Morgan Lewis

2018 YEAR IN REVIEW

SELECT SEC AND FINRA DEVELOPMENTS AND ENFORCEMENT CASES

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Executive Summary

The Morgan Lewis Year in Review highlights key US Securities and Exchange Commission (the SEC or the Commission) and Financial Industry Regulatory Authority (FINRA) enforcement developments and cases regarding broker-dealers, investment advisers, and investment companies.*

THE SEC

For a time in 2018, the Commission actually was fully staffed, with all five seats filled; but as we go to press in early 2019, with the year-end departure of Commissioner Kara M. Stein, the Commission is down one member, and the President has not yet appointed a nominee for the vacant Democratic seat. That said, Fiscal Year 2018 continued to be a time of significant change on the Commission, with the addition of three new Commissioners.

The statistics for the Enforcement Division rebounded this last year, even as the Co-Directors for Enforcement continued to explain that the numbers of cases are not nearly as important as the cases' impact. In Fiscal Year 2018, the Commission brought a total of 821 enforcement actions, composed of 490 independent or standalone actions for securities laws violations, 210 "follow on" administrative proceedings seeking associational bars against individuals, and 121 deregistration actions against issuers that were delinquent in making required filings.

In those cases, the Commission obtained orders and judgments ordering the payment of more than $3.9 billion in penalties and disgorgement. According to the Division, $794 million was returned to investors in 2018, a decline from 2017, which saw a one-time extraordinary jump in monies distributed. Although the monetary sanctions ordered—$1.439 billion in civil penalties and $2.506 of disgorgement—represented an increase for penalties, disgorgement dropped about 15% from 2017, which must be a disappointing statistic in light of the Commission's constantly articulated focus on getting monetary recoveries back to retail investors.

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* Morgan Lewis served as counsel in certain actions described herein. Information concerning the matters described in this outline was derived from generally available materials, including information available to the public on the websites of the US SEC and FINRA, and as otherwise expressly noted.

This outline was prepared by partners Amy J. Greer, Ben A. Indek, and Christine M. Lombardo, of counsel Russell M. Fecteau, and associates Ariel Gursky, Vineeta Kamath, Olga Kamensky, Eric L. Perelman, and Zoe Phillips; with assistance from partners Michèle A. Coffey and Jennifer L. Klass; associates Cara Arnold, Christina M. Aylward, Kathryn Ball, Matthew T. Bohenek, Sydney Booker, Arcangelo S. Cella, Shannon F. Delaney, Sagiv Y. Edelman, Martin Hirschprung, Elizabeth Hood, Sarah Hsu Wilbur, Jessica L. Joy, Richard G.S. Lee, Jonathan E. Maier, John M. Maloy, David E. Marvin, Matthew C. McDonough, Devon Minerve, Haniel Ogburu-Ogbonnaya, Silki Patel, Sandra M. Praxmarer, James L. Severs, Alexander Starr, Kyle T. Sullivan, Robert Thompson, Ellen G. Weinstein, Natalie R. Wengroff, Jonathan P. York, and Erica L. Zong Evenson; summer associates Meredith Compton, Ariel Landa-Seiersen, and Petrina Mironis; and senior paralegal Victoria Curry. Administrative support was provided by Laurie S. Gerner and Kate Lesko.

In Fiscal Year 2018, the Commission conducted more than 3,150 examinations. The Office of Compliance Inspections and Examinations examined 17% of registered investment advisers and 15% of registered investment companies – each of which represents an increase over 2017 – and, together with SROs, 48% of broker-dealers were examined.

The SEC's Office of the Whistleblower received 5,282 whistleblower tips in Fiscal Year 2018, an increase of 798, or 17.8%. The Office of the Whistleblower attributes this enormous jump over prior years at least in part to the US Supreme Court decision in *Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767 (2018),* which held that in order to qualify for the employment retaliation protections included in Section 21F(h) of the Dodd-Frank Act, a putative whistleblower must report possible securities law violations to the Commission.

The Division of Enforcement, and in fact the Commission as a whole, continues to focus its work on the protection of "Main Street" or retail investors. According to the Division, more than half of the standalone cases brought in Fiscal Year 2018 concerned wrongdoing involving retail investors. Throughout the year, we repeatedly saw the Staff and the Commission identify actions and initiatives in terms of how "Main Street" investors would be better protected or were benefited.

More specifically, the Division has promoted three initiatives as all having Main Street investor impact, two of which, the Retail Strategy Task Force and Cyber Unit, were announced during the last fiscal year, and one, the Share Class Selection Disclosure Initiative (SCSDI), represents a continuation, and perhaps something of a culmination, of a series of enforcement actions over a period of years. We can certainly anticipate more of all things retail and all things cyber or crypto, as each of these really seemed to be the touchstones of this last year's work.

Finally, the financial markets have seen some significant volatility through the last year or so, which always affords some opportunity for untoward events, whether by exposing system or process weaknesses or by providing those who would commit fraud with some opening. Should those conditions continue, we may see some unexpected issues on the Enforcement Division's docket.

FINRA

There were several important developments concerning FINRA's enforcement and examination programs last year, including the completion of the consolidation of two enforcement functions, the creation of a new unified structure in the Department of Enforcement, and the announcement of a set of principles that guide Enforcement's work. On the examination front, in 2018 FINRA appointed a new leader of Member Supervision and announced a plan to consolidate its three main programs.

Enforcement's Consolidation is a key outcome of the FINRA360 "self-evaluation and organizational improvement" initiative and was designed to help facilitate more consistent and foreseeable outcomes from a single, unified team of Enforcement staff. The new structure consists of two centralized groups—the Office of the Counsel to the Head of Enforcement and the Investigations unit. Additionally, the Enforcement staff was divided and organized into specialized teams including Main Enforcement, Sales Practice Enforcement, and Market Regulation Enforcement. The Main Enforcement team investigates and prosecutes various disciplinary matters; the Sales

Practice Enforcement team brings disciplinary actions concerning sales practice violations and counsels Member Supervision examiners during investigations and examinations; and the Market Regulation Enforcement team counsels Market Regulation examiners and analysts during investigations and examinations conducted based on FINRA's trading surveillance and prosecutes disciplinary actions that result from those matters.

In 2018, Susan Schroeder, the Head of the Department of Enforcement, announced a set of principles that guide FINRA's decision-making when taking enforcement action. The principles begin with Enforcement's key goals, which include fairness of process, consistent and foreseeable outcomes, and effectively achieving remediation and prevention. To meet those goals, FINRA looks first at whether it is appropriate to bring an enforcement action in light of the particular facts and circumstances of the matter. In doing so, FINRA focuses on harm: whether there was harm to investors, harm to the market, or a significant risk of harm to investors or the market. If it determines that formal enforcement action is not appropriate, Enforcement may issue a Cautionary Action Letter or consider releasing guidance on the issue. Where an enforcement action is appropriate, the Staff considers the imposition of effective sanctions. In FINRA's view, effective sanctions are designed to remediate the particular issue in a matter, or to prevent or deter that issue from occurring again. Of course, as in the past, FINRA's number one priority remains providing restitution to harmed customers.

In January 2018, FINRA published its first annual budget summary. The 2018 Annual Budget Summary and the accompanying cover letter describe the six Financial Guiding Principles that will inform the organizations' financial planning. In explaining one of the principles, "Use Fines to Promote Compliance and Improve Markets," the Budget Summary states that, "[w]hen [FINRA] impose[s] fines, the amounts are based on the facts and circumstances of the misconduct and the principles set forth in our Sanction Guidelines; fines are not based on revenue considerations, and [FINRA] does not establish any minimum amount of fines that must be collected for purposes of [its] annual budget." The Budget Summary further notes that the use of fine monies is subject to special procedures and restrictions, and is not considered in determining employee compensation and benefits.

FINRA published Regulatory Notice 18-17 to advise firms of revisions to its Sanctions Guidelines. The notice stated that FINRA revised the Guidelines to instruct adjudicators to consider customer-initiated arbitrations that result in adverse arbitration awards or settlements when assessing sanctions. According to FINRA, this change should allow adjudicators to identify patterns in a respondent's disciplinary history, past arbitration awards, settlements or findings and impose more stringent sanctions as appropriate. The revisions took effect on June 1, 2018 and will apply to complaints filed on or after June 1, 2018. The revisions will not apply to cases filed before that date or to cases currently pending.

In April 2018, FINRA announced that it named Bari Havlik as Executive Vice President of the newly named Member Supervision team. Later in the year, FINRA announced that it planned to consolidate its Examination and Risk Monitoring Programs, integrating three separate programs —Sales Practice, Risk Oversight and Operational Regulation, and Trading & Financial Compliance Examinations, which are responsible for business conduct, financial, and trading compliance— into one unified, integrated program. This consolidation seeks to eliminate duplication, promote more effective oversight and greater consistency, emphasize a risk-based approach, and create a single point of accountability in examinations. This effort will continue this year and extend into 2020.

Late last year, FINRA released its second annual Report on FINRA Examination Findings. The Report provides observations from recent exams of firms and is meant to serve as a resource to help firms more easily comply with securities rules and regulations and to assist in strengthening firms' compliance programs and supervisory controls. The 2018 Report highlights the following issues: (i) suitability for retail customers; (ii) fixed income mark-up disclosure; (iii) reasonable diligence for private placements; and (iv) financial advisor's abuse of authority.

On January 22, 2019, FINRA published its annual Risk Monitoring and Examination Priorities Letter. The letter took a different approach by highlighting new topics that FINRA will focus on in the upcoming year (as opposed to prior years, when the annual priorities letter also included a recitation of many longstanding priorities). However, FINRA noted that it will continue to review for compliance in areas that have been a consistent focus over the years. FINRA also stated that it will focus on risks related to persons with problematic regulatory history and the adequacy of firm's cybersecurity programs. Three "highlighted items" outlined in the 2019 Letter were online distribution platforms, fixed income mark-up disclosure and regulatory technology. In the sales practice area, risks that are a priority in 2019 include suitability, senior investors, outside business activities and private securities transactions. Operational risks that will be a focus this year include the supervision of digital assets business, the new customer due diligence rule, and suspicious activity reviews. With respect to market risks, in the coming year FINRA will look at a number of areas, including best execution, market manipulation, market access, short sales and short tenders. Finally, as to financial risks, FINRA intends to focus on credit risk and funding and liquidity.

As of the date of publication of this outline, FINRA had not yet announced its 2018 enforcement statistics. The online version of this publication will include that data when it becomes available.

US Securities and Exchange Commission

PERSONNEL CHANGES[1]

For a time in 2018, the Commission was fully staffed, with all five seats filled; but as we go to press in early 2019, with the year-end departure of Commissioner Kara M. Stein, the Commission is down one member, and the President has not yet appointed a nominee for the vacant Democratic seat. That said, Fiscal Year 2018 continued to be a time of significant change on the Commission, with the addition of three new Commissioners.

COMMISSION CHANGES[2]

Republican **Hester Peirce** was sworn in on January 11, 2018, having been confirmed by the Senate on December 22, 2017. Ms. Peirce rejoined the Commission from the Mercatus Center at George Mason University, where she served as a Senior Research Fellow and Director of the Financial Markets Working Group. At the SEC, Commissioner Peirce has experience as a Staff Attorney in the Division of Investment Management and as Senior Counsel to former Commissioner Paul S. Atkins. Following her prior SEC service, Ms. Peirce worked for US Senator Richard Shelby on the Senate Committee on Banking, Housing, and Urban Affairs. Commissioner Peirce's term expires June 5, 2020.

Also on January 11, 2018, Democrat **Robert J. Jackson Jr.** was sworn in as a Commissioner, having been confirmed by the Senate on December 22, 2017. Commissioner Jackson joined the SEC from the NYU School of Law; previously, he had been a professor of law at Columbia Law School. Commissioner Jackson's term will expire June 5, 2019.

Following the conclusion of the term of Commissioner Piwowar and his departure in July 2018, Republican **Elad L. Roisman** was nominated by the President and his nomination was confirmed by the Senate. Commissioner Roisman was sworn in on September 11, 2018, filling a term that expires on June 5, 2023. Prior to re-joining the Commission, Commissioner Roisman was serving the Senate Banking Committee as its Chief Counsel; he had previously served as Counsel to SEC Commissioner Daniel Gallagher.

As set forth below, there were some changes in key Commission Staff positions during FY 2017.

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1 Unless otherwise noted, the information regarding these personnel changes was drawn from SEC Press Releases available on the Commission's website.

2 Because of the timing of this publication and the SEC's fiscal year, some of these entries may have appeared in last year's volume. For the convenience of our readers, we are including personnel transitions from October 1, 2017 through December 31, 2018.

On December 14, 2017, **Kenneth A. Johnson** was named the Commission's **Chief Operating Officer (COO)**, after serving as Acting COO since February 2017. Mr. Johnson previously served as Chief Financial Officer of the SEC and Chief Management Analyst within the former Office of the Executive Director. Before joining the SEC, Mr. Johnson served as an analyst for the Congressional Budget Office.

On March 15, 2018, **Caryn E. Kauffman** was named **Chief Financial Officer** for the Commission. She served as Acting CFO since February 2017, and previously as the Deputy Chief Financial Officer. Prior to joining the SEC as Chief Accounting Officer in 2011, Ms. Kauffman spent 12 years in the audit practice of PricewaterhouseCoopers.

On May 31, 2018, **Julie A. Erhardt** was named the Commission's **Acting Chief Risk Officer**, in a temporary capacity as the Commission continues its search to fill the role. Ms. Erhardt will also serve as a key adviser on matters related to the Commission's operational risk and controls. She currently serves as a Deputy Chief Accountant in the Office of the Chief Accountant, a position she has held since she joined the SEC in 2004. She has previously worked in public accounting and as a partner at Arthur Andersen.

DIVISION OF ENFORCEMENT

On November 2, 2017, **Charles E. Cain** was named the Chief of the Division's specialized **Foreign Corrupt Practices Act (FCPA) Unit**, after serving as Acting Chief since April 2017. Mr. Cain has 15-plus years of experience investigating FCPA matters, most recently as Assistant Director of the FCPA Unit.

On December 7, 2017, **Daniel Michael** was named the Chief of the Division's **Complex Financial Instruments Unit**. Mr. Michael, who joined the SEC in 2010, previously served as an Assistant Director based in the New York Regional Office.

On August 23, 2018, **Matthew S. Jacques** was named **Chief Accountant in the Division**. Mr. Jacques rejoined the SEC, where he served from 2007 to 2013 as a senior enforcement accountant in the Boston Regional Office, from AlixPartners, where he was a managing director. Mr. Jacques also has experience with forensic accounting at Ernst & Young and public accounting at Arthur Andersen.

On September 6, 2018, **Anita B. Bandy** and **Carolyn M. Welshhans** were named **Associate Directors** in the Division. Ms. Bandy joined the SEC in 2004 and most recently served as an Assistant Director in the Division. Ms. Welshhans has served in the SEC since 2007, most recently performing dual roles as an Assistant Director in the Division's Cyber Unit and Market Abuse Unit.

SEC REGIONAL OFFICES

Atlanta Regional Office: **Richard Best – Regional Director**

Mr. Best was named Regional Director of the Atlanta Regional Office on January 10, 2018, after serving as Regional Director of the SEC's Salt Lake Office.

Chicago Regional Office: Joel R. Levin – Regional Director

Mr. Levin was named Regional Director of the Chicago Regional Office on April 5, 2018. He joins the SEC after 25 years at the Department of Justice, including leadership positions in the US Attorney's Office for the Northern District of Illinois.

Denver Regional Office: Kurt L. Gottschall – Regional Director

Mr. Gottschall was named Regional Director of the Denver Regional Office on November 19, 2018. He has been working in that office since 2000, when he started as a staff attorney, working his way up to Associate Regional Director for Enforcement in 2016.

Fort Worth Regional Office: Eric R. Werner – Associate Regional Director

Mr. Werner was named Associate Director for Enforcement in Fort Worth on April 25, 2018. He has been with the Enforcement Division in a variety of roles since 1995, and has served as an Assistant Regional Director in Fort Worth since 2010.

New York Regional Office: Marc P. Berger – Regional Director

Mr. Berger was named the Regional Director of the New York Regional Office on December 18, 2017. He joined the SEC from private practice; prior to his law firm practice, Mr. Berger spent 12 years as an Assistant US Attorney in the Southern District of New York, including as Chief of the Securities and Commodities Fraud Task Force.

Maurya C. Keating – Associate Regional Director

Ms. Keating was named the Associate Regional Director for the Investment Advisor and Investment Company examination program of the New York Office on June 15, 2018. She joined the Commission from her role as Lead Director/Vice-President and Associate General Counsel of AXA Equitable Life Insurance Company.

Salt Lake Regional Office: Daniel J. Wadley – Regional Director

Mr. Wadley was named Regional Director for the Salt Lake Office on June 18, 2018, after serving as Acting Director. He began as a trial counsel in the office in 2010 and has also served as counsel to the co-Directors of Enforcement.

DIVISION OF CORPORATION FINANCE

On October 6, 2017, **Robert Evans III** was named **Chief of the Office of International Corporate Finance** in the Division of Corporation Finance. The Office of International Corporate Finance leads outreach to non-US issuers that participate in the US capital markets. Mr. Evans had recently joined the Division after many years in private practice.

On February 15, 2018, **Kyle Moffatt** was named Chief Accountant in the Division of Corporation Finance, after serving as Acting Chief Accountant since January 2018. Mr. Moffatt has served in

various roles at the Division of Corporation Finance since he joined the SEC in 2000. He has served as an Associate Director overseeing the Division's disclosure review program, previously established the Division's Disclosure Standards Office and served as its first Associate Director, and also served as Associate Chief Accountant in the Division's Office of Chief Accountant.

On June 4, 2018, **Valerie A. Szczepanik** was named **Associate Director** of the Division of Corporation Finance and Senior Advisor for Digital Assets and Innovation for Division Director Bill Hinman. This is a newly created advisory position that involves coordinating efforts across all SEC Divisions and Offices regarding the application of securities laws to emerging digital asset technologies and innovations. Ms. Szczepanik, who most recently served as an Assistant Director in the Division of Enforcement's Cyber Unit, is also the Head of the SEC's Distributed Ledger Technology Working Group, Co-head of its Dark Web Working Group, and a member of the Commission's FinTech Working Group. She joined the SEC in 1997.

DIVISION OF ECONOMIC RISK ANALYSIS

On January 11, 2018, **Dr. Timothy Timura** was named **Deputy Director and Deputy Chief Economist** of the Division of Economic and Risk Analysis (DERA). Most recently, Dr. Timura was an Executive in Residence at the Kogod School of Business at American University; he has decades of experience as a professional money manager. Dr. Timura's initial focus will be assisting the Chief Economist in working on economic policy in agency rulemaking.

On May 31, 2018, **Dr. Chyhe Kim Becker** was named the **Acting Chief Economist and Acting Director** of DERA. She most recently served as an Associate Director in DERA, leading the Office of Litigation Economics. Before joining the SEC in 2008, Dr. Becker was a Principal with Chicago Partners LLC, specializing in securities litigation. Prior to that, she was a Principal with the Economic Consulting group at Deloitte Financial Advisory Services.

DIVISION OF INVESTMENT MANAGEMENT

On November 20, 2017, **Paul G. Cellupica** was named **Deputy Director** of the SEC's Division of Investment Management, where he is responsible for strategic, rulemaking, and industry engagement initiatives, as well as serving as a senior advisor to Division Director Dalia Blass. Most recently, Mr. Cellupica was Managing Director and General Counsel for Securities Law at Teachers Insurance and Annuity Association of America (TIAA). Prior to that he was Chief Counsel for the Americas at MetLife, Inc. He has also previously served the SEC in a number of capacities, including as Assistant Director in the Division of Investment Management.

On June 8, 2018, **Sarah G. ten Siethoff** was named the **Associate Director** for the Division of Investment Management's Rulemaking Office. Most recently Ms. ten Siethoff served as Deputy Associate Director in the Rulemaking Office. Prior to her SEC service, which began in the Division of Investment Management in 2008, she was in private practice.

DIVISION OF TRADING AND MARKETS

On October 18, 2017, **Brett Redfearn** was named **Director** of the Division of Trading and Markets. Mr. Redfearn joined the SEC from J.P. Morgan, where he was Global Head of Market

Structure for the Corporate & Investment Bank. Earlier in his career, Mr. Redfearn ran Business Strategy and Equity Order Flow at the American Stock Exchange. He has also served on the boards of Bats Global Markets, the Chicago Stock Exchange, BIDS Trading, and the National Organization of Investment Professionals.

On July 25, 2018, **Elizabeth Baird** and **Christian Sabella** were named **Deputy Directors** of the Division of Trading and Markets. Ms. Baird joined the SEC after many years in private practice advising clients in matters related to the fixed-income, equities, and options markets. Mr. Sabella joined the Commission in 2011 and, most recently, has been an Associate Director in the Office of Clearance and Settlement.

On September 17, 2018, **Mark E. Wolfe** was named **Associate Director** of the Office of Derivatives Policy and Trading Practices in the Division of Trading and Markets. Mr. Wolfe rejoined the SEC from J.P. Morgan Securities, where he worked as executive director of equities compliance. He first began working at the SEC in 1999, serving as an attorney in the Office of Compliance Inspections and Examinations (OCIE), and, from 2003 to 2006, serving as senior counsel in the Enforcement Division.

On December 14, 2018, **Jeffrey S. Mooney** was named **Associate Director** of the Office of Clearance and Settlement in the Division of Trading and Markets. Mr. Mooney has served in a variety of roles since joining the SEC staff in 1996, most recently as Assistant Director for the Office of Clearance and Settlement.

OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS

On October 26, 2017, **Peter B. Driscoll** was named **Director** of OCIE after serving as Acting Director since 2017. Previously Mr. Driscoll served as OCIE's first Chief Risk and Strategy Officer and OCIE's Managing Executive.

On May 15, 2018, **James Reese** was named **the Chief Risk and Strategy Officer** of OCIE after serving as Acting Chief since 2017. In this role, Mr. Reese leads the exam program's risk-based and data-driven processes and initiatives in connection with identifying risks in the financial markets and exam targeting and selection, among other important issues. Having joined the SEC in 1999, Mr. Reese has served in a variety of roles, beginning his career as an examiner.

On July 25, 2018, **Kristin Snyder** was named **Deputy Director** of OCIE. A 15-year veteran of the SEC, Ms. Snyder will also continue to serve as the Co-National Associate Director of OCIE's Investment Company/Investment Adviser examination program and as the Associate Regional Director for Examinations in the SEC's San Francisco Regional Office.

On July 25, 2018, **Daniel Gregus** was named **National Associate Director of the Clearance and Settlement examination program** of OCIE, having served in an acting role since 2016. Mr. Gregus also will continue to serve as the Associate Regional Director for the Broker-Dealer Examination Program in the SEC's Chicago office. He first joined the Chicago Regional Office in the Division of Enforcement, in 1993.

On December 18, 2018, **Daniel Kahl** was named **Deputy Director** of OCIE. Together with Deputy Director Snyder, Mr. Kahl will oversee many of OCIE's strategic initiatives and advise

OCIE's leadership. He will also continue to serve as OCIE's Chief Counsel. Before joining OCIE, Mr. Kahl led the Division of Investment Management's Office of Investment Adviser Regulation. He has been with the SEC since 2001.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

On December 12, 2017, **William D. Duhnke III** was named **Chairman** of the Public Company Accounting Oversight Board (PCAOB). Mr. Duhnke most recently served as the Staff Director and General Counsel to the US Senate Committee on Rules and Administration. Prior to that, he was the Staff Director and General Counsel to the US Senate Committee on Banking, Housing, and Urban Affairs and the Committee on Appropriations.

The SEC also appointed **J. Robert Brown, Kathleen M. Hamm, James G. Kaiser, and Duane M. DesParte** as **Board members** of PCAOB. Mr. Brown is a law professor at the University of Denver, where he serves as Director of the Corporate and Commercial Law program. Ms. Hamm is the Global Leader of Securities and Fintech Solutions and Senior Strategic Advisor on Cyber Solutions at Promontory Financial Group. Mr. Kaiser, a partner at PricewaterhouseCoopers, is the firm's Global Assurance Methodology & Transformation Leader. At the time of his appointment, Mr. DesParte was expected to retire soon as Senior Vice-President and Corporate Controller at Exelon Corporation.

OFFICE OF INTERNATIONAL AFFAIRS

On May 1, 2018, **Raquel Fox** was named **Director** of the Office of International Affairs. Ms. Fox joined the SEC in 2011, most recently serving as a senior advisor to Chairman Jay Clayton on issues related to Corporation Finance and International Affairs.

