter of months, his customers would be locked into unsuitable, highly illiquid long-term investment vehicles that they would be able to exit only by paying substantial surrender charges."	$850,000
In re Bank of America Corp. (SEC Admin.)	Aug. 2014	"Bank of America admits that it failed to disclose known uncertainties regarding potential increased costs related to mortgage loan repurchase claims stemming from more than $2 trillion in residential mortgage sales from 2004 through the first half of 2008 by the bank and certain companies it acquired. In connection with these sales, Bank of America made contractual representations and warranties about the underlying quality of the mortgage loans and underwriting. In the event that a loan buyer claimed a breach of a representation or warranty, the bank could be obligated to repurchase the related mortgage loan at its outstanding unpaid principal balance."	$245 million

Matter	Date of Settlement	Substance of Admission	Settlement Amount
In re Wells Fargo Advisors, LLC (SEC Admin.)	Sept. 2014	Wells Fargo admitted to having inadequate controls to prevent an employee from insider trading based on non-public information of a potential acquisition. Furthermore, Wells Fargo admitted to unreasonably delaying production of relevant documents to the SEC and to producing an altered document.	$5 million

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70458 / September 19, 2013

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3490 / September 19, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15507

In the Matter of **JPMorgan Chase & Co.,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against JPMorgan Chase & Co. ("JPMorgan").

II.

In anticipation of the institution of these proceedings, JPMorgan has submitted an Offer of Settlement ("Offer") that the Commission has determined to accept. JPMorgan admits the facts contained in Annex A attached hereto, the Commission's jurisdiction over it, and the subject matter of these proceedings; and consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order, the Offer, and the facts contained in Annex A attached hereto, the Commission finds[1] that:

1. Public companies are responsible for devising and maintaining a system of internal accounting controls sufficient to, among other things, provide reasonable assurances that transactions are recorded as necessary to permit preparation of reliable financial statements. In addition, the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") established important requirements for public companies and their management with respect to corporate governance and disclosure. For example, public companies are obligated to maintain disclosure controls and procedures that are designed to ensure that important information flows to the appropriate persons so that timely decisions can be made regarding disclosure in public filings. Commission regulations implementing Sarbanes-Oxley therefore require management to evaluate on a quarterly basis the effectiveness of the company's disclosure controls and procedures and the company to disclose management's conclusion regarding their effectiveness in its quarterly filings.

2. On an investor call conducted in connection with the filing of its quarterly report on May 10, 2012, JPMorgan publicly disclosed a trading loss of approximately $2 billion since the start of the second quarter in a large portfolio of credit derivatives known as the Synthetic Credit Portfolio ("SCP") held by the firm's Chief Investment Office ("CIO"). In the quarterly report, JPMorgan stated that, based upon management's evaluation at the time, its disclosure controls and procedures were effective as of the end of the quarter.

3. Over the next few months, as JPMorgan sought to bring down risk in the SCP, the losses in the SCP grew to nearly $6 billion. Nevertheless, the full extent of the trading losses that had occurred during the first quarter was not detected and reported, in part, because of the ineffectiveness of an internal control function within CIO, known as the Valuation Control Group ("CIO-VCG"). Within JPMorgan and other financial institutions and investment firms, valuation control units frequently serve as an essential internal control by helping to ensure that traders and other market professionals record accurate valuations for trading positions. Valuation control units must be sufficiently independent from the trading desks, and clear and effective written policies are necessary in order to guard against the risk that a company's investment assets will be improperly valued—and its public filings misstated.

4. In the case of CIO, its VCG unit was unequipped to cope with the increase in the size and complexity of the SCP in early 2012, and did not function as an effective internal control in the first quarter of the year. The unit was understaffed, insufficiently supervised, and did not adequately document its actual price-testing policies. Moreover, the actual price-testing methodology employed by CIO-VCG in the first quarter of 2012 was subjective and insufficiently independent from the SCP traders, which enabled the traders to improperly

[1] The findings herein are made pursuant to JPMorgan's Offer and are not binding on any other person or entity in this or any other proceeding.

influence the VCG process. In addition, during the first quarter of 2012, CIO-VCG failed to escalate to CIO and JPMorgan management significant information that management required in order to make informed decisions about disclosure of the firm's financial results for the first quarter of 2012. As a result, JPMorgan did not timely detect or effectively challenge questionable valuations by the SCP traders as the portfolio's losses accumulated in the first quarter of 2012 and publicly misstated its financial results for that period.

5. JPMorgan's response to the CIO trading losses also was affected by inadequate communication between JPMorgan's Senior Management and the Audit Committee of JPMorgan's Board of Directors (the "Audit Committee"). In April 2012, after learning of large counterparty valuation disputes relating to SCP positions, JPMorgan Senior Management initiated several reviews of the SCP marks and of CIO-VCG. By early May 2012, the various reviews had alerted JPMorgan Senior Management to serious issues about CIO-VCG's effectiveness in price-testing the values SCP traders had assigned to positions in the SCP during the first quarter of 2012. These issues, among others, prompted JPMorgan Senior Management to take several actions, including recommending delaying the filing of the firm's quarterly report with the Commission, and substantially revising CIO-VCG policies in early May 2012 to eliminate what Senior Management believed was an undue amount of subjectivity in a control function.

6. Consistent with Sarbanes-Oxley's emphasis on the role that the audit committee of a public company's board of directors should play in corporate governance, JPMorgan's internal controls include a requirement that its management keep the Audit Committee informed of, among other things, the identification of any significant deficiencies or material weaknesses in the firm's internal control over financial reporting. Such updates are necessary for the Audit Committee to fulfill its oversight role and help to assure the integrity and accuracy of information JPMorgan discloses in its public filings.

7. Before JPMorgan filed its quarterly report on May 10, 2012, however, JPMorgan Senior Management did not adequately update the Audit Committee concerning the facts learned during the reviews of CIO-VCG. Nor did it adequately update the Audit Committee on important observations made by the management-commissioned reviews of control breakdowns at CIO-VCG that amounted to, at a minimum, a significant deficiency. Three primary issues relating to the sharing and synthesis of relevant information contributed to the inadequate communications with the Audit Committee. First, several employees involved in conducting the reviews of CIO-VCG failed to timely escalate important facts regarding control deficiencies at CIO-VCG. Second, JPMorgan Senior Management was concerned about the market sensitivity of the SCP positions and the confidential nature of the review, and required that the review teams keep their work strictly confidential, which had the effect of impeding the exchange of information among the review teams and their ability to analyze collectively the information generated by these reviews. Third, despite learning of important information concerning control deficiencies at CIO-VCG, JPMorgan Senior Management did not make a considered assessment of the significance of that information to determine if it revealed a significant deficiency or material weakness at CIO-VCG that had to be disclosed to the Audit Committee.

8. On July 13, 2012, JPMorgan announced that it would restate its results for the first quarter of 2012 because it was no longer confident that the SCP marks used to prepare the

first quarter results, which CIO-VCG was responsible for price testing, "reflect good faith estimates of fair value at quarter end." Also on this date, JPMorgan disclosed to investors that a material weakness in internal control over financial reporting had existed at CIO as of March 31, 2012 based on deficiencies in the CIO-VCG process.

9. On August 9, 2012, JPMorgan filed an amended Form 10-Q with restated results for the first quarter of 2012. The restatement had the effect of moving certain SCP losses from the second quarter to the first quarter. These misstated first quarter results were disclosed not only in the quarterly report filed on Form 10-Q on May 10, 2012, but also in JPMorgan's earnings release for the first quarter, which was filed on Form 8-K with the Commission on April 13, 2012. Also on August 9, 2012, JPMorgan disclosed that its disclosure controls and procedures as of March 31, 2012 were not effective and that management's prior conclusion in the firm's May 10, 2012 quarterly report that they were effective was incorrect.

10. As a result of its failure to maintain effective internal control over financial reporting as of March 31, 2012, and disclosure controls and procedures, and as a result of its filing of inaccurate reports with the Commission (specifically, the Form 8-K filed on April 13, 2012, and the Form 10-Q filed on May 10, 2012), JPMorgan violated Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 13a-11, 13a-13, and 13a-15 thereunder.

11. In response to the Commission's investigation, JPMorgan provided substantial cooperation to Commission staff. JPMorgan has also voluntarily undertaken a comprehensive program of remediation to address, among other things, the internal control deficiencies that are the subject of this proceeding. Most notably, JPMorgan has substantially strengthened the valuation control function within CIO to ensure that price verification procedures are conducted with the appropriate degree of independence and supervision.

IV.

RELEVANT ENTITIES AND PERSONS

12. JPMorgan, a Delaware corporation headquartered in New York, New York, is a global banking and financial services firm whose common stock is registered with the Commission under Section 12(b) of the Exchange Act and traded on The New York Stock Exchange under the symbol "JPM."

13. CIO is a unit of JPMorgan and part of the firm's Corporate/Private Equity reporting segment. Among other things, CIO is responsible for investing excess deposits from JPMorgan's banking arm. CIO maintains offices in New York, New York and London, United Kingdom.

14. JPMorgan "Senior Management," as that term is used herein, refers to one or more of the following individuals who held the listed positions as of May 10, 2012: the JPMorgan Chief Executive Officer, the JPMorgan Chief Financial Officer, the JPMorgan Chief Risk Officer, the JPMorgan Controller, and the JPMorgan General Auditor.

THE MISMARKING OF JPMORGAN'S SYNTHETIC CREDIT PORTFOLIO

JPMorgan, CIO, and the Synthetic Credit Portfolio

15. In 2007, CIO created an investment portfolio, the SCP, which was designed to provide a hedge against adverse credit events. It invested in derivatives that could be expected to generate profit during adverse credit events, such as widespread corporate defaults. The positions in the SCP consisted of credit derivative indices and portions (or "tranches") of those indices, both of which were constructed to track a collection of credit default swaps ("CDS") referencing the debt of corporate issuers.

16. The SCP was invested in two primary index groups: CDX, a group of North American and Emerging Markets indices, and iTraxx, a group of European and Asian indices. Some indices referenced companies considered to be investment grade and others referenced companies considered to be high-yield (which generally means that their credit risk is viewed as higher). Investors in CDX and iTraxx indices, including CIO, can be "long" risk, which is equivalent to being a seller of CDS protection, or "short" risk, which is equivalent to being a buyer of CDS protection.

17. Beginning in 2008, the SCP's investment strategy generally consisted of holding a net short risk position in high-yield indices and tranches, which meant that the SCP was positioned to realize gains if high-yield companies were to default on their corporate debt. The composition of the book changed from time to time in response to CIO's assessment of market conditions.

18. In December 2011, in preparation for complying with the capital adequacy standards of the Third Basel Accord, the SCP traders were instructed to reduce the SCP's use of regulatory capital. To achieve this—and, in light of improving economic conditions, to reduce the SCP's credit protection profile—CIO management and the traders in charge of the SCP considered reducing the size of the SCP's short risk position in high-yield investments. There were substantial costs associated with this strategy. To avoid these costs, CIO management and traders therefore decided to add investments to the SCP's existing long risk investment-grade positions to offset the short risk high-yield position. However, as CIO built its long risk investment-grade positions, which included a large investment in an index known as the CDX North American Investment Grade Index Series 9 10-year, it also added substantially to its existing high-yield short position. JPMorgan did not have risk limits restricting the notional size of the SCP, and CIO's trading strategy led to a large increase in the notional size of the SCP. During the first quarter of 2012, CIO tripled the net notional amount of the SCP. As of March 31, 2012, the SCP contained 132 trading positions with a net notional amount of approximately $157 billion.

Traders Mismark the SCP as Losses Mount

19. Like many other public companies, JPMorgan reported its results, which incorporated the mark-to-market profit and loss of the SCP, at the end of each quarter in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). Under JPMorgan

policy, the SCP traders were required to assign valuations (or "marks") to the positions in the SCP at fair value. Both GAAP and JPMorgan's accounting policy required that the SCP traders do so by making a good-faith estimate of the fair value of each SCP position based on information available in the marketplace. Under GAAP, the positions in the SCP had to be marked "within the bid-ask spread" at the point that is "most representative of fair value in the circumstances," with a particular emphasis on the price where the traders could reasonably expect to transact. GAAP also allows for the use of mid-market pricing "as a practical expedient for fair value measurements within a bid-ask spread."

20. At the end of each business day, the SCP traders had to mark the positions in the SCP and report to CIO management a summary of the portfolio's mark-to-market profits and losses for the day. Additionally, the traders had to provide their valuations for the SCP to the middle office at CIO so that the information could be incorporated into the books and records of JPMorgan.

21. The SCP generated sizeable profits for JPMorgan over the period from 2007 to 2011. In the first quarter of 2012, however, it began experiencing substantial mark-to-market losses. By early March 2012, the most senior SCP trader, who was a managing director within CIO, instructed the other SCP traders to stop reporting losses to CIO management unless there was a market-moving event that could easily explain the losses. In response, a junior SCP trader changed his daily marking methodology for the SCP. Previously, he had derived for each SCP position a bid-offer spread from dealer quotes he had received and then assigned a mark that was generally equivalent to the mid-point in that spread. In response to the most senior trader's instruction, the junior trader began to assign marks that often were at the most aggressive point in the bid-offer spread received that day (*i.e.*, the point that resulted in higher valuations of the SCP positions). For some SCP positions, the junior trader assigned marks in March that were altogether outside every dealer's bid and offer received that day. As a result of these marking practices, the SCP traders intentionally understated mark-to-market losses in the SCP.

22. In March 2012, the junior trader began to maintain a spreadsheet which showed that, by March 15, 2012, the difference between the daily prices he had assigned to the SCP and the average mid-market point between the best bids and offers he had received from dealers had grown to $292 million. Within a few days, the difference had grown further to $432 million. The traders, however, revealed significantly smaller losses in daily reports to CIO management about the portfolio's performance than were indicated by mid-market pricing.

23. On March 30, 2012, the last trading day in the first quarter of 2012, the SCP traders informed the most senior trader in the morning that losses for that day alone could reach $250 million. In response, the most senior trader directed the junior trader not to mark the SCP at the close of business in London, as JPMorgan policy required, but instead to wait for the markets in New York to close because trading information from New York might support higher valuations for the SCP positions.

24. The most senior trader also instructed the junior trader to use the "best" prices (*i.e.*, the most advantageous prices within the bid-offer spread) in marking the SCP. On March 30, the junior trader marked the SCP positions in accordance with these instructions, and reported to CIO management an estimated loss of $138 million. Over the next several weeks, the

traders continued to understate mark-to-market losses in the SCP until their authority over the portfolio was taken away from them on or around April 29, 2012, when JPMorgan Senior Management asked a senior Investment Bank ("IB") trader and senior risk officer to take responsibility for the portfolio.

JPMorgan Issues Its First Quarter
<u>Results and Subsequently Issues a Restatement</u>

25. On April 13, 2012, JPMorgan issued its earnings release for the quarter ending March 31, 2012, which was filed on Form 8-K with the Commission. Also on April 13, JPMorgan Senior Management conducted an earnings call with analysts and investors. The earnings release disclosed that JPMorgan's consolidated quarterly income before income tax expense was $7.641 billion. These results included the understated losses for the SCP, which was based on the SCP traders' marks as of March 30, 2012.

26. One month later, on May 10, 2012, JPMorgan filed on Form 10-Q its report for the first quarter, which ended on March 31, 2012, disclosing that CIO had experienced significant mark-to-market losses in the SCP during the second quarter to date. Also on May 10, 2012, JPMorgan Senior Management conducted a call with analysts, during which the firm disclosed that CIO had suffered losses of approximately $2 billion during the second quarter to date and that there could be additional losses, that the trading strategy that resulted in the losses was "flawed, complex, poorly reviewed, poorly executed, and poorly monitored," that "we've had teams from audit, legal, risk, and various control functions . . . involved in extensive review of what happened," and that "[w]e have more work to do but it's obvious at this point that there are many errors, sloppiness, and bad judgment." The $2 billion calculation was based on marks for positions in the SCP that were derived from independent pricing sources and not from the SCP traders; therefore, the full year-to-date loss figure was not affected by its subsequent conclusions concerning the integrity of the SCP traders' marks.

27. Two months later, on July 13, 2012, JPMorgan announced that it would restate its results for the first quarter of 2012 because it had discovered "information that raises questions about the integrity of the [SCP] marks" and was no longer confident that the marks used to prepare the first quarter results "reflect good faith estimates of fair value at quarter end." On August 9, 2012, JPMorgan filed an amended Form 10-Q with restated results for the first quarter. The restatement had the effect of moving certain SCP losses from the second quarter to the first quarter. Specifically, the restatement reduced the revenues of JPMorgan's Corporate/Private Equity reporting segment in the first quarter by $660 million, from $1.689 billion to $1.029 billion, and the firm's consolidated quarterly income before income tax expense from the previously-reported $7.641 billion to $6.981 billion.

JPMORGAN'S INEFFECTIVE INTERNAL ACCOUNTING CONTROLS
AND DISCLOSURE CONTROLS AND PROCEDURES

28. JPMorgan's May 10, 2012 quarterly report on Form 10-Q contained its financial statements for the first quarter of the year, management's discussion of the firm's various businesses, and other information. In addition, the report stated that JPMorgan's management

evaluated the effectiveness of its disclosure controls and procedures and concluded that they were effective.

29. As discussed below, between late April and May 10, 2012, JPMorgan engaged in an extensive process involving work performed by the Controller's office, the Internal Audit department ("Internal Audit"), valuation experts from the Investment Banking Division ("IB"), and in-house and outside counsel in an effort to evaluate the SCP's quarter-end marks and to understand the CIO valuation control process and the differences between that process and the valuation control process of the IB. As a result, by May 10, various executives and employees of the firm had learned of deficiencies as of March 31, 2012 in CIO's internal controls. Due to failures to timely escalate information and instructions that had the effect of hindering the sharing of information, not all of these deficiencies had been escalated to JPMorgan Senior Management prior to May 10, 2012. And, as to the information that was escalated, JPMorgan Senior Management did not make a considered assessment as to whether critical facts existed—including any significant deficiency or material weakness in internal controls—that had to be disclosed to the Audit Committee. Consequently, JPMorgan Senior Management did not disclose the existence of any significant deficiencies or material weaknesses to the Audit Committee before JPMorgan filed its quarterly report on May 10, 2012.

30. On July 13, 2012, at the same time JPMorgan disclosed to investors that it would restate its results for the first quarter of 2012, the firm announced that a material weakness in internal control over financial reporting had existed at CIO as of March 31, 2012. As a result of the material weakness, JPMorgan also announced that its management had concluded that JPMorgan's disclosure controls and procedures were not effective as of March 31, 2012.

CIO Internal Controls in the First Quarter of 2012

31. As part of fulfilling the requirements to devise and maintain systems of internal accounting controls, financial institutions such as JPMorgan need to have internal controls that adequately monitor and test the accuracy and integrity of, among other things, the valuations of the firm's trading portfolios such as the SCP. CIO-VCG served as a significant control for ensuring that certain assets and liabilities of CIO, including the positions in the SCP, were measured at fair value in accordance with GAAP in JPMorgan's books and records and in the quarterly and annual reports the firm filed with the Commission.

32. For the SCP, CIO-VCG carried out its responsibility by price-testing the marks that the SCP traders assigned to the portfolio's positions on the last business day of every month. Under firm policy applicable during the first quarter of 2012, CIO-VCG performed this price-testing function by undertaking the following steps:

a. First, CIO-VCG had to calculate, as a benchmark, an independent price for each of the SCP positions. A CIO-VCG policy and procedure document indicates that, for index positions, these independent prices were to be obtained from Markit Limited Group ("Markit"), a service that provides consensus-based prices for indices. For tranches, CIO-VCG obtained independent prices from dealer quotes, which it checked against Totem, another consensus pricing service offered by Markit, for any significant discrepancies.

b. After calculating an independent price for each SCP position, CIO-VCG had to establish and apply a threshold (or tolerance) around each price that represented the average bid-offer spread for the security based on quotes received from dealers. While it had authority to make an adjustment to trader marks that fell within these thresholds, CIO-VCG considered such marks to be presumptively marked at fair value and would not make any adjustment to those marks.

c. If the SCP traders' mark for a given position fell outside of the threshold, CIO-VCG would record the excess as a loss (or profit) and make a corresponding adjustment to the mark-to-market profit and loss for the SCP.

d. Finally, if CIO-VCG determined that the market for a particular position had become illiquid, CIO-VCG applied a pre-established formula to calculate and record a liquidity reserve to account for the risk that certain SCP positions could not be sold at fair value due to reduced liquidity in the marketplace.

33. The CIO-VCG staff actively involved in price-testing the SCP's 132 positions at the end of the first quarter of 2012 consisted of one person, who worked at CIO's London office. That person was also responsible for price testing all of CIO's other London-based portfolios.

34. On April 4, 2012, CIO-VCG completed its price-testing process for the SCP for the end of March 2012. It applied the relevant thresholds to adjust downward the fair value of the SCP by approximately $17 million compared to the traders' marks and maintained the previous month's liquidity reserve of approximately $31 million.

