# SEC speaks about whistleblowers

May 20, 2015 | 8:00 am – 10:00 am

## Program:

Join Sean McKessy, Chief of the SEC's Office of the Whistleblower, and others for a discussion concerning the SEC's burgeoning whistleblower program and how it is impacting issuers and their officers, directors, and legal advisers.

Our panelists will discuss the following critical whistleblower issues:

- Whether employee confidentiality and nondisclosure agreements run afoul of SEC whistleblower rules.
- Actions by the SEC to encourage and incentivize reporting of potential securities law violations.
- Steps issuers may take to encourage internal reporting and internal remediation of potential securities law violations.
- Certain activities that may be construed as retaliation or an improper whistleblower impediment.

The Directors Roundtable Institute is a not-for-profit which organizes worldwide programming for directors and their advisors.

## Schedule:

8:00 am – Breakfast and registration
8:30 am – Program
10:00 am – Adjourn

Rosewood Mansion on Turtle Creek
2821 Turtle Creek Boulevard
Dallas, Texas 75219

## Speakers:

Gary Goolsby, Senior Managing Director, FTI Consulting

Mark Keene, Assistant General Counsel, Global Wealth & Investment Management Bank of America

Sean McKessy, Chief of the SEC's Office of the Whistleblower

Mark Oakes, Partner, Securities Litigation, Investigations and SEC Enforcement, Norton Rose Fulbright

Peter Stokes, Partner, Securities Litigation, Investigations and SEC Enforcement, Norton Rose Fulbright

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**Gary Goolsby**
*Senior Managing Director, FTI Consulting*
*gary.goolsby@fticonsulting.com*


Gary Goolsby is a Senior Managing Director at FTI Consulting, based in Houston. Mr. Goolsby has over 40 years of experience in accounting and auditing, risk management, and numerous related investigations, governance, SEC and DOJ matters involving a wide range of industries. Mr. Goolsby has provided professional services to many industries including oil and gas exploration, development, services, refining; mining; financial institutions including brokerage, banks, savings and loans, mortgage banking, insurance; construction and real estate. He has served on various US and global committees focusing on ethics, banking, financial reporting, auditing and risk management issues.


**Mark Keene**
*Assistant General Counsel, Global Wealth & Investment Management Bank of America*
*mark.l.keene@bankofamerica.com*


Mark Keene is an attorney in Bank of America Legal Department's Regulatory Inquiries Group where he handles regulatory inquiries and internal investigations. Mark's responsibilities include conducting and supervising internal investigations, representing the Firm in SEC, FINRA, DOL, and state regulatory inquiries as well as criminal matters (DOJ, DEA, FBI), managing a team of in-house attorneys and paralegals, supervising outside counsel, and providing advice to senior management and support partners. In 2011, Mark was selected to the Firm's Leadership Excellence Program. Before joining the Firm in 2006, Mark was an attorney with the U.S. Securities and Exchange Commission, Division of Enforcement in Washington, D.C. During his time at the Commission, Mark litigated and investigated cases involving possible violations of the federal securities laws. Mark practiced law in Boston for seven years prior to joining the SEC.


**Sean McKessy**
*Chief of the SEC's Office of the Whistleblower*
*McKessyS@SEC.GOV*


Sean McKessy is the Chief of the Whistleblower Office in the Division of Enforcement. The Office consolidates existing resources to administer the whistleblower provisions called for by The Dodd-Frank Wall Street Reform and Consumer Protection Act. Mr. McKessy leads a program working with whistleblowers, handling their tips and complaints, and helping the Commission determine the awards for individuals who provide the agency with information that leads to successful enforcement actions.


**Mark Oakes**
*Partner, Securities Litigation, Investigations and SEC Enforcement, Norton Rose Fulbright*
*mark.oakes@nortonrosefulbright.com*


Mark Oakes focuses on commercial and securities litigation, including shareholder class action defense, derivative litigation, internal investigations, and SEC enforcement matters, among others. The SEC matters involve issues such as allegations of fraudulent accounting, FCPA violations, and insider trading. He also represents clients in DOJ investigations relating to securities fraud, FCPA violations, trade sanctions and embargo laws.