OFFICE OF EQUAL EMPLOYMENT OPPORTUNITY

On April 4, 2018, **Peter Henry** was named **Director** of the Office of Equal Employment Opportunity (OEEO) after serving as Acting Director since 2016. Mr. Henry, who joined the SEC as OEEO Deputy Director in 2014, has practiced federal employment and labor law for 20 years.

OFFICE OF CREDIT RATINGS

On May 7, 2018, **Jessica Kane** was named the **Director** of the Office of Credit Ratings, after serving as Acting Director since 2017. Ms. Kane, who joined the Commission in 2007, has served in various roles at the SEC before joining the Office of Credit Ratings. She advanced several key initiatives as Director of the Office of Municipal Securities and also served in the Division of Corporation Finance and Office of Legislative and Intergovernmental Affairs.

OFFICE OF MUNICIPAL SECURITIES

On September 4, 2018, **Rebecca J. Olsen** was named **Director** of the Office of Municipal Securities (OMS), after serving as Acting Director since 2017. Ms. Olsen first joined the SEC in 2013, as an attorney fellow in OMS, and went on to serve as Chief Counsel and then Deputy Director.

OFFICE OF THE ETHICS COUNSEL

On December 11, 2018, **Danae M. Serrano** was named **Acting Ethics Counsel and Designated Agency Ethics Official**. She has served as the Deputy Ethics Counsel and Alternate Designated Agency Ethics Official since 2013, and served as the Commission's Acting Chief Compliance Officer until August 2018. Ms. Serrano joined the SEC in 2010 as an Assistant Ethics Counsel.

OFFICE OF THE ADVOCATE FOR SMALL BUSINESS CAPITAL FORMATION

On December 21, 2018, **Martha Legg Miller** was named the Commission's first **Advocate for Small Business Capital Formation**, a position and office created pursuant to the SEC Small Business Advocate Act of 2016. In this role, Ms. Miller will lead efforts to advance the interests of small businesses and their investors. She joins the SEC from private practice.

ENFORCEMENT STATISTICS[3]

The statistics for the Enforcement Division show a rebound for this last year, even as the Co-Directors for Enforcement continue to explain that the numbers of cases are not nearly as important as the cases' impact.[4] In Fiscal Year 2018, the Commission brought a total of 821 enforcement actions, composed of 490 independent actions for securities laws violations (standalone cases), 210 "follow on" administrative proceedings seeking associational bars against individuals, and 121 deregistration actions against issuers that were delinquent in making required filings. In those cases, the Commission obtained orders and judgments ordering the payment of more than $3.9 billion in penalties and disgorgement. According to the Division, $794 million was returned to investors in 2018, a decline from 2017, which saw a one-time extraordinary jump in monies distributed. *Id.* at 11.

The Division noted in its Annual Report that included within the total of 821 actions are orders suspending trading in the securities of 280 companies, and bars or suspension orders imposed against more than 550 individuals. *Id.* at 13.

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[3] Unless otherwise noted, the information in this section is drawn from the Commission's Division of Enforcement Annual Report, "Annual Report Division of Enforcement 2018" (ENF Annual Report), https://www.sec.gov/files/enforcement-annual-report-2018.pdf. The SEC's Fiscal Year 2018 ended on September 30, 2018.

[4] *See generally* "Measuring the Impact of the SEC's Enforcement Program," Remarks of Stephanie Avakian, Sept. 20, 2018, https://www.sec.gov/news/speech/speech-avakian-092018.

The chart below reflects the number of cases brought by the SEC over the last decade:

Fiscal Year	Number of Enforcement Actions
2009	664
2010	681
2011	735
2012	734
2013	686
2014	755
2015	807
2016	868
2017	754
2018	821

CATEGORIES OF CASES

The major categories of independent enforcement actions and the number of those cases for Fiscal Year 2018 within each category follows, and we provide the 2017 numbers, as a reference.

Type of Case	Number of Actions	Percentage of Total Actions	Number/Percentage in 2017
Securities Offering	121	25%	94 cases/21%
Investment Advisers/ Investment Companies	108	22%	82 cases/18%
Issuer Reporting/Audit & Accounting	79	21%	95 cases/21%
Broker-Dealer	63	13%	53 cases/12%
Insider Trading	51	10%	41 cases/9%
Market Manipulation	32	7%	41 cases/9%
Public Finance Abuse	15	3%	17 cases/4%
FCPA	13	3%	13 cases/3%
Miscellaneous	3	1%	7 cases/2%
Transfer Agent	2	0%	3 cases/1%
National Recognized Statistical Ratings Organization (NRSRO)	2	0%	0 cases/0%
SRO or Exchange	1	0%	0 cases/0%
TOTAL	490	100%	446 cases/100%

The protection of retail or "Main Street" investors is plainly at the forefront of the Division's priorities, as can be seen from its continued focus on offering frauds and cases against Investment Advisers. Of course, some number of the "securities offering" category, listed above, will include the many cyber-related offerings on which the Division acted this year – all things "cyber" being the other key focus for Fiscal Year 2018 and beyond.

Regulated entities, that is, Investment Advisers, Investment Companies, Broker-Dealers, Transfer Agents, NRSROs and SROs/Exchanges, make up about 36% of the SEC's docket, with that number rising to 52% when you add in the Issuer Reporting and Audit/Accounting matters, which are also matters that may come to the Staff through routine regulatory review and analysis.

Finally, insider trading continues to be an important part of the Division's program. As the Division noted in its Annual Report, the Commission brought charges against 56 individuals in connection with insider trading–related claims.[5] In many of these cases, the Division's Market Abuse Unit's Analysis and Detection Center, which uses data analysis tools to detect suspicious trading patterns across different securities, is responsible for figuring out the complex trading schemes.

CIVIL PENALTIES AND DISGORGEMENT ORDERS

In Fiscal Year 2018, the SEC obtained orders requiring the payment of $1.439 billion in civil penalties and $2.506 of disgorgement. *Id.* at 11. While this represents an increase in penalties ordered, disgorgement dropped about 15% from 2017, which must be a disappointing statistic in light of the Commission's constantly articulated focus on getting monetary recoveries back to retail investors.

By way of further context for the financial sanctions, the Division noted in its Annual Report that the *Petrobras* matter accounted for a significant portion of the monetary relief ordered this fiscal year; in that matter, the Commission ordered disgorgement and prejudgment interest of more than $933 million and a civil penalty of more than $853 million.[6] In total, the *Petrobras* matter alone accounts for more than 45% of the total disgorgement and penalties ordered. For comparison, in 2017 five disgorgement orders totaling more than $100 million accounted for 44% of the disgorgement ordered and four of those cases were FCPA actions, with the remaining order having been entered in an offering fraud case. However, it is worth noting that in each of the last four years, the top 5% of the largest cases for the year have accounted for between 67% and 77% of all of total monetary sanctions ordered for the entire fiscal year.[7]

Fiscal Year	Penalties and Disgorgement
2009	$2.435 billion
2010	$2.85 billion
2011	$2.806 billion
2012	$3.0 billion
2013	$3.4 billion
2014	$4.16 billion
2015	$4.19 billion
2016	$4.082 billion
2017	$3.789 billion
2018	$3.945 billion

5 *See* ENF Annual Report at 16.

6 *See* SEC Press Release, Sept. 27, 2018, "Petrobras Reaches Settlement With SEC for Misleading Investors," https://www.sec.gov/news/press-release/2018-215.

7 *See* ENF Annual Report at 11.

For the first time, in its Annual Report for 2018, the Division culled out how much of the sanctions imposed and collected actually were returned to investors during the most recent four years, which presents an interesting comparison to the table above:[8]

Fiscal Year	Distributed to Harmed Investors	Penalties and Disgorgement for the relevant years	Percentage of Monetary Sanctions Distributed
2015	$158 million	$4.19 billion	3.77%
2016	$140 million	$4.082 billion	3.43%
2017	$1.073 billion	$3.789 billion	28.32%
2018	$794 million	$3.945 billion	20.13%

ADDITIONAL STATISTICS

Some additional statistics that may be of interest that were included in the Commission's annual financial report included the fact that the SEC's total staff numbers about 4,483 full-time employees across the country, in 5 divisions and 25 offices.[9] According to the SEC's Annual Report, more than half of the Commission's personnel are dedicated to the Commission's Enforcement and Examination programs. *Id.* at 16.

The Division's Annual Report noted that the Commission, as a whole, "oversees approximately $90 trillion in annual securities trading, the disclosures of approximately 4,300 exchange-listed public companies valued at approximately $34 trillion, and the activities of over 27,000 registered entities and self-regulatory organizations."[10]

Selected Examination Statistics

In Fiscal Year 2018, the Commission conducted more than 3,150 examinations.[11] The Office of Compliance Inspections and Examinations (OCIE) examined 17% of registered investment advisers and 15% of registered investment companies – each of which represents an increase over 2017 – and, together with SROs, 48% of broker-dealers were examined. *Id.* at 36. These statistics include all types of exams and, according to the SEC, OCIE continues to use risk assessment tools to identify how best to focus its resources on the firms and issues presenting the highest risk profiles. *Id.*

By way of background, OCIE has about 1,000 staff located among its regional offices and its headquarters in Washington, DC.[12] OCIE oversees "more than 13,200 investment advisers,

8 *Id.*

9 *See* US Securities and Exchange Commission, *"Agency Financial Report, Fiscal Year 2018"* (2018 SEC Agency Financial Report) at 8 (Nov. 15, 2018), https://www.sec.gov/reports-and-publications/annual-reports/sec-2018-agency-financial-report.

10 ENF Annual Report at 6.

11 2018 SEC Agency Financial Report at 17.

12 *See* Commission's Office of Compliance Inspections and Examinations, "2019 Examination Priorities" (OCIE Priorities), at 1, https://www.sec.gov/files/OCIE%202019%20Priorities.pdf.

approximately 10,000 mutual funds and exchange traded funds, roughly 3,800 broker-dealers, about 330 transfer agents, 7 active clearing agencies, 21 national securities exchanges, nearly 600 municipal advisors, the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), the Securities Investor Protection Corporation, and the Public Company Accounting Oversight Board." *Id.*

Just as the Enforcement Division has its five guiding principles, OCIE evaluates its work against "four pillars: promoting compliance, preventing fraud, identifying and monitoring risk, and informing policy." *Id.* at 2. And, of course, OCIE can look across its work and programs to find how it stacks up against those pillars.

OCIE identified a number of efforts in 2018 as "promoting compliance," including a variety of outreach programs, communications with the industry and the public, its publication of five separate "Risk Alerts," and the examination program itself. *Id.* at 2-3. OCIE exams resulted in 160 referrals to Enforcement in Fiscal Year 2018, which, taken together with its retail-targeted exams, and the focus in all exams on issues intended to prevent harm to senior investors and those saving for retirement, generally reflect OCIE's efforts at "preventing fraud." *Id.* at 3. "Focused reviews" (which the rest of us might call "sweeps"), which relate to issues that OCIE believes impact risk profiles; examinations of Regulation Systems Compliance Integrity (SCI) entities, such as exchanges, clearing agencies, alternative trading systems, and the like; and the evaluation of emerging risks through the exam process more generally, are all how OCIE describes itself as "identifying and monitoring risk" more broadly. *Id.* at 3-4. Finally, through the exam process, the Commission learns how the industry complies with Commission mandates and manages new challenges, which information OCIE shares with the rest of the SEC to "inform policy" moving forward. *Id.* at 4. We can expect that in the coming year OCIE will continue to evaluate its work internally through the prism of these pillars, and expressing its effectiveness outwardly using this language.

<u>Additional Enforcement Statistics</u>

The Enforcement Division obtained 26 court-ordered asset freezes during the fiscal year, which is down from 35 in FY 2017.[13] In 2018, the Division took five cases to trial in federal district court, one more than in the prior year. *Id.* at 14. The Commission was successful in three trials, got an unfavorable result in one trial, and at the end of the fiscal year was awaiting one verdict following a bench trial. *Id.*

As will be further discussed below, the Commission's administrative proceeding forum was fraught, as a result of the decision by the US Supreme Court in *Lucia v. SEC*, holding that the appointment of the Commission's ALJs violated the Appointments Clause of the US Constitution. *See infra*. As a result, unless the Division had no choice because of the availability of remedies, disputed cases were not filed in the administrative forum, and approximately 200 cases were reassigned for new trials, resulting in both a backlog in this forum and significant drain on trial resources.[14]

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13 *See* ENF Annual Report at 13.

14 *See* "Morgan Lewis Presents 2018: A Conversation with Stephanie Avakian and Steven Peikin," http://www.sechistorical.org/museum/programs/2018; *see also* ENF Annual Report at 14.

Perhaps of more interest to those in the sights of the Division are the statistics related to open and closed investigations. Following is a table comparing data for the last five fiscal years. The Division Staff continues to have a healthy number of open investigations to begin the fiscal year.

Fiscal Year	Investigations Opened	Investigations Closed	Ongoing Investigations At Close of Fiscal Year
2013	908	1,187	1,444
2014	995	822	1,612
2015	980	821	1,677
2016	1,063	776	1,729
2017[15]	965	989	1,695
2018[16]	869	*	1,604

OFFICE OF THE WHISTLEBLOWER[17]

The SEC's Whistleblower program was established pursuant to the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which became effective in July 2010. The program directs the Commission to make whistleblower awards to those eligible individuals who provide information that leads to a successful SEC enforcement action that results in monetary sanctions above $1 million. *Id.* at 4. The recovery amount can range from 10% to 30% of the sanctions collected, at the discretion of the Commission. The Office of the Whistleblower has been reporting to Congress, as required under the law, since December 2010.

The Office of the Whistleblower in its required Annual Report advises that, since its inception, enforcement cases brought based on whistleblower information have resulted in monetary sanctions orders totaling $1.7 billion, including more than $901 million in disgorgement and prejudgment interest, of which almost half, or $452 million, has been or will be returned to harmed investors. *Id.* at 1. Based on those enforcement cases, the Commission has ordered that more than $326 million be paid to 59 individuals through the whistleblower program. *Id.*

In Fiscal Year 2018, $168 million was awarded through the program to 13 individuals, including two of the largest awards ever of $83 million, which was shared by three individuals, and almost $54 million, which was divided by two individuals. *Id.* Of particular interest this year, in addition to the largest ever awards, is an award of $4.1 million to a foreign national working outside of the United States who was also a corporate insider; a $4 million award to an overseas whistleblower; a $2.2 million award to a whistleblower who had initially reported to another

15 *See* Select SEC and Market Data, Fiscal 2017, Enforcement Information Only (Addendum to Division of Enforcement 2017 Annual Report) published June 19, 2018, https://www.sec.gov/files/enforcement-annual-report-2017-addendum-061918.pdf.

16 *See* Securities and Exchange Commission Fiscal Year 2020 Congressional Budget Justification, Annual Performance Plan and Fiscal Year 2018 Annual Performance Report ("2020 Budget Justification"), published March 18, 2019, at 25, https://www.sec.gov/cj. No information was provided this year on closed investigations.

17 *See* "2018 Annual Report to Congress Whistleblower Program" (Nov. 14, 2018), https://www.sec.gov/files/sec-2018-annual-report-whistleblower-program.pdf.

federal agency before coming to the SEC with his/her information;[18] and a $2.1 million award to a former corporate insider whose information resulted in multiple enforcement actions. *Id.* at 10-11.

The Commission has also, this last year, proposed some significant amendments to the Whistleblower Rules, which amendments were published for public comment on July 20, 2018. *Id.* at 26. According to the Office of the Whistleblower and the Commission, the revisions to the Whistleblower Rules are intended to increase efficiency in the claims review process by permitting the Commission to bar individuals from submitting whistleblower applications if they have been found to have previously submitted false information or frivolous claims, as well as incorporating a summary disposition procedure for likely denials, such as where the information was never actually provided to or used by the staff. *Id.* The proposed amendments also afford some flexibility to the Commission in making awards, such as allowing for awards even where nonprosecution or deferred-prosecution agreements are entered in a matter or where sanctions would result in awards that are either very small or very large, and also considerations to avoid double recovery potentials. *Id.* at 27. The expectation is that some of the more outsized, "largest ever" award circumstances would occur less often, if the Commission had additional flexibility in making these awards. Finally, the proposed amendments would alter the definition of "whistleblower" to comport with the decision in *Digital Realty Trust, Inc. v. Somers*,[19] establishing a uniform definition under the Whistleblower Rules. *Id.; see also infra.*

Whistleblower Statistics

In Fiscal Year 2018, the SEC's Office of the Whistleblower received 5,282 whistleblower tips, an increase of 798, or 17.8%. The Office of the Whistleblower attributes this enormous jump, at least in part, to the US Supreme Court decision in *Digital Realty,* which, as more fully discussed below, held that to qualify for the employment retaliation protections included in Section 21F(h) of the Dodd-Frank Act, a putative whistleblower must report possible securities law violations to the Commission.[20] *See id.* at 2.

Fiscal Year	Total Number of Tips	Percentage Increase of Tips	Total Investigations Arising from Tips[21]	Percentage of Investigations Arising from Tips
2012	3,001	*	296	9.8%
2013	3,238	7.9%	289	9.2%
2014	3,620	11.8%	291	8.0%
2015	3,923	8.4%	325	8.3%
2016	4,218	7.5%	336	8.0%
2017	4,484	6.3%	307	6.8%
2018	5,282	17.8%	315	6.0%

18 *See* Exchange Act Rule 21F-4(b)(7), providing a 120-day "safe harbor" for whistleblowers to bring the same information to the SEC as has been reported to another federal agency and have it be treated as though it were reported contemporaneously.

19 138 S. Ct. 767 (2018).

20 *See, generally,* 138 S. Ct. 767 (2018).

21 *See* 2020 Budget Justification at 121.

This last fiscal year, the Office of the Whistleblower received tips from every state and the District of Columbia, with the largest number coming from California, New York, Florida, Texas, and New Jersey. *Id.* at 22 and Appendix B. The Commission also received tips from around the world, with most of the non-US tips coming from Canada, the United Kingdom, and Australia. *Id.* at 23 and Appendix C.

As in prior years, "Other" is always the largest substantive area for tips, this past year accounting for more than 25% of the total tips; the Corporate Disclosures and Financials, Offering Fraud, and Manipulation categories are generally the top three types of allegations asserted. A tally of whistleblower tips by substantive allegation area over the last four years, based on the categories offered by the Office of the Whistleblower, follows. *Id.* at Appendix A.

Allegation Type	Number of Allegations 2018	Number of Allegations 2017	Number of Allegations 2016	Number of Allegations 2015
Other	1,210	1,162	996	956
Offering Fraud	1,054	758	646	613
Corporate Disclosure and Financials	983	954	938	687
Manipulation	624	468	472	482
Trading and Pricing	333	271	257	213
Insider Trading	262	231	262	273
Unregistered Offerings	252	144	143	150
FCPA	202	210	238	186
Market Event	157	125	102	192
Not Reported	109	94	97	114
Municipal Securities and Public Pension	57	58	57	67

US SUPREME COURT DECISION NARROWING WHISTLEBLOWER PROTECTIONS

On February 21, 2018, the United States Supreme Court decided *Digital Realty Trust, Inc. v. Somers*, which resolved a split among the Circuit Courts of Appeals, and decided that putative whistleblowers must bring their concerns regarding violations of the securities laws to the SEC in order to benefit from the retaliation protections incorporated into the Dodd-Frank Act .[22]

The Court concluded that the statutory language of Dodd-Frank was plain and that "whistleblower" was expressly defined under that law as one who provides information to the SEC. 138 S. Ct. at 778. As a result, the protections from retaliation set forth in the statute are only available to one who reports concerns regarding potential violations of the securities laws to the Commission. *Id.* at 777. Further, the Court pointed out that, where Congress intended no such requirement, as in other parts of Dodd-Frank, it did not include this requirement of government reporting; for example, in similar such provisions related to the Consumer Financial Protection Bureau. *Id.* Finally, the Supreme Court's opinion notes that part of the purpose in incorporating the whistleblower provisions of Dodd-Frank at issue in the case was, in fact, to motivate people to share information with the Commission, so the SEC could investigate violative

[22] 138 S. Ct. 767 (2018).

conduct. *Id.* at 777-78. Thus, the regulatory regime was specific and intentionally drafted.[23]

As the Office of Whistleblower already has seen, the Supreme Court's decision has resulted in more reports to the SEC in circumstances where employees may otherwise have chosen to report their concerns internally. However, the 2002 Sarbanes-Oxley Act will continue to protect some whistleblowers who choose to only make internal reports. This complicated issue will no doubt continue to fuel many discussions going forward.

KEY SEC ENFORCEMENT DEVELOPMENTS

The Enforcement Division's key developments through Fiscal Year 2018 and through the end of the calendar year could well be described as "once more, with feeling" – not that they weren't trying hard enough last year, but then the Commission as a whole suffered under the weight of significant transition and uncertainty. This last year, with its plan firmly in place and more predictability overall, the Division executed, thoughtfully laying the groundwork for the coming year and for years to come.

Protecting Retail Investors

The Division of Enforcement, and in fact the Commission as a whole, continues to focus its work and measure its progress against five principles, the first being the protection of "Main Street" or retail investors.[24] According to the Division, more than half of the "standalone" cases brought in Fiscal Year 2018 concerned wrongdoing involving retail investors.[25] Throughout the year, we repeatedly saw the Staff and the Commission identify actions and initiatives in terms of how "Main Street" investors would be better protected or were benefited.

The Division's continued focus on retail investors can be seen in its statistics, which again this past year has skewed toward matters that impact "Main Street": offering frauds, Investment Adviser and Investment Company cases, and market manipulations constitute a full 53% of the standalone enforcement cases. *See supra.* When you add the broker-dealer cases, many of which can be said to have retail impact, that percentage rises to 66%. *Id.* Needless to say, many, or even most, of the cases brought can be said to have retail impact – and the Division and the Commission spent much of this last fiscal year saying just that.

More specifically, the Division has promoted three initiatives as all having Main Street investor impact, two of which, the Retail Strategy Task Force and Cyber Unit, were announced during the last fiscal year, and one, the Share Class Selection Disclosure Initiative (SCSDI), represents a continuation, and perhaps something of a culmination, of a series of enforcement actions over a period of years.[26]

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[23] For more analysis of some of the considerations and issues, please see our contemporaneous Morgan Lewis LawFlash on the decision, *"Supreme Court Holds Dodd-Frank Whistleblower Protection Only Covers Individuals Who 'Tell the SEC,'"* Feb. 23, 2018, https://www.morganlewis.com/pubs/supreme-court-holds-dodd-frank-whistleblower-protection-only-covers-individuals-who-tell-the-sec.

[24] *See, e.g.,* 2018 SEC Agency Financial Report at 2; *see* ENF Annual Report at 2.

[25] *See* ENF Annual Report at 6.

[26] *See generally* 2018 SEC Agency Financial Report at 18-19; *see* ENF Annual Report at 2.

According to Co-Director of Enforcement Stephanie Avakian, while protecting retail investors is everyone's job at the Division of Enforcement, and almost every case can be said to have some retail investor impact, the role of the Retail Strategy Task Force is to generate ideas.[27] The Retail Strategy Task Force is intended to look and think more broadly, for example, at how one office is handling an issue or addressing a problem and consider whether that solution could be implemented successfully across the Division; or how the Division can identify problems in particular locations or affecting specific groups of retail investors using the mass of data collected throughout the Commission. *Id.* During Fiscal Year 2018, the Retail Strategy Task Force undertook a number of lead-generation initiatives based on data analytics, collaborating with data analytics groups throughout the SEC, including in DERA and OCIE, involving issues such as fees and expenses/conflicts of interest in managed accounts, frauds related to unregistered offerings, and market manipulations.[28] In addition, working with Cyber Unit and Microcap Task Force, as well as the Division of Corporation Finance's Digital Asset Working Group, the Retail Strategy Task Force has worked to generate leads and referrals concerning potential trading suspensions for companies that purport to be in the cryptocurrency or blockchain technology business. *Id.* at 7.