35. During its price-testing process for quarter-end marks, CIO-VCG observed that most of the SCP traders' marks migrated to the aggressive end of the bid/offer spread. CIO-VCG questioned one of the SCP traders about this shift. The trader did not explain the shift but merely stated, "Talk to management." CIO-VCG did not disclose to anyone its observations concerning the shift in the SCP traders' marking methodology until questions were being raised about a collateral dispute, which is summarized below, on April 20, 2012. CIO-VCG also did not share the details of its exchange with the SCP trader.

36. CIO-VCG calculated a significant difference between its independent prices and the SCP traders' marks. During its price-testing process, it calculated that the mid-market value of the SCP based on its independent prices was approximately $192 million less than the value based on the SCP traders' marks. It subsequently identified an error in its calculations, which increased the difference from $192 million to approximately $275 million. A March 30, 2012 Internal Audit report on CIO-VCG contained an Action Plan under which CIO-VCG should disclose this discrepancy to CIO management. However, that action plan was not required to be fully implemented until June 30, 2012, and CIO-VCG only disclosed the $17 million fair value

adjustment based on marks that fell outside of its thresholds. Consequently, CIO management was not alerted to the significant difference between the SCP traders' marks and the CIO-VCG calculated mid-market valuations, which warranted further analysis.

37. Shortly after April 4, 2012, CIO Finance, with the approval of CIO management and JPMorgan Senior Management, increased the existing $31 million liquidity reserve by $155 million, based on a determination that certain tranches in the SCP portfolio had become illiquid as of March 30. The traders' marks, as adjusted by CIO-VCG, were then incorporated in the financial information provided for CIO in JPMorgan's earnings release on April 13, 2012 and in the firm's May 10, 2012 report for the first quarter of 2012.

Large Collateral Calls and Increasing Losses Prompt
Multiple Reviews of CIO-VCG and the Traders' Marks

38. On April 20, 2012, JPMorgan Senior Management was informed that the firm had received several collateral calls—requests from trading counterparties for payment or the posting of collateral based on their differing views of the fair value—concerning positions in the SCP. The total amount in dispute was approximately $520 million.

39. A collateral dispute with a CDS counterparty can sometimes be an indication that a firm's internal price for an instrument does not accurately reflect its fair value. Accordingly, in April 2012, the size of the collateral disputes over the SCP raised concerns by JPMorgan Senior Management about the pricing of the SCP positions. In an April 20, 2012 email, a member of JPMorgan Senior Management observed that the collateral disputes were not "a good sign on our valuation process" in the SCP.

40. At the same time that the collateral disputes were being escalated to JPMorgan Senior Management, the SCP was also sustaining large daily losses. This development was inconsistent with what CIO had told JPMorgan Senior Management to expect prior to the April 13 earnings release, and JPMorgan Senior Management was concerned about the losses and the traders' explanations of what was happening to the SCP positions and their strategy for dealing with the risks to the SCP. On or about April 27, JPMorgan Senior Management asked a senior trader from the IB and a senior risk officer to evaluate the portfolio on an urgent basis. Shortly afterwards, the IB trader and risk officer were put in charge of managing and reducing the risk in the SCP, and the SCP traders were relieved of all trading and pricing responsibilities. Additionally, on a going-forward basis, positions in the SCP were to be marked to consensus mid-market prices published by Markit.

41. In late April and early May, JPMorgan Senior Management mobilized resources from various parts of the firm—the IB's valuation experts, Internal Audit, which had prior experience with CIO-VCG's price-testing process, and the Controller's office, which included JPMorgan's fair value accounting experts—as well as the Legal Department and an outside law firm to conduct reviews of the SCP traders' marks and CIO-VCG's price-testing process. At the time, JPMorgan was planning to file with the Commission its report for the first quarter of 2012 in early May 2012. In part due to the questions being raised about the valuation of the SCP, JPMorgan Senior Management, with approval of the Audit Committee, decided to postpone the filing to May 10. JPMorgan Senior Management delayed the filing so that it had additional time

to assess whether CIO's first quarter results, which had been publicly released on April 13, were in fact compliant with GAAP and should be disclosed again in the quarterly report.

The Investment Bank's Review

42. On April 25, 2012, a member of JPMorgan Senior Management asked the Valuation Control Group in the firm's IB ("IB-VCG") to price-test the SCP traders' marks for March 30, 2012 as if the positions had been held by the IB. IB-VCG also reviewed the price-testing work that had been done by CIO-VCG at the end of March 2012. The IB-VCG review was conducted under the supervision of the IB's Chief Financial Officer.

IB-VCG Valuation "In Line with the Counterparties"

43. The next day, IB-VCG performed a preliminary analysis of the SCP traders' marks. On a conference call that day, IB-VCG staff informed CIO management and CIO-VCG that "[t]he rough initial result [of its analysis] . . . seems to, to be in line with the mark-to-market differences you see on the collateral calls. . . . In terms of dollar value, the number seems pretty much in line . . . with the counterparties." In other words, IB-VCG's preliminary valuation of the SCP positions was in line with those of CIO's trading counterparties, who had valued the SCP at several hundreds of millions of dollars less than the SCP traders did.

44. During the conference call, CIO-VCG explained to IB-VCG staff that in setting thresholds around independent prices during its month-end price-testing process, it often consulted with the SCP traders—whose valuations it was supposed to validate—"to see if they have any market input to decide whether, you know, if it's, that's wrong, that's correct, et cetera." CIO-VCG also informed IB-VCG that, when completing its price-testing process, it used dealer quotes selected by SCP traders. IB-VCG staff believed that this process of consulting the traders had the potential to significantly impair the independence and effectiveness of the CIO-VCG process.

45. On Saturday, April 28, 2012, at a meeting with members of JPMorgan Senior Management and CIO management, the IB's CFO presented IB-VCG's analysis of the SCP traders' marks. He reviewed with the attendees a spreadsheet that detailed IB-VCG's work to date ("IB-VCG Spreadsheet"). At that meeting, at least one of the positions in the IB-VCG Spreadsheet was reviewed on a column-by-column basis in order to describe the data included in each individual column.

46. As of this time, JPMorgan Senior Management and CIO management knew that the SCP traders' marks were $275 million greater than independent mid-market prices computed by CIO-VCG based on a combination of broker quotes and data from consensus pricing services. IB-VCG relied exclusively upon consensus pricing services, and the IB-VCG Spreadsheet calculated that the SCP traders' marks were approximately $767 million greater than the values placed on the SCP positions by consensus mid-market prices published by Markit and Totem.

47. As part of its analysis, IB-VCG staff calculated an approximate bid-offer spread, based on market information from March 30, 2012, for six SCP positions, including several of the largest positions and some with the greatest total dollar value differences between trader marks and IB-VCG's consensus pricing. The IB-VCG Spreadsheet contained data regarding 133

positions and reflected, among other things, that for the six positions for which it calculated an approximate bid-offer spread, the traders' quarter-end marks were outside the bid-offer spreads that IB-VCG had approximated.

48. After presenting IB-VCG's analysis, the IB's CFO began to calculate the profit-and-loss impact if CIO marked the SCP to the conservative end of the bid-offer spread, rather than to mid-market prices, as a price-taker would have done (since price-takers often buy and sell at prices that are inferior to the consensus, mid-market Markit or Totem prices). This analysis showed that adjusting marks to the conservative end of the bid-offer spread would have further reduced the value of the SCP by approximately $250 million, resulting in an over $1 billion difference between the traders' marks and a price-taker's marks at the conservative end of the bid-offer spread. JPMorgan Senior Management elected not to pursue this marking methodology with respect to the March 2012 quarter-end marks because, among other reasons, it understood that using mid-market prices was acceptable under GAAP.

Spreadsheet Errors

49. IB-VCG also reviewed the process that CIO-VCG had applied to the traders' quarter-end marks. During this review, IB-VCG learned that in March 2012 CIO-VCG used a spreadsheet in its price-testing process into which data had been manually entered, and that this spreadsheet contained certain errors and reflected differences from the IB-VCG methodology that may have had the effect of understating the difference between the traders' marks and the independent mid-market prices derived by CIO-VCG. On May 8, 2012, IB-VCG forwarded an email to one member of JPMorgan Senior Management explaining these issues. IB-VCG and CIO-VCG were instructed to work together to address the errors and other issues.

50. The next day, IB-VCG corrected one such error, which involved the calculation of the difference between the value of the SCP based on the traders' marks and CIO-VCG's independent prices. Before the correction, the difference was believed to be approximately $275 million. After the correction, the difference increased to $512 million. IB-VCG informed JPMorgan Senior Management of the correction and the quantitative impact it had.

51. Based on the price-testing work of IB-VCG and other information, the management of the IB expressed concerns to JPMorgan Senior Management about the potential for mismarking of the SCP and whether CIO VCG was an effective control over the SCP. On May 6, 2012, for example, a senior IB executive explained to a member of JPMorgan Senior Management that the securities in the SCP had "very good price discovery mechanisms" (*i.e.*, could effectively be priced in the marketplace) and that he could not recall a variance between trader marks and independent prices in the IB "greater than $50mm that remained at any month end across the ENTIRE IB's positions."

52. In light of their concerns relating to CIO, two senior IB executives initially expressed some reservations regarding the scope of their sub-certifications that JPMorgan required officers in the various business lines to provide in connection with its quarterly and annual filings. One of the executives apprised JPMorgan Senior Management that in light of the CIO related information to which he was privy, he had a conversation with an outside lawyer concerning the scope of his certification obligations. After relaying that conversation to the

other Investment Bank executive with certification obligations, both executives signed their sub-certifications.

The Internal Audit Review

53. In addition to the IB-VCG review, on or around May 2, 2012, JPMorgan Senior Management instructed Internal Audit to review the CIO-VCG process, including whether it had been applied consistently over past quarters. Also on May 2, at the end of a meeting of the Audit Committee of JPMorgan's Board of Directors, the Audit Committee, having just been informed of the losses recently suffered, separately requested that Internal Audit review CIO.

54. The Internal Audit team discovered deficiencies with the thresholds CIO-VCG had applied at March 30. As noted above, JPMorgan policy required that CIO-VCG set a threshold around its independent price for each SCP position that was representative of the average spread between the bids and the offers received from dealers for the position. Because the threshold was applied on each side of the independent price, in order to reflect the bid-offer spread the threshold on each side would be one-half of the entire spread.

55. By May 9, 2012, the Internal Audit team learned that in validating the SCP traders' quarter-end marks in March 2012, CIO-VCG had in some cases applied the entire bid-offer spread (rather than one half of the spread) on each side of its independent prices. The result was a threshold that was twice the size of the bid-offer spread and beyond the range of reasonable fair value estimates. The Internal Audit team calculated that, had CIO-VCG applied the thresholds appropriately, it would have adjusted the traders' quarter-end marks downward by $307 million—$290 million more than the $17 million adjustment CIO-VCG had actually made at month end.

56. On May 10, the Internal Audit team collected its work in a draft memo ("Internal Audit Draft Memo"), which stated, among other things, that CIO-VCG was "inconsistent in the application of [its] own thresholds."

57. Although Internal Audit completed this work in the days prior to May 10, it did not fully share this information with JPMorgan Senior Management and did not circulate the Internal Audit Draft Memo to JPMorgan Senior Management or the Audit Committee.

The Controller's Review

58. On April 28, 2012, JPMorgan Senior Management asked the Controller's staff to assess whether the traders' quarter-end marks complied with GAAP and to review the effectiveness of CIO-VCG's quarter-end internal control process.

59. The Controller's staff made several significant observations. One was that, as losses in the SCP increased in March 2012, the traders departed from their historical practice of marking the positions close to the mid-point between the bids and offers received from dealers. Instead, they marked many positions at the aggressive end of the bid-offer spreads, *i.e.*, they marked the positions in a manner that resulted in smaller mark-to-market losses. JPMorgan Senior Management was informed of this fact in late April 2012. The traders justified their marks to the Controller's staff by explaining that the market had become volatile and dislocated.

This volatility, the SCP traders claimed, caused significant intraday price movements that may help explain the difference between the SCP traders' marks and consensus pricing services. To test the volatility explanation, the Controller's staff analyzed intraday pricing information, and determined that the difference between the SCP traders' marks and the mid-market prices was less than the average daily price movement. While accepting the SCP traders' justification, however, the Controller's staff failed to adequately assess whether CIO could transact at the price where the SCP was marked.

60. For two quarter end marks assigned by the SCP traders, the Controller's staff also detected significant differences from mid-market consensus pricing that were not supported by pricing data received by the SCP traders on the date that the mark was assigned. When the Controller's staff questioned these marks, one of the SCP traders agreed that they were too wide as compared to the mid-market price. This fact had not been adequately considered by CIO-VCG during its actual price testing process in connection with the first quarter of 2012, nor was this fact given appropriate scrutiny by the Controller's staff. Consequently, the Controller's staff did not escalate this information to JPMorgan Senior Management.

The Special Review by Outside Counsel

61. In addition to the foregoing reviews, on or around May 1, 2012, JPMorgan retained an outside law firm to provide advice regarding disclosure and to review, among other things, whether the independence of the CIO-VCG process had been improperly compromised by the involvement of the SCP traders. By May 10, 2012, when JPMorgan filed its first quarter report, the law firm had interviewed the employee of CIO-VCG who had price-tested the SCP marks, the executive to whom he reported, and other members of CIO management. The law firm also had collected and reviewed a limited number of the relevant emails and Bloomberg chats from the first quarter of 2012.

The Process for Synthesizing and Escalating Information from the Various Reviews

62. JPMorgan Senior Management led a process that involved daily—sometimes twice daily—meetings and calls in which participants involved in the different reviews discussed what they and their teams were doing and learning. Despite that process, a number of significant facts learned in the course of the various reviews were not shared in these group meetings and calls and were not otherwise escalated to JPMorgan Senior Management. This in turn led to JPMorgan's incomplete understanding of deficiencies relating to the CIO-VCG process in March 2012.

63. JPMorgan Senior Management's emphasis on confidentiality and sharing information on a need-to-know basis contributed to this incomplete understanding. JPMorgan Senior Management was concerned about sensitive information relating to CIO's positions being widely distributed and imposed restrictions on the creation and sharing of work product relating to those positions. These instructions affected the ability of those conducting the reviews to share, learn from, and build upon each other's work.

64. On April 29, 2012, the Controller's staff was instructed not to "discuss [its work] with people outside the immediate group" and to exercise caution in committing its findings to writing.

65. A member of JPMorgan Senior Management also instructed IB-VCG to "keep [its] analysis in a relatively tight group." On April 29, 2012, an IB executive confirmed to the member of JPMorgan Senior Management that IB-VCG "speaks to no one," including the Controller's staff, "without getting my express approval first."

66. Finally, the Internal Audit team was instructed to maintain strict confidentiality in connection with its review.

67. JPMorgan Senior Management did not receive all relevant information for another reason: some employees conducting the reviews failed to appreciate the significance of certain of the facts they had learned and their relevance to the quarterly report that was about to be filed. For example, in looking back on his work after learning in late June that the integrity of the traders' marks was in question, a London-based employee primarily responsible for the Controller's review conducted an after-the-fact assessment, noting that he "[s]hould have better understood the $767 [million] diff.," *i.e.*, IB-VCG's calculation of the disparity between the SCP traders' quarter-end marks and Markit and Totem consensus, mid-market prices. The employee further noted that he "[s]hould have pressed [CIO-VCG] more on how the tolerances (thresholds) were determined" and "should have picked up that the tolerances determined by adding whole bid-offer," a fact already known to members of the Internal Audit team prior to May 10, 2012. Although executives were in contact with those responsible for the various reviews, some of those employees failed to timely analyze and escalate to JPMorgan Senior Management important facts that they had discovered.

JPMorgan Senior Management's
<u>Response to the Information It Received</u>

68. Despite the inadequate information sharing and escalation described above, significant information learned in the management-commissioned reviews was escalated to JPMorgan Senior Management. This information, which related to the adequacy of the CIO-VCG process that produced the $17 million fair value adjustment to the traders' quarter-end marks, included the following:

a. As losses began to mount, SCP traders began consistently marking at or near the very edge of the advantageous side of the bid-offer spread.

b. There was a collateral dispute of over $500 million.

c. Independent analysis by IB-VCG of the SCP traders' quarter-end marks was "in line with . . . the counterparties." Specifically, the value of the SCP based on trader marks was approximately $767 million more than the value based on mid-point consensus pricing.

69. Management also learned of the following facts that directly related to CIO-VCG and the processes it was using in March 2012:

a. The CIO-VCG process relied on manual spreadsheets that contained errors, one of which caused CIO-VCG to understate the disparity between its independent prices and the traders' marks by $237 million.

b. The SCP traders provided some of the quotes that were used in CIO-VCG's price-testing process and this process "need[ed] to be enhanced to ensure independence."

70. In response to what it was learning prior to May 10, JPMorgan Senior Management decided to enhance CIO-VCG's valuation policies. To assist with this task, the persons conducting the reviews recommended certain changes, and a member of JPMorgan Senior Management drafted revisions to CIO-VCG procedures, which were shared with JPMorgan Senior Management and CIO management on May 5, 2012. On May 7, 2012, a senior CIO executive circulated a "proposed operational approach to VCG price testing" that contained additional policy revisions. Both sets of changes were implemented before May 10, 2012.

71. Collectively, the new policies were intended to remediate several of the issues discovered by the management-commissioned reviews of CIO-VCG and the traders' marks:

a. <u>Disparity between CIO-VCG independent prices and traders' marks</u>. The revised policies significantly curtailed the size of thresholds that CIO-VCG could apply, directing that the difference between a trader's mark and CIO-VCG's independent price could not exceed $500,000 for an index position and $2,000,000 for a tranche position.

b. <u>Trader involvement in the VCG process</u>. The revised policies required CIO-VCG to "source broker quotes independently from the market," rather than through the traders, thereby "eliminating any reliance on [the traders] for sourcing of market data."

c. <u>Variance between Markit and CIO-VCG's independent prices</u>. The revised policies stated that, for positions where CIO-VCG could rely on dealer quotes in calculating independent prices, CIO-VCG must obtain at least two quotes and, if two are not available, it must use Markit or Totem as an input. The revised policies also provided that, even when dealer quotes are obtained, "mid prices derived from selected dealer quotes should be compared . . . to Markit/Totem sourced data and any material differences . . . must be reported to the CFO of CIO and must be reconciled."

d. <u>Inadequate oversight over sole CIO-VCG price-tester</u>. The revised policies introduced a new protocol for escalating to management valuation disputes between CIO-VCG and the traders, requiring the involvement of JPMorgan risk personnel and the Chief Financial Officer of CIO.

72. In addition to these policy changes, in early May the staff of IB-VCG prepared a remedial plan to address the spreadsheet errors it had identified in CIO-VCG's price-testing process, and to ensure proper review of the spreadsheets. On May 8, 2012, after CIO finance

management and CIO-VCG concurred in the remedial plan, IB-VCG described it to JPMorgan Senior Management.

The Reviews of CIO-VCG Are Not
<u>Addressed with the Audit Committee</u>

73. The responsibility for overseeing JPMorgan's management on behalf of the firm's stockholders—including oversight of management's responsibilities for internal controls—ultimately rests with JPMorgan's Board of Directors. The Board, in turn, discharges its oversight function through several Board committees. One of the principal committees is the Audit Committee, which is charged with overseeing JPMorgan's efforts to assure that it has effective internal controls, which are critical to the integrity of the firm's financial reports and compliance with applicable policies and laws.

74. To assist the Audit Committee in carrying out its responsibility, the Audit Committee's Charter requires JPMorgan management to provide updates to the Committee on all "significant operating and control issues in internal audit reports," the "initiation and status of significant special investigations," the "identification and resolution status of material weaknesses" in controls, and any "reportable conditions in the internal control environment, including any significant deficiencies." These updates serve an important internal control function, allowing the Audit Committee to fulfill its oversight role by, among other things, keeping the Board up-to-date on significant matters, assessing whether to approve the filing of quarterly and annual reports, and evaluating whether the Committee should conduct its own independent investigation of any issues raised with it.

75. In late April and early May 2012, while JPMorgan's Senior Management was devoting daily attention to CIO-VCG and the SCP traders' quarter-end marks—in large measure to ensure that CIO results reported in its upcoming quarterly report would be accurate—it also was in contact with members of the Audit Committee.

76. However, while JPMorgan Senior Management was informed of, and was addressing, various issues with internal controls at CIO-VCG, JPMorgan Senior Management did not engage in a considered assessment, before the firm filed its first quarter report on May 10, 2012, to determine if these matters constituted a significant deficiency or material weakness in the firm's internal control over financial reporting and therefore had to be disclosed to the firm's Audit Committee. Nor, more broadly, did JPMorgan Senior Management disclose to the Audit Committee its concerns regarding the operation of CIO-VCG.

77. On May 2, 2012, the Audit Committee met with some members of JPMorgan Senior Management. The focus of the meeting was on the mounting losses in the SCP portfolio. Despite the requirement to keep the Audit Committee apprised of the significant control issues that were under review, there was no discussion of the IB-VCG or Controller reviews related to CIO-VCG and the traders' marks, although that work was underway. There was also no discussion of the fact that an outside law firm had been retained to advise on disclosures to be made in the first quarter Form 10-Q that related to CIO and to assess certain aspects of the CIO-VCG process, including whether the SCP traders exercised undue influence on the process.

