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Year in review: the SEC in 2016

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The Securities and Exchange Commission recently announced that it filed a record 868 enforcement actions in its 2016 fiscal year, which ended on Sept. 30, 2016, a 7.5 percent increase over the 807 actions filed in 2015. The 868 actions are comprised of 548 independent or standalone enforcement actions, 195 follow-on administrative proceedings, and 125 actions against delinquent filers. In 2016, the SEC also obtained orders totaling just over $4 billion in disgorgement and civil penalties, a slight decrease from the record $4.19 billion ordered last year.

These results represent a fitting end for SEC Chair Mary Jo White, who took office in April 2013 and stepped down at the conclusion of the Obama administration last week. The Enforcement Division's 2016 results reveal that White largely delivered on promises to strengthen the agency's enforcement division during her nearly four-year tenure. Indeed, independent enforcement actions jumped over 60 percent from 341 in 2013 to 548 in 2016 under her leadership.

The past year also saw a change in the SEC's tools and strategies. For example, the SEC awarded a record $57 million to whistleblowers, with indications of more to come. Similarly, the SEC continued to file actions against gatekeepers, i.e., those who have a professional obligation to identify and prevent misconduct, such as directors, accountants, attorneys and chief compliance officers. And the agency touted its growing use of data analytics, specifically in connection with identifying trading patterns to uncover alleged insider trading rings.

Here is a summary of many of the other notable developments and cases of the past year.

Financial Institutions

The SEC obtained several significant settlements from a number of the country's largest financial institutions. These matters reflect the directives of Chair White and Enforcement Director Andrew Ceresney to bring cases that make a significant impact on the industry and promote the public's confidence in the markets.

• One firm was charged with misusing customer cash maintained in a reserve account to unlawfully free up billions of dollars weekly to finance its trading activities. The firm settled the charges by admitting wrongdoing and paying a $358 million penalty and disgorgement of $57 million.

• The SEC charged two subsidiaries of a large investment adviser with failing to disclose their policy of investing clients in more expensive, proprietary investment products. The firm admitted wrongdoing and paid a civil penalty of $127.5 million and disgorgement and prejudgment interest of over $139 million.

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• A broker-dealer paid a $1 million penalty to settle charges arising from its failures to adopt written policies and procedures reasonably designed to protect customer data. Over a three-year period, an employee transferred data relating to over 700,000 customers onto his personal server, which was later hacked.

Financial Fraud

The SEC did not ignore the traditional enforcement areas of financial fraud and disclosure. Two of the most significant in monetary terms involved an oil services firm and an agricultural conglomerate. The services firm agreed to pay a $140 million penalty to settle charges that it improperly reduced its year-end provision for income taxes by $100 million to manage its earnings results to align them with prior projections. The company had previously touted its favorable effective tax rate as a competitive advantage.

The conglomerate paid an $80 million civil penalty to resolve charges that it misstated company earnings by booking significant amounts of revenue from sales resulting from a rebate program to bolster its flagship product, while failing to recognize the associated costs of the program.

Gatekeepers

The SEC filed a number of actions against gatekeepers, reinforcing public comments by both Chair White and Director Ceresney concerning the important role served by individuals serving in such capacities.

In a first-of-its-kind action, a Big Four accounting firm paid a $4.3 million penalty to resolve auditor independence failures based on close personal relationships between its auditors and its clients. One partner on the audit team maintained a close friendship with the chief financial officer of an audit client and spent over $100,000 in a three-year period to entertain the CFO and his family. Another partner maintained a romantic relationship with a finance executive of a public company that she was auditing.

Another large accounting firm admitted wrongdoing, paid a $3 million penalty, and disgorged audit fees totaling $1.5 million to settle charges that it ignored red flags, failed to obtain adequate audit evidence concerning certain transactions and agreements, and unreasonably relied on unsupported management representations.

In September, a public company and its general counsel were charged for failing to disclose any loss contingency or record an accrual on its books although the company was under investigation by the Department of Justice. The general counsel contributed to this failure by not disclosing the investigation to management.

Insider Trading

The SEC charged 78 parties in cases that involved insider trading, many of which were brought as a result of the SEC's growing use of data and analytic tools to identify suspicious trading.

