



2008 SEC and SRO enforcement year in review Morgan Lewis

C O U N S E L O R S A T L A W

Feb 05 2009 [Morgan, Lewis & Bockius LLP](#) *Complinet exclusive*

The year 2008 was one of dramatic change in the financial markets. The markets were roiled by a number of unprecedented economic events, and the most prominent stock market indices lost significant value, with the Dow Jones Industrial Average declining about 34 percent and the NASDAQ closing down approximately 41 percent from the end of 2007. The year also saw the demise of several broker-dealers, the merger of others, unprecedented government capital infusions, and a move away from the independent investment banking model towards that of commercial banks. Investors and regulators also witnessed several major scandals, and the media and others called for regulatory change. In this context we have prepared a summary of SEC and FINRA enforcement activity in 2008.

SEC regulatory enforcement review

2008 was an eventful year at the SEC. Perhaps most importantly, in mid December 2008, President-elect Barack Obama announced his intention to nominate then – FINRA CEO, Mary Schapiro, to replace Christopher Cox as the chairman of the Commission. Schapiro's appointment since has been confirmed by the US Senate.

On the enforcement front, in the SEC's fiscal year 2008 (which began on October 1, 2007 and ended on September 30, 2008), the Commission brought 671 enforcement actions, the second-highest number of actions ever, and a slight increase in comparison to the 656 cases initiated in fiscal year 2007. Of note, however, the statistics include more than twice as many cases against public issuers for untimely regulatory filings in fiscal year 2008 versus fiscal year 2007; many of these cases were initiated in the last month of the Commission's fiscal year. Moreover, in one of its core areas – the regulation of broker-dealers – its case load was down significantly from about 89 cases in fiscal year 2007 to about 60 cases in fiscal year 2008, a decline of approximately 33 percent. The number of cases initiated by the SEC in fiscal year 2008 against investment advisers increased slightly over the number for fiscal year 2007, although both the 2007 and 2008 figures reflect a sharp drop-off from fiscal years 2005 and 2006. In addition, the number of insider trading and market manipulation cases increased by more than 25 percent and 45 percent, respectively, from fiscal year 2007 figures.

The SEC's civil penalties and disgorgement were also significantly lower than in prior years. In fiscal year 2008, the SEC obtained orders imposing \$256m in civil money penalties, which represents approximately half the amount imposed in fiscal year 2007. The Commission also obtained orders requiring securities law violators to disgorge approximately \$774m, which is a 29 percent decline from fiscal year 2007. One of the few statistical bright spots for the SEC occurred in its efforts to close cases. In fiscal year 2008, the Division of Enforcement closed 1,355 cases, a 260 percent increase from the prior year.

In 2008 the SEC brought actions relating to auction rate securities (as did FINRA and several state regulators), insider trading, on-line account intrusion, regulation [S-P](#), market manipulation, stock loan, and conflicts of interest. The Commission also spent time, effort and resources litigating several market timing and late trading cases that it had initiated in prior years. Moreover, the SEC launched intensive examinations and investigations concerning new topics, such as the malicious creation and spread of rumors intended to manipulate securities prices and the alleged Ponzi scheme attributed to Bernard Madoff. In 2008, the Division of Enforcement found itself the subject of several investigations conducted by the Commission's Office of the Inspector General concerning its handling of certain inquiries. The Division of Enforcement also published its Enforcement Manual, which describes its key investigative practices.

FINRA and NYSE regulatory enforcement review

Last year was the first full year since the merger of NASD regulation and NYSE regulation and the resulting creation of FINRA in late July 2007. FINRA has confirmed that in calendar year 2008, it initiated 946 new cases, expelled 14 member firms, barred 321 individuals from membership, and suspended 300 individuals. In addition, individuals and firms agreed to pay a total of \$1.2 billion in restitution or reimbursement in various settlements in 2008. That figure includes the agreements in principle relating to the contemplated "buybacks" of auction rate securities. Based upon our review, however, it appears that the number of FINRA enforcement cases with large fines is lower than the number of such cases brought in the recent past by NASD and NYSE regulation. Indeed, it appears that there were two FINRA settlements in which the fine imposed was greater than \$1m and one Hearing Panel Decision in which the fine imposed was \$1.53m.

In 2008, FINRA brought enforcement actions on various traditional topics, including variable annuities, mutual fund sales practices, markups, municipal securities, and form filings. In addition, a sweep action relating to trade volume

reporting and a multi-firm OATS case were announced this year. FINRA also brought significant cases in the insider trading and continuing education training areas. As to its regulation and enforcement program, FINRA reported that it completed the creation of a single examination program and enforcement arm; work concerning the consolidation of its rulebook occurred in 2008 and will continue in the coming year. FINRA also published important guidance concerning its views on member firm cooperation.

Notwithstanding its merger with the NASD, NYSE regulation retained oversight and enforcement responsibility for trading violations occurring on the NYSE's systems and facilities. NYSE regulation announced enforcement actions in 2008 against broker-dealers and individuals – albeit at substantially reduced levels – on a variety of topics, including order marking, supervision of post execution changes, odd lot trading, and rule 92.

This article was written by Morgan, Lewis & Bockius LLP partners Ben A. Indek, Anne C. Flannery, Michael S. Kraut, and Bonnie Altro who is an associate in the New York office. Morgan Lewis has more than 100 attorneys dedicated to representing financial institutions and issuers in connection with securities law issues. As part of that practice, the firm's Securities Litigation and Enforcement Practice Group regularly represents investment banks, investment advisers, and mutual funds and their employees in connection with SEC, FINRA and state securities commission investigations and proceedings. Morgan Lewis also conducts internal investigations for those entities and has acted as independent consultant to firms arising out of regulatory settlements.