The SCSDI arose out of a series of cases against investment advisers for their alleged failure to adequately disclose conflicts of interests presented by their receipt of mutual fund compensation, mostly in the form of 12b-1 fees, when they selected for their clients a higher expense cost mutual fund, when a lower-cost share class of the same fund was available.[29] According to the Division, at the time of the SCSDI announcement the Staff had brought some 15 cases involving share class disclosures over the prior five years and there were almost a dozen cases then-pending.[30] The Staff's view was that these matters could be resolved more efficiently through SCSDI, getting money more quickly into the hands of investors than the average two-year investigation time. *Id.* Of interest to those practicing in the area, the Senior Staff's view, which has pervaded the conduct of the SCSDI, is that these cases have "an identical fact pattern,"[31] a claim with which most investment advisers and practitioners in the area might take issue. In any case, according to the Division Staff, the SCSDI has been described as wildly successful, in terms of participation, and the Division advises that it is attempting to conclude the SCSDI on consistent terms, using the fewest possible staffers. *Id.*

Morgan Lewis lawyers have already begun to see the next phase of this process. Firms that choose to not participate in the SCSDI have been contacted and investigations opened, seeking data and information about mutual fund compensation received, including 12b-1 fees, but also other forms of mutual fund revenue sharing or shared fees. We anticipate that these matters will continue to keep the Division Staff busy through, at least, the current fiscal year.

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[27] *See* "Morgan Lewis Presents 2018: A Conversation with Stephanie Avakian and Steven Peikin," http://www.sechistorical.org/museum/programs/2018.

[28] ENF Annual Report at 6.

[29] *See generally* "Share Class Selection Disclosure Initiative" Announcement (Feb. 12, 2018), https://www.sec.gov/enforce/announcement/scsd-initiative.

[30] ENF Annual Report at p. 8.

[31] *See* "Morgan Lewis Presents 2018: A Conversation with Stephanie Avakian and Steven Peikin," http://www.sechistorical.org/museum/programs/2018.

All Things Cyber and Crypto

Another of the "five principles" is to "Keep Pace with Technological Change"[32] and the Division has focused much of those efforts within its Cyber Unit, which was added in 2017, as its first specialized unit since the Division reorganized in 2010 and the specialized units were created.[33] According to the Co-Director of Enforcement, the Cyber Unit is up 30 people, resident in five offices, the Washington, DC home office, New York, Philadelphia, Chicago, and San Francisco, but with every office having a liaison.[34]

The Cyber Unit has been looking at two types of cases, broadly: "garden variety" frauds that have crypto or cyber window dressing and more technical or regulatory issues that may or may not actually rise to the level of a violation, but which the Division believes requires investigation. *Id.* The goal, according to the Senior Staff, is to strike the appropriate balance, between protecting investors from fraud and not stifling real innovation. *Id.* Of course, the Cyber Unit will also participate in cyber breach cases and, according to Co-Director Peikin, unless there are real failures that rise to the level of a violation, as the Division believed it found in connection with the *Voya* and *Yahoo!* matters this last year, the inclination is not to make a victim into a respondent. *Id.* [35]

The Cyber Unit brought 20 standalone cyber-related cases in Fiscal Year 2018, including cases involving Initial Coin Offerings (ICOs) and digital assets, and at the end of the year the Division had 225 cyber-related investigations open.[36] The Staff has tried to keep pace with the exponential increase of crypto-asset offerings, including ICOs and other digital assets. *Id.* The types of issues presented for the Division included not only the potential for outright fraud, dressed up in the latest technological buzzwords, but also the risk profile of these investments, and whether that risk was being appropriately conveyed to investors through, for example, celebrity endorsements. *Id.* at 7-8. With new technology, the Division Staff decided that new tools might be more appropriate than the standard enforcement action and so, in connection with these issues, the Division turned to trading suspensions and to investor education statements, where appropriate, in an effort to address the issues presented more meaningfully. *Id.*

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[32] ENF Annual Report at 3.

[33] *See generally "SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors,"* SEC Press Release 2017-176 (Sept. 25, 2017), https://www.sec.gov/news/press-release/2017-176.

[34] *See* "Morgan Lewis Presents 2018: A Conversation with Stephanie Avakian and Steven Peikin," http://www.sechistorical.org/museum/programs/2018.

[35] *See also* "SEC Charges Firm With Deficient Cybersecurity Procedures," SEC Press Release 2018-213 (Sept. 26, 2018) (charging Voya Financial Advisers with alleged violations of the Safeguards Rule and the Identity Theft Red Flags Rule), https://www.sec.gov/news/press-release/2018-213; *see also* "Altaba, Formerly Known as Yahoo!, Charged With Failing to Disclose Massive Cybersecurity Breach; Agrees To Pay $35 Million," SEC Press Release 2018-71 (Apr. 24, 2018) (charging the company with allegedly failing to disclose to investors one of the world's largest data breaches), https://www.sec.gov/news/press-release/2018-71.

[36] ENF Annual Report at 7.

LITIGATION MATTERS AFFECTING THE ENFORCEMENT DIVISION

Lingering Impacts of the *Kokesh* Decision and the Five-Year Statute of Limitations

Last year we reported on the unanimous decision by the United States Supreme Court in *Kokesh v. Securities and Exchange Commission*, in which the Court held that the five-year statute of limitations under 28 U.S.C. § 2462 applies to disgorgement orders sought by the SEC.[37] The most immediate result and continuing impact of the *Kokesh* decision has been the Division staff's earlier and more aggressive requests for tolling agreements, sometimes even at the very beginning of investigations. Further, since *Kokesh*, other courts have refused to grant injunctions and related relief based on conduct outside of the five-year limitations period.[38] As a result, the Division Staff is feeling more than just the usual public pressure to timely bring cases. In the past, we have heard about the push for "real time enforcement," but, according to Co-Director of Enforcement Peikin, working faster has taken on a new meaning, because of the statute of limitations imposed through the *Kokesh* matter.[39]

Moreover, in what is plainly an effort to gather evidence for potential congressional action and a legislative fix to the *Kokesh* ruling, the Commission and the Enforcement Division have been publicly reporting significant amounts of disgorgement that the Division has had to "forego" because of the *Kokesh* ruling, in both settled and litigated actions, further noting that much of the purported hundreds of millions of dollars not sought represents money that would have been or could have been returned to harmed investors.[40] Needless to say, with the passage of time this reporting will only continue and the total will continue to rise.

Successful Challenge to the Commission's Administrative Forum

On June 21, 2018, the Supreme Court decided the *Lucia* case, determining that the SEC's ALJs were hired in violation of the Appointments Clause of the Constitution.[41] Specifically, the *Lucia* majority concluded that Supreme Court precedent in *Freytag v. Commissioner*[42] controlled its decision in the case. The *Lucia* majority noted that *Freytag* had concluded that special trial judges of the US Tax Court exercised significant authority because they take testimony, conduct trials, enforce discovery orders, and make proposed findings for adoption by a Tax Court Judge.[43] The *Lucia* opinion held if the Tax Court special trial judges were constitutional officers, then the ALJs at the SEC certainly are as well.[44] As a result, the Court held that Lucia had a right to a hearing

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37 *See Kokesh v. Sec. & Exch. Comm'n*, 137 S. Ct. 1635 (2017).

38 *See, e.g., SEC v. Jones*, Civil Action No. 17-11226 (D. Mass. Jan. 5, 2018); *see also SEC v. Gentile*, Civil Action No. 16-1619 (D.N.J. Nov. 9, 2017).

39 *See* "Morgan Lewis Presents 2018: A Conversation with Stephanie Avakian and Steven Peikin," http://www.sechistorical.org/museum/programs/2018.

40 *See* 2018 SEC Agency Financial Report at 112 (reporting in excess of $800 that the Division has had to forego in disgorgement); *see also* ENF Annual Report at 5 (reporting that figure at in excess of $900 million).

41 *Lucia v. SEC*, 138 S. Ct. 2044 (2018).

42 501 US 868 (1991).

43 *Lucia*, 138 S. Ct. at 2052.

44 *Id.* at 2053.

before a constitutionally appointed ALJ, who was selected in a process involving the Commissioners, rather than by the Chief ALJ with the assistance of the Office of Personnel Management.[45] The opinion also emphasized that Lucia was entitled to a rehearing because he had timely challenged the constitutionality of the ALJ's appointment at every stage of the proceedings.[46]

The expectation is that the impact of the *Lucia* opinion will be widespread across the federal government. At oral argument, Lucia's counsel asserted that there are at least 150 ALJs in at least 25 different agencies. In terms of process at the SEC, during the pendency of the *Lucia* matter, the Commission "ratified" the appointment of its ALJs in the event of a decision that their appointment was held to be unconstitutional.[47] For all disputed matters, those matters now must be reheard before a constitutionally appointed ALJ, so as to afford the respondent appropriate process under *Lucia*.[48]

Immediately following the June 21, 2018 decision, the Commission issued an Order staying all pending disputed administrating proceedings for 30 days, which Order was extended for an additional 30 days on July 20, 2018.[49] On August 22, 2018, the Commission issued an Order reiterating that it had ratified the appointments of the ALJs and reiterating that each is appointed by the Commission; allowed the previously entered stay to expire; and ordered new proceedings, vacating any prior orders for 126 Administrative Proceedings.[50] This barrage of rehearings means that the Division Trial Unit staff resources are presently spread pretty thin and, for the near term, we can expect that the Division will only bring new litigated Administrative Proceedings, as needed, in those circumstances where remedies are available only in that forum.[51]

Up Next: Further Defining Liability for Fraudulent or Misleading Statements

The next US Supreme Court decision on the horizon for the Division is in the case of *Lorenzo v. SEC*, which was argued before the Court in November 2018, with its newest member recused, having previously served on the DC Circuit Court of Appeals panel, which ruled in favor of the Commission, but in so doing somewhat narrowed the scope of actionable fraud under Section 10(b) of the Exchange Act.[52] The DC Circuit decision, from which then-Judge Kavanaugh

45 *Id.* at 2051 (background on how SEC hired ALJs), 2055 (holding).

46 *Id.* at 2055.

47 *See "SEC Ratifies Appointment of Administrative Law Judges,"* SEC Press Release 2017-215 (Nov. 30, 2017), https://www.sec.gov/news/press-release/2017-215.

48 *Lucia*, 138 S. Ct. at 2055.

49 *See In re Pending Administrative Proceedings*, Sec. Act Rel. No. 10510 (June 21, 2018), https://www.sec.gov/litigation/opinions/2018/33-10510.pdf; *see also In re Pending Administrative Proceedings*, Sec. Act Rel. No. 10522 (July 20, 2018), https://www.sec.gov/litigation/opinions/2018/33-10522.pdf.

50 *See In re Pending Administrative Proceedings*, Sec. Act Rel. No. 10536 (Aug. 22, 2018), https://www.sec.gov/litigation/opinions/2018/33-10536.pdf.

51 *See* "Morgan Lewis Presents 2018: A Conversation with Stephanie Avakian and Steven Peikin," http://www.sechistorical.org/museum/programs/2018.

52 *See* US Supreme Court public docket, showing Oct. 19, 2018 entry of recusal, https://www.supremecourt.gov/search.aspx?filename=/docket/docketfiles/html/public/17-1077.html; *see also Lorenzo v. SEC*, 872 F.3d 578 (D.C. Cir. 2017).

dissented,[53] found Lorenzo liable for forwarding to investors, via email, misstatements he had received from his boss about an energy investment offering, which he knew to be untrue.[54] Although the Court of Appeals found that Lorenzo was not the "maker" of the statements under the 2011 *Janus*[55] case, and thus could not be liable under Rule 10(b)-5(b), the balance of the Commission's case, holding Lorenzo liable, was upheld, since the Court of Appeals majority found that he acted with scienter when he vouched for the contents of the email and he sent the message under his own signature.[56] Lorenzo appealed to the US Supreme Court, which still has among its members all four of the Justices who dissented in *Janus*, each of whom is likely to vote against Lorenzo. *See supra*.

The decision here could be of key importance because there appears to be no question that Lorenzo knew that he was circulating false information to investors but, because he was forwarding an email that someone else had drafted, his claim is that, under *Janus*, he should not be liable at all, since he is not the "maker" of the statements.[57] Plainly, the scope of the anti-fraud provisions could be altered when this case is decided this spring.

ADDITIONAL AREAS OF FOCUS FOR THE ENFORCEMENT DIVISION

Investment Adviser and Investment Company Investigations

The case statistics, as classified by the Enforcement Division Staff, show 22% of the standalone cases were against investment advisers and investment companies, an increase from 18% of the total in FY 2017, indicating that these registrants continue to be a target of the Division's interest. *See supra.* Because of the overwhelming numbers of registered investment advisers and investment companies, the Commission has, for the most part, ceded periodic broker-dealer examinations to FINRA, focusing on data-identified, risk-based, or other issue-oriented broker-dealer exams.[58] As a result, only about 10% of the exams conducted by OCIE this last fiscal year were of broker-dealers, the balance of the oversight rested in the Commission review of FINRA exams. *Id.* Given that circumstance, presumably, the pipeline of referred matters from OCIE exams is made up largely of issues identified at registered investment advisers and investment companies.

Moreover, since the amount of assets managed by registered investment advisers has increased during the last year to about $84 trillion, *id.,* for the Division to look closely at investment advisers and investment companies, when it has also made retail investors its primary focus, just makes sense, as the SCSDI demonstrates. The types of issues we have seen have not changed significantly from last year and the Division Staff continues to look closely at conflicts of interest,

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[53] In dissent, Judge Kavanaugh would not hold Lorenzo liable at all. *See* 872 F.3d at 596 *et seq.*

[54] *See id.* at 590-92.

[55] *Janus Capital Group v. First Derivative Traders*, 564 U.S. 135 (2011).

[56] *See Lorenzo,* 872 F.3d at 590-92.

[57] *See id.* at 590-91.

[58] *See* OCIE Priorities at 1 ("over 300" broker-dealer examinations out of a total of "over 3,150" examinations") *and see supra*.

disclosures of conflicts, and fees and costs to investors, investment opportunity allocation, and undisclosed compensation or benefits. *See infra.*

Market Structure and "Wall Street" Cases

As Co-Director of Enforcement Steve Peikin has noted, a lot of the cases brought against Wall Street firms are seen as having a significant impact on the retail investor at the end of the transaction.[59] Further, Peikin noted, the Division Staff has the expertise in its specialized units, for example, the Complex Financial Instruments Unit, and the interest to consider a variety of different important issues, so the Division need not make a binary choice between "Main Street" cases and "Wall Street" cases. *Id.*

This last fiscal year, among the Wall Street cases, there were a number of important and sizeable cases related to complex products and trading, such as those related to American Depositary Receipts (ADRs), as well as several significant cases related to alleged misrepresentations in connection with order handling and routing practices. *See infra.*

Among those matters related to more purely market structure and operations, the Commission settled an enforcement action against the New York Stock Exchange, NYSE American, and NYSE Arca, which included the first-ever charges for violations of Regulation Systems Compliance Integrity (SCI). *Id.* The Division also brought a series of cases related to alleged Electronic Blue Sheet (EBS) reporting deficiencies. *Id.*

Financial Reporting and Auditor Misconduct

This was another significant year for financial reporting and auditor misconduct cases. The Commission continues to look to gatekeepers, including corporate officers and outside auditors, to ensure that information provided to the investing public is accurate. During the course of Fiscal Year 2018, some 54 entities and 94 individuals were charged in connection with issuer financial disclosures and auditor misconduct matters.[60] And this last year, some of those individuals settling SEC charges were officers or former officers of corporate bold-faced names, like Tesla, Inc., Theranos, Inc., Petrobras, Rio Tinto, Walgreens Boots Alliance, Inc., and SeaWorld Entertainment Inc. *Id.*

In addition to some outright fraudulent conduct, which took a variety of forms, these cases ran the gamut from revenue recognition and reporting problems, to valuation and impairment issues, to inadequate internal controls, to missing or incomplete disclosures. *Id.* The Enforcement Division has the benefit of referrals from the Division of Corporation Finance, which considers filings – and the restatements of financial reports – regularly and is attuned to emerging issues in particular industries, as well as the fact that many of these types of matters play out prominently in business media reports.

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59 *See* "Morgan Lewis Presents 2018: A Conversation with Stephanie Avakian and Steven Peikin," http://www.sechistorical.org/museum/programs/2018.

60 ENF Annual Report at 17.

Insider Trading and Other Fraudulent Trading on Material Nonpublic Information

After a period of hand-wringing about the potential impact of the *Newman*[61] and *Salman*[62] cases on insider trading investigations and prosecutions, we can comfortably say at this point that, as to the SEC anyway, the Division has not slowed its pace investigating and bringing cases for insider trading, as well as for the electronic stealing and other misuses of material nonpublic information, with a full 10% of the standalone cases this last fiscal year being classified as insider trading matters. *See supra.*

Among this year's higher profile matters included insider trading charges brought against a sitting US Congressman and his son;[63] charges for insider trading brought against a player in the National Football League and an investment banker whom he had met at a party;[64] and charges in a sprawling, insider trading ring that stretched from the United States to Singapore to India, and which was identified, again, by the Market Abuse Unit's Analysis and Detection Center, which uses data analytics to look for suspicious trading patterns for further investigation.[65]

The Commission also brought charges this last year in the hacking of . . . the Commission. Although in 2017 the SEC had announced that its EDGAR system had been hacked and the perpetrator(s) had accessed nonpublic information,[66] it was not until January 2019 that the Enforcement Division Staff brought a wide-ranging case against nine individuals and entities in three countries, as well as a number of relief defendants, in a scheme that allegedly generated more than $4.1 million in profits.[67] According to the Division, the hacker and several of the traders previously have been charged by the SEC in connection with similar conduct – hacking into newswire services for, and then trading on, nonpublic information. *Id.*

Often in these cases, trading and other data from FINRA's Office of Fraud Detection and Market Intelligence will be crucial, and the criminal authorities will participate in these matters, often bringing parallel charges.

LOOKING AHEAD

In a continuation of its focus on "retail" and "Main Street" investor protection, as well as the protection of assets saved by retail investors for retirement, the coming year likely will bring action on Regulation Best Interest. In April 2018, the Commission proposed for public comment

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[61] *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

[62] *United States v. Salman*, 137 S. Ct. 420 (2016).

[63] *See "SEC Charges U.S. Congressman and Others With Insider Trading,"* SEC Press Release 2018-151 (Aug. 8, 2018), https://www.sec.gov/news/press-release/2018-151.

[64] *See "SEC Charges NFL Player and Former Investment Banker With Insider Trading,"* SEC Press Release 2018-170 (Aug. 29, 2018), https://www.sec.gov/news/press-release/2018-170.

[65] *See "SEC Halts Alleged Insider Trading Ring Spanning Three Countries,"* SEC Press Release 2018-273 (Dec. 6, 2018), https://www.sec.gov/news/press-release/2018-273.

[66] *See generally "Statement on EDGAR Hacking Enforcement Action,"* Statement of Chairman Jay Clayton (Jan. 15, 2019), https://www.sec.gov/news/public-statement/statement-clayton-011519#_ftn1.

[67] *See "SEC Brings Charges in Edgar Hacking Case,"* SEC Press Release 2019-1 (Jan. 15, 2019), https://www.sec.gov/news/press-release/2019-1.

a rulemaking package designed to serve Main Street investors that would, among other things, (i) require broker-dealers to act in the best interest of retail customers, (ii) reaffirm and in some cases clarify the fiduciary duty owed by investment advisers to their clients, and (iii) require broker-dealers and investment advisers to clarify for all retail investors the type of financial professional they are, and disclose key facts about their relationship.[68]

Of course, we can also expect the Enforcement Division to continue to find the retail customer protection or benefit aspect to most of its cases. And there is no reason to expect that the focus on investment advisers and investment companies will be any less in the coming year. The SCSDI cases will finally be announced, and we also likely will learn more about how the Division staff intends to manage those matters and entities that choose to not self-report.

We can anticipate more of all things cyber and crypto, given the number of open investigations in this space that has been previously noted. However, we can also expect pressure to build for the Commission to regulate by rulemaking, rather than Enforcement, in this space, with some of that pressure coming from inside the building, as they say.[69]

Finally, the financial markets have seen some significant volatility through the last year or so, which always affords some opportunity for untoward events, whether by exposing system or process weaknesses or by providing those who would commit fraud with some opening. Should those conditions continue, we may see some unexpected issues on the Enforcement Division's docket.

SEC ENFORCEMENT AND EXAMINATION PRIORITIES

Based on our review of currently available information, we believe that the following list reflects some of the SEC's top enforcement and examination priorities:[70]

Protecting Retail Investors

- Disclosure of Fees and Expenses Associated with Investing
  - Disclosures of fees and expenses
  - Costs and expenses associated with wrap fee programs

- Conflicts of Interest
  - Use of services and products provided by affiliates
  - Securities-backed lines of credit or nonpurpose loans
  - Borrowings from clients

- Senior Investors and Retirement Accounts and Products
  - Identification of financial exploitation of seniors

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68 *See* 2018 SEC Agency Financial Report at 16.

69 *See "Regulation: A View from Inside the Machine,"* Speech by Commissioner Hester M. Peirce (Feb. 8, 2019), https://www.sec.gov/news/speech/peirce-regulation-view-inside-machine.

70 *See id.* at pp. 23-26, 28-31; *see also* OCIE Priorities at pp. 6-12.

    - Supervision and controls related to products and services directed to senior investors

- Management of Investment Portfolios and Trading
    - Fair allocation of investment opportunities
    - Ensuring that investments are consistent with client objectives
    - Disclosure compliance
    - Suitability, in terms of client objectives and risk tolerance

- Never-Before or Not Recently Examined Investment Advisers
    - Risk-based

- Mutual Funds and Exchange Traded Funds (ETFs)
    - Prioritize exams of these funds
        - Assess industry practices and regulatory compliance with an eye on retail investors
    - Performance and risk, focusing on:
        - Index funds tracking custom indices
        - ETFs with little secondary market trading or smaller assets under management (AUM)
        - Funds with higher exposures to structured products
        - Aberrational underperformance relative to peers
        - Funds managed by advisers newer to the product area
        - Advisers that advise an investment company and private fund, with a similar strategy

- Municipal Advisors (MAs)
    - Prioritize exams of MAs that have never been examined, with a focus on:
        - Registration and professional requirements
        - Disclosures of conflicts of interest
        - Compliance with regulatory requirements

- Broker-Dealers Holding Customer Assets
    - Examinations will focus on Customer Protection Rule compliance

- Microcap Securities
    - Continued review of broker-dealers selling microcap stocks, focusing on:
        - Manipulative schemes utilizing these securities
        - Reg SHO compliance
        - Rule 15c2-11 compliance

Critical Market Infrastructure

- Clearing Agencies
    - Annual reviews of those firms identified as systemically important, as well as risk-based exams of other registered clearing firms, with a focus on:
        - Regulatory compliance
        - Remediation of prior deficiencies

- Regulation SCI Entities (exchanges, clearing agencies, certain ATS)
    - Policies, procedures, and controls
    - Governance, internal audit
    - Business continuity and risk-management programs

- Transfer Agents (TAs)
    - Transfers, recordkeeping, and protection of funds and securities
    - Internal account controls reporting
    - TAs that act as agent for issuers of private offerings, or microcap, crowdfunded, blockchain, or digital asset–backed securities

- National Securities Exchanges
    - Internal audit, surveillance, and funding for regulatory programs

FINRA

- Continued review of FINRA's operations and regulatory programs

- Quality of broker-dealer and municipal advisor examinations

MSRB

- Effectiveness of internal policies, procedures and controls

Crypto Products: Digital Assets/Distributed Ledger

- Monitor the offer and sale of digital assets for regulatory compliance

- Identify market participants offering, selling, trading, or managing digital assets and assess their activities, with a focus on:
    - Portfolio management
    - Trading of digital assets
    - Safety of client assets
    - Pricing of client portfolios
    - Compliance and controls

Cybersecurity

- Governance and ongoing risk assessment of cybersecurity programs

- Information security governance, policies, and procedures related to retail trading information

- Data protection, including access rights and controls

- Vendor management

- Incident response

Anti-Money Laundering (AML) Programs

- Continued review of regulated entity AML programs
    - Implementing all elements of the AML programs
    - Independent and robust evaluation of AML program testing

- Continued review of appropriate filing of Suspicious Activity Reports

SEC ENFORCEMENT ACTIONS[71]

Cases Relating to Broker-Dealer Firms and Their Employees/Affiliated Persons

American Depositary Receipts (ADRs)

***In re Deutsche Bank Trust Company Americas*, Securities Act Rel. No. 10523, 2018 SEC LEXIS 1775 (July 20, 2018); *In re Deutsche Bank Securities, Inc.*, Exch. Act Rel. No. 83677, 2018 SEC LEXIS 1777 (July 20, 2018)**

The Commission accepted an Offer of Settlement from Deutsche Bank Trust Company Americas (DBTC), a depository bank, and Deutsche Bank Securities, Inc. (DBSI), a registered broker-dealer, for improper handling of American Depositary Receipts (ADRs). The Commission alleged that despite its contractual obligation, DBTC obtained and lent pre-released ADRs to other broker-dealers without taking reasonable steps to determine whether the appropriate number of ordinary shares of the foreign company's stock evidenced by the ADRs were owned by and in the custody of either the broker or its customer on whose behalf the pre-released ADRs were obtained. According to the Commission Order, DBTC also, at times, facilitated short sales and enabled the settlement of trades with ADRs that were not backed by ordinary shares. The Commission found that this conduct violated Section 17(a)(3) of the Securities Act. As a result, DBTC was ordered to cease and desist from future violations and pay approximately $44.5 million in disgorgement, approximately $6.6 million in prejudgment interest, and a civil monetary penalty of approximately $22.2 million. The Commission credited DBTC's voluntary remedial measures in reaching this settlement.