**Peter Stokes**
*Partner, Securities Litigation, Investigations and SEC Enforcement, Norton Rose Fulbright*
*peter.stokes@nortonrosefulbright.com*


A partner in the Austin office, Peter Stokes has spent his entire career representing clients in securities lawsuits and SEC enforcement matters. He has substantial experience defending clients against shareholder class and derivative lawsuits involving numerous issues. Peter also enjoys speaking and publishing on securities-related issues and has co-authored the annual State Bar of Texas Fifth Circuit Securities Update for seven consecutive years, as well as three recent guest columns in Securities Law 360 and two recent articles in the Journal of Taxation and Regulation of Financial Institutions.

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.

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.

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

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

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

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.

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.

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[9] 240 C.F.R. § 21F-9(a).

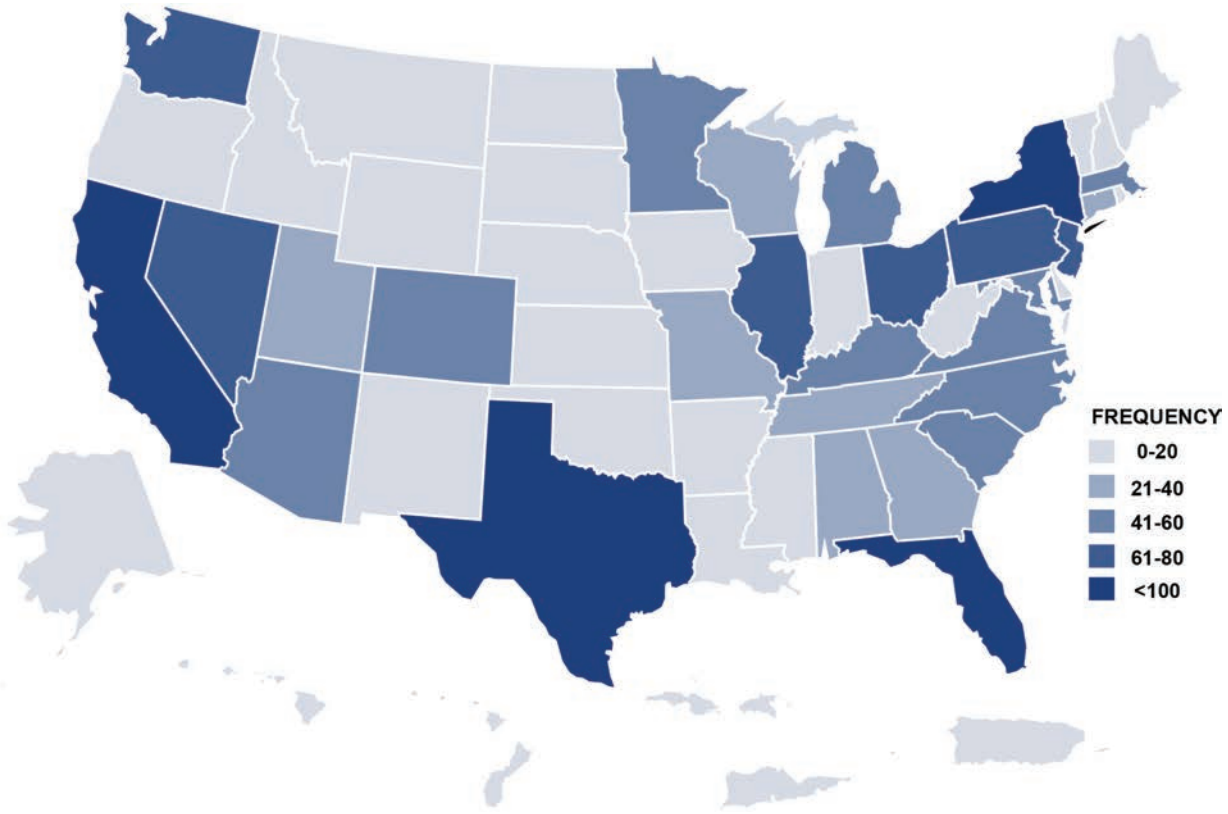
[10] The Commission also receives TCRs from individuals who do not wish or are not eligible to be considered for an award under the whistleblower program. The data in this report is limited to those TCRs that include the required whistleblower declaration and does not reflect all TCRs received by the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