78. During a full meeting of the Board of Directors hours before the filing of JPMorgan's first quarter report on May 10, 2012, JPMorgan Senior Management mentioned that reviews of what occurred in CIO were underway, including by Internal Audit, legal, the Controller's staff, and risk management. But, JPMorgan Senior Management did not discuss the details of or facts learned in the IB-VCG, Controller, or Internal Audit reviews.

79. Because the Audit Committee was not apprised of the initiation of the reviews or facts learned as a result of those reviews, it was unable to provide input on the issues before the filing of JPMorgan's first quarter report, and was unable to engage with those doing the work to ensure that it was sufficient from the perspective of the Audit Committee.

80. As noted above, the Audit Committee was not made aware before JPMorgan filed its first quarter report of the facts learned by various members of the review teams, including that CIO-VCG's March 2012 price-testing process was compromised by spreadsheet errors, that SCP traders may have exerted influence over that process, or that CIO-VCG applied valuation thresholds that were in some instances twice the applicable spread.

81. Other information learned by various members of the review teams that further called into question CIO-VCG's March 2012 quarter-end valuation process was not shared with the Audit Committee. At the end of the first quarter, CIO-VCG made a fair value adjustment of $17 million to the traders' marks. However, certain facts raised issues as to the adequacy of this adjustment and the process through which it was made, including the $520 million in collateral disputes over SCP positions, the $767 million disparity between the SCP traders' marks and consensus, mid-market prices, the fact that the traders marked some of the largest notional SCP positions outside the bid-offer spread approximated by IB-VCG, and the fact that the traders began to mark the SCP at the aggressive end of the bid-offer spread when losses began to mount.

82. Finally, the Audit Committee was not apprised of, or included in, JPMorgan Senior Management's efforts to remedy the control issues at CIO-VCG by revising valuation policies to ensure proper oversight by CIO management. As a result, the Audit Committee did not have any input into the proposed changes or an understanding of the reasons that motivated them.

Subsequent Disclosures by JPMorgan

83. Based on the information available to it, the Audit Committee approved of the content of JPMorgan's quarterly report on Form 10-Q that was filed on May 10, 2012. On July 13, 2012, JPMorgan disclosed that a material weakness existed in its internal control over financial reporting stemming from the "effectiveness of CIO's internal controls over valuation of the synthetic credit portfolio." In its amended Form 10-Q for the first quarter of 2012 filed on August 9, 2012, JPMorgan disclosed that this material weakness finding "was the result of issues in certain interrelated and interdependent control elements comprising that process, including insufficient engagement of CIO senior finance management in the valuation control process in light of the increased size and heightened risk profile of the synthetic credit portfolio during the first quarter of 2012, and in the effectiveness of certain procedures employed during the first quarter of 2012 by the CIO Valuation Control Group in performing the price verifications."

84. JPMorgan also corrected prior statements concerning its disclosure controls and procedures. In its May 10 Form 10-Q, JPMorgan stated, "As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of the Firm's management, including its Chairman and Chief Executive Officer and its Chief Financial Officer, of the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on that evaluation, the Chairman and Chief Executive Officer and the Chief Financial Officer concluded that these disclosure controls and procedures were effective." On August 9, 2012, when JPMorgan disclosed that it had determined that a material weakness existed at CIO as of March 31, 2012, it also disclosed that, "[a]s a result of that determination, the Firm's Chairman and Chief Executive Officer and Chief Financial Officer also concluded that the Firm's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) were not effective at March 31, 2012."

V.

As a result of the conduct described above, JPMorgan violated Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 13a-11, 13a-13, and 13a-15 thereunder.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in JPMorgan's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. JPMorgan cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 13a-11, 13a-13, and 13a-15 thereunder.

B. JPMorgan shall, within ten (10) business days of the entry of this Order, pay a civil money penalty in the amount of $200,000,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) JPMorgan may transmit payment electronically to the Commission, which will provide detailed ACH transfer/ Fedwire instructions upon request;

(2) JPMorgan may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) JPMorgan may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand- delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying JPMorgan Chase & Co. as Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Andrew M. Calamari, Regional Director – New York Regional Office, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, NY 10281.

C. Such civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Fair Fund distribution"). Regardless of whether any Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, JPMorgan agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of JPMorgan's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, JPMorgan agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

D. JPMorgan shall pay all reasonable administrative costs and expenses of any distribution, including the fees and expenses of a tax administrator, within thirty (30) days after receipt of an invoice for such services.

By the Commission.

Elizabeth M. Murphy
Secretary

ANNEX A

JPMorgan Chase & Co. ("JPMorgan") admits to the facts set forth below and acknowledges that its conduct violated the federal securities laws:

RELEVANT ENTITIES AND PERSONS

1. JPMorgan, a Delaware corporation headquartered in New York, New York, is a global banking and financial services firm whose common stock is registered with the Commission under Section 12(b) of the Exchange Act and traded on The New York Stock Exchange under the symbol "JPM."

2. CIO is a unit of JPMorgan and part of the firm's Corporate/Private Equity reporting segment. Among other things, CIO is responsible for investing excess deposits from JPMorgan's banking arm. CIO maintains offices in New York, New York and London, United Kingdom.

3. JPMorgan "Senior Management," as that term is used herein, refers to one or more of the following individuals who held the listed positions as of May 10, 2012: the JPMorgan Chief Executive Officer, the JPMorgan Chief Financial Officer, the JPMorgan Chief Risk Officer, the JPMorgan Controller, and the JPMorgan General Auditor.

THE MISMARKING OF JPMORGAN'S SYNTHETIC CREDIT PORTFOLIO

JPMorgan, CIO, and the Synthetic Credit Portfolio

4. In 2007, CIO created an investment portfolio, the SCP, which was designed to provide a hedge against adverse credit events. It invested in derivatives that could be expected to generate profit during adverse credit events, such as widespread corporate defaults. The positions in the SCP consisted of credit derivative indices and portions (or "tranches") of those indices, both of which were constructed to track a collection of credit default swaps ("CDS") referencing the debt of corporate issuers.

5. The SCP was invested in two primary index groups: CDX, a group of North American and Emerging Markets indices, and iTraxx, a group of European and Asian indices. Some indices referenced companies considered to be investment grade and others referenced companies considered to be high-yield (which generally means that their credit risk is viewed as higher). Investors in CDX and iTraxx indices, including CIO, can be "long" risk, which is equivalent to being a seller of CDS protection, or "short" risk, which is equivalent to being a buyer of CDS protection.

6. Beginning in 2008, the SCP's investment strategy generally consisted of holding a net short risk position in high-yield indices and tranches, which meant that the SCP was positioned to realize gains if high-yield companies were to default on their corporate debt. The composition of the book changed from time to time in response to CIO's assessment of market conditions.

7. In December 2011, in preparation for complying with the capital adequacy standards of the Third Basel Accord, the SCP traders were instructed to reduce the SCP's use of regulatory capital. To achieve this—and, in light of improving economic conditions, to reduce the SCP's credit protection profile—CIO management and the traders in charge of the SCP considered reducing the size of the SCP's short risk position in high-yield investments. There were substantial costs associated with this strategy. To avoid these costs, CIO management and traders therefore decided to add investments to the SCP's existing long risk investment-grade positions to offset the short risk high-yield position. However, as CIO built its long risk investment-grade positions, which included a large investment in an index known as the CDX North American Investment Grade Index Series 9 10-year, it also added substantially to its existing high-yield short position. JPMorgan did not have risk limits restricting the notional size of the SCP, and CIO's trading strategy led to a large increase in the notional size of the SCP. During the first quarter of 2012, CIO tripled the net notional amount of the SCP. As of March 31, 2012, the SCP contained 132 trading positions with a net notional amount of approximately $157 billion.

Traders Mismark the SCP as Losses Mount

8. Like many other public companies, JPMorgan reported its results, which incorporated the mark-to-market profit and loss of the SCP, at the end of each quarter in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). Under JPMorgan policy, the SCP traders were required to assign valuations (or "marks") to the positions in the SCP at fair value. Both GAAP and JPMorgan's accounting policy required that the SCP traders do so by making a good-faith estimate of the fair value of each SCP position based on information available in the marketplace. Under GAAP, the positions in the SCP had to be marked "within the bid-ask spread" at the point that is "most representative of fair value in the circumstances," with a particular emphasis on the price where the traders could reasonably expect to transact. GAAP also allows for the use of mid-market pricing "as a practical expedient for fair value measurements within a bid-ask spread."

9. At the end of each business day, the SCP traders had to mark the positions in the SCP and report to CIO management a summary of the portfolio's mark-to-market profits and losses for the day. Additionally, the traders had to provide their valuations for the SCP to the middle office at CIO so that the information could be incorporated into the books and records of JPMorgan.

10. The SCP generated sizeable profits for JPMorgan over the period from 2007 to 2011. In the first quarter of 2012, however, it began experiencing substantial mark-to-market losses. By early March 2012, the most senior SCP trader, who was a managing director within CIO, instructed the other SCP traders to stop reporting losses to CIO management unless there was a market-moving event that could easily explain the losses. In response, a junior SCP trader changed his daily marking methodology for the SCP. Previously, he had derived for each SCP position a bid-offer spread from dealer quotes he had received and then assigned a mark that was generally equivalent to the mid-point in that spread. In response to the most senior trader's instruction, the junior trader began to assign marks that often were at the most aggressive point in the bid-offer spread received that day (*i.e.,* the point that resulted in higher valuations of the SCP positions). For some SCP positions, the junior trader assigned marks in March that were

altogether outside every dealer's bid and offer received that day. As a result of these marking practices, the SCP traders intentionally understated mark-to-market losses in the SCP.

11. In March 2012, the junior trader began to maintain a spreadsheet which showed that, by March 15, 2012, the difference between the daily prices he had assigned to the SCP and the average mid-market point between the best bids and offers he had received from dealers had grown to $292 million. Within a few days, the difference had grown further to $432 million. The traders, however, revealed significantly smaller losses in daily reports to CIO management about the portfolio's performance than were indicated by mid-market pricing.

12. On March 30, 2012, the last trading day in the first quarter of 2012, the SCP traders informed the most senior trader in the morning that losses for that day alone could reach $250 million. In response, the most senior trader directed the junior trader not to mark the SCP at the close of business in London, as JPMorgan policy required, but instead to wait for the markets in New York to close because trading information from New York might support higher valuations for the SCP positions.

13. The most senior trader also instructed the junior trader to use the "best" prices (*i.e.*, the most advantageous prices within the bid-offer spread) in marking the SCP. On March 30, the junior trader marked the SCP positions in accordance with these instructions, and reported to CIO management an estimated loss of $138 million. Over the next several weeks, the traders continued to understate mark-to-market losses in the SCP until their authority over the portfolio was taken away from them on or around April 29, 2012, when JPMorgan Senior Management asked a senior Investment Bank ("IB") trader and senior risk officer to take responsibility for the portfolio.

JPMorgan Issues Its First Quarter
<u>Results and Subsequently Issues a Restatement</u>

14. On April 13, 2012, JPMorgan issued its earnings release for the quarter ending March 31, 2012, which was filed on Form 8-K with the Commission. Also on April 13, JPMorgan Senior Management conducted an earnings call with analysts and investors. The earnings release disclosed that JPMorgan's consolidated quarterly income before income tax expense was $7.641 billion. These results included the understated losses for the SCP, which was based on the SCP traders' marks as of March 30, 2012.

15. One month later, on May 10, 2012, JPMorgan filed on Form 10-Q its report for the first quarter, which ended on March 31, 2012, disclosing that CIO had experienced significant mark-to-market losses in the SCP during the second quarter to date. Also on May 10, 2012, JPMorgan Senior Management conducted a call with analysts, during which the firm disclosed that CIO had suffered losses of approximately $2 billion during the second quarter to date and that there could be additional losses, that the trading strategy that resulted in the losses was "flawed, complex, poorly reviewed, poorly executed, and poorly monitored," that "we've had teams from audit, legal, risk, and various control functions . . . involved in extensive review of what happened," and that "[w]e have more work to do but it's obvious at this point that there are many errors, sloppiness, and bad judgment." The $2 billion calculation was based on marks for positions in the SCP that were derived from independent pricing sources and not from the

SCP traders; therefore, the full year-to-date loss figure was not affected by its subsequent conclusions concerning the integrity of the SCP traders' marks.

16. Two months later, on July 13, 2012, JPMorgan announced that it would restate its results for the first quarter of 2012 because it had discovered "information that raises questions about the integrity of the [SCP] marks" and was no longer confident that the marks used to prepare the first quarter results "reflect good faith estimates of fair value at quarter end." On August 9, 2012, JPMorgan filed an amended Form 10-Q with restated results for the first quarter. The restatement had the effect of moving certain SCP losses from the second quarter to the first quarter. Specifically, the restatement reduced the revenues of JPMorgan's Corporate/Private Equity reporting segment in the first quarter by $660 million, from $1.689 billion to $1.029 billion, and the firm's consolidated quarterly income before income tax expense from the previously-reported $7.641 billion to $6.981 billion.

JPMORGAN'S INEFFECTIVE INTERNAL ACCOUNTING CONTROLS AND DISCLOSURE CONTROLS AND PROCEDURES

17. JPMorgan's May 10, 2012 quarterly report on Form 10-Q contained its financial statements for the first quarter of the year, management's discussion of the firm's various businesses, and other information. In addition, the report stated that JPMorgan's management evaluated the effectiveness of its disclosure controls and procedures and concluded that they were effective.

18. As discussed below, between late April and May 10, 2012, JPMorgan engaged in an extensive process involving work performed by the Controller's office, the Internal Audit department ("Internal Audit"), valuation experts from the Investment Banking Division ("IB"), and in-house and outside counsel in an effort to evaluate the SCP's quarter-end marks and to understand the CIO valuation control process and the differences between that process and the valuation control process of the IB. As a result, by May 10, various executives and employees of the firm had learned of deficiencies as of March 31, 2012 in CIO's internal controls. Due to failures to timely escalate information and instructions that had the effect of hindering the sharing of information, not all of these deficiencies had been escalated to JPMorgan Senior Management prior to May 10, 2012. And, as to the information that was escalated, JPMorgan Senior Management did not make a considered assessment as to whether critical facts existed—including any significant deficiency or material weakness in internal controls—that had to be disclosed to the Audit Committee. Consequently, JPMorgan Senior Management did not disclose the existence of any significant deficiencies or material weaknesses to the Audit Committee before JPMorgan filed its quarterly report on May 10, 2012.

19. On July 13, 2012, at the same time JPMorgan disclosed to investors that it would restate its results for the first quarter of 2012, the firm announced that a material weakness in internal control over financial reporting had existed at CIO as of March 31, 2012. As a result of the material weakness, JPMorgan also announced that its management had concluded that JPMorgan's disclosure controls and procedures were not effective as of March 31, 2012.

CIO Internal Controls in the First Quarter of 2012

20. As part of fulfilling the requirements to devise and maintain systems of internal accounting controls, financial institutions such as JPMorgan need to have internal controls that adequately monitor and test the accuracy and integrity of, among other things, the valuations of the firm's trading portfolios such as the SCP. CIO-VCG served as a significant control for ensuring that certain assets and liabilities of CIO, including the positions in the SCP, were measured at fair value in accordance with GAAP in JPMorgan's books and records and in the quarterly and annual reports the firm filed with the Commission.

21. For the SCP, CIO-VCG carried out its responsibility by price-testing the marks that the SCP traders assigned to the portfolio's positions on the last business day of every month. Under firm policy applicable during the first quarter of 2012, CIO-VCG performed this price-testing function by undertaking the following steps:

a. First, CIO-VCG had to calculate, as a benchmark, an independent price for each of the SCP positions. A CIO-VCG policy and procedure document indicates that, for index positions, these independent prices were to be obtained from Markit Limited Group ("Markit"), a service that provides consensus-based prices for indices. For tranches, CIO-VCG obtained independent prices from dealer quotes, which it checked against Totem, another consensus pricing service offered by Markit, for any significant discrepancies.

b. After calculating an independent price for each SCP position, CIO-VCG had to establish and apply a threshold (or tolerance) around each price that represented the average bid-offer spread for the security based on quotes received from dealers. While it had authority to make an adjustment to trader marks that fell within these thresholds, CIO-VCG considered such marks to be presumptively marked at fair value and would not make any adjustment to those marks.

c. If the SCP traders' mark for a given position fell outside of the threshold, CIO-VCG would record the excess as a loss (or profit) and make a corresponding adjustment to the mark-to-market profit and loss for the SCP.

d. Finally, if CIO-VCG determined that the market for a particular position had become illiquid, CIO-VCG applied a pre-established formula to calculate and record a liquidity reserve to account for the risk that certain SCP positions could not be sold at fair value due to reduced liquidity in the marketplace.

22. The CIO-VCG staff actively involved in price-testing the SCP's 132 positions at the end of the first quarter of 2012 consisted of one person, who worked at CIO's London office. That person was also responsible for price testing all of CIO's other London-based portfolios.

23. On April 4, 2012, CIO-VCG completed its price-testing process for the SCP for the end of March 2012. It applied the relevant thresholds to adjust downward the fair value of the SCP by approximately $17 million compared to the traders' marks and maintained the previous month's liquidity reserve of approximately $31 million.

24. During its price-testing process for quarter-end marks, CIO-VCG observed that most of the SCP traders' marks migrated to the aggressive end of the bid/offer spread. CIO-VCG questioned one of the SCP traders about this shift. The trader did not explain the shift but merely stated, "Talk to management." CIO-VCG did not disclose to anyone its observations concerning the shift in the SCP traders' marking methodology until questions were being raised about a collateral dispute, which is summarized below, on April 20, 2012. CIO-VCG also did not share the details of its exchange with the SCP trader.

25. CIO-VCG calculated a significant difference between its independent prices and the SCP traders' marks. During its price-testing process, it calculated that the mid-market value of the SCP based on its independent prices was approximately $192 million less than the value based on the SCP traders' marks. It subsequently identified an error in its calculations, which increased the difference from $192 million to approximately $275 million. A March 30, 2012 Internal Audit report on CIO-VCG contained an Action Plan under which CIO-VCG should disclose this discrepancy to CIO management. However, that action plan was not required to be fully implemented until June 30, 2012, and CIO-VCG only disclosed the $17 million fair value adjustment based on marks that fell outside of its thresholds. Consequently, CIO management was not alerted to the significant difference between the SCP traders' marks and the CIO-VCG calculated mid-market valuations, which warranted further analysis.

26. Shortly after April 4, 2012, CIO Finance, with the approval of CIO management and JPMorgan Senior Management, increased the existing $31 million liquidity reserve by $155 million, based on a determination that certain tranches in the SCP portfolio had become illiquid as of March 30. The traders' marks, as adjusted by CIO-VCG, were then incorporated in the financial information provided for CIO in JPMorgan's earnings release on April 13, 2012 and in the firm's May 10, 2012 report for the first quarter of 2012.

Large Collateral Calls and Increasing Losses Prompt
Multiple Reviews of CIO-VCG and the Traders' Marks

27. On April 20, 2012, JPMorgan Senior Management was informed that the firm had received several collateral calls—requests from trading counterparties for payment or the posting of collateral based on their differing views of the fair value—concerning positions in the SCP. The total amount in dispute was approximately $520 million.

28. A collateral dispute with a CDS counterparty can sometimes be an indication that a firm's internal price for an instrument does not accurately reflect its fair value. Accordingly, in April 2012, the size of the collateral disputes over the SCP raised concerns by JPMorgan Senior Management about the pricing of the SCP positions. In an April 20, 2012 email, a member of JPMorgan Senior Management observed that the collateral disputes were not "a good sign on our valuation process" in the SCP.

29. At the same time that the collateral disputes were being escalated to JPMorgan Senior Management, the SCP was also sustaining large daily losses. This development was inconsistent with what CIO had told JPMorgan Senior Management to expect prior to the April 13 earnings release, and JPMorgan Senior Management was concerned about the losses and the traders' explanations of what was happening to the SCP positions and their strategy for dealing with the risks to the SCP. On or about April 27, JPMorgan Senior Management asked a senior trader from the IB and a senior risk officer to evaluate the portfolio on an urgent basis. Shortly afterwards, the IB trader and risk officer were put in charge of managing and reducing the risk in the SCP, and the SCP traders were relieved of all trading and pricing responsibilities. Additionally, on a going-forward basis, positions in the SCP were to be marked to consensus mid-market prices published by Markit.

30. In late April and early May, JPMorgan Senior Management mobilized resources from various parts of the firm—the IB's valuation experts, Internal Audit, which had prior experience with CIO-VCG's price-testing process, and the Controller's office, which included JPMorgan's fair value accounting experts—as well as the Legal Department and an outside law firm to conduct reviews of the SCP traders' marks and CIO-VCG's price-testing process. At the time, JPMorgan was planning to file with the Commission its report for the first quarter of 2012 in early May 2012. In part due to the questions being raised about the valuation of the SCP, JPMorgan Senior Management, with approval of the Audit Committee, decided to postpone the filing to May 10. JPMorgan Senior Management delayed the filing so that it had additional time to assess whether CIO's first quarter results, which had been publicly released on April 13, were in fact compliant with GAAP and should be disclosed again in the quarterly report.