But the biggest insider trading news of the past year was the U.S. Supreme Court's decision in December to affirm the 9th U.S. Circuit Court of Appeals' decision in *Salman v. United States*. The court reaffirmed that prosecutors could demonstrate that an inside tipper received a "personal benefit" in breach of the insider's fiduciary duty where the tipper provided only a gift of material, nonpublic information to a trading relative or friend. In doing so, the Supreme Court rejected the 2nd U.S. Circuit Court of Appeals' more restrictive view articulated in *United States v. Newman*, which had required prosecutors to prove that an insider, who "gifted" information to a trading relative or friend, also received "a pecuniary or similar benefit" in exchange for the tip.

Actions Against Private Firms and Advisers

Recently, the SEC has heightened its focus on failures to disclose conflicts of interests by those that hold fiduciary duties to investors or clients. Last fall, the SEC filed a series of actions against private equity advisers for breaching their fiduciary duties to the funds they advised by, among other things, obtaining benefits at the expense of fund investors and/or improperly allocating costs to the underlying funds without proper disclosure to fund investors. In all, the SEC filed eight actions against private equity advisers in 2016. Those eight included the following:

- One of the world's largest private equity funds paid $39 million to settle charges that it failed to inform investors that its fund advisers would receive accelerated monitoring fees before the sale or initial public offering of certain portfolio companies, payments which decreased the value of the companies.
- In another "first," the SEC charged a private equity adviser with acting as an unregistered broker-dealer. The adviser performed brokerage services in-house, without registering as a broker-dealer, rather than using investment banks or broker-dealers to handle the acquisition and disposition of portfolio companies for a pair of private equity funds that it advised.

Public Finance

The SEC furthered its commitment to police the long-overlooked public finance markets in 2016.

For the first time, the agency sued a municipal advisor for breaching its fiduciary duty, created in 2010 under Dodd-Frank, requiring the advisor to place its clients' interests ahead of its own. The advisor, which paid an $85,000 penalty and disgorged its fees of nearly $300,000, failed to disclose to its client that it had arranged for the municipal offerings to be underwritten by a broker-dealer where the advisor's employees were registered representatives.

Also, in September 2016, the SEC announced that it had prevailed in its first federal jury trial against a municipality (Miami, Fla.) and one of its officers for violations of the federal securities laws relating to misleading bond disclosures.

Foreign Corrupt Practices Act

The SEC filed 21 FCPA-related actions this past year, a record number. The two largest settlements involved a hedge fund and a European telecommunications company.

The hedge fund used intermediaries and agents to pay bribes to high-level African government officials to obtain investments from overseas sovereign wealth funds and mining rights. It paid a $2.1 million penalty and disgorgement of $199 million to resolve the SEC's claims.

The telecommunications company offered and paid over $100 million in bribes to Uzbek government officials to enter the Uzbek telecommunications market. The company agreed to pay over $795 million to resolve the regulatory actions against it: $167.5 million to the SEC, $230.1 million to the Department of Justice, and $397.5 to Dutch regulators.

In addition, a U.S.-based telecommunications company paid $7.5 million to settle FCPA charges related to hiring relatives of Chinese officials to advance its position in the Chinese market and providing gifts, travel, and entertainment to officials at government-owned Chinese telecommunications companies.

And in a move likely intended to encourage self-reporting and cooperation, the SEC announced non-prosecution agreements with two companies who self-reported bribes paid to Chinese officials by foreign subsidiaries.

Whistleblowers

The fiscal year 2016 statistics reported from the SEC's Office of Whistleblower reflect the growing importance of whistleblowers to the Enforcement Division. In the last year, the SEC issued whistleblower awards to 34 individuals totaling over $57 million, an amount greater than all previous years combined. The 10 highest awards each exceeded $1 million, with the largest over $30 million. The assistance received from the whistleblowers led to over $548 million in ordered sanctions.

The SEC continued to assert its authority under the Dodd-Frank Act to protect potential and actual whistleblowers. In the first standalone whistleblower action, the SEC charged a company for firing an employee with several years of positive performance reviews because he reported to senior management and the SEC that the company's financial statements might be misstated. The company paid a $500,000 penalty to settle the matter.

The SEC also brought several enforcement actions against companies that supposedly used restrictive language in employment and severance agreements in violation of Rule 21F-17 purportedly to chill employees from blowing the whistle to the SEC.

With the pending confirmation of new SEC Chair Jay Clayton and an administration committed to curtailing Dodd-Frank, the coming year will usher in a new enforcement regime that will likely move away from the SEC's aggressive stance under Chair White.

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