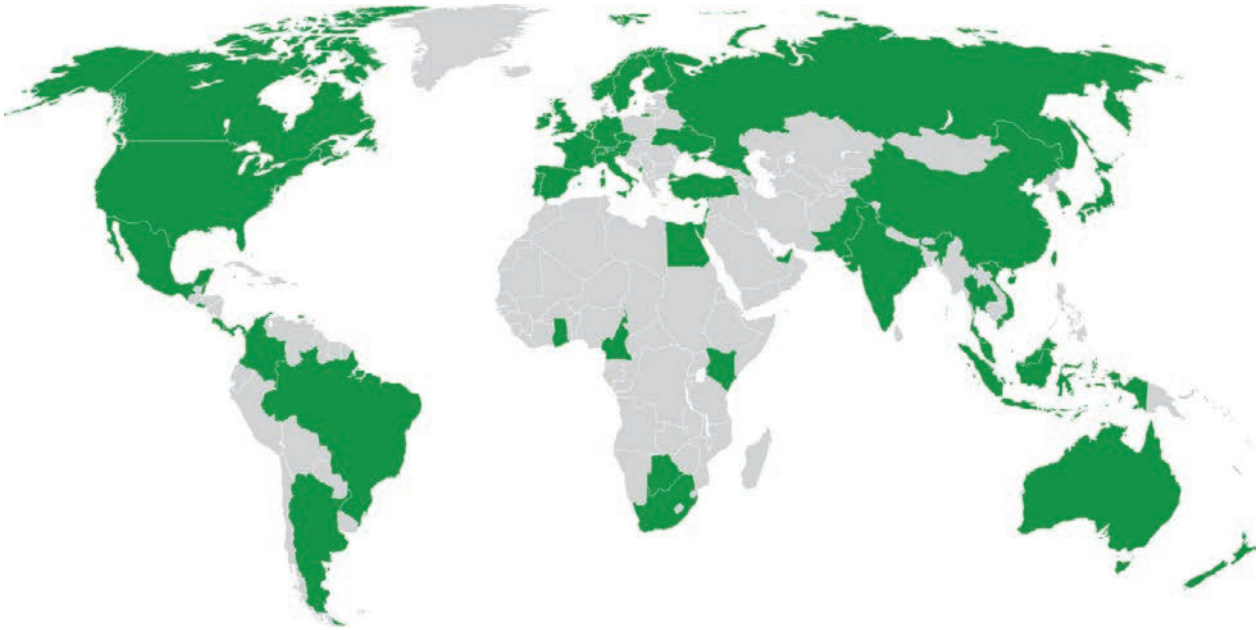
## Origin of Whistleblower Complaints

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.

[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.