The Investment Bank's Review

31. On April 25, 2012, a member of JPMorgan Senior Management asked the Valuation Control Group in the firm's IB ("IB-VCG") to price-test the SCP traders' marks for March 30, 2012 as if the positions had been held by the IB. IB-VCG also reviewed the price-testing work that had been done by CIO-VCG at the end of March 2012. The IB-VCG review was conducted under the supervision of the IB's Chief Financial Officer.

IB-VCG Valuation "In Line with the Counterparties"

32. The next day, IB-VCG performed a preliminary analysis of the SCP traders' marks. On a conference call that day, IB-VCG staff informed CIO management and CIO-VCG that "[t]he rough initial result [of its analysis] . . . seems to, to be in line with the mark-to-market differences you see on the collateral calls. . . . In terms of dollar value, the number seems pretty much in line . . . with the counterparties." In other words, IB-VCG's preliminary valuation of the SCP positions was in line with those of CIO's trading counterparties, who had valued the SCP at several hundreds of millions of dollars less than the SCP traders did.

33. During the conference call, CIO-VCG explained to IB-VCG staff that in setting thresholds around independent prices during its month-end price-testing process, it often consulted with the SCP traders—whose valuations it was supposed to validate—"to see if they have any market input to decide whether, you know, if it's, that's wrong, that's correct, et cetera." CIO-VCG also informed IB-VCG that, when completing its price-testing process, it

used dealer quotes selected by SCP traders. IB-VCG staff believed that this process of consulting the traders had the potential to significantly impair the independence and effectiveness of the CIO-VCG process.

34. On Saturday, April 28, 2012, at a meeting with members of JPMorgan Senior Management and CIO management, the IB's CFO presented IB-VCG's analysis of the SCP traders' marks. He reviewed with the attendees a spreadsheet that detailed IB-VCG's work to date ("IB-VCG Spreadsheet"). At that meeting, at least one of the positions in the IB-VCG Spreadsheet was reviewed on a column-by-column basis in order to describe the data included in each individual column.

35. As of this time, JPMorgan Senior Management and CIO management knew that the SCP traders' marks were $275 million greater than independent mid-market prices computed by CIO-VCG based on a combination of broker quotes and data from consensus pricing services. IB-VCG relied exclusively upon consensus pricing services, and the IB-VCG Spreadsheet calculated that the SCP traders' marks were approximately $767 million greater than the values placed on the SCP positions by consensus mid-market prices published by Markit and Totem.

36. As part of its analysis, IB-VCG staff calculated an approximate bid-offer spread, based on market information from March 30, 2012, for six SCP positions, including several of the largest positions and some with the greatest total dollar value differences between trader marks and IB-VCG's consensus pricing. The IB-VCG Spreadsheet contained data regarding 133 positions and reflected, among other things, that for the six positions for which it calculated an approximate bid-offer spread, the traders' quarter-end marks were outside the bid-offer spreads that IB-VCG had approximated.

37. After presenting IB-VCG's analysis, the IB's CFO began to calculate the profit-and-loss impact if CIO marked the SCP to the conservative end of the bid-offer spread, rather than to mid-market prices, as a price-taker would have done (since price-takers often buy and sell at prices that are inferior to the consensus, mid-market Markit or Totem prices). This analysis showed that adjusting marks to the conservative end of the bid-offer spread would have further reduced the value of the SCP by approximately $250 million, resulting in an over $1 billion difference between the traders' marks and a price-taker's marks at the conservative end of the bid-offer spread. JPMorgan Senior Management elected not to pursue this marking methodology with respect to the March 2012 quarter-end marks because, among other reasons, it understood that using mid-market prices was acceptable under GAAP.

Spreadsheet Errors

38. IB-VCG also reviewed the process that CIO-VCG had applied to the traders' quarter-end marks. During this review, IB-VCG learned that in March 2012 CIO-VCG used a spreadsheet in its price-testing process into which data had been manually entered, and that this spreadsheet contained certain errors and reflected differences from the IB-VCG methodology that may have had the effect of understating the difference between the traders' marks and the independent mid-market prices derived by CIO-VCG. On May 8, 2012, IB-VCG forwarded an email to one member of JPMorgan Senior Management explaining these issues. IB-VCG and CIO-VCG were instructed to work together to address the errors and other issues.

39. The next day, IB-VCG corrected one such error, which involved the calculation of the difference between the value of the SCP based on the traders' marks and CIO-VCG's independent prices. Before the correction, the difference was believed to be approximately $275 million. After the correction, the difference increased to $512 million. IB-VCG informed JPMorgan Senior Management of the correction and the quantitative impact it had.

40. Based on the price-testing work of IB-VCG and other information, the management of the IB expressed concerns to JPMorgan Senior Management about the potential for mismarking of the SCP and whether CIO VCG was an effective control over the SCP. On May 6, 2012, for example, a senior IB executive explained to a member of JPMorgan Senior Management that the securities in the SCP had "very good price discovery mechanisms" (*i.e.*, could effectively be priced in the marketplace) and that he could not recall a variance between trader marks and independent prices in the IB "greater than $50mm that remained at any month end across the ENTIRE IB's positions."

41. In light of their concerns relating to CIO, two senior IB executives initially expressed some reservations regarding the scope of their sub-certifications that JPMorgan required officers in the various business lines to provide in connection with its quarterly and annual filings. One of the executives apprised JPMorgan Senior Management that in light of the CIO related information to which he was privy, he had a conversation with an outside lawyer concerning the scope of his certification obligations. After relaying that conversation to the other Investment Bank executive with certification obligations, both executives signed their sub-certifications.

The Internal Audit Review

42. In addition to the IB-VCG review, on or around May 2, 2012, JPMorgan Senior Management instructed Internal Audit to review the CIO-VCG process, including whether it had been applied consistently over past quarters. Also on May 2, at the end of a meeting of the Audit Committee of JPMorgan's Board of Directors, the Audit Committee, having just been informed of the losses recently suffered, separately requested that Internal Audit review CIO.

43. The Internal Audit team discovered deficiencies with the thresholds CIO-VCG had applied at March 30. As noted above, JPMorgan policy required that CIO-VCG set a threshold around its independent price for each SCP position that was representative of the average spread between the bids and the offers received from dealers for the position. Because the threshold was applied on each side of the independent price, in order to reflect the bid-offer spread the threshold on each side would be one-half of the entire spread.

44. By May 9, 2012, the Internal Audit team learned that in validating the SCP traders' quarter-end marks in March 2012, CIO-VCG had in some cases applied the entire bid-offer spread (rather than one half of the spread) on each side of its independent prices. The result was a threshold that was twice the size of the bid-offer spread and beyond the range of reasonable fair value estimates. The Internal Audit team calculated that, had CIO-VCG applied the thresholds appropriately, it would have adjusted the traders' quarter-end marks downward by $307 million—$290 million more than the $17 million adjustment CIO-VCG had actually made at month end.

45. On May 10, the Internal Audit team collected its work in a draft memo ("Internal Audit Draft Memo"), which stated, among other things, that CIO-VCG was "inconsistent in the application of [its] own thresholds."

46. Although Internal Audit completed this work in the days prior to May 10, it did not fully share this information with JPMorgan Senior Management and did not circulate the Internal Audit Draft Memo to JPMorgan Senior Management or the Audit Committee.

The Controller's Review

47. On April 28, 2012, JPMorgan Senior Management asked the Controller's staff to assess whether the traders' quarter-end marks complied with GAAP and to review the effectiveness of CIO-VCG's quarter-end internal control process.

48. The Controller's staff made several significant observations. One was that, as losses in the SCP increased in March 2012, the traders departed from their historical practice of marking the positions close to the mid-point between the bids and offers received from dealers. Instead, they marked many positions at the aggressive end of the bid-offer spreads, *i.e.*, they marked the positions in a manner that resulted in smaller mark-to-market losses. JPMorgan Senior Management was informed of this fact in late April 2012. The traders justified their marks to the Controller's staff by explaining that the market had become volatile and dislocated. This volatility, the SCP traders claimed, caused significant intraday price movements that may help explain the difference between the SCP traders' marks and consensus pricing services. To test the volatility explanation, the Controller's staff analyzed intraday pricing information, and determined that the difference between the SCP traders' marks and the mid-market prices was less than the average daily price movement. While accepting the SCP traders' justification, however, the Controller's staff failed to adequately assess whether CIO could transact at the price where the SCP was marked.

49. For two quarter end marks assigned by the SCP traders, the Controller's staff also detected significant differences from mid-market consensus pricing that were not supported by pricing data received by the SCP traders on the date that the mark was assigned. When the Controller's staff questioned these marks, one of the SCP traders agreed that they were too wide as compared to the mid-market price. This fact had not been adequately considered by CIO-VCG during its actual price testing process in connection with the first quarter of 2012, nor was this fact given appropriate scrutiny by the Controller's staff. Consequently, the Controller's staff did not escalate this information to JPMorgan Senior Management.

The Special Review by Outside Counsel

50. In addition to the foregoing reviews, on or around May 1, 2012, JPMorgan retained an outside law firm to provide advice regarding disclosure and to review, among other things, whether the independence of the CIO-VCG process had been improperly compromised by the involvement of the SCP traders. By May 10, 2012, when JPMorgan filed its first quarter report, the law firm had interviewed the employee of CIO-VCG who had price-tested the SCP marks, the executive to whom he reported, and other members of CIO management. The law

firm also had collected and reviewed a limited number of the relevant emails and Bloomberg chats from the first quarter of 2012.

The Process for Synthesizing and
<u>Escalating Information from the Various Reviews</u>

51. JPMorgan Senior Management led a process that involved daily—sometimes twice daily—meetings and calls in which participants involved in the different reviews discussed what they and their teams were doing and learning. Despite that process, a number of significant facts learned in the course of the various reviews were not shared in these group meetings and calls and were not otherwise escalated to JPMorgan Senior Management. This in turn led to JPMorgan's incomplete understanding of deficiencies relating to the CIO-VCG process in March 2012.

52. JPMorgan Senior Management's emphasis on confidentiality and sharing information on a need-to-know basis contributed to this incomplete understanding. JPMorgan Senior Management was concerned about sensitive information relating to CIO's positions being widely distributed and imposed restrictions on the creation and sharing of work product relating to those positions. These instructions affected the ability of those conducting the reviews to share, learn from, and build upon each other's work.

53. On April 29, 2012, the Controller's staff was instructed not to "discuss [its work] with people outside the immediate group" and to exercise caution in committing its findings to writing.

54. A member of JPMorgan Senior Management also instructed IB-VCG to "keep [its] analysis in a relatively tight group." On April 29, 2012, an IB executive confirmed to the member of JPMorgan Senior Management that IB-VCG "speaks to no one," including the Controller's staff, "without getting my express approval first."

55. Finally, the Internal Audit team was instructed to maintain strict confidentiality in connection with its review.

56. JPMorgan Senior Management did not receive all relevant information for another reason: some employees conducting the reviews failed to appreciate the significance of certain of the facts they had learned and their relevance to the quarterly report that was about to be filed. For example, in looking back on his work after learning in late June that the integrity of the traders' marks was in question, a London-based employee primarily responsible for the Controller's review conducted an after-the-fact assessment, noting that he "[s]hould have better understood the $767 [million] diff.," *i.e.*, IB-VCG's calculation of the disparity between the SCP traders' quarter-end marks and Markit and Totem consensus, mid-market prices. The employee further noted that he "[s]hould have pressed [CIO-VCG] more on how the tolerances (thresholds) were determined" and "should have picked up that the tolerances determined by adding whole bid-offer," a fact already known to members of the Internal Audit team prior to May 10, 2012. Although executives were in contact with those responsible for the various reviews, some of those employees failed to timely analyze and escalate to JPMorgan Senior Management important facts that they had discovered.

JPMorgan Senior Management's
<u>Response to the Information It Received</u>

57. Despite the inadequate information sharing and escalation described above, significant information learned in the management-commissioned reviews was escalated to JPMorgan Senior Management. This information, which related to the adequacy of the CIO-VCG process that produced the $17 million fair value adjustment to the traders' quarter-end marks, included the following:

a. As losses began to mount, SCP traders began consistently marking at or near the very edge of the advantageous side of the bid-offer spread.

b. There was a collateral dispute of over $500 million.

c. Independent analysis by IB-VCG of the SCP traders' quarter-end marks was "in line with . . . the counterparties." Specifically, the value of the SCP based on trader marks was approximately $767 million more than the value based on mid-point consensus pricing.

58. Management also learned of the following facts that directly related to CIO-VCG and the processes it was using in March 2012:

a. The CIO-VCG process relied on manual spreadsheets that contained errors, one of which caused CIO-VCG to understate the disparity between its independent prices and the traders' marks by $237 million.

b. The SCP traders provided some of the quotes that were used in CIO-VCG's price-testing process and this process "need[ed] to be enhanced to ensure independence."

59. In response to what it was learning prior to May 10, JPMorgan Senior Management decided to enhance CIO-VCG's valuation policies. To assist with this task, the persons conducting the reviews recommended certain changes, and a member of JPMorgan Senior Management drafted revisions to CIO-VCG procedures, which were shared with JPMorgan Senior Management and CIO management on May 5, 2012. On May 7, 2012, a senior CIO executive circulated a "proposed operational approach to VCG price testing" that contained additional policy revisions. Both sets of changes were implemented before May 10, 2012.

60. Collectively, the new policies were intended to remediate several of the issues discovered by the management-commissioned reviews of CIO-VCG and the traders' marks:

a. <u>Disparity between CIO-VCG independent prices and traders' marks</u>. The revised policies significantly curtailed the size of thresholds that CIO-VCG could apply, directing that the difference between a trader's mark and CIO-VCG's independent price could not exceed $500,000 for an index position and $2,000,000 for a tranche position.

b. Trader involvement in the VCG process. The revised policies required CIO-VCG to "source broker quotes independently from the market," rather than through the traders, thereby "eliminating any reliance on [the traders] for sourcing of market data."

c. Variance between Markit and CIO-VCG's independent prices. The revised policies stated that, for positions where CIO-VCG could rely on dealer quotes in calculating independent prices, CIO-VCG must obtain at least two quotes and, if two are not available, it must use Markit or Totem as an input. The revised policies also provided that, even when dealer quotes are obtained, "mid prices derived from selected dealer quotes should be compared . . . to Markit/Totem sourced data and any material differences . . . must be reported to the CFO of CIO and must be reconciled."

d. Inadequate oversight over sole CIO-VCG price-tester. The revised policies introduced a new protocol for escalating to management valuation disputes between CIO-VCG and the traders, requiring the involvement of JPMorgan risk personnel and the Chief Financial Officer of CIO.

61. In addition to these policy changes, in early May the staff of IB-VCG prepared a remedial plan to address the spreadsheet errors it had identified in CIO-VCG's price-testing process, and to ensure proper review of the spreadsheets. On May 8, 2012, after CIO finance management and CIO-VCG concurred in the remedial plan, IB-VCG described it to JPMorgan Senior Management.

The Reviews of CIO-VCG Are Not Addressed with the Audit Committee

62. The responsibility for overseeing JPMorgan's management on behalf of the firm's stockholders—including oversight of management's responsibilities for internal controls—ultimately rests with JPMorgan's Board of Directors. The Board, in turn, discharges its oversight function through several Board committees. One of the principal committees is the Audit Committee, which is charged with overseeing JPMorgan's efforts to assure that it has effective internal controls, which are critical to the integrity of the firm's financial reports and compliance with applicable policies and laws.

63. To assist the Audit Committee in carrying out its responsibility, the Audit Committee's Charter requires JPMorgan management to provide updates to the Committee on all "significant operating and control issues in internal audit reports," the "initiation and status of significant special investigations," the "identification and resolution status of material weaknesses" in controls, and any "reportable conditions in the internal control environment, including any significant deficiencies." These updates serve an important internal control function, allowing the Audit Committee to fulfill its oversight role by, among other things, keeping the Board up-to-date on significant matters, assessing whether to approve the filing of quarterly and annual reports, and evaluating whether the Committee should conduct its own independent investigation of any issues raised with it.

64. In late April and early May 2012, while JPMorgan's Senior Management was devoting daily attention to CIO-VCG and the SCP traders' quarter-end marks—in large measure to ensure that CIO results reported in its upcoming quarterly report would be accurate—it also was in contact with members of the Audit Committee.

65. However, while JPMorgan Senior Management was informed of, and was addressing, various issues with internal controls at CIO-VCG, JPMorgan Senior Management did not engage in a considered assessment, before the firm filed its first quarter report on May 10, 2012, to determine if these matters constituted a significant deficiency or material weakness in the firm's internal control over financial reporting and therefore had to be disclosed to the firm's Audit Committee. Nor, more broadly, did JPMorgan Senior Management disclose to the Audit Committee its concerns regarding the operation of CIO-VCG.

66. On May 2, 2012, the Audit Committee met with some members of JPMorgan Senior Management. The focus of the meeting was on the mounting losses in the SCP portfolio. Despite the requirement to keep the Audit Committee apprised of the significant control issues that were under review, there was no discussion of the IB-VCG or Controller reviews related to CIO-VCG and the traders' marks, although that work was underway. There was also no discussion of the fact that an outside law firm had been retained to advise on disclosures to be made in the first quarter Form 10-Q that related to CIO and to assess certain aspects of the CIO-VCG process, including whether the SCP traders exercised undue influence on the process.

67. During a full meeting of the Board of Directors hours before the filing of JPMorgan's first quarter report on May 10, 2012, JPMorgan Senior Management mentioned that reviews of what occurred in CIO were underway, including by Internal Audit, legal, the Controller's staff, and risk management. But, JPMorgan Senior Management did not discuss the details of or facts learned in the IB-VCG, Controller, or Internal Audit reviews.

68. Because the Audit Committee was not apprised of the initiation of the reviews or facts learned as a result of those reviews, it was unable to provide input on the issues before the filing of JPMorgan's first quarter report, and was unable to engage with those doing the work to ensure that it was sufficient from the perspective of the Audit Committee.

69. As noted above, the Audit Committee was not made aware before JPMorgan filed its first quarter report of the facts learned by various members of the review teams, including that CIO-VCG's March 2012 price-testing process was compromised by spreadsheet errors, that SCP traders may have exerted influence over that process, or that CIO-VCG applied valuation thresholds that were in some instances twice the applicable spread.

70. Other information learned by various members of the review teams that further called into question CIO-VCG's March 2012 quarter-end valuation process was not shared with the Audit Committee. At the end of the first quarter, CIO-VCG made a fair value adjustment of $17 million to the traders' marks. However, certain facts raised issues as to the adequacy of this adjustment and the process through which it was made, including the $520 million in collateral disputes over SCP positions, the $767 million disparity between the SCP traders' marks and consensus, mid-market prices, the fact that the traders marked some of the largest notional SCP

positions outside the bid-offer spread approximated by IB-VCG, and the fact that the traders began to mark the SCP at the aggressive end of the bid-offer spread when losses began to mount.

71. Finally, the Audit Committee was not apprised of, or included in, JPMorgan Senior Management's efforts to remedy the control issues at CIO-VCG by revising valuation policies to ensure proper oversight by CIO management. As a result, the Audit Committee did not have any input into the proposed changes or an understanding of the reasons that motivated them.

Subsequent Disclosures by JPMorgan

72. Based on the information available to it, the Audit Committee approved of the content of JPMorgan's quarterly report on Form 10-Q that was filed on May 10, 2012. On July 13, 2012, JPMorgan disclosed that a material weakness existed in its internal control over financial reporting stemming from the "effectiveness of CIO's internal controls over valuation of the synthetic credit portfolio." In its amended Form 10-Q for the first quarter of 2012 filed on August 9, 2012, JPMorgan disclosed that this material weakness finding "was the result of issues in certain interrelated and interdependent control elements comprising that process, including insufficient engagement of CIO senior finance management in the valuation control process in light of the increased size and heightened risk profile of the synthetic credit portfolio during the first quarter of 2012, and in the effectiveness of certain procedures employed during the first quarter of 2012 by the CIO Valuation Control Group in performing the price verifications."

73. JPMorgan also corrected prior statements concerning its disclosure controls and procedures. In its May 10 Form 10-Q, JPMorgan stated, "As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of the Firm's management, including its Chairman and Chief Executive Officer and its Chief Financial Officer, of the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on that evaluation, the Chairman and Chief Executive Officer and the Chief Financial Officer concluded that these disclosure controls and procedures were effective." On August 9, 2012, when JPMorgan disclosed that it had determined that a material weakness existed at CIO as of March 31, 2012, it also disclosed that, "[a]s a result of that determination, the Firm's Chairman and Chief Executive Officer and Chief Financial Officer also concluded that the Firm's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) were not effective at March 31, 2012."

Dissenting Statement In the Matter of Lynn R. Blodgett and Kevin R. Kyser, CPA, Respondents

Commissioner Luis A. Aguilar

Aug. 28, 2014

During my tenure, I have been a strong supporter of the SEC's Enforcement program. I have advocated for an effective Enforcement program by focusing on individual accountability, effective sanctions that deter and punish egregious misconduct, and policies designed to eradicate recidivism. [1] The importance of a strong and robust Enforcement program cannot be overstated. It is a vital component of an effective capital market on which investors can rely. Much of the agency's enforcement decisions are to be commended. However, I am obligated to speak out when it appears that the agency falters.