In a separate settlement with DBSI, the Commission alleged that when borrowing ADRs from pre-release brokers, DBSI did not take reasonable steps to ensure that it could satisfy the pre-release brokers' obligations, including the obligation that the pre-release broker or its customer maintain ownership of the ordinary shares for the benefit of the ADR holder. According to the Commission Order, DBSI should have recognized the risk that it could have been receiving pre-released ADRs not backed by ordinary shares. The Commission also alleged that DBSI failed to establish and implement effective policies and procedures to detect and prevent the violations described herein. The Commission found that this conduct violated Section 17(a)(3) of the Securities Act and Section 15(b)(4)(E) of the Exchange Act. DBSI was censured and ordered to pay disgorgement of $995,506, prejudgment interest of $155,006, and a $497,753 civil monetary penalty. The Commission credited DBSI's cooperation with the Staff in reaching this resolution.

***In re SG Americas Securities, LLC, as successor entity to Newedge USA, LLC*, Exch. Act Rel. No. 84277, 2018 SEC LEXIS 2579 (Sept. 25, 2018)**

The Commission accepted an Offer of Settlement from SG Americas Securities, LLC (SGA), as successor-in-interest to Newedge USA, LLC (Newedge), for Newedge's improper handling of ADRs. The Commission alleged that despite its contractual obligation, Newedge obtained and

[71] The cases described herein are settlements in which the respondents neither admitted nor denied the allegations against them, unless the description explicitly states otherwise.

lent pre-released ADRs to other broker-dealers without taking reasonable steps to determine whether the appropriate number of ordinary shares of the foreign company's stock evidenced by the ADRs were owned by and in the custody of either the broker or its customer on whose behalf the pre-released ADRs were obtained. In addition, the Commission alleged that when borrowing ADRs from pre-release brokers, Newedge did not take reasonable steps to ensure that it could satisfy the pre-release brokers' obligations, including the obligation that the pre-release broker or its customer maintain ownership of the ordinary shares for the benefit of the ADR holder. According to the Commission Order, Newedge should have recognized the risk that it could have been receiving pre-released ADRs not backed by ordinary shares. The Commission also alleged that Newedge failed to establish and implement effective policies and procedures to detect and prevent the violations described herein. The Commission found that this conduct violated Section 17(a)(3) of the Securities Act and Section 15(b)(4)(E) of the Exchange Act. As a result, SGA was censured; ordered to cease and desist from future violations; and pay $486,672 in disgorgement, $82,656 in prejudgment interest, and a civil monetary penalty of $250,000. The Commission credited SGA's cooperation with the Staff and its remedial measures in reaching this resolution.

***In re Citibank, N.A.*, Securities Act Rel. No. 10571, 2018 SEC LEXIS 3108 (Nov. 7, 2018)**

The Commission accepted an Offer of Settlement from Citibank, N.A., for its improper handling of ADRs. Citibank served as a depositary bank that issued and canceled ADRs pursuant to a deposit agreement. The Commission alleged that despite its contractual obligation, the firm obtained and lent pre-released ADRs to broker-dealers without taking reasonable steps to determine whether the appropriate number of ordinary shares of the foreign company's stock evidenced by the ADRs were owned by and in the custody of either the broker or its customer on whose behalf the pre-released ADRs were obtained. The firm also, at times, facilitated short sales and enabled the settlement of trades with ADRs that were not backed by ordinary shares. The Commission found that this conduct violated Section 17(a)(3) of the Securities Act. As a result, the firm was ordered to cease and desist from future violations and pay approximately $20.9 million in disgorgement, approximately $4.3 million in prejudgment interest, and a civil monetary penalty of approximately $13.6 million. According to the SEC, the civil penalty would have been higher but for the firm's cooperation and its ongoing agreement to cooperate in a related enforcement action.

***In re Melanie Ryan*, Securities Act Rel. No. 10524, 2018 SEC LEXIS 1828 (July 24, 2018)**

The Commission accepted an Offer of Settlement from Melanie Ryan (Ryan), the former Chief Compliance Officer of a registered broker-dealer, in connection with the firm's practice of lending pre-released ADRs. According to the Commission Order, the firm did not take reasonable steps to determine whether the requisite number of ordinary shares were owned and custodied by the person on whose behalf the firm was obtaining ADRs and, as a result, issuances of ADRs were often not backed by ordinary shares. Ryan allegedly told the depository banks—through pre-release agreements and certifications—that the firm's customers owned and custodied the requisite number of ordinary shares that corresponded with any pre-released ADRs, when in fact Ryan had reason to know that her representations were incorrect. As a result, the firm was able to obtain pre-released ADRs without proper compliance with its obligations. Ryan's conduct

violated Section 17(a)(3) of the Securities Act. In connection with this settlement, the Commission ordered Ryan to cease and desist from future violations and pay a $10,000 civil penalty, which would have been higher but for Ryan's cooperation and ongoing agreement to cooperate in a related enforcement action.

In re JPMorgan Chase Bank, N.A., Securities Act. Rel. No. 10600, 2018 SEC LEXIS 3650 (Sept. 28, 2018)

The Commission accepted an Offer of Settlement from JPMorgan Chase Bank, N.A., a financial services firm that serves as a depository bank that issues and cancels ADRs, related to the firm's improper practices concerning the pre-release of ADRs. In a pre-release transaction, a market participant obtains newly issued ADRs without simultaneously delivering the corresponding ordinary shares. The Commission alleged that the firm failed to determine whether the pre-release brokers or its customers, from whom the pre-released ADRs were obtained, actually beneficially owned the corresponding number of ordinary shares represented by the pre-released ADRs. As a result, in many instances ADRs were issued that were not backed by the ordinary shares. According to the Commission Order, the firm also facilitated short sales without any corresponding ownership of ordinary shares. As a result, the Commission found that the firm violated Section 17(a)(3) of the Securities Act and ordered the firm to cease and desist from future violations and to pay disgorgement of approximately $71 million, prejudgment interest of approximately $14.4 million, and a civil monetary penalty of approximately $49.7 million. The Commission credited the firm's remedial acts and the cooperation it afforded the Commission staff in determining to accept the Offer of Settlement.

American Depositary Shares

In re Merrill Lynch, Pierce, Fenner & Smith Inc., Exch. Act Rel. No. 82826, 2018 SEC LEXIS 677 (Mar. 8, 2018)

The Commission accepted an Offer of Settlement from Merrill Lynch, Pierce, Fenner & Smith Inc. (Merrill Lynch or the firm) for selling American Depository Shares (ADSs) that were unregistered and did not meet an exemption from registration. The ADSs represented ordinary shares in a foreign private issuer. According to the Commission Order, Merrill Lynch failed to avail itself of an exemption from registration because the firm failed to engage in a reasonable inquiry into the facts surrounding the proposed sales prior to effecting the transactions, and the sales therefore constituted an unlawful distribution. The Commission alleged that the firm was aware of red flags suggesting that gifted shares remained under the control of the issuer, its management, and the issuer's Chairman. The firm also allegedly failed to conduct any subsequent reviews when presented with additional red flags that raised questions about whether the purported gifts were bona fide. According to the Commission, the firm also failed to make an inquiry as to whether the ADSs could be sold without registration when other red flags emerged such as the resignation of the issuer's auditor citing the Chairman's admissions of fraud. As a result, the Commission found that the firm violated Section 5(a) and 5(c) of the Securities Act. The firm was censured; ordered to cease and desist from future violations; and required to pay $127,545 in disgorgement, $27,340 in prejudgment interest, and a $1.25 million civil money penalty.

Anti–Money Laundering/Suspicious Activity Reports (SARs)

***SEC v. Charles Schwab & Co., Inc.*, Lit. Rel. No. 24189, 2018 SEC LEXIS 1667 (July 9, 2018)**

The Commission accepted an Offer of Settlement from Charles Schwab & Co., Inc. (Schwab or the firm) for failing to file Suspicious Activity Reports (SARs) on suspicious transactions executed by 83 independent investment advisors. According to the Commission's Complaint, filed in the United States District Court for the Northern District of California, the firm determined that the advisors had engaged in conduct that violated internal policies and presented risk to the firm and/or its customers, and thereafter prohibited the advisors from using the Schwab platform to custody their client accounts. According to the Commission's Complaint, the suspicious transactions allegedly included instances of potential self-dealing, fraudulent activity, and excessive advisory fees, among others. On the same day the Complaint was filed, the firm consented to the entry of a judgment, which was entered by the Court, finding that its failure to file SARs in these instances constituted violations of Section 17(a) of the Exchange Act and Rule 17a-8. The firm agreed to be permanently enjoined from future violations and to pay a $2.8 million civil penalty.

***In re COR Clearing, LLC*, Exch. Act Rel. No. 84309, 2018 SEC LEXIS 2685 (Sept. 28, 2018)**

The Commission accepted an Offer of Settlement from COR Clearing, LLC, related to the firm's failure to file SARs related to low-priced securities. The firm primarily provides clearing and settlement services to introducing broker-dealers. According to the Commission Order, customers of the introducing broker-dealers deposited large blocks of low-priced securities, sold the securities, and soon thereafter withdrew the proceeds of these sales. The firm's own procedures recognized that this activity could constitute a red flag of a possible illegal, unregistered distribution. The firm, however, failed to take appropriate steps and file SARs based on the deposit and sale of low-priced securities and the subsequent withdrawal of proceeds. As a result, the Commission alleged that the firm violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. In connection with this settlement, the Commission imposed sanctions that censured the firm, ordered the firm to cease and desist from future violations, and imposed an $800,000 civil monetary penalty. The firm also agreed to begin significantly limiting the sale of penny stocks deposited at the firm, and to implement additional systems and procedures to ensure compliance in this area. The Commission credited the firm's remedial acts in accepting the Offer of Settlement.

***In re Chardan Capital Markets, LLC*, Exch. Act Rel. No. 83251, 2018 SEC LEXIS 1142 (May 16, 2018); *In re Industrial and Commercial Bank of China Financial Services, LLC*, Exch. Act Rel. No. 83253, 2018 SEC LEXIS 1144 (May 16, 2018); *In re Jerard Basmagy*, Exch. Act Rel. No. 83252, 2018 SEC LEXIS 1143 (May 16, 2018).**

The Commission accepted Offers of Settlement from Chardan Capital Markets, LLC (Chardan), a registered broker-dealer; Chardan's clearing firm, Industrial and Commercial Bank of China Financial Services, LLC (ICBCFS); and Chardan's then Chief Compliance Officer and Anti–Money Laundering (AML) Officer, Jerard Basmagy, concerning Chardan's failure to file SARs. According to the Commission Order, Chardan did not conduct the requisite review of significant penny stock

liquidations that occurred through seven customer accounts during the relevant period, and failed to file corresponding SARs, even though ICBCFS raised concerns to Chardan about the transactions. Basmagy was required to investigate and follow up on potential red flags, and file SARs as appropriate, which he failed to do. ICBCFS, despite its own concerns, also failed to file SARs concerning the customers and transactions that it identified as suspicious. In addition, ICBCFS failed to promptly produce documents to the Commission Staff, despite repeated requests for the documents.

As a result of this conduct, the Commission determined that Chardan violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder and that Basmagy aided and abetted and caused Chardan's violations. Chardan was censured, ordered to cease and desist from future violations, and required to pay a civil penalty of $1 million. The Commission credited Chardan's remedial measures in determining to accept the Offer of Settlement. Basmagy was ordered to cease and desist from future violations, barred from the securities industry and from participating in any penny stock offering, and required to pay a civil penalty of $15,000. Separately, the Commission determined that ICBCFS violated Section 17(a) of the Exchange Act and Rules 17a-4(j) and 17a-8 thereunder. ICBCFS was censured, ordered to cease and desist from future violations, and required to pay civil penalties of $860,000. In a related action, FINRA accepted a settlement from ICBCFS that imposed sanctions of a $5.3 million fine and required ICBCFS to retain an independent compliance consultant. *See Indus. & Commercial Bank of China Fin. Servs., LLC*, FINRA Matter No. 2015045550801 (May 16, 2018).

***In re TD Ameritrade, Inc.*, Exch. Act Rel. No. 84269, 2018 SEC LEXIS 2570 (Sept. 24, 2018)**

The Commission accepted an Offer of Settlement from TD Ameritrade, Inc., for its failure to file SARs. According to the Commission Order, the firm terminated its business relationship with 111 independent investment advisors that presented unacceptable business, credit, operational, reputational, or regulatory risk. The Commission alleged that although the firm filed SARs for certain transactions concerning the terminated advisors, the firm failed to file SARs concerning the suspicious transactions of a number of other terminated advisors because the firm did not consistently and appropriately refer such terminated advisors to the firm's AML Department for further review. As a result, the Commission found that the firm violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. The firm was censured, ordered to cease and desist from future violations, and required to pay a $500,000 civil penalty. The Commission credited the firm's remedial acts in accepting the Offer of Settlement.

***In re Aegis Capital Corporation*, Exch. Act Rel. No. 82956, 2018 SEC LEXIS 800 (Mar. 28, 2018); *In re McKenna et al.*, Exch. Act Rel. No. 82957, 2018 SEC LEXIS 801 (Mar. 28, 2018); *In re Eugene Terracciano*, Exch. Act Rel. No. 83604, 2018 LEXIS 83604 (July 6, 2018)**

The Commission accepted an Offer of Settlement from Aegis Capital Corporation, a registered broker-dealer, in which the firm admitted to failing to file SARs for hundreds of suspect transactions. According to the Commission Order, many of the transactions involved red flags of potential market manipulation or had no business or apparent lawful purpose. The Commission also alleged that the firm's surveillance system was ineffective because it failed to analyze low-priced securities transactions in DVP/RVP accounts. In addition, the Commission alleged that

senior firm personnel became aware of AML red flags through alerts from the firm's clearing firm, but the firm did not file SARs or otherwise prepare written analyses or compile other records to indicate that the red flags had been considered. The firm also failed to investigate why its own internal surveillance systems had not flagged certain transactions as suspicious. As a result, the Commission found that the firm violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. The firm was censured, ordered to cease and desist from future violations, and required to pay a $750,000 civil penalty, and agreed to retain a compliance consultant. In accepting the Offer of Settlement, the Commission credited the firm's remedial efforts. On the same day, FINRA also announced a separate settlement with the firm for similar conduct. *See* FINRA Matter No. 2013038750901 (Mar. 28, 2018).

The Commission also accepted an Offer of Settlement from Kevin McKenna, the firm's AML Compliance Officer from June 2012 to mid-2013, and Robert Eide, the firm's current CEO. McKenna was responsible for filing SARs on behalf of the firm and was the primary point of contact for the clearing firms engaged by the firm. According to the Commission Order, despite a large number of AML alerts related to low-priced securities transactions, many of which were examples of red flags in the firm's written supervisory procedures, McKenna did not file SARs on the firm's behalf or create any written analysis on why the alerts did not require SARs to be filed. The Commission also alleged that Eide received certain of the AML alerts that should have generated SARs, and was alerted by both the clearing firm and by direct letter from OCIE that the firm's SAR-filing practices were deficient, but failed to take adequate steps to ensure that SARs were filed on the firm's behalf. The Commission found that McKenna aided and abetted, and Eide caused, the firm's violations of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. McKenna and Eide were ordered to cease and desist from committing or causing further violations, and McKenna was suspended from serving in a compliance capacity and from working in an AML compliance or AML capacity for 18 months and was required to pay a $20,000 civil penalty. Eide was required to pay a $40,000 civil penalty.

In connection with this matter, the SEC also brought an action against Eugene Terracciano, the firm's AML Compliance Officer during the relevant period. According to the Commission, the firm's written supervisory procedures indicated that he was responsible for filing SARs on the firm's behalf. The Commission also alleged that he became aware of transactions that exhibited numerous red flags through alerts from the firm's clearing firm. Terracciano, however, allegedly failed to produce written analysis or otherwise demonstrate that he considered filing SARs for these transactions. Several months into the proceedings, the Commission accepted a partial settlement from Terracciano, which found that Terracciano aided, abetted and caused the firm's violations of Section 17(a) of the Exchange Act and Rule 17a-8. He was ordered to cease and desist from further violations and required to pay a $20,000 civil penalty. Terracciano also agreed to continued proceedings to determine whether any additional remedial action is appropriate in the public's interest.

Customer Protection Rule Violations

***In re Wedbush Securities Inc.*, Exch. Act. Rel. No. 82630, 2018 SEC LEXIS 360 (Feb. 5, 2018)**

The Commission accepted an Offer of Settlement from Wedbush Securities Inc. for violations of Section 15(c)(3) of the Exchange Act (the Customer Protection Rule) and Rule 15c3-3 thereunder,

as well as Section 17(a)(1) of the Exchange Act and Rule 17a-5(a) thereunder. According to the Commission Order, the firm's weekly calculations to determine the net amount that should have been deposited into the Reserve Account from September 2014 to January 2015 included a significant error, resulting in weekly Reserve Account deficiencies ranging from approximately $10 million to $193 million. The Commission alleged that the error caused the firm to include inaccurate information in the monthly FOCUS Reports it filed with the Commission. The Commission Order further asserted that once the calculation error was discovered, the firm was required to immediately deposit $133 million into its Reserve Account to address the deficiency, which created a significant liquidity challenge for the firm. Concurrent with the SEC action, FINRA accepted an Offer of Settlement from the firm for related violations of the Customer Protection Rule, among others. *See Dep't of Enf't v. Wedbush Sec. Inc.*, Discip. Proceeding 2012033105901 (OHO Feb. 5, 2018). The Commission's Order noted the FINRA settlement and the firm's history of related compliance deficiencies. In connection with this settlement, the Commission imposed sanctions that censured the firm; ordered it to cease and desist from future violations; and pay disgorgement of $275,851, prejudgment interest of $28,346, and a $1 million civil penalty. The firm also agreed to retain a qualified independent compliance consultant.

***In re Electronic Transaction Clearing, Inc.*, Exch. Act Rel. No. 82898, 2018 SEC LEXIS 754 (Mar. 19, 2018)**

The Commission accepted an Offer of Settlement from Electronic Transaction Clearing, Inc., a registered broker-dealer, for violations of Section 15(c)(3) of the Exchange Act (the Customer Protection Rule) and Rule 15c3-3 thereunder; Section 15(c)(2) of the Exchange Act and Rule 15c2-1(a)(1) thereunder; and Section 17(a)(1) of the Exchange Act and Rule 17a-5(a) and 17a-5(d)(2) thereunder. The Commission alleged that on several occasions, the firm moved approximately $7.8 million in cash customers' fully paid securities to its omnibus margin account maintained at another clearing firm to meet that firm's in-house margin requirements. According to the Commission Order, on three occasions, the firm delivered fully paid securities of two cash customers valued at more than $17.77 million from the firm's DTC account to another clearing firm's DTC account in exchange for immediate funds. The Commission also alleged that the firm failed to properly segregate a customer's excess margin securities, as it caused approximately $17.7 million of excess margin securities to be loaned out by another clearing firm without obtaining its customer's consent. The SEC Order further stated that the firm did not report these failures in its monthly and quarterly FOCUS reports or in its annual financial report for 2015. As a result, the Commission imposed sanctions that censured the firm, ordered it to cease and desist from future violations, and required it to pay an $80,000 civil penalty. The Commission credited the firm's remedial acts in accepting the Offer of Settlement.

Customer Personally Identifiable Information (PII) Breach

***In re Voya Financial Advisors, Inc.*, Exch. Act Rel. No. 84288, 2018 SEC LEXIS 2595 (Sept. 26, 2018)**

The Commission accepted an Offer of Settlement from Voya Financial Advisors, Inc., for failing to adopt written procedures reasonably designed to protect customer records and information and for failing to develop and implement a written Identity Theft Prevention Program. According to the Commission Order, one or more persons impersonating one of the firm's contractor representatives called the firm's technical support line and requested a reset of representatives'

passwords for a web portal used to access customer information. The Commission alleged that the firm's response to the intrusion was insufficient, and that the intruders were thereby able to obtain personally identifiable information concerning at least 5,600 customers. As a result, the Commission determined that the firm's policies and procedures to protect customer information and to prevent and respond to cybersecurity incidents were not reasonably designed. The Commission also found that the firm did not review and update its Identity Theft Prevention Program in response to changes in risks to its customers or provide adequate training to its employees concerning identity theft red flags. By its conduct, the Commission concluded that the firm violated Rule 30(a) of Regulation S-P and Rule 201 of Regulation S-ID. In connection with this settlement, the firm was censured, ordered to cease and desist from future violations, and required to pay a $1 million civil penalty, and agreed to retain a compliance consultant. The Commission credited the firm's remedial measures in determining to accept the Offer of Settlement, including the hiring of a Chief Information Officer.

Electronic Blue Sheets (EBS) Deficiencies

***In re Convergex Execution Solutions, LLC*, Exch. Act. Rel. 84116, 2018 SEC LEXIS 2270 (Sept. 13, 2018)**

The Commission accepted a Settlement Offer from Convergex Execution Solutions, LLC, now known as Cowen Execution Services LLC, a US-based broker-dealer and investment adviser, in which the firm admitted it had failed to take reasonable steps to ensure that the securities transactions reported in a substantial number of its 6,574 Electronic Blue Sheet (EBS) submissions contained complete and accurate information, even though the firm had previously been sanctioned by FINRA in March 2012 for deficient EBS submissions. The Commission specifically found that these deficient submissions stemmed largely from coding errors that would, for example, systematically fail to provide sufficient customer identifying information. According to the Commission Order, the firm's software platform failed to detect many of these deficiencies, and the firm had no process to compare the information reported in its EBS submissions against the underlying data except through annual validations. The Commission found that the firm violated Section 17(a)(1) of the Exchange Act and Rules 17a-4(j) and 17a-25 thereunder. In connection with this settlement, the Commission censured the firm, ordered the firm to cease and desist from future violations, and required it to pay a $2.75 million civil penalty. The Commission considered the firm's cooperation and remedial efforts in accepting the Settlement Offer.

***In re Citadel Securities LLC*, Exch. Act Rel. No. 84759, 2018 SEC LEXIS 3445 (Dec. 10, 2018); *In re MUFG Securities Americas Inc.*, Exch. Act Rel. No. 84758, 2018 SEC LEXIS 3444 (Dec. 10, 2018); *In re Natixis Securities Americas LLC*, Exch. Act Rel. No. 84760, 2018 SEC LEXIS 3447 (Dec. 10, 2018)**

The Commission accepted Offers of Settlement from Citadel Securities LLC (Citadel), MUFG Securities Americas Inc. (MUSA), and Natixis Securities Americas LLC (Natixis), all registered broker-dealers, in which each firm admitted that it failed to submit complete and accurate data in response to the Commission Staff's requests for EBSs. According to the Commission, complete and accurate EBS data is critical to many aspects of the Commission's operations and its ability to discharge its enforcement and regulatory mandates. The Commission alleged that Citadel provided incorrect reporting of trade execution time data for approximately 80 million trades;

MUFG submitted incorrect trade information for approximately 650,000 trades; and Natixis provided inaccurate trade data for approximately 150,000 trades, respectively. According to the Commission, the incorrect reporting occurred, in large part, because the broker-dealers lacked processes to detect errors in their EBS submissions. As a result, the Commission found that each broker-dealer willfully violated Section 17(a)(1) of the Exchange Act and Rules 17a-4(j) and 17a-25 thereunder. Citadel, MUFG, and Natixis, respectively, were censured, ordered to cease and desist from future violations, and required to pay civil penalties as follows: Citadel, $3.5 million; MUSA, $1.4 million; and Natixis, $1.25 million. The Commission considered the cooperation and remedial efforts by each broker-dealer in accepting their Offers of Settlement.