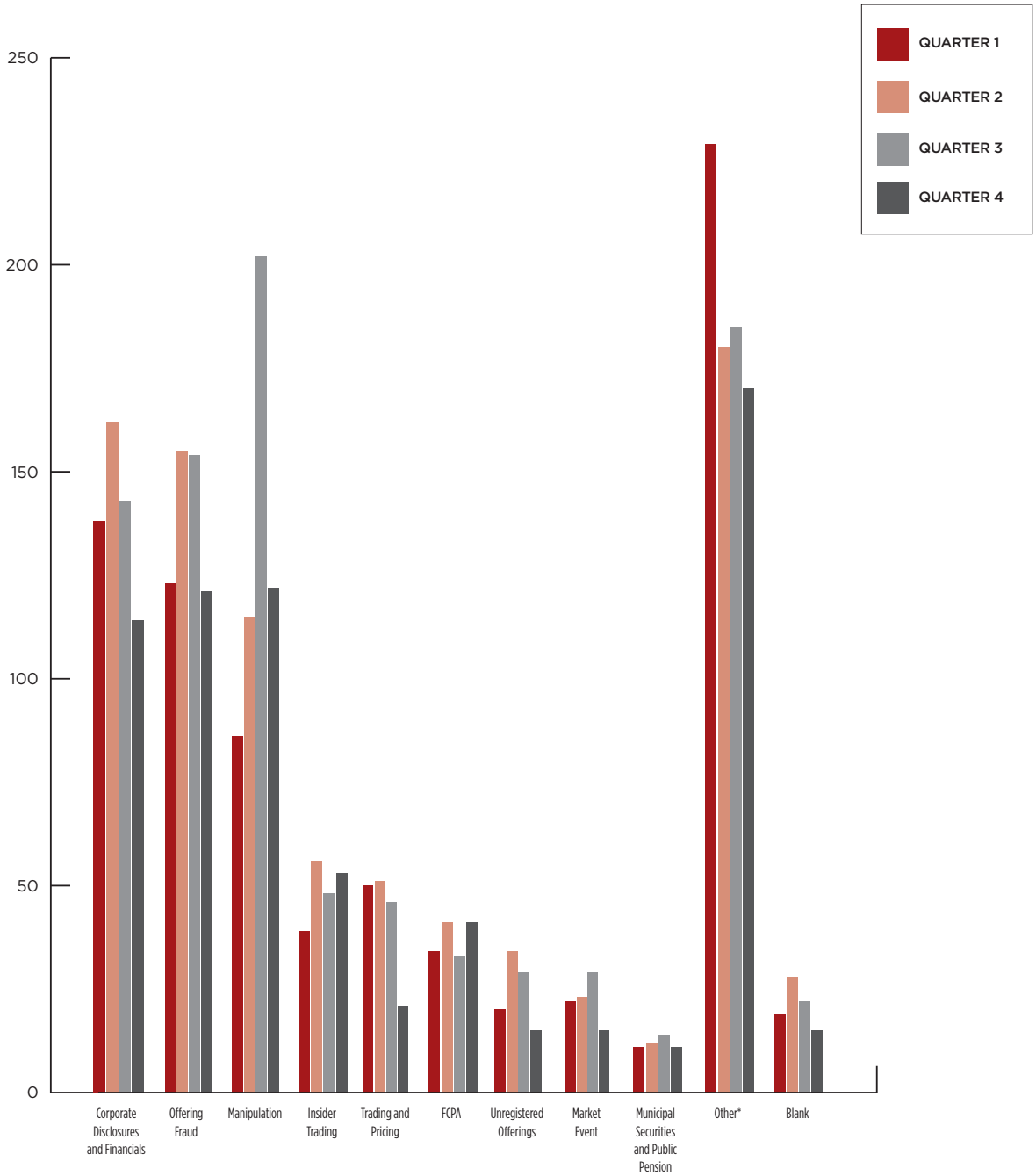
within thirty business days of receipt of an application for a whistleblower award. OWB also adopted additional performance measures that it will evaluate on an annual basis.

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]