Accordingly, I respectfully dissent from the Commission's Order accepting the settlement offer of Kevin R. Kyser, a Certified Public Accountant and former Chief Financial Officer ("CFO") of Affiliated Computer Services, Inc. ("ACS" or "Company").

Given the egregious conduct that Mr. Kyser engaged in at ACS, the Commission's settlement, which lacks fraud charges or a timeout in the form of a Rule 102(e) suspension, is a wrist slap at best.

First, let's discuss the improper accounting at issue here. As the Commission's Order[2] states, ACS violated generally accepted accounting principles ("GAAP") by inserting itself into pre-existing sales transactions between a manufacturer and a reseller for the primary purpose of booking revenues from those transactions.[3] Thus, the Company's involvement in those transactions had no economic substance.[4] ACS's misconduct enabled it to improperly report approximately $125 million in revenues,[5] and, crucially, gave the misleading impression that it had met its internal revenue growth guidance.[6] ACS failed to disclose the true nature of these improper transactions,[7] and falsely reported its internal revenue growth in public filings.[8]

Second, let's discuss how Mr. Kyser, in his critical role as CFO, facilitated ACS's misconduct. As described in the Commission's own Order, Mr. Kyser:

- Understood that ACS had inserted itself into these pre-existing transactions and that they would impact ACS's reported revenue growth;[9]
- Was responsible for the content of ACS's false and misleading public filings with the Commission, earnings releases, and analyst conference calls;[10]
- Highlighted ACS's false and misleading internal revenue growth in earnings releases and analyst conference calls;[11]
- Failed to ensure that ACS adequately disclosed and described the significance of these transactions in ACS's public filings and analyst conference calls;[12]
- Signed false certifications in connection with the Company's periodic filings;[13] and

- Received an inflated bonus based on ACS's financial performance that was overstated by 43%. [14]

Accountants—especially CPAs—serve as gatekeepers in our securities markets. They play an important role in maintaining investor confidence and fostering fair and efficient markets. When they serve as officers of public companies, they take on an even greater responsibility by virtue of holding a position of public trust. To this end, when these accountants engage in fraudulent misconduct, the Commission *must* be willing to charge fraud and *must* not hesitate to suspend the accountant from appearing or practicing before the Commission. This is true regardless of whether the fraudulent misconduct involves *scienter*.

The Commission instead chose to charge Mr. Kyser with limited, narrow non-fraud charges, comprising of violations of the books and records, internal controls, reporting, and certification provisions of the federal securities laws. In the past, respondents with the same state of mind and similar type of misconduct as Mr. Kyser have been charged with violations of the antifraud provisions of the Securities Act, in particular, Sections 17(a)(2) and/or (3), as well as the books and record and internal control violations.[15]

In addition, where CPAs engage in this type of egregious securities fraud—especially misconduct that relates to the CPAs' core expertise of financial reporting—the Commission has rightly required such persons to forfeit their privilege to appear and practice before the Commission by imposing a suspension under Rule 102(e) of the Commission's Rules of Practice.[16]

Beyond this particular matter, I am concerned that the Commission is entering into a practice of accepting settlements without appropriately charging fraud and imposing Rule 102(e) suspensions against accountants in financial reporting and disclosure cases. I am also concerned that this reflects a lack of conviction to charge what the facts warrant and to bring appropriate remedies.

The statistics on financial reporting and disclosure cases and related Rule 102(e) suspensions reflect a troubling trend. In fiscal year 2010, the Commission brought 117 financial reporting and disclosure cases against issuers and individuals, and imposed Rule 102(e) suspensions in 54% of those cases. [17] In 2011, the number of financial reporting and disclosure cases against issuers and individuals brought by the Commission fell to 86, and the Commission imposed Rule 102(e) suspensions in 53% of those cases.[18] In 2012, again the number of similar cases brought by the Commission fell, this time to 76, and the Commission imposed Rule 102(e) suspensions in 49% of those cases.[19] In 2013, the Commission brought only 68 similar cases, and imposed Rule 102(e) suspensions in only 41% of those cases.[20] These declining numbers reveal a departure from the Commission's efforts to keep bad apples out of the securities industry, and this puts investors and the integrity of the Commission's processes at grave risk.

In my six years as a Commissioner, I have watched defendants fight charging decisions on all fronts, including fighting tooth-and-nail to avoid being suspended from appearing or practicing before the Commission pursuant to Rule 102(e). This is to be expected, as a suspension order takes a fraudster out of the industry, and often has a far more lasting impact on the fraudster than the imposition of a monetary fine.[21]

A Rule 102(e) suspension is an appropriate sanction to be imposed when people choose to engage in deception and perpetuate fraud—in other words, when people engage in flagrant, harmful misconduct. Thus, to avoid sanctions under Rule 102(e), defendants strenuously object to scienter-based and non-scienter-based fraud charges[22] (as opposed to lesser charges, such as books and records or internal control violations). That is to be expected.

What is not to be expected is when defendants engage in fraud and the Commission affirmatively accepts a weak settlement with lesser charges. This leaves the investing public significantly at risk, as bad actors are not appropriately charged or sanctioned and are permitted to continue to operate in the securities industry. This is completely unacceptable.

I am concerned that this case is emblematic of a broader trend at the Commission where fraud charges—particularly non-scienter fraud charges—are warranted, but instead are downgraded to books and records and internal control charges. This practice often results in individuals who willingly engaged in fraudulent misconduct retaining their ability to appear and practice before the Commission.

I fear that cases in the future will continue to be weak. More specifically, I fear that when the staff determines not to seek a Rule 102(e) suspension, it will also forgo bringing fraud charges. Likewise, I am concerned that Commission Orders may, at times, be purposely vague and/or incomplete, and written in a way so as to lead the public to conclude that no fraud had occurred. When this happens, the public is denied a full accounting and appreciation of the egregious nature of a defendant's misconduct. In addition, this practice muzzles my voice by not allowing any statement by me (including this dissent) to include a fulsome description of facts that support the view that the Commission should have brought fraud charges.[23] This adversely impacts my ability as a Commissioner to provide the American public honest and transparent information—including a description of facts discovered by the staff during its investigation. In the end, these behind-the-curtain decisions can make fraudulent behavior appear to be an honest mistake.

In my view, Mr. Kyser's egregious misconduct violated, at a minimum, the non-scienter-based antifraud provisions of the Securities Act. Accordingly, charges under Sections 17(a)(2) and/or (3) are warranted and a Rule 102(e) suspension is necessary and appropriate in this case.

The Commission must send a strong and consistent message to the industry that the Commission takes seriously its responsibility of requiring integrity in the financial markets. For these reasons, I dissent.

[1] *See,* for example, Commissioner Luis A. Aguilar: *A Stronger Enforcement Program to Enhance Investor Protection* (Oct. 25, 2013), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370540071677; *Taking a No-Nonsense Approach to Enforcing the Federal Securities Laws* (Oct. 18, 2012), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1365171491510; *Combating Securities Fraud at Home and Abroad"* (May 28, 2009), *available at* http://www.sec.gov/news/speech/2009/spch052809laa.htm; *Reinvigorating the Enforcement Program to Restore Investor Confidence* (Mar. 18, 2009), *available at* http://www.sec.gov/news/speech/2009/spch031809laa.htm; *Empowering the Markets Watchdog to Effect Real Results* (Jan. 10, 2009), *available at* http://www.sec.gov/news/speech/2009/spch011009laa.htm.

[2] Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, Securities Exchange Act of 1934 Release No. 72938, Accounting and Auditing Enforcement Release No. 3578, Administrative Proceeding File No. 3-16045 (Aug. 28, 2014) (hereinafter "Order"), *available at* http://www.sec.gov/litigation/admin/2014/34-72938.pdf.

[3] "At or near the end of each quarter ended September 30, 2008 through the quarter ended June 30, 2009, Affiliated Computer Services ("ACS") arranged for an equipment manufacturer to re-direct through its pre-existing orders through ACS, which gave the appearance that ACS was involved." Order at p. 2. "ACS improperly applied GAAP in determining the amount of revenue to report in each of its quarters in FY 2009. In making a determination of the amount of revenue to report, ACS did not appropriately take into account all of the critical terms of the arrangement and therefore failed to

reflect the lack of economic substance of the 'resale transactions' under GAAP." Order at p. 4. *See also* SEC Press Release, "SEC Charges Two Information Technology Executives With Mischaracterizing Resale Transactions to Increase Revenue" (Aug. 28, 2014) (hereinafter "Press Release"), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542786775 ("The Securities and Exchange Commission today charged two executives at a Dallas-based information technology company with mischaracterizing an arrangement with an equipment manufacturer to purport that it was conducting so-called "resale transactions" to inflate the company's reported revenue.").

[4] "ACS, however, had no substantive involvement in the orders, and there were no changes to the terms of the pre-existing orders." Order at p. 2. "In making a determination of the amount of revenue to report, ACS did not appropriately take into account all of the critical terms of the arrangement and therefore failed to reflect the lack of economic substance of the 'resale transactions' under GAAP." Order at p. 4.

[5] "ACS improperly reported approximately $125 million in revenue due to such arrangements." Order at p. 2. "In total, ACS reported revenue of $124.5 million from such arrangements during fiscal 2009. … In making a determination of the amount of revenue to report, ACS did not appropriately take into account all of the critical terms of the arrangement and therefore failed to reflect the lack of economic substance of the 'resale transactions' under GAAP. In addition, ACS's internal controls were insufficient to provide reasonable assurance that ACS reported revenues in conformity with GAAP, primarily because ACS failed to appropriately evaluate the economic substance of the 'resale transactions.'" Order at p. 4.

[6] "The revenue from these 'resale transactions' enabled ACS to meet its publicly disclosed internal revenue growth ("IRG") guidance for three of the four quarters for that fiscal year." Order at p. 4.

[7] "Even though the 'resale transactions' were the largest contributors to ACS's internal revenue growth, ACS did not disclose them in its September 30, 2008 Form 10-Q. In subsequent quarters, ACS disclosed these transactions as 'information technology outsourcing related to deliveries of hardware and software.' This description did not accurately disclose the nature of these transactions, and falsely suggested that they were executed as part of existing ACS outsourcing contracts." Order at p. 4.

[8] "As a result, ACS falsely reported its internal revenue growth, which Blodgett and Kyser highlighted in earnings releases and analyst conference calls during the period." Order at p. 2.

[9] "Blodgett and Kyser understood the origination of these 'resale transactions' and their impact on ACS's reported revenue growth." Order at p. 5. *See also* Press Release, *supra* note 3 ("ACS positioned itself in the middle of pre-existing transactions without adding value, but still improperly reported the revenue. Blodgett and Kyser knew the truth about these deals, and they were responsible for ensuring that ACS accurately disclosed the full story to investors.") (*quoting* David R. Woodcock, Director of the SEC's Fort Worth Regional Office and Chair of the SEC's Financial Reporting and Audit Task Force).

[10] "During all relevant periods, Respondents Blodgett and Kyser were, respectively, ACS's chief executive officer and chief financial officer. As such, they were responsible for the content of ACS's filings with the Commission, as well as ACS's earnings releases and analyst conference calls." Order at p. 2.

[11] "As a result, ACS falsely reported its internal revenue growth, which Blodgett and Kyser highlighted in earnings releases and analyst conference calls during the period." Order at p. 2.

[12] "Blodgett and Kyser understood the origination of these 'resale transactions' and their impact on ACS's reported revenue growth. However, Blodgett and Kyser did not ensure that ACS adequately described their significance in ACS's public filings and on analyst calls." Order at p. 5.

[13] "Blodgett and Kyser certified each of ACS's fiscal year 2009 Forms 10-Q and 10-K." Order at p. 5.

[14] "As a result of the improperly reported revenue, Blodgett and Kyser received bonuses based on fiscal 2009 performance that were 43% higher than they would have received if ACS had properly applied GAAP with respect to determining the amount of revenue to report from the resale transactions." Order at p. 5.

[15] It has long been held that the second and third subsections of Section 17(a) of the Securities Act, Sections 17(a)(2) and (3), can be satisfied by proof of negligence, rather than scienter as is necessary for Section 17(a)(1) of the Securities Act. *See Aaron v. SEC*, 446 U.S. 680, 697 (1980) (stating that "It is our view, in sum, that the language of §17 (a) requires scienter under § 17 (a)(1), but not under § 17 (a)(2) or § 17 (a)(3)."). For examples of accountants found to have negligently violated the federal securities laws and charged with violations of Securities Act Sections 17(a)(2) and (3), *see e.g., In the Matter of Fifth Third Bank and Daniel Poston,* Securities Act Release No. 9490 (Dec. 4, 2013) (Misclassification of loans; imposing a Rule 102(e) suspension on a CFO in a matter in which the individual was charged with violations of Sections 17(a)(2) and (3) of the Securities Act), *available at* http://www.sec.gov/litigation/admin/2013/33-9490.pdf*; In the Matter of Craig On (CPA)*, Exchange Act Release No. 66051 (Dec. 23, 2011) (Understated loan losses; imposing a Rule 102(e) suspension on a CFO in a matter in which the individual was charged with, among other things, violations of Sections 17 (a)(2) and (3) of the Securities Act), *available at* http://www.sec.gov/litigation/admin/2011/34-66051.pdf; *In the Matter of Larry E. Hulse, CPA*, Exchange Act Release No. 62589 (July 29, 2010) (Improper reserve adjustments; imposing a Rule 102(e) suspension on Sunrise Senior Living, Inc.'s CFO in a matter in which the individual was charged with violations of Sections 17(a)(2) and (3) of the Securities Act), *available at* http://www.sec.gov/litigation/admin/2010/34-62589.pdf; *In the Matter of Lawrence Collins, CPA*, Exchange Act Release No. 64808 (July 5, 2011) (Improper revenue reporting; imposing a Rule 102(e) suspension in a matter in which a finance division employee was charged with violations of Sections 17(a)(2) and (3) of the Securities Act), *available at* http://www.sec.gov/litigation/admin/2011/34-64808.pdf; *In the Matter of Gregory Pasko, CPA*, Exchange Act Release No. 61149 (Dec. 10, 2009) (Earnings management; imposing a Rule 102(e) suspension on the Director of External Reporting at SafeNet, Inc. after he was charged with non-scienter-based violations of the antifraud (Sections 17(a)(2) and (3) of the Securities Act), books and records and internal controls violations of the federal securities laws), *available at* http://www.sec.gov/litigation/admin/2009/34-61149.pdf.

[16] *Id.* Indeed, in the last five years, there is only one case where the Commission did not obtain a suspension against a CPA/CFO who was subject to an antifraud injunction. *See SEC v. John Michael Kelly et al.*, Lit. Rel. No. 22109 (Sept. 29, 2011), *available at* http://www.sec.gov/litigation/litreleases/2011/lr22109.htm. In that matter, the Commission agreed to a settlement with Mr. Kelly permanently enjoining him from violations of the non-scienter antifraud provisions of the federal securities laws (Securities Act Sections 17(a)(2) and (3)), but did not impose a Rule 102(e) suspension against him. In my view, agreeing to that settlement was an abdication of the Commission's responsibility to police the financial reporting system and maintain the integrity of the securities markets. Thus, I dissented in that case.

[17] Select SEC and Market Data, Fiscal 2010, at 11, *available at* http://www.sec.gov/about/secstats2010.pdf.

[18] Select SEC and Market Data, Fiscal 2011, at 16, *available at* http://www.sec.gov/about/secstats2011.pdf.

[19] Select SEC and Market Data, Fiscal 2012, at 14, *available at* http://www.sec.gov/about/secstats2012.pdf.

[20] Select SEC and Market Data, Fiscal 2013, at 13, *available at* http://www.sec.gov/about/secstats2013.pdf.

[21] *See*, Jayne W. Barnard, *When Is a Corporate Executive "Substantially Unfit to Serve?"* 70 N.C.L. Rev. 1489, 1522 (1992).

[22] For the same reasons, defendants who are accountants have also been known to object to charges under Exchange Act Section 13(b)(5) (knowingly circumventing or failing to implement internal controls or knowingly falsifying records) and/or Exchange Act Rule 13b2-2 (lying to auditors).

[23] Facts and information discovered by the investigative staff in the course of an investigation that are not described in a Commission Order or other public document are deemed confidential and, therefore, SEC representatives are prohibited from revealing to the public such non-public information that are not made a matter of the public record. *See, e.g.,* 17 C.F.R. Section 230.122, which provides that "[e]xcept as provided by 17 C.F.R. 203.2, officers and employees are hereby prohibited from making … confidential [examination and investigation] information or documents or any other non-public records of the Commission available to anyone other than a member, officer or employee of the Commission, unless the Commission or the General Counsel, pursuant to delegated authority, authorizes the disclosure of such information or the production of such documents as not being contrary to the public interest."

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Chairman's Address at SEC Speaks 2014

Chair Mary Jo White

Washington, D.C.

Feb. 21, 2014

Good morning. I am very honored to be giving the welcoming remarks and to offer a few perspectives from my first 10 months as Chair. Looking back at remarks made by former Chairs at this event, the expectation seems to be for me to talk about the "State of the SEC." I will happily oblige on behalf of this great and critical agency.

In 1972, 42 years ago at the very first SEC Speaks, there were approximately 1,500 SEC employees charged with regulating the activities of 5,000 broker-dealers, 3,500 investment advisers, and 1,500 investment companies.

Today the markets have grown and changed dramatically, and the SEC has significantly expanded responsibilities. There are now about 4,200 employees – not nearly enough to stretch across a landscape that requires us to regulate more than 25,000 market participants, including broker-dealers, investment advisers, mutual funds and exchange-traded funds, municipal advisors, clearing agents, transfer agents, and 18 exchanges. We also oversee the important functions of self-regulatory organizations and boards such as FASB, FINRA, MSRB, PCAOB, and SIPC. Only SIPC and FINRA's predecessor, the NASD, even existed back in 1972.

Today the agency also faces an unprecedented rulemaking agenda. Between the Dodd-Frank and JOBS Acts, the SEC was given nearly 100 new rulemaking mandates ranging from rules that govern the previously unregulated derivatives markets, impose proprietary trading restrictions on many financial institutions, increase transparency for hedge funds and private equity funds, give investors a say-on-executive pay, establish a new whistleblower program, lift the ban on general solicitation, reform and more intensely oversee credit rating agencies, and so many others. These rulemakings, coupled with the implementation and oversight effort that each one brings, have added significantly to our already extensive responsibilities and challenge our limited resources. These mandates also present the risk that they will crowd out or delay other pressing priorities. But we must not let that happen.

All of this is upon us at a time when our funding falls significantly short of the level we need to fulfill our mission to investors, companies, and the markets. As Chair, I owe a duty to Congress, the staff, and to the American people to use the funds we are appropriated prudently and effectively. But it also is incumbent upon me to raise my voice when the SEC is not being provided with sufficient resources. The SEC is deficit neutral. Our appropriations are offset by modest transaction fees we collect from SROs. What does that mean? It means that if Congress provides us with increased funding, it will not increase the budget deficit or take resources from other programs or agencies, but it would go directly to protecting investors and strengthening our markets. Given the critical role we play for investors and our expanded responsibilities, obtaining adequate funding for the SEC is and must be a top priority.

Fortunately, what has remained a constant over the years at the SEC is its magnificent and dedicated staff. Indeed, it was the commitment, expertise, and moral, apolitical compass of the staff that led me here. The SEC staff is a deep reservoir of extraordinary talent and expertise with a strong and enduring commitment to public service and independence. And that is what has sustained the excellence of this agency since its founding.

Exercising my prerogative as Chair, I would now like to ask each SEC employee in the audience to stand and be recognized. Please remain standing while I ask that everyone here today who once worked at the SEC to please also stand to be recognized. In our most challenging moments, I urge all of us to think about the colleagues we just recognized, marvel at their public service and say thank you.

Back to the state of the SEC in 2014.

When I arrived at the SEC last April, I initially set three primary priorities: implementing the mandatory Congressional rulemakings of the Dodd-Frank and the JOBS Acts; intensifying the agency's efforts to ensure that the U.S. equity markets are structured and operating to optimally serve the interests of all investors; and further strengthening our already robust enforcement program. Ten months later, I am pleased with what we have accomplished.

Rulemaking

When I arrived, it was imperative to set an aggressive rulemaking agenda. Congress had seen to that and our own core mission demanded it. And, through the tireless work of the staff and my fellow Commissioners, we made significant progress.