Exchange Failures

***In re New York Stock Exchange LLC, NYSE American LLC and NYSE Arca, Inc.*, Exch. Act Rel. No. 82808, 2018 SEC LEXIS 666 (Mar. 6, 2018)**

The Commission accepted Offers of Settlement from the New York Stock Exchange (NYSE), NYSE American (American), and NYSE Arca (Arca) (collectively, NYSE Exchanges) for several regulatory failures, including the Commission's first-ever charged violation of Regulation Systems Compliance Integrity (SCI). NYSE, American, and Arca are national securities exchanges registered with the Commission. According to the Commission Order, NYSE and Arca disseminated quotes inaccurately marked as "automated" at a time when customers were unable to consistently access quotations because of connectivity problems. The SEC also alleged that Arca failed to implement rules describing price collars for reopening auctions, had erroneously implemented a marketwide regulatory halt in violation of a national market plan, and failed to publish order imbalance information in violation of its own rules. The Commission Order further asserted that NYSE and American lacked policies and procedures for "reasonably designed" backup and recovery capabilities concerning business continuity and disaster recovery plans, and that NYSE and American also failed to have rules concerning the treatment of two order types that allowed for the detection (but not the quantity) of non-displayed depth liquidity on the exchanges' order books. As a result, the Commission found that NYSE and American violated Section 17(a)(2) of the Securities Act; the NYSE Exchanges violated Section 19(b)(1) of the Exchange Act; Arca violated Section 19(g)(1) of the Exchange Act; NYSE and American violated Rule 1001(a)(1) and 1001(a)(2)(v) of Regulation SCI; and Arca violated Rule 608(c) of Regulation NMS. The NYSE Exchanges were censured; ordered to cease and desist from future violations; and required to pay, jointly and severally, a $14 million civil penalty.

Municipal Bond Flipping

***In re Charles Morris*, Exch. Act Rel. No. 83838, 2018 SEC LEXIS 1991 (Aug. 14, 2018); *In re NW Capital Markets Inc. et al.*, Exch. Act Rel. No. 83840, 2018 SEC LEXIS 1992 (Aug. 14, 2018)**

The Commission accepted Offers of Settlement from Charles Morris (Morris), the former head of municipal underwriting, sales, and trading at registered broker-dealer NW Capital Markets Inc. (NW Capital or the firm), as well as Morris's direct supervisor, James Fagan (Fagan), concerning improper trading in municipal bonds. According to the Commission Orders, a customer of NW Capital engaged in "flipping," a practice the Commission described as obtaining allocations of new issue municipal bonds from underwriters and then immediately reselling the bonds at a profit

once trading begins. The SEC asserts that Morris allegedly accepted undisclosed and improper payments from a customer in exchange for Morris's agreement to purchase new issue bonds from the customer. The Commission further alleges that Morris also allocated certain new issue bonds to NW Capital's customer with the understanding that Morris would purchase the bonds back for the firm's inventory at a higher price than the customer initially paid. In addition, according to the SEC's Order, Morris allegedly obtained new issue bonds from the customer, which had been acquired from other underwriters, even though NW Capital's customer was not a registered broker-dealer. The Commission found that Fagan failed to reasonably supervise Morris and did not conduct regular reviews of his trading activity as required by the firm's supervisory policies and procedures.

The Commission found that Morris's conduct constituted violations of Section 17(a)(1) and (3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c) thereunder, and MSRB Rule G-17, and that he caused violations of Section 15(a)(1) of the Exchange Act. Morris was ordered to cease and desist from future violations; was barred from the securities industry and from participating in any penny stock offering; and was required to pay disgorgement of $156,347, prejudgment interest of $22,661, and civil penalty of $75,000.

NW Capital was found by the Commission to have violated MSRB Rule G-17, caused violations of Section 15(a)(1) of the Exchange Act, and violated Section 15B(c)(1) of the Exchange Act. NW Capital was censured; ordered to cease and desist from future violations; and required to pay disgorgement of $41,770, prejudgment interest of $5,295, and a civil money penalty of $40,000. The Commission Order found that Fagan violated Section 15(b)(4)(E) of the Exchange Act and MSRB Rule G-27. He was censured, ordered to cease and desist from future violations, suspended as a supervisor, and required to pay a civil penalty of $10,000.

The Commission also took action against the customer, filing Complaints in two separate federal district court proceedings, alleging similar violations of, among other things, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Section 15(a)(1) of the Exchange Act, and MSRB Rule G-17. *See generally* SEC Press Release 2018-153, "SEC Files Charges in Municipal Bond 'Flipping' and Kickback Schemes" (Aug. 14, 2018), https://www.sec.gov/news/press-release/2018-153.

Fraudulent Bond Offering

***In re John T. Lynch, Jr.*, Exch. Act. Rel. No. 82634, 2018 SEC LEXIS 376 (Feb. 6, 2018)**

The Commission accepted an Offer of Settlement from John T. Lynch, Jr. (Lynch), an investment banker and former underwriter's counsel for Lawson Financial Corporation, a registered broker-dealer. In connection with the underwriting of a dozen fraudulent conduit municipal bond offerings, the Commission alleged that Lynch failed to conduct reasonable due diligence on the bond offerings because he conducted only a cursory inquiry into the information provided to him and other parties despite being aware of numerous red flags. Consequently, according to the Commission Order, initial purchasers and buyers and sellers in the secondary market were deprived of material information, and the related fraud was allowed to go undetected. The SEC also asserted that Lynch failed to obtain a written continuing disclosure for an April 2013 offering, despite the representation in the official statement that such a disclosure existed. Further, the Commission alleged that Lynch was listed in the official statements as underwriter's counsel despite not being an active member of any state bar since 1983. As a result, the Commission

found that Lynch violated Section 17(a)(2) and (3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder. Lynch also was found to have aided and abetted and caused the firm's violation of Section 15(c) of the Exchange Act and Rule 15c2-12 thereunder. Lynch was barred from the securities industry and from acting as an officer or director of an underwriter with the right to reapply for reentry after one year. In a related action, *In re Lawson Financial Corp. et al.*, Exch. Act Rel. No. 80376, 2017 SEC LEXIS 1043 (Apr. 5, 2017), the Commission accepted Offers of Settlement from the firm and its former CEO for violations related to the above-described conduct.

Manipulative Trading Activity

In re Timary Delorme, Exch. Act Rel. No. 82953, 2018 SEC LEXIS 793 (Mar. 27, 2018)

The Commission accepted an Offer of Settlement from Timary Delorme (Delorme), a registered representative, for her involvement in a manipulative trading scheme. According to the Commission Order, Delorme purchased, in her customers' accounts, stocks of microcap issuers controlled by a third party and, in exchange, Delorme received undisclosed material benefits, paid to her husband, from this third party. The Commission further asserted that Delorme engaged in matched trades in these stocks for the purpose of impacting the price of these securities. As a result, Delorme violated Section 17(a)(1) and (3) of the Securities Act and Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5(a) and (c) thereunder. Delorme was ordered to cease and desist from future violations, barred from the securities industry, barred from participating in any penny stock offering, and required to pay a $50,000 civil penalty. The Commission considered Delorme's sworn Statement of Financial Condition asserting her inability to pay a civil penalty in setting the amount of the civil penalty.

SEC v. Pawel P. Dynkowski, et al., Lit. Rel. No. 24197, 2018 SEC LEXIS 1702 (July 12, 2018)

The U.S. District Court for the District of Delaware entered a consent final judgment against Joseph Mangiapane, Jr. (Mangiapane), a registered representative, for his role in a stock manipulation scheme. According to the Commission's Complaint, which was initially filed against multiple parties on May 20, 2009, he helped plan and execute sell orders for nominee accounts in furtherance of the scheme. He also allegedly helped launder proceeds from a pump-and-dump scheme involving the stock of a different issuer. The SEC also asserted that wash sales, matched orders, and other manipulative trading devices were allegedly timed to coincide with false and misleading press releases for the purpose of artificially inflating the stock price. Mangiapane consented to a judgment that permanently enjoined him from violating Sections 5 and 17(a)(3) of the Securities Act and required him to pay disgorgement of $26,000 and a civil penalty of $26,000. He also consented to a Commission Order that bars him from associating with any broker or dealer and bars him from participating in any penny stock offering. The Court previously entered final judgments against 11 other defendants in this matter.

Material Nonpublic Information

In re Anthony P. Chiera et al., Exch. Act Rel. No. 82485, 2018 SEC LEXIS 77 (Jan. 11, 2018)

The Commission accepted an Offer of Settlement from Anthony P. Chiera (Chiera) and Jeffrey R. Belfiore (Belfiore) wherein it was alleged that Chiera, a registered representative associated with a broker-dealer and investment adviser, traded shares of URS Corporation (URS) on material, nonpublic information obtained from Belfiore, in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. According to the Commission Order, in or around May 2014, Belfiore learned about the potential acquisition of his employer, URS, and disclosed the acquisition to his longtime friend, Chiera, because Belfiore sought his friend's assistance in finding employment if the acquisition eliminated his job position. The Commission further alleges that between July 2 and 9, 2014, before news of the potential acquisition became public, Chiera purchased shares of URS, and after the merger was announced, Chiera sold his shares, for a profit of approximately $48,000. The SEC Order also asserts that, with assistance from Chiera, Belfiore subsequently was hired by Chiera's employer. In settlement, Chiera was ordered to cease and desist from future violations; barred from association from any broker, dealer, or investment advisor; and barred from participating in any offering of a penny stock. He also was ordered to pay a civil penalty of $48,984, disgorgement of $48,984, and prejudgment interest of $2,847. Belfiore was ordered to pay a penalty of $25,000 and was barred from acting as an officer or director of a public company for four years.

In re Michael Johnson, Exch. Act Rel. No. 83602, 2018 SEC LEXIS 1934 (July 6, 2018)

The Commission accepted an Offer of Settlement from Michael Johnson (Johnson), a former registered representative, who allegedly misappropriated material, nonpublic information about a proposed acquisition from a relative who provided personal tax accounting services to a senior officer at the purchasing company during the merger negotiations. The Commission Order alleged that Johnson owed a duty of trust or confidence to the relative and understood that the information he had obtained was confidential, but nonetheless purchased shares in advance of the public announcement of the merger. As a result, the Commission found that Johnson violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. In connection with this settlement, the Commission barred Johnson from the securities industry and from participating in any penny stock offering; prohibited him from serving as an officer or director of a registered investment company; ordered him to cease and desist from future violations; and required him to pay disgorgement of $88,699, prejudgment interest of $6,721, and a civil penalty of $88,699. FINRA also accepted a Letter of Acceptance, Waiver and Consent from Johnson arising out of the same conduct. *See* FINRA Matter No. 2016051575301 (Oct. 14, 2016).

Material Nonpublic Information Supervision

In re Mizuho Securities USA, LLC, Exch. Act Rel. No. 83685, 2018 SEC LEXIS 1789 (July 23, 2018)

The Commission accepted an Offer of Settlement from Mizuho Securities USA, LLC, a registered broker-dealer. The Commission alleged that the firm failed to maintain and enforce policies and procedures to prevent the misuse of material nonpublic customer order information concerning

the repurchase of shares by issuers. In particular, the SEC asserted that the firm lacked an adequate information barrier to prevent its execution and sales traders from disclosing material, nonpublic customer buyback order information internally to firm traders and externally to customers. According to the Commission Order, the firm's failures constituted violations of Section 15(g) of the Exchange Act. In connection with this settlement, the Commission censured the firm, ordered it to cease and desist from future violations, and required it to pay a $1,250,000 civil penalty. The Commission considered the firm's remedial efforts in determining to accept the Offer of Settlement.

Misappropriation of Assets

***In re Paul W. Smith*, Exch. Act Rel. No. 83178, 2018 SEC LEXIS 1069 (May 7, 2018)**

The Commission accepted an Offer of Settlement from Paul W. Smith (Smith), a registered representative who also acted as an investment advisor to The Haverford Group (Haverford), an entity that Smith formed for pooled investments. According to the Commission Order, Smith engaged in a scheme to defraud Haverford and its investors by misappropriating Haverford's assets, falsely stating to investors that their money was being invested in securities, and mailing false account statements and other documents to investors. The Commission barred Smith from the securities industry and from participating in penny stock offerings in any capacity. In a related civil action, *Securities and Exchange Commission v. Paul W. Smith*, Civil Action Number 17-5480 (E.D. Pa. Dec. 20. 2017), Smith consented to be permanently enjoined from future violations of Section 17(a) of the Securities Act; Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; as well as Section 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-(8) thereunder. In a parallel criminal proceeding, Smith was sentenced to more than five years in prison and ordered to pay more than $886,000 in restitution. *United States v. Paul W. Smith*, Criminal Case No. 2:17-626 (E.D. Pa. Jan. 11, 2018).

Municipal Advisor Violations

***In re Anthony A. Stovall*, Exch. Act Rel. No. 82443, 2018 SEC LEXIS 18 (Jan. 5, 2018)**

The Commission accepted an Offer of Settlement from Anthony A. Stovall (Stovall), a registered representative who was the co-head of the Municipal Finance Group at a now-defunct underwriter. According to the Commission Order, Stovall directed funds to the president and owner of a registered municipal advisor, and, shortly thereafter, the municipal advisor recommended that its municipal issuer client (the City) hire Stovall as the underwriter for an anticipated bond offering. The SEC further asserted that the City thereafter hired Stovall, who failed to disclose that he had provided improper gifts to the owner of the municipal advisor in violation of MSRB Rules G-17 and G-20. As a result, according to the Commission Order, Stovall was suspended for six months from association with any broker, dealer, or investment adviser and from participation in any penny stock offering. The Commission also ordered Stovall to pay a $20,000 civil penalty.

Municipal Fund Disclosure Violations

***In re Ameriprise Financial Services, Inc.*, Exch. Act Rel. No. 82792, 2018 SEC LEXIS 626 (Feb. 28, 2018)**

The Commission accepted an Offer of Settlement from Ameriprise Financial Services, Inc. based upon the firm's alleged failure to ascertain whether certain retirement plan account customers were eligible for less expensive share classes and, instead, recommended and sold them more expensive mutual fund share classes. According to the Commission Order, the firm did so without disclosing that it would receive greater compensation for purchases of the more expensive share classes. Specifically, the SEC alleged that the firm recommended and sold customers Class A shares with an up-front sales charge, or Class B or Class C shares with a back-end contingent deferred sales charge and higher ongoing fees and expenses, when the customers were eligible to purchase load-waived Class A shares. Based on the foregoing, the Commission found that the firm violated Section 17(a)(2) and 17(a)(3) of the Securities Act. The firm voluntarily provided remediation of approximately $1.78 million plus interest of approximately $191,000 to all eligible customers who purchased more expensive shares, and the firm converted all eligible customer holdings to the share class with the lowest expense ratio for which they were eligible. The Commission credited the firm's cooperation and prompt remedial efforts in reaching this settlement. As a result, the firm was censured, ordered to cease and desist from future violations, and required to pay a $230,000 civil penalty.

Net Capital Violations

***In re JH Darbie & Co., Inc. et al.*, Exch. Act Rel. No. 82951 2018, SEC LEXIS 792 (Mar. 27, 2018)**

The Commission accepted a joint Offer of Settlement from JH Darbie & Co., Inc., a registered broker-dealer, and Robert Y. Rabinowitz (Rabinowitz), its CEO and FINOP, for violating the net capital rule. According to the Commission Order, the firm made erroneous net capital calculations, failed to consider foreign accounts in the minimum net capital requirement, misclassified foreign commission receivables, failed to accrue for legal liabilities, and filed inaccurate monthly FOCUS Reports. The SEC asserted that Rabinowitz allegedly caused the firm's violations by failing to properly compute and report the firm's net capital even though he was aware that foreign commissions were received and misclassified as allowable receivables, and that he also was involved in communications concerning the firm's failure to accrue for a legal liability. As a result, the Commission found that the firm violated Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder, and Section 17(a)(1) of the Exchange Act and Rule 17a-3 and 17a-5 thereunder. The Commission found that Rabinowitz caused the firm's violations and he made or caused to be made false statements in the firm's reports filed with the Commission. The firm was censured, ordered to cease and desist from future violations, and required to pay a civil penalty of $50,000 plus agreed-upon post-Order interest of $113. In addition, the firm agreed to hire a new FINOP. Rabinowitz also was ordered to cease and desist from committing and causing future violations and was required to pay a civil penalty of $25,000 plus agreed-upon post-Order interest of $56.50. Rabinowitz further agreed not to serve as a FINOP for three years and to take and pass the Series 27 examination prior to resuming service as a FINOP.

Order Handling Practices – Misrepresentations

***In re Merrill Lynch, Pierce, Fenner & Smith Inc.*, Exch. Act Rel. No. 83462, 2018 SEC LEXIS 1442 (June 19, 2018)**

The Commission accepted an Offer of Settlement from Merrill Lynch, Pierce, Fenner & Smith Inc., in which the firm admitted that it had falsely represented to financial institution customers that the firm had executed millions of orders internally when it had actually routed them to other broker-dealers (External Liquidity Providers or ELPs), including proprietary trading firms and wholesale market makers. In particular, the Commission found that the firm misreported ELP executions in reports to customers and billing invoices, and when responding to customer inquiries. According to the Commission Order, the information about these execution practices was material to the financial institution customers in assessing their own performances and making routing decisions. The firm discontinued this practice in May 2013, but failed to inform its customers about its past practices and continued to generate reports that misrepresented trade venue information for executions that occurred prior to May 2013. The Commission found that this conduct constituted violations of Section 17(a)(2) and Section 17(a)(3) of the Securities Act. As a result, the firm was censured, ordered to cease and desist from future violations, and was required to pay a civil penalty of $42 million. The Commission recognized the firm's cooperation beginning in May 2017 in agreeing to accept the Offer of Settlement.

***In re Citigroup Global Markets, Inc. and Citi Order Routing and Execution, LLC*, Exch. Act Rel. No. 84124, 2018 SEC LEXIS 2295 (Sept. 14, 2018)**

The Commission accepted an Offer of Settlement from Citigroup Global Markets, Inc. (CGMI) and Citi Order Routing and Execution, LLC (CORE), both of which are registered broker-dealers (collectively, the Firms). According to the Commission Order, CGMI was responsible for marketing and sales of Citi Match, a dark pool that matched and executed buy and sell orders, while CORE was responsible for the day-to-day operation of Citi Match. The Commission alleged that CGMI represented to institutional users of Citi Match that high-frequency traders (HFT) were not permitted to enter orders in Citi Match, when in fact two HFT firms participated in Citi Match. In addition, the SEC alleged that CGMI failed to adequately disclose that orders sent to Citi Match could be routed and executed at external venues, which typically charged less for trade executions than Citi Match, but CGMI nonetheless charged its users the higher Citi Match commission rate. Finally, according to the Commission Order, CORE operated as an exchange because it provided Citi Match as a marketplace for NMS stocks, but CORE failed to register as a national securities exchange or otherwise failed to meet an exemption from registration. As a result, the Commission found that CGMI violated Section 17(a)(2) of the Securities Act and that CORE violated Section 5 of the Exchange Act. In connection with this settlement, the Commission imposed sanctions that censured the Firms and ordered them to cease and desist from future violations. CGMI was ordered to pay disgorgement of approximately $4.7 million, prejudgment interest of $718,690, and a $6.5 million civil monetary penalty. CORE was ordered to pay a $1 million civil penalty.

***In re Credit Suisse Securities (USA) LLC*, Exch. Act Rel. No. 10565, 2018 SEC LEXIS 2684 (Sept. 28, 2018)**

The Commission accepted an Offer of Settlement from Credit Suisse (USA) LLC for material misrepresentations and omissions concerning its handling of held retail equity orders, which

orders must be executed immediately and do not allow for price and time discretion. According to the Commission Order, during the relevant period the firm operated a wholesale market-making desk called Retail Execution Services (RES) to execute orders for retail broker-dealer customers, which represented that it offered "enhanced liquidity" by accessing internal and external pools of liquidity, but RES executed only a *de minimis* number of held orders in dark pools. Further, the SEC alleged that RES represented that opportunities for "robust" and "enhanced" price improvement was one of the "core" elements of RES's approach to executing orders, but failed to disclose that a subset of orders, those not included in public execution quality reports pursuant to Commission Rule 605 ("non-605 orders"), typically would not receive any price improvement. The Commission also asserted that RES further represented that it would seek to execute customer orders at the "most favorable terms reasonably available" and would avoid price impairment caused by market impact. However, according to the Commission Order, for certain outsized non-605 orders, RES used a routing tactic that sent an order only to lit markets without first attempting to fill the order in the firm's and other dark pools and electronic liquidity providers and failed to disclose the frequency with which RES used this routing tactic. The Commission found that the firm violated Section 17(a)(2) of the Securities Act, and, as a result, was censured, ordered to cease-and-desist from committing or causing any future violations, and required to pay a $5 million civil penalty.

***In re ITG Inc. and AlterNet Securities, Inc.*, Exch. Act Rel. No. 84548, 2018 SEC LEXIS 3109 (Nov. 7, 2018)**

The Commission accepted an Offer of Settlement from ITG Inc. (ITG) and AlterNet Securities, Inc. (AlterNet), affiliated broker-dealers, in connection with the operation of POSIT, an alternative trading system or "dark pool." According to the Commission Order, ITG failed to establish adequate safeguards and procedures to protect the confidential trading information of POSIT subscribers. The Commission also alleged that ITG disclosed confidential trading information of POSIT subscribers, even though ITG represented to subscribers and prospective subscribers that POSIT would allow subscribers to trade without "signaling their trading intentions" and that ITG would maintain the confidentiality of subscriber order information. The SEC further asserted that ITG also failed to disclose certain material features of POSIT, including that there were two separate liquidity pools in POSIT and that ITG had implemented a "speedbump" to slow interactions involving orders from certain high-frequency trading firms. As a result, the Commission found that ITG and AlterNet violated Section 17(a)(2) and 17(a)(3) of the Securities Act and ITG willfully violated Rule 301(b)(2) and (b)(10) of Regulation ATS. In connection with this settlement, ITG and AlterNet were censured, ordered to cease and desist from future violations, and required to pay a $12 million civil penalty. The Commission credited the remedial actions taken in determining to accept the Offer of Settlement.

Recordkeeping Violations

***In re Cantor Fitzgerald & Co.*, Exch. Act. Rel. No. 83565, 2018 SEC LEXIS 1598 (June 29, 2018)**

The Commission accepted an Offer of Settlement from Cantor Fitzgerald & Co. for violations of Section 17(a) of the Exchange Act and Rule 17a-3(a)(19) thereunder. According to the Commission Order, associated persons at the firm, including the former global co-head of equities, circumvented procedures for paying and recording commissions. In particular, the Commission

alleged that certain traders used personal checks to pay a portion of their commissions to the former global co-head of equities, who the firm said was not permitted to receive commissions on the accounts he serviced. The SEC further asserted that the commission-splitting arrangement also created a conflict of interest as the former global co-head of equities was responsible for supervising the relevant traders, and that the individuals involved in the commission-splitting arrangement failed to maintain records of the payments, which prevented the firm from making accurate records as well. As a result, the firm was censured, ordered to cease and desist from future violations, and required to pay a $1.25 million civil penalty.

***In re Loop Capital Markets, LLC*, Exch. Act Rel. No. 81898, 2017 SEC LEXIS 3338 (Oct. 19, 2017)**

The Commission accepted an Offer of Settlement from Loop Capital Markets, LLC, a registered broker-dealer, for allegedly failing to preserve certain business communications. According to the Commission Order, a senior registered representative used a personal email account to send communications regarding a finance transaction in order to avoid review and surveillance by the firm. The Commission alleged that at least one senior employee at the firm was aware that the registered representative was not complying with the firm's policy prohibiting the use of personal email for work. The Commission ultimately requested information related to the finance transaction, but the firm was unable to provide the communications transmitted through the registered representative's personal email account. As a result, the Commission found that the firm violated Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder; the firm was ordered to cease and desist from committing or causing any future violations and required to pay a $25,000 civil money penalty.