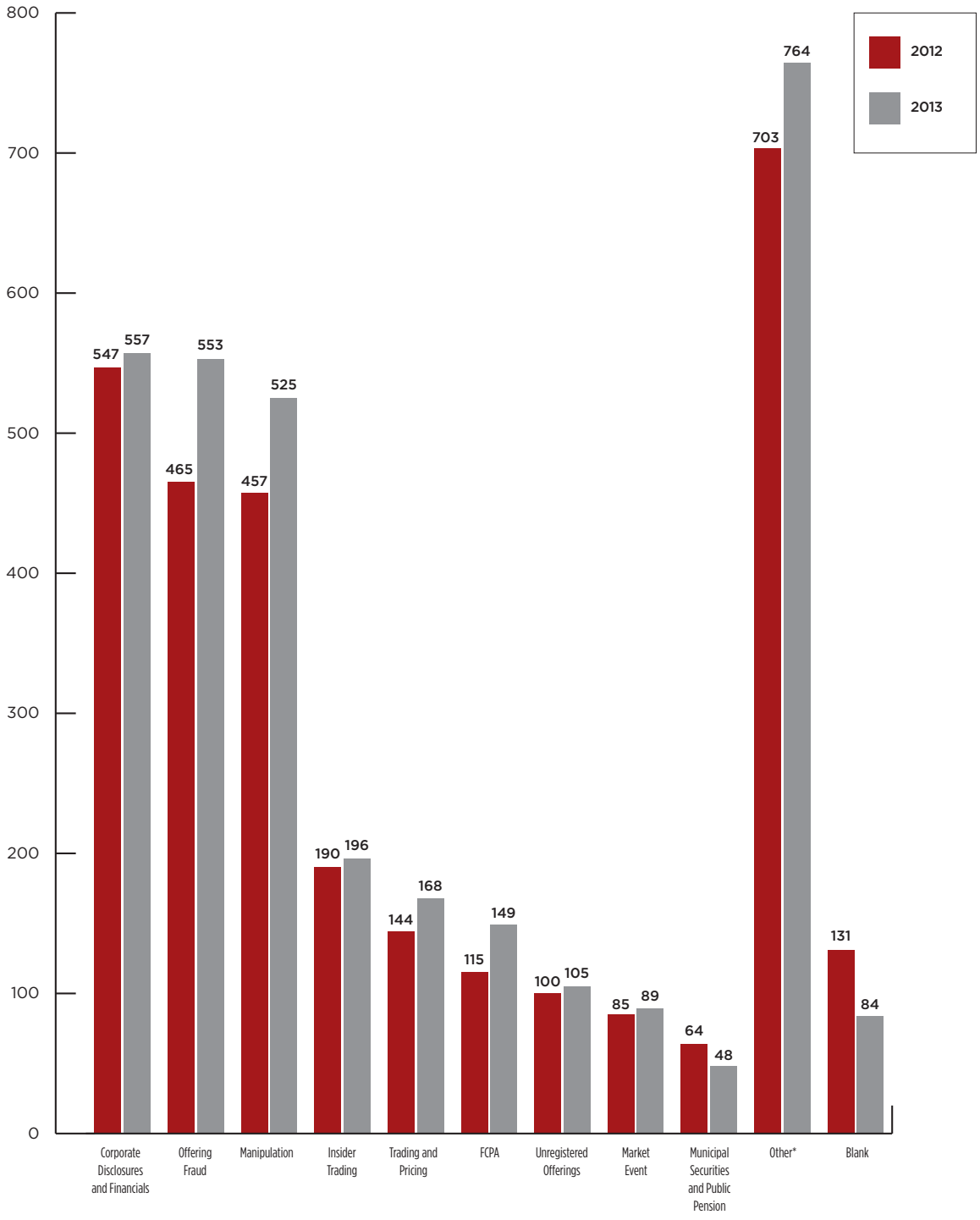
[35] *Id.* at vi, 24, 26.
[36] *Id.* at vi, 30.