On the day I was sworn in as Chair, we adopted identity theft rules requiring broker-dealers, mutual funds, investment advisers, and others regulated by us to adopt programs to detect red flags and prevent identity theft.[1]

A month later, we proposed rules to govern cross-border swap transactions in the multi-trillion dollar global over-the-counter derivatives markets.[2]

A month after that, we proposed rules to reform and strengthen the structure of money market funds.[3]

Last summer and fall, we made significant progress in implementing the reforms to the private offering market mandated by Congress in the JOBS Act. We lifted the ban on general solicitation[4] and we proposed rules that would provide new investor protections and important data about this new market.[5] We also proposed new rules that would permit securities-based crowdfunding and update and expand Regulation A.[6]

We adopted a Dodd-Frank Act rule disqualifying bad actors from certain private offerings.[7]

We adopted some of the most significant changes in years to the financial responsibility rules for broker-dealers.[8]

We adopted rules governing the registration and regulation of municipal advisors.[9]

We adopted rules removing references to credit agency ratings in certain broker-dealer and investment company regulations.[10]

In December, together with the banking regulators and the CFTC, we adopted regulations implementing the Volcker Rule.[11]

And, just last week we announced the selection of Rick Fleming, the deputy general counsel at the North American Securities Administrators Association, as the first Investor Advocate, a position established by Dodd-Frank.[12]

As even this partial list shows, we have made significant progress on our rulemakings, although more remains to be done. But we must always keep the bigger picture in focus and not let the sheer number nor the sometimes controversial nature of the Congressional mandates distract us from other important rulemakings and initiatives that further our core mission as we set and carry out our priorities for the year ahead.

Other Critical Initiatives

To be more specific, in 2014, in addition to continuing to complete important rulemakings, we also will intensify our consideration of the question of the role and duties of investment advisers and broker dealers, with the goal of enhancing investor protection. We will increase our focus on the fixed income markets and make further progress on credit rating agency reform. We will also increase our oversight of broker-dealers with initiatives that will strengthen and enhance their capital and liquidity, as well as providing more robust protections and safeguards for customer assets.

We also will continue to engage with other domestic and international regulators to ensure that the systemic risks to our interconnected financial systems are identified and addressed – but addressed in a way that takes into account the differences between prudential risks and those that are not. We want to avoid a rigidly uniform regulatory approach solely defined by the safety and soundness standard that may be more appropriate for banking institutions.

In 2014, we also will prioritize our review of equity market structure, focusing closely on how it impacts investors and companies of every size. One near-term project that I will be pushing forward is the development and implementation of a tick-size pilot, along carefully defined parameters, that would widen the quoting and trading increments and test, among other things, whether a change like this improves liquidity and market quality.

In 2013, our Trading and Markets Division continued to develop the necessary empirical evidence to accurately assess our current equity market structure and to consider a range of possible changes. Today we have better sources of data to inform our decisions. For example, something we call MIDAS collects, nearly instantaneously, one billion trading data records every day from across the markets. We have developed key metrics about the markets using MIDAS and placed them on our website last October so the public, academics, and all market participants could share, analyze, and react to the information that allows us to better test the various hypotheses about our markets to inform regulatory changes.[13]

The SEC, the SROs, and other market participants are also proceeding to implement the Consolidated Audit Trail Rule,[14] which when operational will further enhance the ability of regulators to monitor and analyze the equity markets on a more timely basis. Indeed, it should result in a sea change in the data currently available, collecting in one place every order, cancellation, modification, and trade execution for all exchange-listed equities and equity options across all U.S. markets. It is a difficult and complex undertaking, which must be accorded the highest priority by all to complete.

We also are very focused on ensuring the resilience of the systems used by the exchanges and other market participants. It is critically important that the technology that connects market participants be deployed and used responsibly to reduce the risk of disruptions that can harm investors and undermine confidence in our markets. A number of measures have already been taken and, in 2014, we will be focused on ensuring that more is done to address these vulnerabilities. One significant vulnerability that must be comprehensively addressed across both the public and private sectors is the risk of cyber attacks. To encourage a discussion and sharing of information and best practices, the SEC will be holding a cybersecurity roundtable in March.[15]

Enforcement

Let me turn to enforcement at the SEC in 2014 because vigorous and comprehensive enforcement of our securities laws must always be a very high priority at the SEC. And it is.

When I arrived in April, I found what I expected to find – a very strong enforcement program. Through extraordinary hard work and dedication, the Commission's Enforcement Division achieved an unparalleled record of successful cases arising out of the financial crisis. To date, we have charged 169 individuals or entities with wrongdoing stemming from the financial crisis – 70 of whom were CEOs, CFOs, or other senior executives. At the same time, the Commission also brought landmark insider trading cases and created specialized units that pursued complex cases against investment advisers, broker dealers and exchanges, as well as cases involving FCPA violations, municipal bonds and state pension funds. In 2013 alone, Enforcement's labors yielded orders to return $3.4 billion in disgorgement and civil penalties, the highest amount in the agency's history. But there is always more to do.

Admissions

Last year, we modified the SEC's longstanding no admit/no deny settlement protocol to require admissions in a broader range of cases. As I have said before,[16] admissions are important because they achieve a greater measure of public accountability, which, in turn, can bolster the public's confidence in the strength and credibility of law enforcement, and the safety of our markets.

When we first announced this change, we said that we would consider requiring admissions in certain types of cases, including those involving particularly egregious conduct, where a large numbers of investors were harmed, where the markets or investors were placed at significant risk, where the conduct undermines or obstructs our investigative processes, where an admission can send a particularly important message to the markets or where the wrongdoer poses a particular future threat to investors or the markets. And now that we have resolved a number of cases with admissions, you have specific examples of where we think it is appropriate to require admissions as a condition of settlement.[17] My expectation is that there will be more such cases in 2014 as the new protocol continues to evolve and be applied.

Financial Fraud Task Force

Last year, the Enforcement Division also increased its focus on accounting fraud through the creation of a new task force.[18] The Division formed the Financial Reporting and Audit Task Force to look at trends or patterns of conduct that are risk indicators for financial fraud, including in areas like revenue recognition, asset valuations, and management estimates. The task force draws on resources across the agency, including accountants in the Division of Corporation Finance and the Office of the Chief Accountant and our very talented economists in the Division of Economic Risk and Analysis (DERA). The task force is focused on more quickly identifying potential material misstatements in financial statements and disclosures. The program has already generated several significant investigations and more are expected to follow.

In addition to the new admissions protocol and the Financial Fraud Task Force, the Enforcement Division also has other exciting new initiatives including a new Microcap Task Force[19] and a renewed focus on those who serve as gatekeepers in our financial system, just to name a few.

* * *

We have talked about our rulemaking agenda, some of our ongoing market structure initiatives, and a bit about what is new and developing in Enforcement. But what else lies ahead?

Corporation Finance: JOBS Act and Disclosure Reform

As we move to complete our rulemakings in the private offering arena, it is important for the SEC to keep focused on the public markets as well. Our JOBS Act related-rulemaking will provide companies with a number of different alternatives to raise capital in the private markets. Some have even suggested that if the private markets develop sufficient liquidity, there may not be any reason for a company to go public or become a public company in the way we think of it now. That would not be the best result for all investors.

While the JOBS Act provides additional avenues for raising capital in the private markets and may allow companies to stay private longer, the public markets in the United States also continue to offer very attractive opportunities for capital. They offer the transparency and liquidity that investors need and, at the same time, provide access to the breadth of sources of capital necessary to support significant growth and innovation. For our part, we must consider how the SEC's rules governing public offerings and public company reporting and disclosure may negatively impact liquidity in our markets and how they can be improved and streamlined, while maintaining strong investor protections.

Last year, I spoke about disclosure reform[20] and in December the staff issued a report that contains the staff's preliminary conclusions and recommendations as to how to update our disclosure rules.[21]

What is next?

This year, the Corp Fin staff will focus on making specific recommendations for updating the rules that govern public company disclosure. As part of this effort, Corp Fin will be broadly seeking input from companies and investors about how we can make our disclosure rules work better, and, specifically, investors will be asked what type of information they want, when do they want it and how companies can most meaningfully present that information.

Investment Management: Enhanced Asset Manager Risk Monitoring

The SEC of 2014 is an agency that increasingly relies on technology and specialized expertise. This is particularly evident in the SEC's new risk monitoring and data analytics activities. One important example is the SEC's new focus on risk monitoring of asset managers and funds.

Last year featured a very concrete success from these risk monitoring efforts when the SEC brought an enforcement case against a money market fund firm charging that it failed to comply with the risk limiting conditions of our rules.[22]

In the past year, the SEC has established a dedicated group of professionals to monitor large-firm asset managers. These professionals who include former portfolio managers, investment analysts, and examiners track investment trends, review emerging market developments, and identify outlier funds.

The tools they use include analytics of data we receive, high-level engagement with asset manager executives and mutual fund boards, data-driven, risk-focused examinations, and with respect to money market funds certain stress testing results.

What is next?

I asked the IM staff for an "action plan" to enhance our asset manager risk management oversight program. Among the initiatives under near-term consideration are expanded stress testing, more robust data reporting, and increased oversight of the largest asset management firms. To be an effective 21st century regulator, the SEC is using 21st century tools to address the range of 21st century risks.

OCIE: Innovation in Exam Planning

We also are using powerful new data analytics and technology tools in our National Exam Program to conduct more effective and efficient risk-based examinations of our registrants.

OCIE's Office of Risk Assessment and Surveillance aggregates and analyzes a broad band of data to identify potentially problematic behavior. In addition to scouring the data that we collect directly from registrants, we look at data from outside the Commission, including information from public records, data collected by other regulators, SROs and exchanges, and information that our registrants provide to data vendors. This expanded data collection and analysis not only enhances OCIE's ability to identify risks more efficiently, but it also helps our examiners better understand the contours of a firm's business activities prior to conducting an examination.

What is next?

The Office of Risk Assessment and Surveillance is developing exciting new technologies – text analytics, visualization, search, and predictive analytics – to cull additional red flags from internal and external data and information sources. These tools will help our examiners be even more efficient and effective in analyzing massive amounts of data to more quickly and accurately hone in on areas that pose the greatest risks and warrant further investigation. In an era of limited resources and expanding responsibilities, it is essential to identify and target these risks more systematically. And we are doing that.

Conclusion

Let me stop here. Hopefully, I have at least given you a window into the strong, busy, and proactive state of the SEC in 2014. More importantly, throughout the next two days, you will hear directly from our staff about the many ways we are meeting the current challenges that we all face in our complex and rapidly changing markets and how we are preparing for tomorrow's challenges.

This year as in every year, we look forward to hearing your ideas and input on our rulemakings and other initiatives. Your views are very important to us and assist us to implement regulations that are true to our mission, effective, and workable.

Thank you and enjoy the conference.

[1] *See Identity Theft Red Flags Rule* Release No. 34-69359, (Apr. 10, 2013), available at http://www.sec.gov/rules/final/2013/34-69359.pdf.

[2] *See* Title VII of the Dodd-Frank Act and *Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants* Release No. 34-69490, (May 1, 2013), available at http://www.sec.gov/rules/proposed/2013/34-69490.pdf.

[3] *See Money Market Fund Reform; Amendments to Form PF* Release No. 33-9408, (Jun. 5, 2013), available at http://www.sec.gov/rules/proposed/2013/33-9408.pdf.

[4] *See Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*, Release No. 33-9415 (Jul. 10, 2013), available at http://www.sec.gov/rules/final/2013/33-9415.pdf.

[5] *See* Release No. 33-9416, *Amendments to Regulation D, Form D and Rule 156* (Jul. 10, 2013).

[6] *See Crowdfunding*, Release No. 33-9470 (Oct. 23, 2013), available at http://www.sec.gov/rules/proposed/2013/33-9470.pdf and *Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act*, Release No. 33-9497 (Dec. 18, 2013), available at http://www.sec.gov/rules/proposed/2013/33-9497.pdf.

[7] *See* Release No. 33-9414, *Disqualification of Felons and Other "Bad Actors"* (Jul. 10, 2013), available at http://www.sec.gov/rules/final/2013/33.9414.pdf.

[8] *See* Release No. 34-70072, *Financial Responsibility Rules for Broker-Dealers* (Jul. 30, 2013), available at http://www.sec.gov/rules/final/2013/34-70072.pdf.

[9] *See* Release No. 34-70462, *Registration of Municipal Advisors* (Sep. 20, 2013), available at http://www.sec.gov/rules/final/2013/34-70462.pdf.

[10] *See* Release No. 34-71194, *Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934* (Dec. 27, 2013), available at http://www.sec.gov/rules/final/2013/34-71194.pdf; Release No. 33-9506, *Removal of Certain References to Credit Ratings Under the Investment Company Act* (Dec. 27, 2013), available at http://www.sec.gov/rules/final/2013/33-9506.pdf.

[11] *See* Release No. BHCA-1, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds* Bank Holding Company Act (Dec. 10, 2013), available at http://www.sec.gov/rules/final/2013/bhca-1.pdf.

[12] *See* Press Release No. 2014-27, *SEC Names Rick Fleming as Investor Advocate* (Feb. 12, 2014), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540780377.

[13] The MIDAS web site and interactive tools are available at http://www.sec.gov/marketstructure.

[14] *See* Release No. 34-67457, *Consolidated Audit Trail* (Jul. 18, 2012), available at http://www.sec.gov/rules/final/2012/34-67457.pdf.

[15] *See* Press Release No. 2014-32, *SEC to Hold Cybersecurity Roundtable* (Feb. 14, 2014), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540793626.

[16] *The Importance of Trials to the Law and Public Accountability*, remarks at the 5th Annual Judge Thomas A. Flannery Lecture (Nov. 14, 2013), available at http://www.sec.gov/News/Speech/Detail/Speech/1370540374908.

[17] *See* Press Release No. 2013-159, *Philip Falcone and Harbinger Capital Agree to Settlement* (Aug. 19, 2013), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539780222; Press Release No. 2013-187, *JPMorgan Chase Agrees to Pay $200 Million and Admits Wrongdoing to Settle SEC Charges* (Sep. 19, 2013), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539819965; Press Release No. 2013-266, *SEC Charges ConvergEx Subsidiaries With Fraud for Deceiving Customers About Commissions* (Dec. 18, 2013), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540521484; Press Release No. 2014-17, *Scottrade Agrees to Pay $2.5 Million and Admits Providing Flawed 'Blue Sheet' Trading Data* (Jan. 29, 2014), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540696906.

[18] *See* SEC Spotlight on the Financial Reporting and Audit Task Force, available at https://www.sec.gov/spotlight/finreporting-audittaskforce.shtml.

[19] *See* SEC Spotlight on Microcap Fraud, available at http://www.sec.gov/spotlight/microcap-fraud.shtml.

[20] *The Path Forward on Disclosure*, remarks at the National Association of Corporate Directors Leadership Conference 2013 (Oct. 15, 2013), available at http://www.sec.gov/News/Speech/Detail/Speech/1370539878806. *See also The SEC in 2014*, remarks at the 41st Annual Securities Regulation Institute (Jan. 27, 2014), available at http://www.sec.gov/News/Speech/Detail/Speech/1370540677500.

[21] *Report on Review of Disclosure Requirements in Regulation S-K* (Dec. 2013), available at http://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf.

[22] *In the Matter of Ambassador Capital Management, LLC, and Derek H. Oglesby*, Admin. Proc. File No. 3-15625 (2013), available at http://www.sec.gov/litigation/admin/2013/ia-3725.pdf.

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SEC to Pursue More Insider Trading Cases In Administrative Forum, Director Says

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from Corporate Law & Accountability Report

By Yin Wilczek

June 11 — Going forward, the Securities and Exchange Commission will bring more insider trading cases through its administrative forum, Enforcement Director Andrew Ceresney said June 11.

Addressing a D.C. Bar event, Ceresney observed that the SEC has brought insider trading actions as administrative proceedings in the past, but those have been “pretty rare.”

“It will be a case-by-case determination, but” looking ahead, “I do think you will see more insider trading cases” going the administrative route, Ceresney said. He also stressed that this is not a reaction to the commission's recent trial losses, which he discussed and acknowledged were “almost wholly” in the insider trading arena.

The SEC official said he expressed his own opinions, which did not necessarily reflect those of the commission or other staff members.

Dodd-Frank

The SEC's increasing use of its administrative venue over the last few years was spurred by the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act.

The financial reform statute enhanced the SEC's enforcement powers in several respects, including giving it the authority to obtain monetary penalties in administrative proceedings against all individuals, not just those associated with regulated entities. The legislation also increased the amount of fines that the SEC can seek in administrative cases.

Ceresney told the legal gathering that one reason the administrative forum will be used even more frequently in the future—not just for insider trading, but for other areas as well—is that enough time has passed that the commission is now filing actions that involve post-Dodd-Frank conduct.

In choosing a forum, the Enforcement Division considers a “whole host of factors,” including whether discovery is required, whether the case would play well before a jury and whether the SEC would need additional time to prepare its case, given the expedited schedule for administrative proceedings, Ceresney said. He added that the commission will not be able to obtain through its administrative forum the “three-times” fines available through the courts, “so you sacrifice that,” but in certain cases, “that will not be a disadvantage.”

Section 21A of the 1934 Securities Exchange Act—which applies to penalties for insider trading violations—allows a court to impose penalties of up to three times the profit gained or loss avoided as a result of the misconduct.

Insider Trading Fines

Panel moderator Larry Ellsworth—a partner at Jenner & Block LLP, Washington, and co–author of Bloomberg BNA's “Portfolio 15: Inside Information: Prevention of Abuse”—asked Ceresney whether the U.S. Court of Appeals for the Second Circuit's *SEC v. Rosenthal* decision would impede the imposition of fines in insider trading administrative proceedings. The court ruled in the 2011 decision that §21A is the only basis to impose penalties in SEC insider trading cases in federal court and that the fines should be linked to the amount of profit gained or loss incurred.

The SEC's position is that “the Dodd-Frank amendment providing for penalties is not limited in any respect and applies to insider trading just as it applies to other types of cases,” Ceresney responded.

During the event, several attorneys suggested that the SEC has procedural advantages in its administrative forum and asked whether the commission would be open to amending some of the processes, such as allowing defendants to conduct some discovery. One asked whether the SEC would revise its rules to allow “some type of removal process.”

Ceresney said his “definitive answer” to the removal question was “no.” The SEC official also stressed that the administrative process is “fair and I don't think I will advocate for changes.” However, he added that his door is open and he will not “rule out a discussion or dialogue” about possible changes.

Another attorney asked Ceresney whether he was concerned—given the commission's procedural leg-up in administrative proceedings—about courts scrutinizing the constitutional basis of the rulings. “I think we are on pretty solid ground on the constitutionality” of administrative law judge holdings, Ceresney said.

Trial Losses

In a discussion of the SEC's recent trial losses, Ceresney said that insider trading actions are “challenging cases for us.” Among other problems, the evidence is “typically circumstantial” and the SEC cannot produce “victim witnesses” to sway juries. He also said that juries—perceiving the SEC as similar to criminal authorities—apply a “higher standard than the preponderance of the evidence standard” to commission cases.

That said, if the SEC chooses not to bring a difficult insider trading case, “nobody will bring that case” and “misconduct will go unpunished,” Ceresney added. “The bottom line is we exercise tremendous rigor in deciding whether to bring cases and we will continue to do so.”

In the most recent loss, a jury June 6 absolved Manouchehr Moshayedi, the former chief executive officer of STEC Inc., of the SEC's insider trading allegations.

Ceresney also was asked to elaborate on SEC Chairman Mary Jo White's recent announcement that the commission will use 1934 Securities Exchange Act Section 20(b) to pursue individuals and to get around liability limitations imposed by the U.S. Supreme Court in *Janus Capital Group Inc. v. First Derivative Traders*. The provision imposes primary liability on a person who “by means of any other person” violates the federal securities laws.

Ceresney said §20(b) “provides a mechanism for attaining liability in appropriate cases where we haven't necessarily focused in the past.” He added that the provision will be used in the “coming months,” but not in every disclosure case pursued by the agency. The division will use the provision to advance its theory of liability “where it makes sense,” he said.

Change to Settlement Approach?

In other comments, Ceresney told the audience that the SEC's current approach to settlements will not change as a result of the U.S. Court of Appeals for the Second Circuit's ruling in *SEC v. Citigroup Global Mkts. Inc.*. The appellate court essentially affirmed the strong deference accorded to the SEC in settlements of enforcement actions.

The commission's current approach is that it will forego its traditional practice of allowing settling defendants to neither admit nor deny its allegations in certain cases—such as those involving egregious circumstances—and insist on admissions.

Ceresney also was asked when defendants and their attorneys will be informed that the commission has determined it wants an admission. He responded that the determination “certainly won't be early in the investigation,” adding that defendants generally will be told when settlement is raised and the terms are being discussed.

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1. The SEC as Prosecutor and Judge

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The SEC as Prosecutor and Judge

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Body

A year after vowing to take more of its law-enforcement cases to trial, Securities and Exchange Commission officials now say the agency will increasingly bypass courts and juries by prosecuting wrongdoers in hearings before SEC administrative law judges, also known as ALJs. "I think you'll see that more and more in the future," SEC Enforcement Director Andrew Ceresney told a June gathering of Washington lawyers, adding that insider trading cases were especially likely to go before administrative judges.

The 2010 Dodd-Frank law vastly expanded SEC discretion to charge wrongdoers administratively, and this summer the agency increased the number of administrative law judges on staff to five from three in anticipation of an increased workload. This follows a recent string of SEC jury-trial losses in federal courts, though agency officials insist the timing is coincidental.