***In re BGC Financial, L.P.*, Exch. Act Rel. No. 83650, 2018 SEC LEXIS 1720 (July 17, 2018)**

The Commission accepted an Offer of Settlement from BGC Financial, L.P., a registered broker-dealer, for recordkeeping violations. According to the Commission Order, the firm deleted audio files for the recorded lines of eight registered representatives because the firm failed to advise the appropriate firm personnel to retain the files. In addition, the Commission alleged that the firm failed to maintain accurate books and records concerning certain transactions involving compensation, travel, entertainment, and other expenses. The SEC further asserted that the firm made inaccurate entries relating to a high-performing representative's compensation and relating to the firm's reimbursement of another registered representative for personal events, and failed to accurately record gifts to the firm's customers and firm funds used for personal expenses. As a result, the Commission found that the firm violated Section 17(a)(1) of the Exchange Act and Rules 17a-3 and 17a-4(j) thereunder. The firm was censured, ordered to cease and desist from future violations, and required to pay a $1.25 million civil penalty.

Regulation SHO Issues

***In re Industrial and Commercial Bank of China Financial Services LLC*, Exch. Act Rel. No. 82533, 2018 SEC LEXIS 135 (Jan. 18, 2018)**

The Commission accepted an Offer of Settlement from Industrial and Commercial Bank of China Financial Services LLC, a registered broker-dealer and a participant of a registered clearing

agency, for alleged repeated violations of Rule 204(a) of Regulation SHO. According to the Commission Order, the firm failed to close out certain Continuous Net Settlement fails-to-deliver because the firm improperly claimed credit against its close-out obligations while not meeting the requirements of Rule 204(e) of Regulation SHO. The Commission alleged that as part of its Rule 204 procedures, the firm identified which correspondent broker-dealers were responsible for each fail-to-deliver position, and if a correspondent broker-dealer claimed credit, the firm noted the claimed credit, but did not take any affirmative action to close out the fail-to-deliver position. The Commission alleged that the claimed credit was inadequate because the firm credited purchases that occurred after the settlement date for the transaction, incorrectly doubled-counted some purchases for credit against its close-out obligations, claimed credit that was based on purchases that never occurred, and sold the same securities in the same amount after purchasing sufficient shares to cover the close-out obligation. As a result, the Commission found that the firm experienced prolonged fail-to-deliver positions in violation of Rule 204(a). The firm agreed to cooperate in all related investigations and proceedings, and was censured, ordered to cease and desist from future violations, and required to pay a $1.25 million civil penalty. The Commission considered the firm's remedial acts in determining to accept the Offer of Settlement.

***In re Bayes Capital, LLC*, Exch. Act Rel. No. 83556, 2018 SEC LEXIS 1589 (June 28, 2018)**

The Commission accepted an Offer of Settlement from Bayes Capital, LLC, a former registered broker-dealer, concerning repeated violations of the order-marking, locate, and circuit breaker requirements in Regulation SHO. According to the Commission Order, the firm mismarked one million principal sales as sell-long when it did not own shares of the relevant securities or have a net long position in the securities at the time of order entry. The Commission also alleged that the firm failed to comply with the locate requirement in Regulation SHO for more than two million short sales executed in the firm's principal account. Finally, the Commission alleged that the firm did not establish, maintain, and enforce any written policies and procedures to comply with the circuit breaker requirements of Regulation SHO. As a result, the Commission found that the firm violated Rules 200(g)(1), 201(b), and 203(b)(1) of Regulation SHO. The firm was censured, ordered to cease and desist from future violations, and required to pay a $300,000 civil money penalty.

Regulatory Issues re: RMBS Transactions

***In re Merrill Lynch, Pierce, Fenner & Smith Inc.*, Exch. Act Rel. No. 83408, 2018 SEC LEXIS 1372 (June 12, 2018)**

The Commission accepted an Offer of Settlement from Merrill Lynch, Pierce, Fenner & Smith in connection with allegations that the firm failed to reasonably supervise traders and salespersons (Firm personnel) who purchased and sold non-agency residential mortgage-backed securities (non-agency RMBS). According to the Commission Order, the Firm personnel made materially false or misleading statements, directly and indirectly, to customers, and charged customers excessive, undisclosed markups that were unrelated to the prevailing market price. In particular, the SEC alleged that Firm personnel misrepresented the price at which the non-agency RMBS could be bought and sold, the amount of profit the firm would realize from the trades, and whether the firm was in active negotiations with the seller after agreeing to purchase the non-agency RMBS from the seller. The Commission also asserted that the firm failed to implement

procedures reasonably expected to prevent and detect such false or misleading statements, and that the firm's procedures failed to provide for a meaningful review of potentially excessive markups on certain non-agency RMBS. The Commission found that this conduct violated Section 15(b)(4)(E) of the Exchange Act. The firm agreed to be censured; pay a monetary civil penalty of $5,267,720; pay disgorgement and prejudgment interest totaling $10,535,441; and cooperate with the Staff in ongoing investigations. The Commission credited the firm's remedial efforts in reaching this settlement.

***SEC v. Shapiro*, Lit. Rel. No. 24312, 2018 SEC LEXIS 2773 (Oct. 10, 2018)**

The U.S. District Court for the Southern District of New York entered a final judgment against Ross B. Shapiro (Shapiro), the former head of the residential mortgage-backed securities trading desk at Nomura Securities International. According to the Commission's Complaint, which was initially filed on September 8, 2015, Shapiro made material misrepresentations and omissions to investors to generate additional revenue for the firm. The Complaint alleged that Shapiro misrepresented the prices at which the firm bought and sold the securities and the spread earned on the transactions. He also allegedly directed other firm traders to engage in similar misconduct. As a result, Shapiro was permanently enjoined from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act. He was required to pay a $200,000 civil penalty. The Commission also entered an administrative order barring Shapiro from the securities industry and from participating in any penny stock offering, with a right to reapply after two years. *See In re Shapiro*, Exch. Act Rel. No. 84390, 2018 SEC LEXIS 2770 (Oct. 10, 2018).

Regulatory Issues re: CMBS Transactions

***In re: Deutsche Bank Securities, Inc. et al.*, Exch. Act Rel. No. 82686, 2018 SEC LEXIS 407 (Feb. 12, 2018)**

The Commission accepted Offers of Settlement from Deutsche Bank Securities, Inc., a registered broker-dealer, and Benjamin Solomon (Solomon), the former global head of securitized products at Deutsche Bank, for failing to reasonably supervise the firm's non-agency commercial mortgage-backed securities (CMBS) traders and salespersons. According to the Commission Order, CMBS traders and salespersons made false and misleading statements to customers in an effort to increase the firm's profits. The Commission alleged that the firm failed to establish and/or implement procedures to prevent and detect such false and misleading statements. In addition, Solomon allegedly failed to take appropriate action to prevent CMBS traders and salespersons from making false and misleading statements. In particular, the SEC alleged that Solomon failed to act when he learned that traders were making misleading statements and, in some cases, participated in misstatements to the firm's customers. As a result, the Commission found that the firm and Solomon violated Section 15(b)(4)(E) of the Exchange Act and that Solomon also violated Section 15(b)(6)(A)(i) of the Exchange Act. The Commission censured the firm and required it to pay a $750,000 civil penalty, approximately $1.4 million in disgorgement, $123,741 in prejudgment interest, and approximately $3.7 million in remediation to customers. Solomon was suspended from the securities industry for 12 months and was required to pay a $165,000 civil penalty. The Commission credited the firm's remedial efforts and Solomon's cooperation in accepting the Offers of Settlement.

Sales Practices Violations

***In re Wells Fargo Advisors, LLC*, Exch. Act Rel. No. 83508, 2018 SEC LEXIS 1534 (June 25, 2018)**

The Commission accepted an Offer of Settlement from Wells Fargo Advisors, LLC, for improperly soliciting customers to effectively exchange their market-linked investments (MLI), redeeming their existing MLI early, and purchasing new MLIs. MLIs have limited liquidity and significant upfront fees. According to the Commission Order, certain of the firm's representatives did not reasonably investigate or understand the significant costs of MLI exchanges, but nonetheless recommended that customers redeem their MLIs early and use the proceeds from those redemptions to purchase new MLIs. The Commission alleged that the firm thereby obtained commissions by means of recommendations that contained implied representations that firm personnel had formed a reasonable basis for the recommendations when they had not done so. As a result, the Commission found that the firm violated Section 17(a)(2) and Section 17(a)(3) of the Securities Act. The firm was censured; ordered to cease and desist from committing or causing any future violations; and required to pay disgorgement of $930,377, prejudgment interest of $178,064, and a civil penalty of $4 million. The Commission considered the firm's remedial acts in accepting the Offer of Settlement.

Supervision

***In re Ameriprise Financial Services, Inc.*, Exch. Act Rel. No. 83848, 2018 SEC LEXIS 1998 (Aug. 15, 2018)**

The Commission accepted an Offer of Settlement from Ameriprise Financial Services, Inc., for failing to adopt and implement a supervisory system reasonably designed to detect and prevent misappropriation of client assets. Specifically, the Commission alleged that the firm's system used to identify situations where a representative attempted to change the client's address to an address controlled by the representative did not function properly. In addition, according to the Commission Order, the firm's automated transaction-based analysis tool that was intended to identify situations where a representative attempted to direct a cash disbursement from a client account to an address controlled by a representative faced limitations in its design with respect to cash disbursements via check. As a result, the SEC asserted that the firm failed to detect the misappropriation of more than $1 million in client funds by five former representatives. The Commission found that Ameriprise violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder and failed to reasonably supervise the five representatives within the meaning of Section 15(b)(4)(E) of the Exchange Act and 203(e)(6) of the Advisers Act. The firm was censured, ordered to cease and desist from future violations, and required to pay a civil penalty of $4.5 million. The Commission credited the firm's reimbursement to all impacted clients and the retention of a compliance consultant to assess the firm's policies and procedures in reaching this settlement.

***In re Cadaret, Grant & Co., Inc.*, Exch. Act. No. 10542, 2018 SEC LEXIS 2239 (Sept. 11, 2018)**

The Commission accepted Offers of Settlement from Cadaret, Grant & Co. Inc., a U.S.-based dually registered broker-dealer and investment adviser; its Chief Executive Officer, Arthur Grant

(Grant); Chief Compliance Officer, Beda Lee Johnson (Johnson); and registered representative Eugene Long (Long) (collectively, the Respondents). According to the Commission Order, registered representatives of the firm had recommended brokerage customers buy and hold certain complex nontraditional exchange-traded products (ETPs), despite failing to take reasonable steps to research the consequences of such investments and establish a reasonable basis for their recommendations. The SEC alleged that these recommendations resulted in losses exceeding $350,000, averaging approximately 90% of the customers' original investments. The Commission also found that the firm failed to adopt and implement written policies and procedures designed to prevent the sale of nontraditional ETPs unsuitable for the investment objectives of retail clients, and that supervisory personnel failed to implement a reasonable system to supervise representatives in their recommendations of these products. The Commission found that the Respondents violated Section 17(a)(2) and 17(a)(3) of the Securities Act, Section 15(b)(4)(E) and 15(b)(6) of the Exchange Act, and Section 206(4) and Rule 206(4)-7 of the Advisers Act. In connection with this settlement, the Commission censured the firm and ordered it to cease and desist from future violations, prohibited Grant and Johnson from acting in a supervisory capacity for 12 months, and censured Long and ordered him to cease and desist from future violations. The Respondents were further ordered to pay disgorgement, prejudgment interest, and a civil penalty that totaled $938,194. The firm also agreed to retain a qualified independent compliance consultant. The Commission considered the Respondents' cooperation in determining to accept the Settlement Offer.

***In re Alexander Capital, L.P.*, Exch. Act Rel. No. 83562, 2018 SEC LEXIS 1595 (June 29, 2018); *In re Philip A. Notto II*, Exch. Act Rel. No. 83563, 2018 SEC LEXIS 1596 (June 29, 2018); *In re Barry T. Eisenberg*, Exch. Act Rel. No. 83564, 2018 SEC LEXIS 1597 (June 29, 2018)**

The Commission accepted an Offer of Settlement from Alexander Capital, L.P. for allegedly failing to reasonably supervise three registered representatives who made unsuitable investments, churned their customers' accounts and engaged in unauthorized transactions. The Commission also accepted settlement offers from Philip A. Notto II (Notto), who allegedly failed to reasonably supervise two of the representatives, and Barry T. Eisenberg (Eisenberg), who allegedly failed to reasonably supervise the other representative. According to the Commission Order, for both reasonable basis and customer-specific suitability, the firm allegedly failed to provide specific guidance to supervisors and failed to implement reasonable mechanisms to address whether supervisors were appropriately discharging their duties. The Commission further asserted that the firm also failed to develop reasonable systems concerning unauthorized trading, and did not provide guidance concerning the exception reports supervisors were expected to use. The Commission concluded that if the firm had reasonably developed systems in place, the firm likely would have prevented and detected the violations of the federal securities laws by the registered representatives.

The Commission found the firm, Notto and Eisenberg each violated Section 15(b)(4)(E) of the Exchange Act. The firm was censured; required to retain an independent consultant; and ordered to pay disgorgement of approximately $193,774, prejudgment interest of approximately $23,436, and a civil penalty of approximately $193,774. The Commission credited the firm's remedial efforts in accepting the Offer of Settlement. Notto agreed to a permanent supervisory bar and a $20,000 civil penalty. Eisenberg agreed to a five-year supervisory bar and a $15,000 civil penalty.

Unauthorized Trading

***In re Citigroup Inc. and Citigroup Global Markets, Inc.*, Exch. Act Rel. No. 83859, 2018 SEC LEXIS 2011 (Aug. 16, 2018)**

The Commission accepted an Offer of Settlement from Citigroup Inc. (Citigroup), a financial services holding company, and Citigroup Global Markets, Inc. (CGMI), a dually registered broker-dealer and investment advisor. According to the Commission Order, CGMI failed to reasonably supervise its traders to prevent mismarked and unauthorized trading in proprietary accounts that ultimately caused CGMI's and Citigroup's books and records to be inaccurate. The Commission alleged that three traders, each on different trading desks, mismarked opaque, illiquid positions that were overvalued by the traders and not effectively price-verified. In addition, the Commission stated that two of the scenarios involved unauthorized trading in U.S. Treasury securities and that the losses related to those scenarios were concealed by the mismarking. The SEC further asserted that the unauthorized trading and mismarking was not detected for more than a year. The Commission found that CGMI violated Section 17(a) of the Exchange Act and Rule 17a-3(a) and 17a-5 thereunder and Section 15(b)(4)(E) of the Exchange Act. Citigroup violated Section 13(b)(2)(A) of the Exchange Act. CGMI was censured and ordered to cease and desist from committing or causing future violations. In addition, CGMI and Citigroup agreed to a civil penalty of $5.75 million. The Commission considered CGMI's and Citigroup's prompt remedial acts in determining to accept the Offer of Settlement, including that the relevant issues were self-reported to the Commission Staff.

Cases Relating to Investment Advisers/Investment Companies and Their Employees/Affiliated Persons[72]

Advertising

***SEC v. Howard B. Present*, Litig. Rel. No. 24077, 2018 SEC LEXIS 772 (Mar. 22, 2018); *In re Howard B. Present*, Investment Advisers Act Rel. No. 4870, 2018 SEC LEXIS 814 (Mar. 29, 2018)**

In this civil action filed by the Commission in December 2014, and following a jury trial where he was found liable on all charges, on March 22, 2018 the US District Court of Massachusetts entered a final judgment against Howard B. Present (Defendant), the former CEO of F-Squared Investments, Inc. (F-Squared), a registered investment adviser. The Commission's complaint alleged that from August 2008 to September 2013, Defendant made materially false and misleading statements about the AlphaSector strategy, the flagship product of F-Squared, and its advertised performance. Defendant falsely claimed that AlphaSector's advertised performance was based on the actual results of real clients' investments when, in fact, the performance was based on back-tested results; further, the advertised performance was substantially overstated due to a calculation error. Defendant was found to have violated Sections 206(1), 206(2), 206(4) and 207 of the Advisers Act and Rule 206(4)-8 thereunder, and aided and abetted F-Squared's violation of Section 206(4) and Rule 206(4)-1 thereunder. The judgment permanently enjoined Defendant from future violations of the Advisers Act, imposed a $1.575 million penalty and ordered Defendant to pay disgorgement of $10,849,604 together with prejudgment interest thereon in the amount of $1,377,003. Following the entry of the judgment, the Enforcement Division filed a follow-on Administrative Action to determine whether further relief, including a bar, might be in the public interest.

***In re Arlington Capital Management, Inc. and Joseph F. LoPresti*, Investment Advisers Act Rel. No. 4885, 2018 SEC LEXIS 910 (Apr. 16, 2018)**

The Commission accepted an offer of settlement from Arlington Capital Management, Inc. (Firm), a registered investment adviser, and Joseph F. LoPresti (collectively, Respondents), the Firm's president, 80% owner, and, at the time of the conduct described below, Chief Compliance Officer. The Commission alleged that from 2012 to 2015 Respondents misled clients and prospective clients regarding the Firm's investment performance in written advertisements as well as in LoPresti's weekly radio broadcasts and video webcasts. The Firm allegedly invested client assets in model portfolios designed from computer trading models and, over time, made numerous adjustments and improvements to those models based on additional historical testing and recent market results, which either enhanced back-tested performance or reduced back-tested volatility. The Commission alleged that the Firm advertised performance results using the back-tested results without adequately disclosing (i) that the results were hypothetical and back-tested, in

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[72] Because of dual registration or multiple parties, a number of the previously discussed cases in the prior section titled "Cases Relating to Broker-Dealer Firms and Their Employees/Affiliated Persons" could be placed in this section as well; however, we have chosen not to repeat them here.

some cases failing to disclose this at all and in other cases disclosing this in small print or in ways that otherwise lacked prominence, and (ii) that the performance results were derived using models that had been adjusted over the years with the benefit of hindsight.

The Commission further alleged that the Firm's advertising also contained misleading statements concerning comparisons to benchmarks, that the Firm failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act in connection with its advertisements, and that LoPresti was responsible for the Firm's misleading advertising and, as Chief Compliance Officer, its failure to implement adequate policies and procedures.

In determining to accept the offer of settlement, the Commission considered Respondents' cooperation with Commission staff and remedial acts, which included revisions to advertising policies and procedures, naming a new Chief Compliance Officer, and hiring a new compliance consultant to assist the Firm in implementing compliance changes. The Commission censured Respondents; ordered Respondents to cease and desist from future violations of Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1 and 206(4)-7 thereunder; imposed civil money penalties of $75,000 on LoPresti and $125,000 on the Firm; and required the Firm to comply with undertakings that included retention of a compliance consultant and enhancements to its policies and procedures.

***In re William M. Greenfield*, Investment Advisers Act Rel. No. 4961, 2018 SEC LEXIS 1685 (July 10, 2018); *In re Brian S. Eyster*, Investment Advisers Act Rel. No. 4962, 2018 SEC LEXIS 1686 (July 10, 2018); *In re HBA Advisors, LLC and Jaime Enrique Biel*, Investment Advisers Act Rel. No. 4963, 2018 SEC LEXIS 1687 (July 10, 2018); *In re Leonard S. Schwartz*, Investment Advisers Act Rel. No. 4964, 2018 SEC LEXIS 1688 (July 10, 2018); *In re Romano Brothers & Company*, Investment Advisers Act Rel. No. 4965, 2018 SEC LEXIS 1681 (July 10, 2018)**

In a collection of unrelated but thematically linked actions, the Commission accepted offers of settlement from a number of registered investment advisers (HBA Advisors, Romano Brothers), investment adviser representatives and principals of advisory firms (Eyster, Biel, Greenfield) and a marketing consultant to investment advisers (Schwartz) (collectively, Respondents) in connection with alleged violations of the prohibition on testimonials under Advisers Act Rule 206(4)-1, the Advertising Rule. Specifically, the Commission alleged that Respondents caused violations of the testimonial rule where they collected and published advertisements containing testimonials concerning the investment advisers – and, in certain cases, investment adviser representatives – and the investment advice and services they rendered. The testimonials were available to the public on various websites, including YouTube.com, Google.com, Facebook.com, Twitter.com, and Yelp.com. By publishing videos containing client testimonials, the Commission alleged that Respondents violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(1) thereunder. The Commission censured Romano Brothers and ordered them to cease and desist from further violations of Section 206(4) and Rule 206(4)-1(a)(1) thereunder. Respondent Schwartz was ordered to pay a civil money penalty of $35,000. Respondents Romano Brothers and HBA Advisors each were ordered to pay a civil money penalty of $15,000. Respondents Biel, Greenfield, and Eyster each were ordered to pay a civil money penalty of $10,000.

***In re Massachusetts Financial Services Company,* Investment Advisers Act Rel. No. 4999, 2018 SEC LEXIS 2156 (Aug. 31, 2018)**

The Commission accepted an offer of settlement from Massachusetts Financial Services Company (Respondent), a registered investment adviser, in connection with alleged material misstatements and omissions to advisory clients and others concerning hypothetical returns for Respondent's blended research stock ratings. According to the Commission Order, from 2006 to 2015 Respondent advertised that the basis of its blended research philosophy was that fundamental and quantitative management styles excel in differing market conditions, and that blending fundamental and quantitative stock ratings could over time yield better returns than either type of ratings alone. To illustrate the validity of this claim, Respondent advertised the results of a hypothetical portfolio of stocks developed on the basis of this analysis. The Commission alleged that the performance figures advertised by Respondent were misleading because they failed to disclose that some of the quantitative ratings used to create the hypothetical portfolio were determined using a retroactive, back-tested application of a quantitative model. The Commission also alleged that in certain advertisements Respondent falsely claimed that the hypothetical portfolio was based on its own stock ratings in the mid-1990s, even though Respondent had not generated such ratings at that time. Moreover, the Commission stated that the selection of market environments by Respondent for the back-test period was misleading, since it was designed to contribute to the superior performance figures. The Commission stated that Respondent also did not adopt and implement policies and procedures reasonably designed to prevent such violations of the Advisers Act advertising rule, and that its own compliance department contributed to the violations since (i) it was unaware that certain of the quantitative ratings were back-tested, and (ii) different groups of compliance personnel were used to review the relevant advertisements, resulting in disparate marketing presentations for the same materials. As a result of this conduct, the Commission found that Respondent violated Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1 and 206(4)-7 thereunder. The Commission censured Respondent, and ordered it to cease and desist from further violations of the Advisers Act and to pay a civil money penalty of $1.9 million.

***In re Creative Planning, Inc. and Peter A. Mallouk*, Investment Advisers Act Rel. No. 5035, 2018 SEC LEXIS 2422 (Sept. 18, 2018)**

The Commission accepted an offer of settlement from Creative Planning, Inc. (CPI), a registered investment adviser, and Peter A. Mallouk, the President and majority owner of CPI (collectively, Respondents). The Commission alleged that CPI (i) distributed hundreds of radio advertisements that contained prohibited client testimonials; (ii) failed to enforce the firm's code of ethics with regard to the radio advertisements and also regarding the reporting and review of certain securities accounts in which Mallouk had a beneficial interest; (iii) failed to keep true and accurate books and records; and (iv) failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act. The Commission ordered CPI to cease and desist from committing or causing any violations and any future violations of Sections 204, 204A, and 206(4) of the Advisers Act and Rules 204-2(a)(11), 204A-1, 206(4)-1(a)(1), and 206(4)-7 thereunder, and ordered Mallouk to cease and desist from committing or causing any violations of Section 204A of the Advisers Act and Rule 204A-1 thereunder. The Commission

further ordered that CPI pay a civil money penalty of $200,000 and that Mallouk pay a civil money penalty of $50,000.

***In re Sterling Global Strategies, LLC*, Investment Advisers Act Rel. No. 5085, 2018 SEC LEXIS 3600 (Dec. 20, 2018)**

The Commission accepted an offer of settlement from Sterling Global Strategies, LLC (Respondent), a registered investment adviser, in connection with its alleged marketing of hypothetical performance figures. According to the Commission Order, Respondent made material misstatements and omissions to its clients and prospective clients when advertising the back-tested performance of one of its investment strategies. Specifically, the Commission alleged that the back-tested performance was improperly calculated, and deviated from the actual strategy in a number of material respects, including consistency between the hypothetical portfolio and the model rules underlying the index on which the portfolio was based. The Commission found that these deviations, along with other calculation inaccuracies, artificially inflated the performance results. The Commission also alleged that Respondent failed to adopt and implement policies and procedures designed to prevent inaccuracies in advertisements concerning its back-tested performance. The Commission censured Respondent and ordered that Respondent cease and desist from committing or causing any violations of Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1(a)(5) and 206(4)-7 thereunder. The Commission also ordered that Respondent pay $175,000 in civil money penalties and comply with certain undertakings, including hiring an independent compliance consultant.

