

2007 Year In Review: SEC and SRO Enforcement Cases and Developments Regarding Broker-Dealers

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This short article highlights selected U. S. Securities and Exchange Commission (“SEC” or the “Commission”), NASD, NYSE Regulation, and Financial Industry Regulatory Authority (“FINRA”) enforcement actions and developments in 2007 regarding broker-dealers.

In the SEC’s fiscal year 2007 (stretching between October 1, 2006 and September 30, 2007), the Commission initiated 14% more enforcement actions (656) than in the prior year (574). The civil penalties and disgorgement obtained by the SEC in these matters, however, decreased 52% to \$1.6 billion from \$3.3 billion in fiscal year 2006. In fact, an analysis of SEC settlements involving financial institutions over the last four Commission fiscal years reveals a significant increase in the imposition of relatively small fines and a dramatic decline in the number of large sanctions.

Specifically focusing on enforcement actions against broker-dealers, in fiscal year 2007 the Commission brought 89 such cases versus 75 last year. This represents 14% of the SEC’s docket, a slight increase from 13% in fiscal year 2006. These figures are significantly down from fiscal year 2004 when 22% of the SEC’s cases involved broker-dealers.

With respect to broker-dealer enforcement, the SEC made headlines this year in the pursuit of

alleged insider trading and tipping by Wall Street professionals; the U. S. Department of Justice also criminally prosecuted a number of these individuals. As in previous years, the Commission brought cases in the mutual fund market timing, auction rate securities and research conflict of interest areas. Actions regarding municipal securities returned again this year, and the SEC opened several new fronts with Regulation S-P, 529 plans, gifts and gratuities, suspicious activity report filing, sales to seniors, and on-line brokerage account intrusion actions. In the policy and process arenas, the Commission changed the way it negotiates civil penalties, reorganized its structure, and developed new enforcement case management procedures. Finally, the Commission entered into new cooperative arrangements with certain key foreign financial regulatory counterparts, and some at the SEC signaled an interest in “prudential regulation” and “mutual recognition” of foreign compliance regimes.

In fiscal year 2008, Commission enforcement efforts regarding broker-dealers are likely to focus on, among other things, mortgage securities valuation, insider trading, frontrunning, sales to senior citizens, and municipal securities.

The single most important topic at the self-regulatory organization (“SRO”) level was consolidation. In July 2007, the previously announced merger between the NASD and NYSE Regulation became effective. FINRA, the new SRO, spent the better part of the year developing its organizational structure, working on creating one examination program and establishing the procedures for its new single enforcement arm. Work towards

a consolidated rulebook was also undertaken and will continue in 2008. FINRA also took incremental steps towards principles-based regulation in 2007.

As a separate entity in the first half of 2007, the NASD continued to be active in some of the same areas that occupied its time in prior years, including anti-money laundering, mutual fund sales practices and research conflicts of interest. In addition, two significant actions were brought in connection with marketing materials distributed to investors and one major case involved supervision of gifts and gratuities and NASD registration requirements. Consistent with its long-standing enforcement program, these cases also focus on broker-dealer supervision. While no official statistics have been released as of the date of this publication, our preliminary review of NASD enforcement activity indicates that for calendar year 2007, the number of cases the NASD brought seems to have declined from prior years. The amount of fines imposed on member firms also appears to have decreased from previous years. One possible explanation for these declines is the time and energy devoted to the merger of NASD with NYSE Regulation.

At NYSE Regulation, enforcement actions continued in several areas that had been the subject of disciplinary cases in years past, such as: NYSE floor activities (enforcement of trading rules, specialist matters, and a significant stock loan case), prospectus delivery, anti-money laundering, net capital and other financial operations issues and registration. NYSE Regulation also brought a major action in a new area – the unregistered private

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placement arena. These matters also typically include a supervisory charge. Again, there has been no official announcement by NYSE Regulation concerning its enforcement activity statistics for 2007. However, based on our preliminary review, in 2007 the number of enforcement actions brought by NYSE Regulation (approximately 161) dropped 44% from 232 cases in 2006, although the fines assessed by NYSE Regulation in 2007 (approximately \$26 million) nearly matched the fines assessed in 2006 (approximately \$29 million). Again, the drop-off may be merger-related.

After its official launch in July 2007, FINRA concluded and publicized several cases that had been begun by the NASD (including actions regarding e-mail retention and production and compliance with the 2003 breakpoint self assessment). Several of the priority areas for FINRA in 2008 are investment fraud involving seniors, variable annuities, subprime mortgages, anti-money laundering, and Regulation SHO.

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