Coincidence or not, a surge in administrative prosecutions should alarm anyone who values jury trials, due process and the constitutional separation of powers. The SEC often prefers to avoid judicial oversight and exploit the convenience of punishing alleged lawbreakers by administrative means, but doing so is unconstitutional. And if courts allow the SEC to get away with it, other executive-branch agencies are sure to follow.

To begin with the obvious, executive-branch agencies like the SEC are not courts established under Article III of the Constitution. These agencies exercise legislative power through rule-making and executive power through prosecution, but the Constitution gives them no judicial power to decide cases and controversies -- especially not the very cases they are prosecuting. Executive agencies usurp that judicial power when they shunt penal law-enforcement prosecutions into their own captive administrative hearings.

Nearly 70 years ago, the Administrative Procedures Act established today's system of quasi-judicial tribunals overseen by administrative law judges. But these tribunals are not courts, and the administrative law judges are not life-tenured judicial officers appointed under Article III of the Constitution. They are executive-branch employees who conduct hearings at the direction of agency leaders following procedural rules dictated by the agencies themselves.

The SEC's rules favor the prosecution. The rules give the accused only a few months to prepare a defense -- after SEC prosecutors have typically spent years building the case -- and they give administrative law judges only a few months after the hearing to evaluate the mountains of evidence presented and write detailed decisions that typically run several dozens of single-spaced pages. The rules also allow SEC prosecutors to use hearsay and other unreliable evidence, and they severely limit the kinds of pretrial discovery and defense motions that are routinely allowed in courts.

Administrative hearings also do not have juries, even when severe financial penalties and forfeitures are demanded. And because these hearings are nominally civil rather than criminal, guilt is determined by a mere preponderance of the evidence -- the lightest evidentiary burden known to modern law -- rather than beyond reasonable doubt. In short, while administrative prosecutions create the illusion of a fair trial, and while administrative law judges generally strive to appear impartial, these proceedings afford defendants woefully inadequate due process.

More important, the proceedings violate the Constitution's separation of powers. Every phase of the proceeding, and every government official involved, is controlled by the agency in its role as chief prosecutor. The SEC assigns and directs a team of employees to prosecute the case. It assigns another employee, the administrative law judge, to decide guilt or innocence and to impose sanctions. Appeals must be taken to the same SEC commissioners who launched the prosecution, and their decision is typically written by still other SEC employees.

The entire process ordinarily takes years, during which many SEC targets are bankrupted by legal costs and their inability to find work with reputable companies. Only after SEC commissioners decide all appeals can the accused finally seek relief from a federal court. But appeals rarely succeed because the law requires courts to defer to the agency's judgment, especially on disputed facts.

The SEC used to employ administrative proceedings for relatively uncontroversial purposes such as preventing suspicious stock offerings, suspending rogue brokers or consummating settlements where no court involvement was necessary. But through a series of laws beginning in the 1980s and continuing through Dodd-Frank, the SEC has been transformed from a conventional regulator into a penal law-enforcement prosecutor with enormous power to punish private citizens and businesses. In 2013 the agency obtained a record $3.4 billion in monetary sanctions, and it now routinely seeks million-dollar sanctions against accused wrongdoers.

On its website, the SEC accurately describes itself as ″first and foremost″ a law-enforcement agency. As such, the agency should play no role in deciding guilt and meting out punishment against the people it prosecutes. Those roles should be reserved for juries and life-tenured judges appointed under Article III of the Constitution. Today's model of penal SEC law enforcement is categorically unsuited for rushed and truncated administrative hearings in which the agency and its own employees serve as prosecutor, judge and punisher. Such administrative prosecution has no place in a constitutional system based on checks and balances, separation of powers and due process.

Mr. Ryan, a former assistant director of enforcement at the SEC, is a partner with King & Spalding LLP, and his clients include companies and individuals involved in SEC law-enforcement proceedings.

(See related letters: ″Letters to the Editor: Judge, Jury and Executioner: Is That What We Want?″ -- WSJ Aug 12, 2014 and ″Letters to the Editor: Respect Administrative Law Judges″ -- WSJ August 29, 2014)

Notes

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Load-Date: August 29, 2014

The Directors Roundtable: Key Issues Facing Boards of Directors

New SEC Enforcement Initiatives & Governance Risks

Dana Kopper, Managing Director

October 21, 2014

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Environmental Scan
Evolving Trends
Integrated Risk Management

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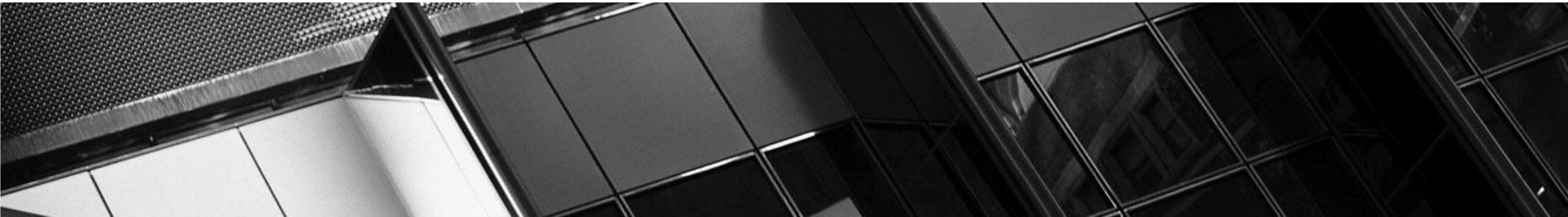
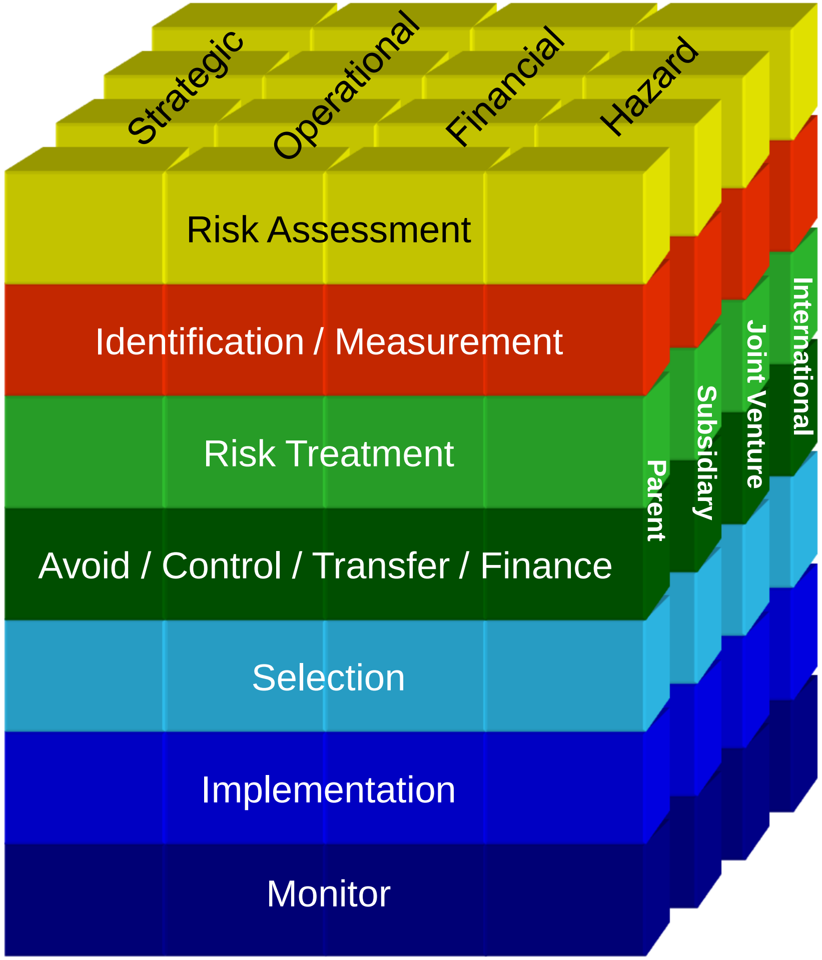


Domestic & International Environmental Scan…

Continuing Challenges / Evolving Risks: D&O Market Reactions:
Loss Ratios: High. Result: Increased Scrutiny; Premiums; and Retentions

Judicial	Litigation Trends
Legislative	SOX / Dodd Frank; Heightened Board Oversight
Regulatory / DOJ	Investigations; Enforcement Actions; Whistleblowers; Individuals & Gatekeepers
Plaintiffs	Securities Class; Opt Outs; Derivatives; Merger Objections

Enterprise Risk Management
Foundational Platform For Today's Complex Environment



- **Strategic**
  - Competition, Social, Capital Availability, Merger, Acquisition
- **Operational**
  - Cyber, Product Failure, Regulatory, Compliance, Internal Controls, Integrity, Reputational
- **Financial**
  - Pricing Risk, Asset Risk, Currency Risk, Liquidity Risk, Credit Risk, Investment Management Risk
- **Hazard**
  - Property Damage, Income, Liability, Personnel

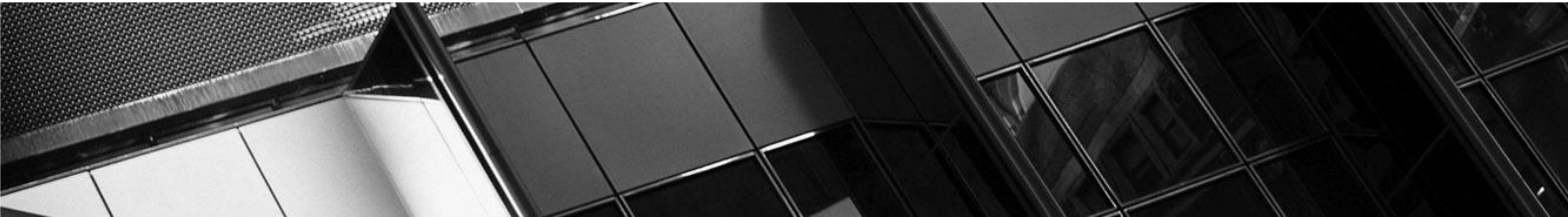
Integrating Risk Management Strategies

CORE BENEFITS

- **Reduced Risk Profile**
- **Reduced Cost of Risk**
- **Enhanced Personal and Organizational Asset Protection**

Governance Risk Management

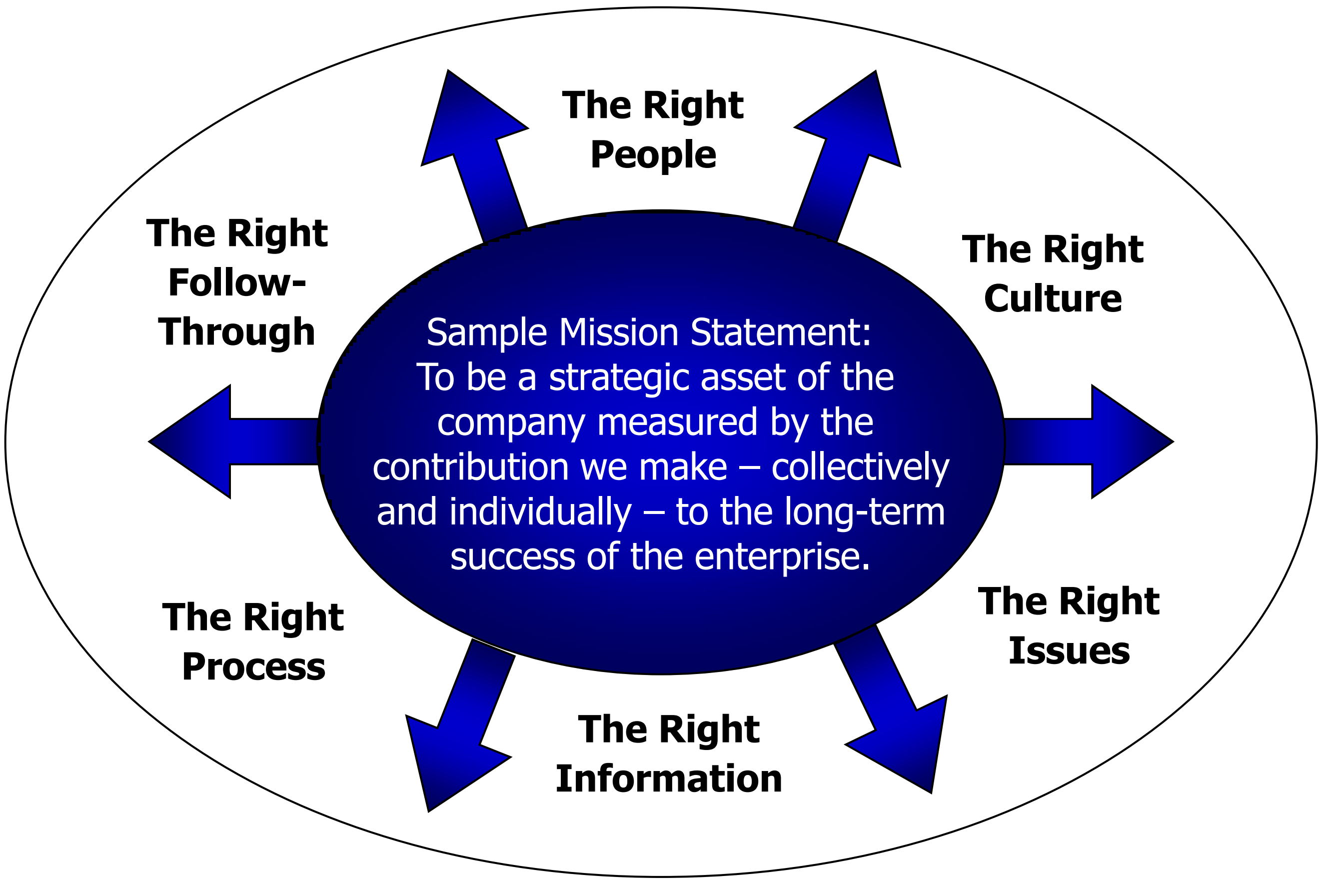
Management & Professional Liability



Board Dynamics…

Structure Versus Execution…Substantial Source of D&O Claims
More Than Guidelines, Charters & Checklists …

These High-Performance Characteristics…



…Foster Superior Shareholder Value & Risk Mitigation

Source: NACD

How Effective Are We?

- **Sample Core Areas of Board Governance**
  - Structure & Composition
  - Director & CEO Compensation
  - Strategic Planning
  - Processes & Procedures
  - Interaction
  - Information
  - Committees
  - Roles & Responsibilities
  - Accountability Methods
  - Risk Oversight; Organizational Compliance Efficacy
  - Code of Conduct & Ethics

How Engaged Should We Be?

LEAST INVOLVED — MOST INVOLVED

The Passive Board

- Functions at the discretion of the CEO.
- Limits its activities and participation
- Limits its accountability
- Ratifies management's preferences

The Certifying Board

- Certifies to shareholders that the CEO is doing what the board expects and that management will take corrective action when needed.
- Emphasizes the need for independent directors and meets without the CEO.
- Stays informed about current performance and designates external board members to evaluate the CEO.
- Establishes an orderly succession process.
- Is willing to change management to be credible to shareholders.

The Engaged Board

- Provides insight, advice, and support to the CEO and management team.
- Recognizes its ultimate responsibility to oversee CEO and company performance; guides *and* judges the CEO.
- Conducts useful, two-way discussions about key decisions facing the company.
- Seeks out sufficient industry and financial expertise to add value to decisions.
- Takes time to define the roles and behaviors required by the board and the boundaries of CEO and board responsibilities.

The Intervening Board

- Becomes intensely involved in decision making around key issues.
- Convenes frequent, intense meetings, often on short notice.

The Operating Board

- Makes key decisions that management then implements.
- Fills gaps in management experience.

Individual Contractual Indemnity
A Critical Tool

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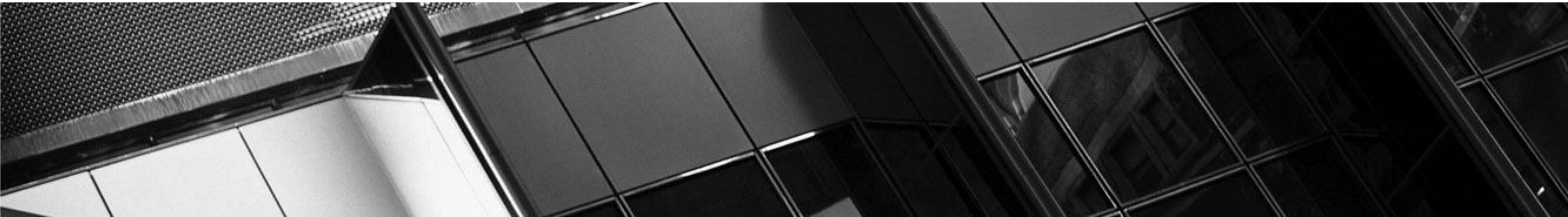

Indemnification…Generally

3

Contractual Indemnity Agreements
(Contract Between Individual and Company)

2

Articles of Incorporation/Association/Bylaws
(All Directors and Officers)

1

Statutory

Harmonized Indemnification

PE Funds & International

- **Indemnity Agreements** — Individual and Portfolio Interface — **5**

Company

- **Contractual Indemnity Agreements** — (Contract Between Individual and Company) — **4**
- **Articles of Incorporation / Bylaws** — (All Directors and Officers) — **3**
- **Statutory** — **2**

Transaction

- **Purchase & Sale Agreement** — **1**

International Indemnity Topics
A Partial Sampling

- **Individual contractual agreements (U.S. and international) expand and clarify the nature and scope of indemnification.**
- **Enhanced indemnification will create more financial risk for funding organization.**
- **Enhanced indemnification is consistent with original intent of indemnification to encourage good faith risk-taking on the part of directors and officers.**

- Mandate indemnification
- Not prohibit indemnification for gross negligence, recklessness, etc. (standards of conduct)
- Mandate advancement of defense expenses "on demand"
- Terms to discourage wrongful refusals to indemnify; enhance enforcement rights
- Create individual contractual rights that cannot be unilaterally amended, or misinterpreted by successor organizations
- Expand expense definition to include federal, state, local, or foreign taxes based upon actual or deemed receipt of indemnity payments or advancements
- Specify outside directorships
- Provide right and prosecution costs to enforce rights
- Accelerate determination process
- Clarify lack of action to be deemed favorable determination
- Provide appropriate severability provisions
- Burden of proof on corporation to overcome indemnity presumptions; order or plea not determinative of good faith conduct
- Provide litigation appeal rights
- Strengthen binding effect provisions in change of control situations

D&O Liability Insurance Overview

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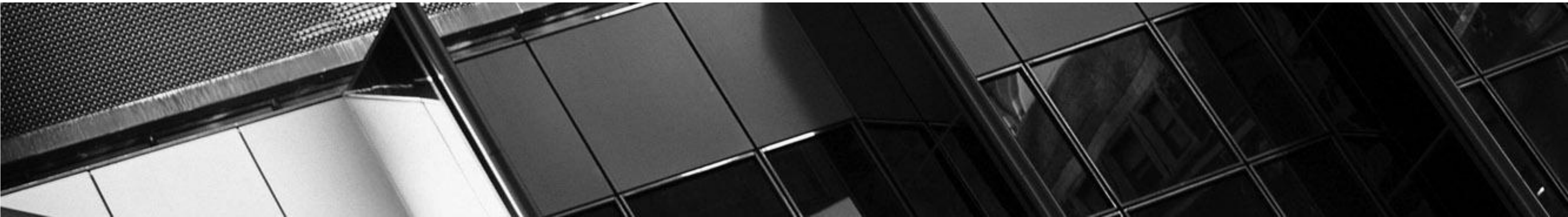


D&O Liability Insurance Coverage Part Overview

Including Enhanced Personal Asset Protection (DIC)

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

Enhanced Personal Asset Protection

- *Dedicated limits personal asset protection which cannot be impaired by corporate liabilities.*
- *Non-rescindable under any circumstance.*
- *Drop Down Provision (When Underlying Insurance or Indemnification Fails.)*
- *Broader Coverage (Insuring Agreements / Definitions)*
- *One Conduct Exclusion for Officers (Adjudicated Personal Conduct with Defense Cost Carve Back)*

Enhanced Personal Asset Protection (DIC)

Coverage A
Excess & Difference-In-Conditions (DIC) Policy
$50MM Aggregate Limit

$150MM Aggregate Limit

Coverage A
Personal Asset Protection For Non-Indemnifiable Claims

Coverage B
Corporate Asset Protection For Indemnifiable Claims

Coverage C
Corporate Asset Protection For Corporate Entity Securities Claims

Traditional D&O Insurance

Coverage A	Coverage B	Coverage C
Retention Nil	**Retention $1MM**	**Retention $1MM**