Advisory Fees

***In re Aisling Capital LLC*, Investment Advisers Act Rel. No. 4951, 2018 SEC LEXIS 1607 (June 29, 2018)**

The Commission accepted an offer of settlement from Aisling Capital LLC (Respondent), a venture capital fund adviser. The Commission alleged that Respondent failed to offset a percentage of the consulting fees it received from two portfolio companies of its private fund clients against management fees paid by those funds, as was required pursuant to the funds' offering documents. The Commission alleged that as a result of this failure to offset, the funds and their limited partners overpaid $759,870 in management fees. The Commission alleged that, after being contacted by Division of Enforcement staff, Respondent voluntarily reimbursed the funds' limited partners for the overpaid fees, plus interest; named a new Chief Compliance Officer; retained a compliance consulting firm to conduct quarterly testing of its expense allocation and disclosure policies and procedures; and implemented new controls to verify the accuracy of its fee and offset calculations. In accepting the offer of settlement, the Commission considered Respondent's cooperation with Commission staff and remedial acts. The Commission ordered Respondent to cease and desist from committing or causing any violations of Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder and to pay a civil money penalty of $200,000.

***In re Beverly Hills Wealth Management, LLC and Margaret Mulligan Black (AKA Margaret Mulligan Scott)*, Investment Advisers Act Rel. No. 4975, 2018 SEC LEXIS 1773 (July 20, 2018)**

The Commission accepted an offer of settlement from Beverly Hills Wealth Management, LLC (BHWM), a registered investment adviser, and its principal, Margaret Mulligan Black (collectively, Respondents). The Commission alleged that in April 2016, Respondents withheld prepaid, unearned advisory fees totaling $131,000 from 63 departing clients who requested to terminate their advisory relationship with BHWM, notwithstanding contrary representations made in its Form ADV brochures and investment advisory agreements. The Commission further stated that Respondents omitted material facts and made false and misleading statements regarding BHWM's financial condition in its Form ADV brochures by failing to disclose that it was insolvent. As a result of this conduct, the SEC found that Respondents violated Sections 204(a), 206(2), 206(4), and 207 of the Advisers Act and Rules 204-1(a)(2) and 206(4)-7 thereunder. Respondents were ordered to cease and desist from further violations and pay civil money penalties totaling $150,000.

***In re Karen Bruton, CPA*, Exchange Act Rel. No. 84198, 2018 SEC LEXIS 2429 (Sept. 19, 2018); *In re Karen Bruton, CPA and Hope Advisors, LLC*, Investment Advisers Act Rel. No. 5038, 2018 SEC LEXIS 2457 (Sept. 19, 2018); *SEC v. Hope Advisers, LLC, et al.*, Litig. Rel. No. 24285, 2018 SEC LEXIS 2512 (Sept. 21, 2018); *In re Dawn Roberts*, Investment Advisers Act Rel. No. 5044, 2018 SEC LEXIS 2588 (Sept. 25, 2018); *In re Todd Wortman*, Investment Advisers Act Rel. No. 5045, 2018 SEC LEXIS 2589 (Sept. 25, 2018)**

The Commission obtained a consent judgment in federal district court against Tennessee-based Hope Advisors, LLC (Hope) and Karen Bruton, CPA, the principal of Hope, following more than two years of civil proceedings.

The Commission's Complaint against Hope and Bruton alleged that Hope managed two private hedge funds in which its only compensation was an incentive fee, calculated as a share of the profits earned in the funds' accounts each month, and that Hope engaged in a continuous pattern of trading to inflate its incentive fee by structuring trading so that a profit would be realized at the end of the month and guaranteeing that losses would not be realized until the following month. The Commission alleged that many of these trades could not reasonably have been expected to generate a profit for the funds, and served solely to generate millions of dollars in advisory fees for Hope to the detriment of the funds' investors. The Commission's Complaint alleged that, if Hope had not engaged in the scheme, it would have received almost no incentive fees between at least October 2014 and June 2016. As part of the consent judgment, the court found that Hope and Bruton violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, and ordered that they pay disgorgement of $1,237,235 and a civil money penalty of $250,000.

In connection with these same proceedings, consent judgments also were entered against the remaining defendants, Hope's chief compliance officer Dawn Roberts and employee Todd

Wortman, enjoining each from future violations of Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

Thereafter, in separate follow-on civil administrative proceedings, the Commission initiated administrative proceedings against Bruton that are still pending, and accepted offers of settlement from Roberts and Wortman. The Commission, pending a hearing, temporarily barred Bruton from practicing as an accountant before it; Roberts was suspended from associated for a period of 12 months; and Wortman was barred from association for one year.

In re Retirement Capital Strategies, Inc., **Investment Advisers Act Rel. No. 5064, 2018 SEC LEXIS 3264 (Nov. 19, 2018)**

The Commission accepted an offer of settlement from Retirement Capital Strategies, Inc. (Respondent), a registered investment adviser. The Commission alleged that Respondent failed to apply advisory fee discounts to certain client accounts contrary to its disclosures, representations to clients, and advisory agreements. From January 2010 through February 2018, Respondent offered clients an advisory fee between 0.4% and 1.5%, which was determined based on fee breakpoints described in a fee schedule that reduced the applicable advisory fee rate as client assets increased. The fee schedule was incorporated by reference in client advisory agreements, distributed to clients upon request, and, starting in 2011, disclosed in the Form ADV brochure that Respondent filed with the Commission. The Commission alleged that notwithstanding this disclosure, Respondent failed to apply the breakpoint discounts, and consequently improperly calculated advisory fees and thereby overcharged certain clients. The Commission further stated that Respondent allowed related account balances of clients within a household to be aggregated for purposes of achieving fee breakpoints; however, Respondent failed to consistently and timely aggregate the assets across accounts within a household, resulting in some clients paying higher fee rates than they otherwise would have been assessed. As a result, the Commission alleged that Respondent overcharged 293 client accounts approximately $304,000. The Commission also alleged that Respondent failed to adopt and implement policies and procedures reasonably designed to prevent it from charging advisory fees greater than those disclosed to clients, and procedures designed to consistently aggregate household accounts for all clients, as applicable. As a result of this conduct, the Commission found that Respondent violated Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder. In considering Respondent's offer of settlement, the Commission considered remedial efforts undertaken by Respondent, including Respondent's review and remediation of client accounts to refund excess fees, with interest, and retention of a compliance consultant. The Commission censured Respondent, ordered it to cease and desist from further violations of the Advisers Act, and ordered it to pay a civil money penalty of $50,000.

Compliance Policies and Procedures

In re Ameriprise Financial Services, Inc., **Investment Advisers Act Rel. No. 4985, 2018 SEC LEXIS 1998 (Aug. 15, 2018)**

The Commission accepted an offer of settlement from Ameriprise Financial Services, Inc. (Respondent), a dually registered investment adviser and broker-dealer. The Commission alleged

that Respondent failed to adopt and implement policies and procedures to prevent misappropriation of client assets by Respondent's representatives. According to the Commission's Order, from 2011 to 2014 Respondent's manual and automated surveillance tools used to detect fraudulent misappropriation of client funds did not function properly. The Commission alleged that as a result Respondent failed to timely detect and prevent five of its representatives from misappropriating more than $1 million of clients' assets by forging client signatures and requesting unauthorized client address changes. The Commission alleged that Respondent was unaware that its systems were not operating effectively, and that Respondent failed to test its systems during the relevant period to see if there were any errors.

In determining to accept Respondent's offer, the Commission considered the cooperation and certain remedial acts of Respondent, such as Respondent hiring a compliance consultant to assess the reasonableness of its policies, procedures, and controls for safeguarding customer assets against misappropriation; reimbursing impacted clients for the losses they had incurred; and implementing a new automated money movement control system. The Commission censured Respondent and ordered it to cease and desist from committing or causing any violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. The Commission ordered Respondent to pay a civil money penalty of $4.5 million.

Conflicts of Interest Disclosure

***In re Financial Fiduciaries, LLC and Thomas Batterman,* Investment Advisers Act Rel. No. 4863, 2018 SEC LEXIS 657 (Mar. 5, 2018)**

The Commission accepted an offer of settlement from Financial Fiduciaries, LLC, a registered investment adviser, and Thomas Batterman, its founder and principal (collectively, Respondents). The Commission alleged that Financial Fiduciaries breached its fiduciary duty to certain clients by failing to disclose in its Form ADV, or otherwise, conflicts of interest caused by its financial arrangements with a third-party trust company. The Commission also alleged that from 2012 to mid-2014 an employee of the third-party trust company that had custody over certain of Financial Fiduciaries' clients' assets was a "related person" of Financial Fiduciaries since that employee was also an employee of a corporation under common control with Financial Fiduciaries. The Commission alleged that because of this "dual-employee" Financial Fiduciaries violated the Advisers Act Custody Rule. The Commission further alleged that Batterman, as Financial Fiduciaries' principal, caused these violations. The Commission ordered that Respondents cease and desist from further violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-2 thereunder, and ordered Financial Fiduciaries and Batterman to pay civil money penalties of $40,000 and $20,000, respectively.

***In re Voya Investments, LLC and Directed Services LLC*, Investment Advisers Act Rel. No. 4868, 2018 SEC LEXIS 684 (Mar. 8, 2018)**

The Commission accepted an offer of settlement from Voya Investments, LLC, a registered investment adviser, and Directed Services LLC, until August 2017 a dually registered broker-dealer and investment adviser (collectively, Respondents) in connection with alleged disclosure-related violations of the Advisers Act. According to the Commission Order, from at least 2003 until 2017 Respondents failed to disclose relevant conflicts of interest and made misleading disclosures in

connection with their practice of recalling securities on loans through lending arrangements to third-party financial institutions so that Respondents' affiliates could receive tax benefits. The Commission noted that Respondents served as investment advisers to certain insurance-dedicated mutual funds offered to annuity and life insurance customers through insurance companies affiliated with Respondents. The SEC alleged that in order to generate additional income for the mutual funds and their investors, Respondents lent securities held by the funds to parties looking to borrow the securities and then recalled the loaned securities before their dividend record dates, so that Respondents' insurance company affiliates, who were the shareholders of record for the funds' shares, could receive a tax benefit based on the dividends received. According to the Commission, the recall practice caused the funds and their investors to lose securities-lending income without receiving any offsetting tax benefit for the periods in which the securities were recalled. The Commission further stated that Respondents failed to disclose the conflict of interest to the funds' board of directors or in the funds' prospectuses. The Commission censured Respondents, ordered that they cease and desist from further violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, and ordered them to pay civil money penalties of $500,000, disgorgement of $2,635,490.25, and prejudgment interest of $511,978.89.

***In re Michael Devlin*, Investment Advisers Act Rel. No. 4973, 2018 SEC LEXIS 1750 (July 19, 2018)**

The Commission accepted an offer of settlement from Michael Devlin (Respondent), the managing partner and chief compliance officer of a registered investment adviser (Adviser) that managed five private equity funds. The SEC alleged that in May 2013 Respondent arranged for one of the funds managed by the Adviser to invest into a subsidiary of a portfolio company, on the condition that some of the investment proceeds would be used to purchase from him a personal investment he had previously made. The Commission alleged that Respondent did not disclose the conflicted transaction to the fund's limited partner advisory committee (LPAC) or obtain the LPAC's consent to this conflicted transaction, which disclosure and consent were required by the Adviser's compliance policies and by the fund's limited partnership agreement. The Commission found that Respondent violated Section 206(2) of the Advisers Act in connection with this activity. Respondent was ordered to cease and desist from further violations of the Advisers Act, barred from the securities industry for one year, and further ordered to pay a civil money penalty of $80,000.

***In re Merrill Lynch, Pierce, Fenner & Smith Incorporated*, Investment Advisers Act Rel. No. 4989, 2018 SEC LEXIS 2022 (Aug. 20, 2018)**

The Commission accepted an offer of settlement from Merrill Lynch, Pierce, Fenner & Smith Incorporated (Respondent), a registered investment adviser and broker-dealer. The Commission alleged that Respondent failed to disclose conflicts of interest associated with the evaluation process it employed in connection with a termination recommendation for certain products. Specifically, the Commission alleged that in a break from ordinary practices, Respondent's governance committee deferred acting on removal of a third-party investment adviser from its retail advisory platform after senior executives of the third-party adviser contacted Respondent's management and made an appeal that it remain on the platform.

The Commission alleged that, following this pitch, the proposed termination was deferred, and between the deferral and the full reinstatement of the products to the platforms as open to new purchases slightly less than a year later Respondent earned approximately $4,030,000 in fees based on its clients' investment in the products. The Commission alleged that the communications between the companies' senior management regarding the products, and the resulting conflict of interest in Respondent's decisionmaking process, were not disclosed to Respondent's clients or to its full governance committee. In accepting Respondent's offer of settlement, the Commission considered the remedial acts and cooperation of Respondent. The Commission censured Respondent and ordered Respondent to cease and desist from committing or causing any violations of Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, and to pay $4,032,871.89 in disgorgement, $806,981.03 in prejudgment interest, and a civil money penalty of $4,032,871.89.

***In re LendingClub Asset Management, LLC, f/k/a LC Advisors, LLC, Renaud Laplanche and Carrie Dolan*, Investment Advisers Act Rel. No. 5054, 2018 SEC LEXIS 2665 (Sept. 28, 2018)**

The Commission accepted an offer of settlement from LendingClub Asset Management, LLC, formerly known as LC Advisors, LLC, a registered investment adviser (LCA); Renaud Laplanche, the founder and CEO of LCA; and Carrie Dolan, the CFO of LCA until August 2016 and thereafter an advisor to LCA (collectively, Respondents). According to the Commission Order, LCA provides investment advisory services to several private credit funds that purchase loan interests offered by LendingClub Corporation (LendingClub), a publicly traded online marketplace lending company. The Commission alleged that, from approximately December 2015 through April 2016, LCA, through Laplanche, caused one of the private funds it managed (Fund) to purchase interests in certain loans that were at risk of expiring unfunded on the LendingClub platform, which would have deprived LendingClub of revenue it could otherwise earn. The Commission alleged that LCA caused the Fund to purchase these interests to benefit LendingClub, not the Fund, in breach of LCA's fiduciary duty to the Fund, and, moreover, that these purchases were inconsistent with the loan allocation procedures LCA disclosed in its Form ADV and in its private placement memorandum for the Fund. The Commission alleged further that Respondents acted negligently when they improperly adjusted monthly returns for the Fund and other LCA-managed funds to improve reported returns. The Commission also stated that LCA failed to implement written policies and procedures designed to prevent violations of the Advisers Act. As a result of this conduct, the Commission found that Respondents violated Sections 204(a), 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rules 204-1(a), 206(4)-7, and 206(4)-8 thereunder. LCA and Dolan were censured, and Laplanche was barred from association for three years. Respondents were ordered to cease and desist from committing or causing any further violations of the Advisers Act. The payment of civil money penalties was ordered in the amount of $4 million for LCA, $200,000 for Laplanche, and $65,000 for Dolan. The Commission also ordered Respondents to comply with certain undertakings, including providing notice of the Commission's order to LCA's advisory clients.

***In re Landaas & Company and Robert W. Landaas,* Investment Advisers Act Rel. No. 5072, 2018 SEC LEXIS 3500 (Dec. 12, 2018)**

The Commission accepted an offer of settlement from Landaas & Company (the Firm), a dually registered investment adviser and broker-dealer, and its principal owner, Robert W. Landaas (collectively, Respondents), in connection with Respondents' use of a clearing broker and alleged resulting receipt of undisclosed financial compensation. The Commission alleged that Respondent used an unaffiliated clearing broker, which charged the Firm's clients a $20 markup in the form of a "confirmation fee" for its services. The Commission found that, while sometimes this markup was used to pay the clearing broker for its services, there were several instances when the Firm kept part of the markup for itself as compensation for acting as the introducing broker. The Commission alleged that although the Firm disclosed its use of a clearing broker, it did not disclose to clients that the Firm itself would be receiving compensation to act as introducing broker, or that this compensation created a conflict of interest. According to the Commission, certain of the Firm's representatives misunderstood the nature of the confirmation fee and as a result incorrectly told clients that the Firm did not receive any portion of it. The Commission found that the marked-up confirmation fee also caused the Firm to breach its fiduciary duty to seek best execution for its advisory clients.

The Commission further alleged that the unaffiliated clearing broker shared with the Firm revenues that it received from mutual funds in the broker's no-transaction-fee (NTF) mutual fund program. According to the Commission Order, the receipt of these undisclosed payments created a financial incentive for the Firm to favor NTF funds over other investments and created yet another conflict of interest that the Firm did not disclose. The Commission also alleged that the Firm failed to adopt and implement written policies and procedures reasonably designed to meet its best execution obligations. As a result of this conduct, the Commission found that Respondents violated or caused violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder. The Commission censured Respondents and ordered that they cease and desist from further violations of the Advisers Act. The Commission also ordered Respondents to pay disgorgement of $408,483.06, prejudgment interest of $60,458.14, and a civil money penalty of $130,000. The Commission further imposed certain undertakings on the Firm, including hiring an independent compliance consultant.

***In re Yucaipa Master Manager Inc.*, Investment Advisers Act Rel. No. 5074, 2018 SEC LEXIS 3519 (Dec. 13, 2018)**

The Commission accepted an offer of settlement from Yucaipa Master Manager Inc. (Respondent), a registered investment adviser and private fund manager. The Commission alleged that Respondent negligently failed to disclose several financial conflicts of interest to the private funds it manages. Specifically, the Commission alleged that Respondent failed to disclose the existence of certain third-party business arrangements with two consulting firms, including one in which Respondent's principal made a personal investment. The Commission further alleged that Respondent misallocated fees and did not disclose its practice of charging the funds for specific types of in-house employees to assist in preparing fund tax returns. Finally, the Commission found that Respondent failed to adopt written policies and procedures reasonably designed to prevent violations of the Advisers Act. The Commission found that Respondent

violated Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder. The Commission censured Respondent, ordered it to cease and desist from further violations of the Advisers Act, and ordered it to pay disgorgement of $1,863,242, prejudgment interest of $71,070, and $1 million in civil money penalties. Additionally, the Commission ordered that Respondent hire an independent compliance consultant.

Conflicts of Interest Disclosure – Mutual Fund Share Class Selection

***In re Geneos Wealth Management, Inc.*, Investment Advisers Rel. No. 4877, 2018 SEC LEXIS 4877 (Apr. 6, 2018)**

The Commission accepted an offer of settlement from Geneos Wealth Management, Inc. (Respondent), a registered investment adviser and broker-dealer. The Commission alleged that Respondent invested certain advisory clients in mutual fund share classes that charged 12b-1 fees when these clients were eligible to invest in less-expensive share classes of the same funds that did not charge 12b-1 fees. As a result, according to the Commission, Respondent received at least $1,047,617.50 in 12b-1 fees in its capacity as a broker-dealer, based on its advisory clients' investments in the higher-fee share classes. The Commission further alleged that Respondent received revenue-sharing payments from its clearing brokers in connection with its advisory clients' investments in mutual funds in the clearing brokers' NTF mutual fund programs. The Commission also found that investing advisory clients in fund share classes that charged 12b-1 fees where those clients are eligible for less-expensive share classes violated Respondent's duty to seek best execution. The Commission alleged that Respondent's Form ADV disclosures regarding its mutual fund share class selection and revenue-sharing practices were inadequate, including Respondent's failure to identify updated disclosures in March 2017 as a material change, and that Respondent failed to adopt written policies and procedures reasonably designed to prevent violations of the Advisers Act and rules in connection with these practices. The Commission censured Respondent, and ordered it to cease and desist from committing or causing further violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder and to pay disgorgement of $1,433,802, prejudgment interest of $124,318, and a civil money penalty in the amount of $250,000.

***In re PNC Investments LLC*, Investment Advisers Act Rel. No. 4878, 2018 SEC LEXIS 866 (Apr. 6, 2018)**

The Commission accepted an offer of settlement from PNC Investments LLC (Respondent), a dually registered investment adviser and broker-dealer. The Commission alleged that Respondent invested advisory clients in mutual fund share classes with 12b-1 fees instead of share classes of the same funds without 12b-1 fees, and received more than $5,129,000 in 12b-1 fees and $497,000 in marketing support payments as a result. The Commission alleged that Respondent's Form ADV disclosures regarding these practices were inadequate, and that Respondent breached its duty to seek best execution by investing clients in 12b-1 fee paying share classes, when lower-cost share classes were available. The Commission further alleged that Respondent improperly charged more than $105,000 in advisory fees to clients whose investment adviser representative (IAR) had departed the firm and whose accounts had not been reassigned to a new IAR within 30 days. The Commission also alleged that Respondent failed to adopt and implement written

compliance policies and procedures governing mutual fund share class selection and orphaned accounts; failed to implement the policies and procedures it had adopted regarding conflicts of interest; and failed to implement the policies and procedures it had adopted regarding the assignment of new IARs in a timely manner, and not charging advisory fees without receiving IAR services. The Commission censured Respondent, and ordered it to cease and desist from committing or causing further violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder and to pay disgorgement of $5,732,009, prejudgment interest of $675,770, and a civil money penalty in the amount of $900,000.

***In re Securities America Advisors, Inc.*, Investment Advisers Act Rel. No. 4876, 2018 SEC LEXIS 868 (Apr. 6, 2018)**

The Commission accepted an offer of settlement from Securities America Advisors, Inc. (Respondent), a registered investment adviser, in connection with its role in investing advisory clients in mutual fund share classes that charged 12b-1 fees. The Commission alleged that Respondent's IARs purchased, recommended, or held, on behalf of certain advisory clients, mutual fund share classes that charged 12b-1 fees when those clients were otherwise eligible to invest in lower-cost share classes of those same funds, and that as a result Securities Americas, Inc. (SAI), a broker-dealer affiliate of Respondent, received 12b-1 fees, some of which were passed on to its registered representatives who acted in dual capacities as Respondent's IARs. The Commission alleged that Respondent's disclosures regarding mutual fund share class selection, which stated that IARs *may* receive 12b-1 fees from the sale of mutual funds and that the receipt of such fees may create a conflict of interest, were inadequate. Further, the Commission alleged that by causing clients to invest in the 12b-1 fee paying share classes when they were eligible for lower-cost share classes, Respondent failed to comply with its duty to seek best execution. Lastly, the Commission alleged that Respondent failed to adopt and implement written compliance policies and procedures governing mutual fund share class selection, and failed to implement the policies and procedures it had adopted regarding conflicts of interest.

In accepting the offer of settlement, the Commission considered Respondent's remedial efforts, which included the implementation of new policies requiring IARs to purchase for advisory accounts the lowest cost share class available, converting existing advisory account holdings to the lowest-cost share class at no cost or tax consequence to the client, and crediting back to existing clients any newly incurred 12b-1 fees for shares that had not yet been converted. The Commission censured Respondent, and ordered it to cease and desist from committing or causing further violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder and to pay $4,473,025.50 in disgorgement, $580,423.14 in prejudgment interest, and a civil money penalty of $775,000.

***In re First Western Advisors*, Investment Advisers Act Rel. No. 4995, 2018 SEC LEXIS 2076 (Aug. 24, 2018)**

The Commission accepted an offer of settlement from First Western Advisors (Respondent), a registered investment adviser and broker-dealer. The Commission alleged that from at least March 20, 2012 to December 31, 2016, Respondent disclosed to its advisory clients that it did not receive compensation in any form from the sale of mutual funds when, in fact, it received

compensation in its capacity as a broker-dealer in the form of 12b-1 fees, totaling $139,698.50 during this period. In addition, the Commission alleged that Respondent's IARs invested certain advisory clients in mutual fund share classes that charged 12b-1 fees, despite those clients' eligibility to invest in lower-cost share classes of the same funds, which practice was inconsistent with Respondent's duty to seek best execution for those transactions. The Commission further alleged that Respondent failed to disclose the conflict of interest arising from these mutual fund share class selection practices, and failed to implement written policies and procedures reasonably designed to prevent violations of the Advisers Act in connection with such practices. The Commission censured Respondent, and ordered it to cease and desist from committing further violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder and to pay $139,698.50 in disgorgement, $13,068.62 in prejudgment interest, and a civil money penalty of $50,000.