# APPENDIX A
## WHISTLEBLOWER TIPS BY ALLEGATION TYPE
## FISCAL YEAR 2013



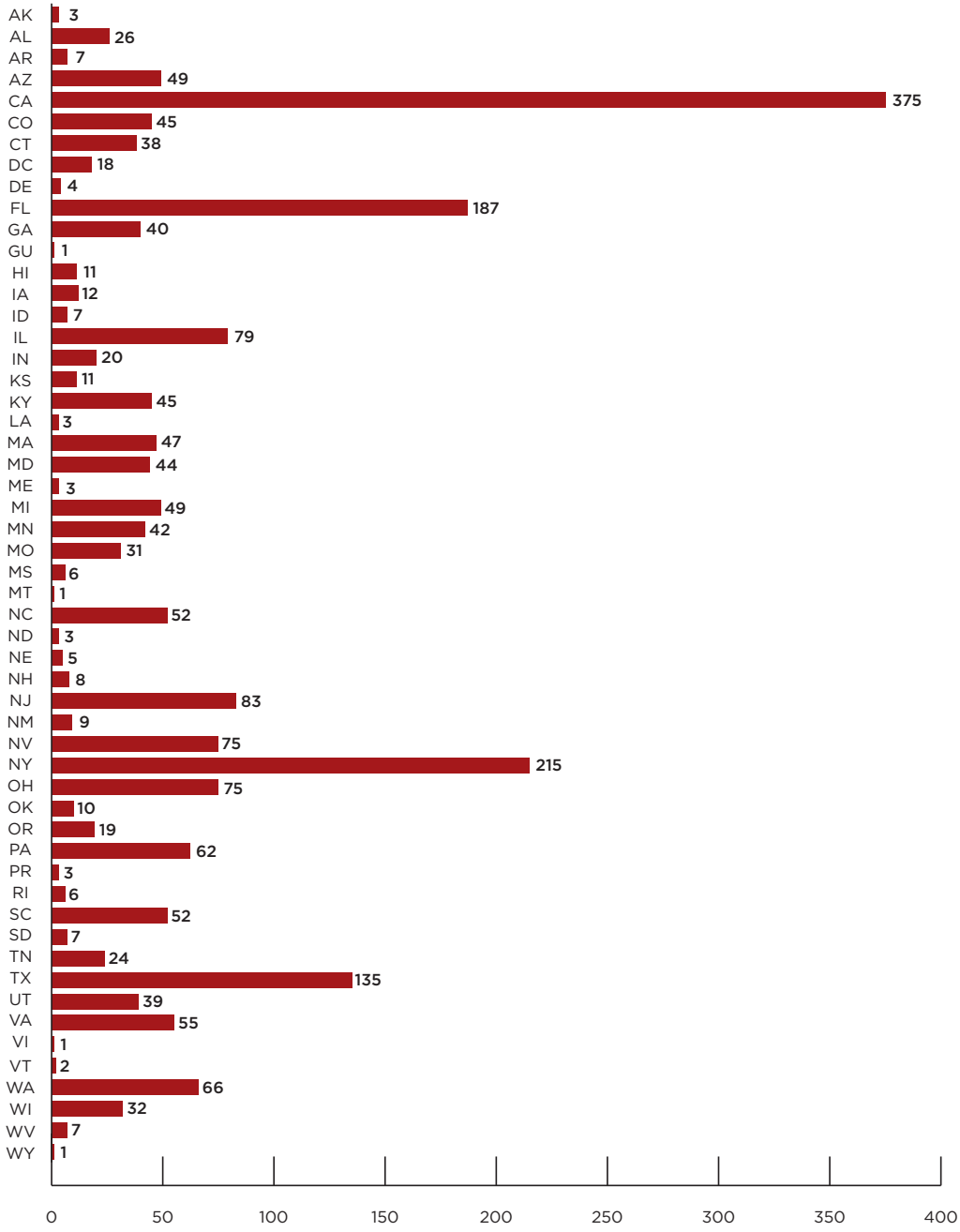

* "Other" indicates that the submitter has identified their WB TCR as not fitting into any allegation category that is listed on the online questionnaire.