LOCKTON

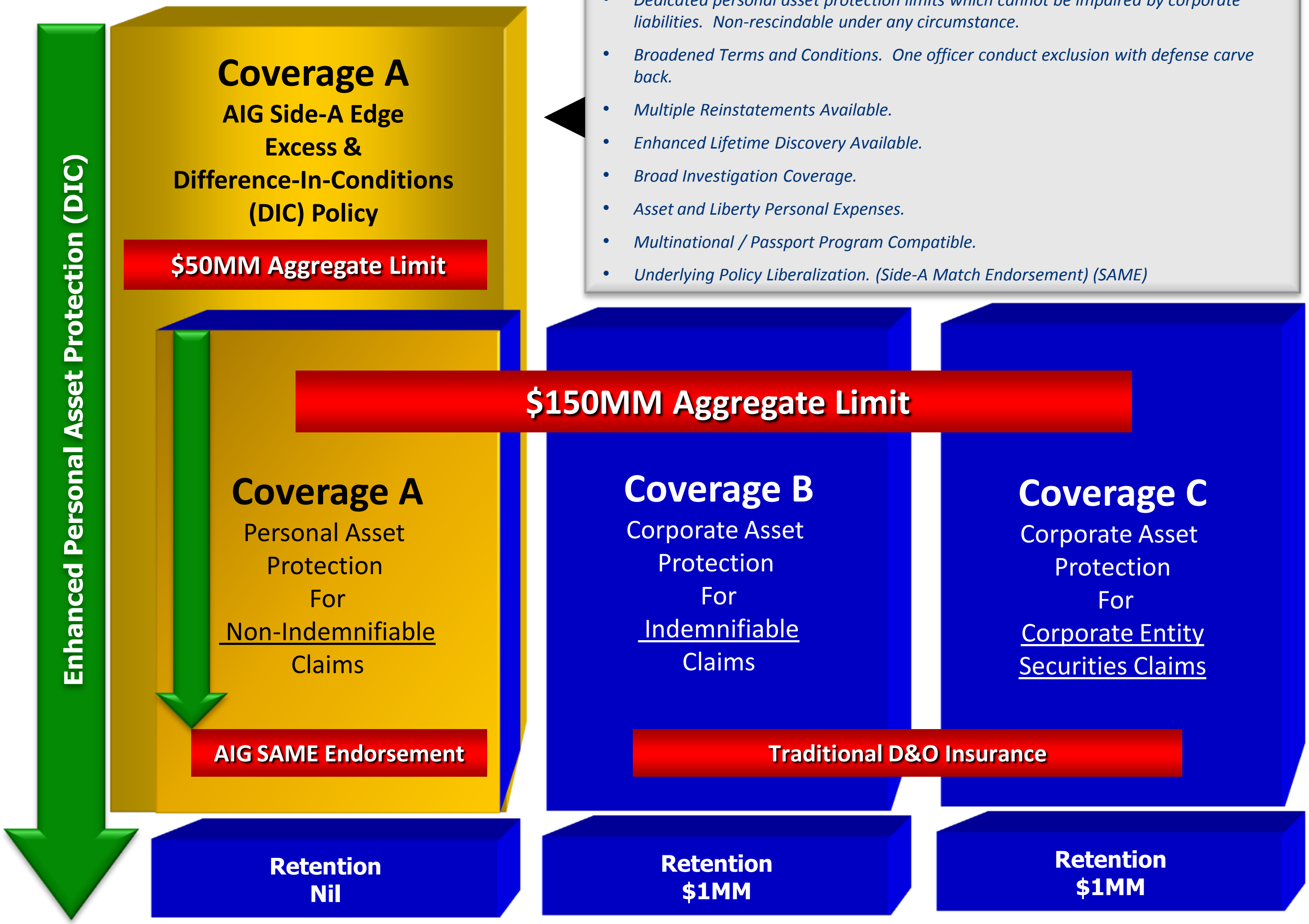
D&O Liability Insurance Coverage Part Overview

Full Tower Enhanced Personal Asset Protection (DIC)

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

AIG Side –A Edge - Enhanced Personal Asset Protection

- *Dedicated personal asset protection limits which cannot be impaired by corporate liabilities. Non-rescindable under any circumstance.*
- *Broadened Terms and Conditions. One officer conduct exclusion with defense carve back.*
- *Multiple Reinstatements Available.*
- *Enhanced Lifetime Discovery Available.*
- *Broad Investigation Coverage.*
- *Asset and Liberty Personal Expenses.*
- *Multinational / Passport Program Compatible.*
- *Underlying Policy Liberalization. (Side-A Match Endorsement) (SAME)*



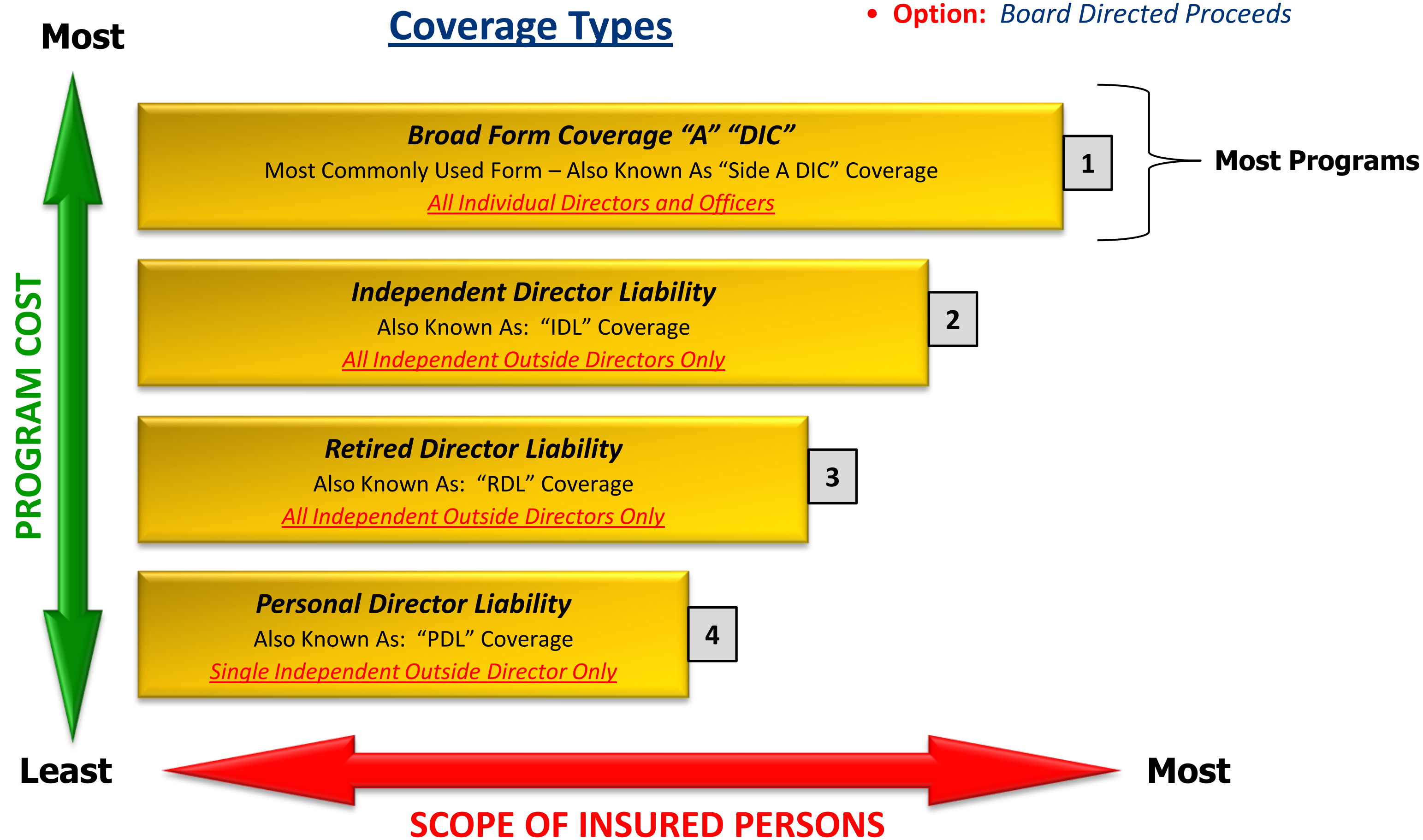
Enhanced Personal Asset Protection

Four (4) Coverage "A" Difference-In-Conditions (DIC) Optional Forms

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

Coverage Quality Versus Coverage Focus

- **Coverage Quality:** *Same When Properly Negotiated*
- **Coverage Focus:** *Insured Persons*
- **Implications:** *Objective Driven – Discuss*
- **Option:** *Board Directed Proceeds*



Basic Insuring Agreement Preambles
A Partial Sampling

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- **Coverage A / Non-Indemnifiable Loss**
  - *Policy shall pay the **Loss** of any **Insured Person** that no Organization has indemnified or paid arising from a **Claim** against an Insured Person for any **Wrongful Acts** of such Insured Person.*
  - *Applies to Pre-Claim Inquiry without Wrongful Act requirement.*
- **Coverage B / Indemnifiable Loss**
  - *Policy shall pay the **Loss** of an **Organization** arising from a **Claim** made against an Insured Person for any **Wrongful Act** of such Insured Person, but, only to extent Organization has indemnified such Loss.*
  - *Applies to Pre-Claim Inquiry without Wrongful Act requirement.*
- **Coverage C / Organization**
  - *Policy shall pay the **Loss** of any **Organization** arising from a **Securities Claim** made against such an Organization for **Wrongful Acts** of such Organization. (Derivative demand investigation [sublimit] and derivative dismissals included)*

Basic Definitions
A Partial Sampling

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- **Loss**
  - *Damages; settlements; judgments; Defense Expenses; Crisis Loss; Derivative Investigation Cost (sublimit); Liberty Protection Costs; Pre-Claim Inquiry Costs; and others.*
- **Insured Persons & Entities (Organizations)**
  - *Entities (Organizations): named entity and each subsidiary (>50% control).*
  - *Persons: executives –past, present, future duly elected or appointed director, officer, trustee, governor, management committee member of JV, management board of LLC; foreign equivalents including supervisory boards; shadow directors; general counsel; risk managers; employees (co-defendant basis); and others.*
- **Claim & Securities Claim**
  - *See following slides*
- **Wrongful Act**
  - *Breach of duty; neglect; error; misstatement; misleading statement; omission; or act; employees on co-defendant basis; Organization solely with respect to Securities Claims.*

Claim Definition
A Partial Sampling

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- **Written demand for monetary, non-monetary, or injunctive relief.**
- **Civil, criminal, administrative, regulatory or alternative dispute resolution *proceeding* against an *Insured* commenced by:**
  - Service of a complaint or similar pleading;
  - Return of an indictment, information, or similar document (criminal);
  - Receipt or filing of a notice of charges.
- **Civil, criminal, administrative, regulatory *investigation* of an *Insured Person* commenced by:**
  - Insured Person identified in writing by an Enforcement Body as a target;
  - Service of a subpoena (or foreign equivalent) against an Insured Person;
  - Target letters can include Wells Notices, whether or not labeled as such.

Securities Claim Definition
A Partial Sampling

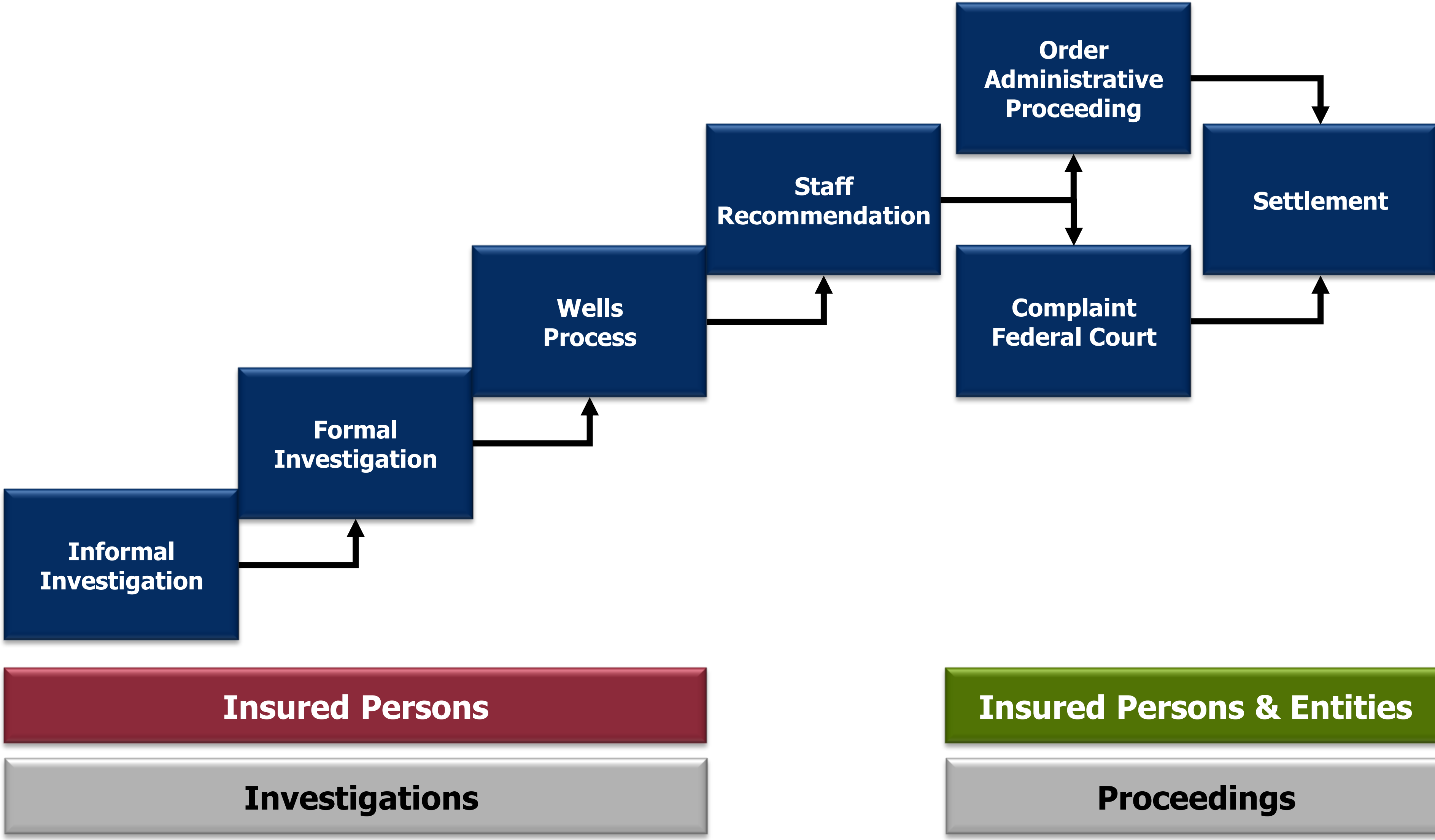
Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- **Securities Claim**, *other than an administrative or regulatory "proceeding" against, or "investigation" of an Organization*, made against any Insured
- Alleging violation of any law, rule, or regulation, whether statutory or common law (including, but, not limited to the purchase or sale or offer or solicitation of an offer to purchase or sell securities).
- Which is brought by…
  - *Any person or entity alleging, arising out of, based upon or attributable to the purchase or sale or offer to purchase or sell any securities of an Organization; or*
  - *Any security holder or purchaser or seller of securities of an Organization with respect to such security holder's, purchaser's, or seller's interest in securities of such Organization; or*
  - *Derivative Suit.*
- **Administrative or Regulatory Proceeding –Organization**
  - *Securities Claim definition does include administrative or regulatory proceeding coverage against the Organization provided that such proceeding is commenced and continuously maintained against Insured Persons.*

SEC Investigations

How Do Most Public Company D&O Policies Respond?

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.



Entity Investigation Option Sample

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- ***Response Coverage*** **(Separate Program / Not Liability Insurance)**
  - Limits Available: $1MM to $50MM
  - Estimated Costs: $40K to $60K Per Million of Limits (Expensive)
  - **Part 1:**
    - ***Securities Violations By Enforcement Body***.
    - Wrongful Act Not Required to Begin or Sustain Investigation Response Cover.
  - **Part 2:**
    - ***Internal Investigations / Derivative Investigations*** (With or Without a Securities Claim).
    - Wrongful Act or Enforcement Body Involvement Not Required to Begin or Sustain Investigation Response Cover.
  - **Part 3:**
    - ***FCPA, or Foreign Equivalent, Investigations*** (With or Without a Securities Claim)
    - Wrongful Act or Enforcement Body Involvement Not Required to Begin or Sustain Investigation Response Cover.

Entity Investigation Option Sample

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- ***Liability Coverage*** **(Part of D&O Liability Insurance Contract)**
  - Limits Available: Same as Underlying Primary and Excess "ABC" Insurance Programs.
  - Estimated Costs: 25% to 40% (of Underlying Insurance Premiums) Additional Premium (AP). (Relatively Expensive)
  - Limited Coverage:
    - **Only Available Concurrently with a Securities Claim Against Insured Persons.**
    - **Not Available for Investigations of Insured Entity that Pre-Date Securities Claims.**
    - **Not Available for Any Form of Informal or Internal Investigation of Insured Entity.**
    - **Only for Formal Investigations. Wrongful Act Requirement.**

Directors & Officers Liability - New

Halliburton – U.S. Supreme Court Decision June 23, 2014

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- ***Class Certification Event Study Endorsement***
    - *Limits Available: Policy Aggregate*
    - *Estimated Costs: No Additional Premium*
    - *Retention: None*

Class Certification Event Study Expenses means the reasonable and necessary fees, costs and expenses of an expert witness consented to by the Insurer, which consent shall not be unreasonably withheld, incurred by an Insured to conduct an admissible event study regarding any issues of fact relevant to the court's decision as to whether to grant class certification in a Securities Claim.

If the Panel Counsel firm defending a Securities Claim recommends to the Insured a specific expert witness to conduct an event study in the defense of such Securities Claim, then the Insured may hire such expert witness to perform such event study without further approval by the Insurer.

Other Claim & Coverage Types

A Partial Sampling

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- **Pre-Claim Inquiry** *(Insured Persons)*
  - *Verifiable request to appear at a meeting or interview; or produce documents;*
  - *But, only at request of Enforcement Body or Organization; and*
  - *As respects Organization, only as part of Enforcement Body investigation; or*
  - *An Organization's Derivative Demand Investigation.*
  - *No Wrongful Act requirement.*
  - *Does not include routine or regularly scheduled regulatory actions.*
- **Extradition** *(Insured Persons)*
- **Liberty Protection** *(Insured Persons – Foreign)*
- **Personal Reputation** *(Insured Persons)*
- **Employed Lawyers Professional** *(Insured Persons)*
- **Whistleblower Actions** *(Insured Persons and Entities)*
- **SOX 304 and Dodd-Frank 954 Expenses** *(No Actual Clawback)*
- **FCPA & UK Bribery Act** *(No Fines and Penalties – Insured Persons and Entities)*
- **Foreign Liberalization** *(Insured Persons & Entities)*
- **Selling and/or Controlling Shareholders** *(Insured Persons)*

Common Policy Exclusions

A Partial Sampling *(Within Exclusions or Definitions)*

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- **Personal Conduct**
  - *Illegal personal profit, advantage, or remuneration;*
  - *Deliberate fraud, or deliberate criminal acts by the Insured;*
  - *Subject to a final, non-appealable, adjudication.*
- **Prior or Pending Litigation**
- **Personal Injury** *(Securities Claim Carveback)*
- **Bodily Injury or Property Damage**
- **Entity versus Insured** *(With Carvebacks)*
- **ERISA** *(Company Benefit Plans Only)*
- **Compensation and Labor Liability**
- **Taxes, Fines, and Penalties** *(except punitives, multiplied, or exemplary where permitted by law)*
- **Matters Deemed Uninsurable Pursuant to Law**
- **Inadequate Price Paid or Consideration in M&A**

International D&O and E&O Notes…

- **Top 10 Countries With Mature D&O Liability Systems / Laws**
  1. Australia
  2. Canada
  3. England
  4. France
  5. Germany
  6. Hong Kong
  7. Italy
  8. Japan
  9. Korea
  10. The Netherlands

- **Up & Coming Jurisdictions – Economically More Powerful Than Most of the Top 10**
  - ✓ **Brazil**
  - ✓ **China**
  - ✓ **India**

- ***Summary Notes***
  - Public & private company D&O litigation trending upward.
  - Mature D&O liability systems (Top 10) all include specific laws focused on right of civil and criminal remedies for class or mass tort actions.
  - Heightened awareness of individual culpability within corporate settings, especially amongst regulators.
  - Aggrieved overseas investors seek litigation alternatives outside of the U.S.
  - Anti-Corruption/Anti-Bribery Laws: FCPA; UK Bribery Act; OECD based; United Nations conventions far reaching.
  - Enforcement and follow-on civil actions increasing significantly and now converging with domestic enforcement

International D&O and E&O Considerations

- International litigation increasing.
- Many countries have reconsidered (or are reconsidering) D&O insurance and indemnity.
- Host Country Considerations:
  1. Non-admitted insurances permitted or specifically prohibited?
  2. If non-admitted form permitted, does host country form provide specific benefit?
  3. Organizational indemnification of individual directors, officers, principals, et al, permitted?
  4. Organizational indemnity payments permitted from one country to another?
  5. Insurance proceeds repatriated from one country to another?
  6. Civil or criminal penalties for such repatriations?
  7. Tax implications associated with premium, claim, or indemnity payments?
  8. Subsidiary or JV boards?
  9. Board member insurance / indemnity expectations?