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



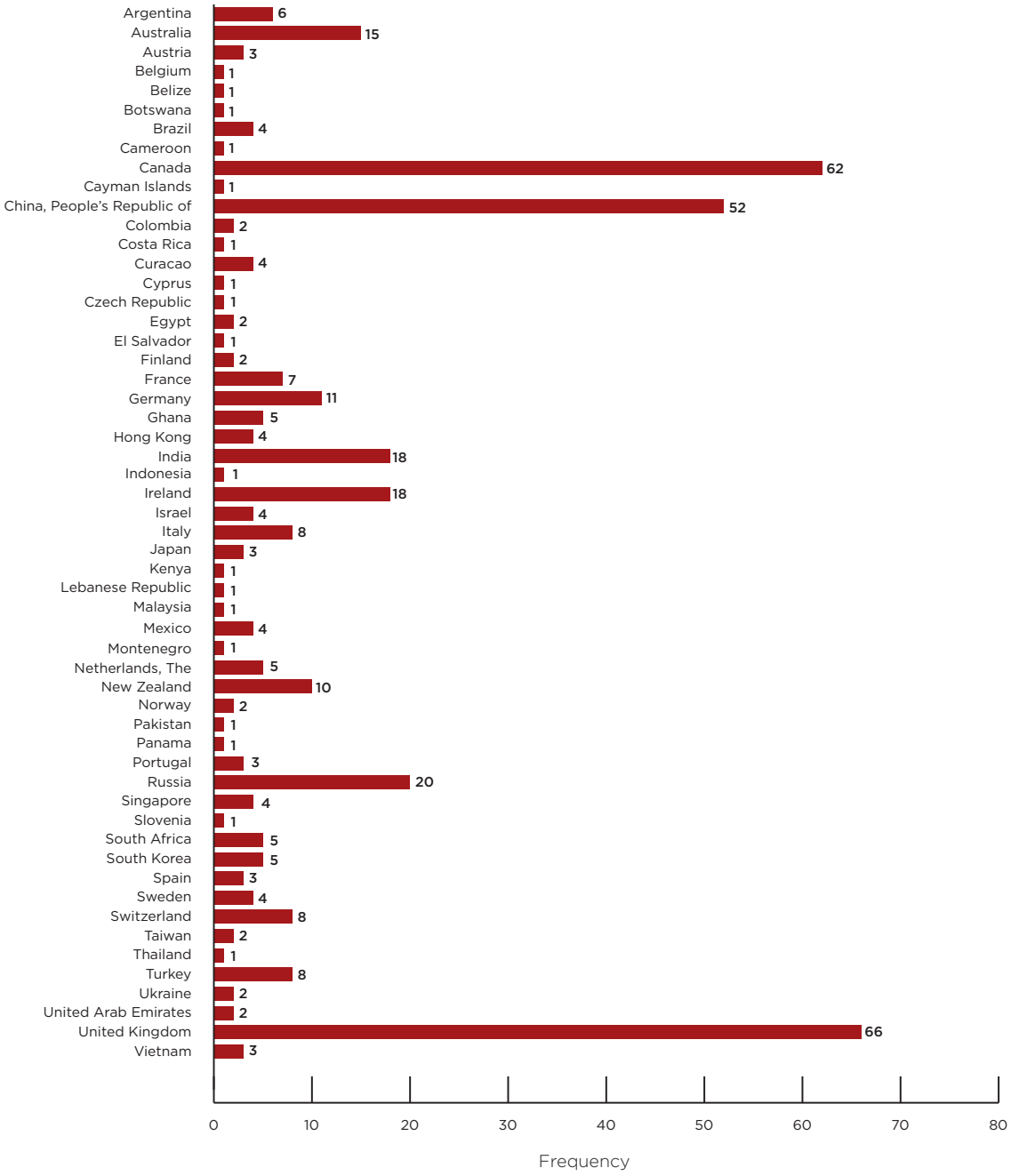

* "Other" indicates that the submitter has identified their WB TCR as not fitting into any allegation category that is listed on the online questionnaire.

# 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*

# *The SEC as Prosecutor* and Judge

The Wall Street Journal

August 5, 2014 Tuesday



**Section:** Pg. A13

**Length:** 1023 words

**Byline:** By Russell G. Ryan

## 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.

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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)



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**Load-Date:** August 29, 2014

# 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

Friday, June 13, 2014



*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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# 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 |
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| | | "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 |
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| *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 |