***In re Harbour Investments, Inc.*, Investment Advisers Act Rel. No. 5006, 2018 SEC LEXIS 2269 (Sept. 13, 2018)**

The Commission accepted an offer of settlement from Harbour Investments, Inc., a registered investment adviser and broker-dealer (Respondent). The Commission alleged that Respondent failed to fully and fairly disclose compensation received from a third-party broker-dealer (Custodian A) by Respondent between 2012 and 2016. The Commission alleged that this arrangement created incentives for Respondent to favor Custodian A over other custodians when making recommendations to clients as to where to custody their assets. The Commission further alleged that, during the same period, Respondent invested some of its advisory clients in mutual fund share classes with 12b-1 fees when lower-cost share classes of the same fund were available, and that, in its capacity as a broker-dealer, Respondent received 12b-1 fees from some investments in these share classes, which created a conflict of interest that Respondent did not fully disclose. The Commission further alleged that investing clients in a more expensive share class when a less-expensive share class in the same fund was available is inconsistent with Respondent’s duty to seek best execution for its advisory clients. Finally, the Commission alleged that Respondent failed to implement certain of its policies and procedures designed to mitigate conflicts of interest. In determining to accept the settlement offer, the Commission considered Respondent's cooperation and remedial acts. The Commission censured Respondent, and ordered it to cease and desist from committing or causing further violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder and to pay $157,327 in disgorgement, $9,152 in prejudgment interest, and a civil money penalty of $75,000. The Commission also required Respondent to comply with certain undertakings, including to post the order on its website.

***In re Capital Analysts, LLC*, Investment Advisers Act Rel. No. 5009, 2018 SEC LEXIS 2308 (Sept. 14, 2018)**

The Commission accepted an offer of settlement from Capital Analysts, LLC, a registered investment adviser (Respondent). The Commission alleged that Respondent failed to adequately disclose to clients the conflicts of interest in connection with its mutual fund share class selection practices and receipt of revenue-sharing payments. Specifically, the Commission alleged that Respondent invested certain advisory clients in mutual fund share classes with 12b-1 fees instead

of available lower-cost share classes of the same funds. The Commission further alleged that Respondent's affiliated broker-dealer received the 12b-1 fees based on these investments, that Respondent did not adequately disclose this conflict of interest in its Forms ADV or otherwise, and that Respondent breached its duty to seek best execution for its clients by investing them in mutual fund share classes with 12b-1 fees rather than lower-cost share classes. The Commission also alleged that Respondent failed to adequately disclose to its clients compensation that its affiliated broker-dealer received through an agreement with its third-party clearing broker, consisting of shareholder servicing fees received when Respondent invested its clients in certain NTF mutual funds that did not pay 12b-1 fees, and conflicts arising from that compensation, including the resulting incentive for Respondent to invest clients in such funds. Finally, the Commission alleged that Respondent failed to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder in connection with its mutual fund share class selection practices. In determining to accept the settlement offer, the Commission considered Respondent's cooperation and remedial acts, including, beginning in March 2016, to invest advisory clients in, and initiate conversions to, the lowest-cost share class available. The Commission censured Respondent, and ordered it to cease and desist from committing or causing further violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder and to pay $1,627,306 in disgorgement, $193,043 in prejudgment interest, and a civil money penalty of $300,000.

***In re American Portfolios Advisors, Inc.*, Investment Advisers Act Rel. No. 5083, 2018 SEC LEXIS 3639 (Dec. 20, 2018)**

The Commission accepted an offer of settlement from American Portfolios Advisors, Inc. (Respondent), a registered investment adviser, in connection with its mutual fund share class selection practices for advisory clients. The Commission alleged that Respondent invested advisory client resources in mutual fund share classes that charged 12b-1 fees instead of less-expensive share classes of the same funds that were available without 12b-1 fees. The Commission stated that as a result of these investments, Respondent received $850,000 in 12b-1 fees, which presented a financial conflict of interest that Respondent failed to disclose to its clients. The Commission further alleged that by not investing clients in the lowest-cost share class, Respondent failed in its duty to seek best execution for its clients. The Commission further alleged that Respondent failed to implement written policies and procedures designed to prevent violations of the Advisers Act and the rules thereunder in connection with its mutual fund share class selection practices. The Commission censured Respondent, and ordered it to cease and desist from committing or causing further violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder and to pay disgorgement of $850,000, prejudgment interest of $45,353, and a civil money penalty of $250,000.

***In re PPS Advisors, Inc. and Lawrence Nicholas Passaretti*, Investment Advisers Act Rel. No. 5084, 2018 SEC LEXIS 3640 (Dec. 20, 2018)**

The Commission accepted an offer of settlement from PPS Advisors, Inc. (Firm), a formerly registered investment adviser, and its co-founder, CEO, and CIO, Lawrence Nicholas Passaretti (collectively, Respondents), in connection with the Firm's asset management services to its advisory clients through a wrap fee advisory program. The Commission alleged that Respondents

invested advisory clients in mutual fund share classes that charged 12b-1 fees instead of less-expensive share classes of the same funds that were available without 12b-1 fees. The Commission stated that the Firm's disclosures did not properly inform its clients of the conflict of interest present in its share class selection practices, specifically that the Firm's investment adviser representatives received additional compensation for investing in a fund's 12b-1 fee paying share class. The Commission further alleged that, as a result of this investment practice, the Firm failed in its duty to seek best execution for those transactions. The Commission also found that the Firm did not adopt and implement written policies and procedures to prevent this type of violation, and other violations of the Advisers Act and its rules relating to mutual fund share class selection. The Commission censured Respondents, and ordered them to cease and desist from committing or causing further violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder and to pay $600,000 in disgorgement, $31,746 in prejudgment interest, and $75,000 in civil money penalties.

In re Thoroughbred Financial Services, LLC, Thomas Jenkins Parker, and Lawrence Randall "Randy" Hartley, **Investment Advisers Act Rel. No. 5090, 2018 SEC LEXIS 3625 (Dec. 21, 2018)**

The Commission accepted an offer of settlement from Thoroughbred Financial Services, LLC (the Firm), a dually registered investment adviser and broker-dealer, and two of its IARs, Thomas Jenkins Parker and Lawrence Randall "Randy" Hartley (collectively, Respondents). The Commission alleged that Respondents invested advisory client assets in mutual fund share classes that paid 12b-1 fees, when lower-cost share classes of the same funds were available, without adequately disclosing to clients the fact that the Firm and its IARs received the 12b-1 fees based on these investments. The Commission alleged that this practice was also inconsistent with Respondents' disclosures to the Firm's clients about how conflicts would be managed in the Firm's own Code of Ethics. The Commission further stated that this practice caused Respondents to breach their duty to seek best execution, and that, in connection with certain client transactions, the Firm's investment strategy allowed it to avoid paying mutual fund transaction clearance charges that the Firm otherwise would have paid. The Commission also alleged that the Firm failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act in connection with its mutual fund share class selection practices. Finally, the SEC alleged that Parker and Hartley made misleading statements and omissions to certain clients to lead them to agree to higher account management fees.

The Commission censured Respondents, and ordered that they cease and desist from committing or causing further violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder. The Commission ordered the Firm to pay disgorgement of $720,250.20, prejudgment interest of $108,368.10, and a civil money penalty of $75,000. The Commission ordered Parker to pay disgorgement of $217,883.16, prejudgment interest of $31,750.80, and a civil money penalty of $75,000. The Commission ordered Hartley to pay disgorgement of $158,032.42, prejudgment interest of $22,957.20, and a civil money penalty of $65,000.

Conflicts of Interest Disclosure – Receipt of Undisclosed Compensation

***In re LKL Investment Counsel, LLC (a/k/a LKL Investments, LLC) and Mark H. Love*, Investment Advisers Act Rel. No. 4836, 2018 SEC LEXIS 7 (Jan. 3, 2018)**

The Commission accepted an offer of settlement from a formally registered investment adviser, LKL Investment Counsel LLC (LKL), and its principal, Mark H. Love (collectively, Respondents), in connection with Respondents' alleged misrepresentations in Forms ADV filed with the Commission, failure to produce documents to Commission examination staff, and certain compliance-related deficiencies. Specifically, the Commission alleged that Love recommended to certain LKL clients that they invest in private funds in which he held a managerial interest, without disclosing in LKL's Forms ADV his position with those funds, and that he stood to receive fees and a share of investment profits from those funds. The Commission stated that although those clients knew of Love's involvement with the private funds, LKL's Forms ADV Parts 1 and 2 from 2010 to 2015 falsely stated that Love had no outside financial industry activities or affiliations and did not have ownership or proprietary interests in client transactions.

The Commission further alleged that when LKL attempted to partially correct its Form ADV in March 2016, it failed to disclose the complete list of funds with which Love was involved, and further failed to deliver its revised Form ADV Part 2 brochure or a summary of material changes to clients as required given material changes in previously overstated AUM figures. Lastly, the Commission alleged various LKL compliance issues, including (i) failure to conduct annual compliance reviews under Advisers Act Rule 206(4)-7; (ii) failure to implement its policies and procedures requiring full disclosure of Love's outside business activities; (iii) failure to adopt policies and procedures related to advisory fees; and (iv) errors in charging and refunding advisory fees totaling approximately $8,500. Noting that LKL withdrew its registration with the SEC and undertook to remediate affected clients, the Commission censured Respondents and ordered them to cease and desist from committing or causing any violations of Sections 204(a), 206(4), and 207 of the Advisers Act and Rules 204-3 and 206(4)-7 thereunder. Love was further barred from serving in a compliance capacity with respect to any investment advisory entity. The Commission also ordered LKL and Love to pay civil money penalties of $100,000 and $50,000, respectively.

***In re WCAS Management Corporation*, Investment Advisers Act Rel. No. 4896, 2018 SEC LEXIS 965 (Apr. 24, 2018)**

The Commission accepted an offer of settlement from WCAS Management Corporation (Respondent), an investment adviser to various private equity funds (Funds). The Commission alleged that Respondent received $623,035 in payments under an agreement with a group purchasing organization (GPO), pursuant to which the GPO paid Respondent a share of the revenue that the GPO received from vendors as a result of purchases made through the GPO by portfolio companies owned by the Funds. The Commission alleged that Respondent failed to disclose to the Funds and their investors the conflicts of interest associated with this arrangement, and improperly consented to the arrangement and accompanying conflicts on behalf of the Funds despite being required, under the Funds' organizational documents, to obtain approval for

transactions that give rise to conflicts of interest between a Fund and Respondent from a committee composed of limited partners unaffiliated with Respondent. After the Commission contacted Respondent in May 2017, Respondent voluntarily stopped receiving the fee from the GPO. The Commission censured Respondent, ordered Respondent to cease and desist from future violations of Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, and ordered Respondent to pay disgorgement of $623,035, prejudgment interest of $65,784.78, and a civil money penalty of $90,000.

***In re Lyxor Asset Management, Inc.*, Investment Advisers Act Rel. No. 4932, 2018 SEC LEXIS 1304 (June 4, 2018)**

The Commission accepted an offer of settlement from Lyxor Asset Management, Inc. (Respondent), a New York–based registered investment adviser. The Commission alleged that Respondent failed to disclose a conflict of interest surrounding its receipt of fees from two affiliated investment advisers (Advisers) with which it placed client assets for investment. In particular, according to the Commission, Respondent entered into agreements with the Advisers requiring such Advisers to make payments to Respondent based upon the total amount of its clients' assets Respondent placed or maintained in funds advised by the Advisers. The Commission alleged that Respondent failed to disclose the agreement or the payments to its clients. The Commission further alleged that the arrangement was in contravention of Respondent's investment management agreements with two of its clients, and that Respondent lacked policies and procedures reasonably designed to detect and prevent conflicts of interest and failed to account on its books and records for the amounts owed and ultimately paid by the Advisers. Respondent ultimately reimbursed its clients the funds it received pursuant to the agreements, plus interest, following discussions with Commission staff during an examination. The Commission ordered Respondent to cease and desist from future violations of Sections 204(a), 206(2), and 206(4) of the Advisers Act and Rules 204-2(a)(2) and 206(4)-7 thereunder, and imposed a censure and a civil money penalty of $500,000.

***In re deVere USA, Inc.*, Investment Advisers Act Rel. No. 4933, 2018 SEC LEXIS 1311 (June 4, 2018); *SEC v. Alderson et al.*, Litig. Rel. No. 24157, 2018 SEC LEXIS 1323 (June 5, 2018)**

The Commission accepted an offer of settlement from deVere USA, Inc. (Respondent), a registered investment adviser. The Commission alleged that Respondent failed to make full and fair disclosure to clients and prospective clients of material conflicts of interest regarding compensation obtained from third-party product and service providers. Specifically, the Commission claimed that between at least June 2013 and March 2016, in connection with client asset transfers, Respondent did not disclose arrangements in which third-party custodian and trustee firms recommended by Respondent compensated an overseas affiliate of Respondent that, in most cases, in turn, compensated Respondent's IARs who had made the recommendation. The Commission further alleged that Respondent paid its IARs a share of entry fees for certain funds and structured notes recommended to clients, as well as a percentage of the currency conversion fee charged to clients by a foreign exchange provider affiliated with and recommended by Respondent, in each case without disclosing the payments or conflicts of interest. Additionally, the Commission alleged that Respondent's IARs made materially misleading or incomplete

statements regarding the transfer of assets in question. According to the Commission Order, the undisclosed compensation was primarily how the IARs were compensated. The Commission further alleged that Respondent failed to satisfy disclosure requirements with respect to its Form ADV filings by failing to disclose the compensation received by Respondent and its IARs, and failed to both tailor its compliance program to its actual business and undertake many of the responsibilities laid out in its existing compliance manual. The Commission ordered Respondent to cease and desist from future violations of Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 thereunder, and imposed a censure and a civil money penalty of $8 million. Respondent also agreed to certain undertakings, including, among other things, retaining an independent compliance consultant to review its policies and procedures.

In a related action, the Commission filed a complaint in the Southern District of New York charging two former managers and IARs of Respondent, CEO Benjamin Alderson and Bradley Hamilton, for making misleading statements and omissions in connection with the conduct described above. The Commission's complaint alleged that Respondent violated Section 206(1) and 206(2) of the Advisers Act, and also charged Alderson with aiding and abetting violations of Sections 204, 206(4), and 207 of the Advisers Act and Rules 204-2 and 206(4)-7 thereunder. The complaint seeks an injunction, disgorgement plus prejudgment interest, and civil money penalties.

***In re THL Managers V, LLC and THL Managers VI, LLC,* Investment Advisers Act Rel. No. 4952, 2018 SEC LEXIS 1608 (June 29, 2018)**

The Commission accepted an offer of settlement from THL Managers V, LLC and THL Managers VI, LLC (Respondents), each a private equity fund adviser. The Commission alleged that, upon either the private sale or an IPO of a portfolio company, Respondents automatically terminated certain portfolio company agreements and received accelerated lump-sum fees that would have been payable to Respondents for providing services for the remaining terms of the agreements. The Commission also alleged that Respondents did not adequately disclose to their fund clients, their advisory committees, or their investors, prior to their commitment of capital, future accelerated lump-sum fees upon termination of the agreements, despite disclosing in fund governing documents that they may receive accelerated fees from portfolio companies held by funds they advised and, in subsequent reports and filings, the amount of fees that had been accelerated. The Commission further alleged that, because receipt of accelerated fees from portfolio companies posed a conflict of interest for Respondents, Respondents could not effectively consent to this practice on behalf of the funds they advised and, as a result, negligently breached their fiduciary duty to the funds. The Commission further alleged that Respondents failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act arising from the receipt of the insufficiently disclosed fees. In accepting the offer of settlement, the Commission considered Respondents' cooperation with Commission staff, specifically noting Respondents' promptness and responsiveness to staff inquiries. The Commission ordered Respondents to cease and desist from future violations of Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder, and ordered them to pay a $1.5 million civil money penalty to the Commission and disgorgement of $4,806,016 with prejudgment interest of $200,000 to affected fund investors.

In re BB&T Securities, LLC, **Investment Advisers Act Rel. No. 5002, 2018 SEC LEXIS 2209 (Sept. 7, 2018)**

The Commission accepted an offer of settlement from BB&T Securities, LLC (BB&TS), a dually registered investment adviser and broker-dealer, a current division of which, BB&T Investment Services, Inc., was, at the time of the conduct at issue, a state-registered investment adviser affiliated with BB&TS (Respondent). The Commission alleged that Respondent failed to adequately disclose to its clients certain facts giving rise to material conflicts of interest. Specifically, the Commission alleged that between March 2012 and July 2015 Respondent was engaged in the business of, among other things, recommending to its clients that they invest in wrap fee programs sponsored by three other investment advisers (sponsors), one of which was an affiliate of Respondent (Affiliated Adviser). The Commission further alleged that, in connection with these recommendations, Respondent failed to disclose sufficient facts to enable clients to determine that the compensation arrangement between Respondent and the Affiliated Adviser created an incentive for Respondent and its investment advisory representatives to recommend that clients invest in the Affiliated Adviser's wrap fee program rather than the programs offered by the two unaffiliated sponsors. In determining to accept the settlement offer, the Commission considered Respondent's remedial acts, including voluntarily reimbursing clients $635,000 in early termination fees. The Commission ordered Respondent to cease and desist from committing or causing any future violations of Section 206(2) of the Advisers Act and to pay a civil money penalty of $100,000.

Cross-Trades/Affiliated Transactions

In re Hamlin Capital Management, LLC**, Investment Advisers Act Rel. No. 4983, 2018 SEC LEXIS 1978 (Aug. 10, 2018)**

The Commission accepted an offer of settlement from Hamlin Capital Management, LLC (Respondent), a registered investment adviser. The Commission alleged that Respondent breached its fiduciary duties by favoring certain advisory clients over others through its pricing methods when engaging in cross-trades. According to the Commission's Order, Respondent's cross-trades favored its purchasing client transactions over its selling client transactions by arranging for the buy-side transaction to be executed at a lower price than the valuation price, which was set predominantly by the bonds' underwriters (Bid Price). The Commission further alleged that Respondent would often challenge the underwriters' Bid Price with a substantially higher price than the secondary market trade, and would only use broker-dealers that executed cross-trades at Respondent's predetermined spreads. The Commission alleged that as a result of these practices, Respondent's buy-side clients saved more than $829,344; Respondent deprived its seller-side clients of approximately $414,672 in market savings; and clients buying securities at Respondent's predetermined pricing overpaid by approximately $194,500. The Commission also alleged that Respondent's Form ADV misrepresented that it would execute cross-trades at the current market price, and failed to disclose that cross-trades would be executed at a Bid Price, and that Respondent failed to adopt and implement policies and procedures reasonably designed to prevent violations of the Advisers Act in connection with cross-trading practices and disclosing conflicts of interest. In determining to accept the offer of settlement, the Commission considered the cooperation and prompt remedial acts of Respondent, including

the enhancements Respondent made to its policies, procedures, controls, and disclosures regarding cross-trading and security valuation, as well as voluntary payment to affected clients. The Commission censured Respondent, and ordered it to cease and desist from further violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rules 206(4)-7 and 206(4)-8(a)(2) thereunder. The Commission also ordered Respondent to pay a civil money penalty of $900,000.

***In re Cushing Asset Management*, Investment Company Act Rel. No. 33226, 2018 SEC LEXIS 2312 (Sept. 14, 2018)**

The Commission accepted an offer of settlement from Cushing Asset Management, LP, a registered investment adviser (Respondent). The Commission alleged that Respondent caused its clients' violations of the affiliated transaction provisions of the Investment Company Act in connection with two undisclosed cross-trades of approximately $33,500,000. The Commission alleged that, on December 20, 2012, Respondent sold, on behalf of a hedge fund it managed, 1,565,786 units of a publicly traded master limited partnership (MLP) to a closed-end fund and an open-end fund it also managed (the Registered Funds), using two brokers to execute the trades, resulting in its clients incurring $125,000 in brokerage fees. The Commission further alleged that, although Respondent sought legal advice as to how to conduct the trades so that they would not be prohibited "cross trades," Respondent's traders did not follow the oral instructions they received or seek guidance on how to implement these instructions, and, as a result, the trades constituted cross-trades between the affiliated hedge fund and Registered Funds, and Respondent caused the hedge fund client it advised to violate Section 17(a)(1) of the Investment Company Act by knowingly selling securities to affiliated registered investment companies in the absence of an order from the Commission exempting the transaction from the prohibition on doing so. The Commission ordered Respondent to cease and desist from committing or causing any violations and any future violations of Section 17(a)(1) of the Investment Company Act and to pay a civil money penalty of $100,000.

Custody

***In re New Silk Route Advisors, L.P.*, Investment Advisers Act Rel. No. 4970, 2018 SEC LEXIS 1721 (July 17, 2018)**

The Commission accepted an offer of settlement from New Silk Route Advisors, L.P. (Respondent), a registered investment advisor that advises two private equity funds (NSR Funds). The Commission alleged that since registering with the Commission in 2012, Respondent failed to timely distribute annual audited financial statements to investors in the NSR Funds in violation of the audit provision for private funds under Advisers Act Rule 206(4)-2, the Custody Rule. The Commission stated that although the NSR Funds were subject to an annual audit, financial statements were distributed to investors more than 120 days after the end of the NSR Funds' fiscal years, in violation of the Custody Rule, and, further, Respondent did not make material changes to its audit processes year over year. The Commission alleged that since Respondent did not make any material changes to its audit processes following FY 2012, it was not able to rely on guidance from the Commission's Division of Investment Management for situations in which audited financials were delayed due to "unforeseen circumstances." The Commission also

stated that Respondent failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Custody Rule. As a result of this conduct, the Commission found that Respondent violated Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder. The Commission censured Respondent, ordered it to cease and desist from further violations of the Advisers Act, and ordered it to pay a civil money penalty of $75,000.

Digital Assets

In re Crypto Asset Management, LP and Timothy Enneking, **Investment Advisers Act Rel. No. 5004, 2018 SEC LEXIS 2241 (Sept. 11, 2018)**

The Commission accepted an offer of settlement from Crypto Asset Management, LP, an unregistered investment adviser (Firm), and Timothy Enneking, its founder and sole principal (collectively, Respondents). The Commission alleged that, by forming, offering to investors, and managing a pooled investment vehicle for investing in digital assets, Respondents engaged in the unregistered sale of securities, without an exemption from registration, and also operated an unregistered investment company. Further, the SEC alleged that Respondents misrepresented to actual and prospective clients that their fund was the "first regulated crypto asset fund in the United States" and had filed a registration statement with the Commission in connection with an offering of securities. The Commission alleged that Respondents failed to take reasonable steps to ensure the accuracy of these statements before disseminating them to actual and potential investors. The Commission ordered the Firm to cease and desist from committing or causing any violations of Sections 5(a), 5(c), and 17(a)(2) of the Securities Act; Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder; and Section 7(a) of the Investment Company Act, and ordered Enneking to cease and desist from committing or causing any violations of Section 17(a)(2) of the Securities Act and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. The Commission further ordered Respondents to pay a civil money penalty of $200,000.

Digital Investment Advisers

In re Wealthfront Advisers, LLC and f/k/a Wealthfront, Inc., **Investment Advisers Act Rel. No. 5086, 2018 SEC LEXIS 3629 (Dec. 21, 2018)**

The Commission accepted an offer of settlement from Wealthfront Advisers, LLC (WFA, or Respondent), a registered investment adviser, in connection with Respondent's disclosures to clients and the public regarding the tax-loss harvesting feature of its automated advisory program. The Commission alleged that Respondent made available on its website a series of White Papers that falsely claimed it monitored all client accounts to avoid any transaction that might trigger a "wash sale," or an investment transaction where a security is sold at a loss and, within 30 days of sale, the same or a substantially identical security is purchased. A wash sale precludes investors from realizing the tax benefit (offsetting income or capital gains) of having sold a security to realize a loss. Specifically, the Commission alleged that from October 2012 through mid-May 2016 wash sales were permitted to occur in Respondent's advisory program, and Respondent did not monitor client accounts to avoid account rebalancing or client-directed securities transactions that resulted in a wash sale.

The Commission further alleged that Respondent published testimonials and other misleading advertisements on its Twitter feed by selectively retweeting certain positive posts by other Twitter users, including those that Respondent knew or should have known had an economic interest in promoting its services (e.g., WFA employees, investors in WFA, and WFA clients that were eligible to receive free services). The Commission further alleged that Respondent did not preserve copies of advertisements or retain copies of communications distributed to investors through its Twitter account, as required by the Advisers Act books and records rules. Finally, the Commission alleged that Respondent operated a program in which it paid third-party bloggers a referral fee based on the amount of assets for clients that were referred to WFA through hyperlinks placed on favorable blog posts. The Commission stated that Respondent paid approximately $97,000 to participating bloggers for soliciting new client accounts, and received tens of millions of dollars in AUM as a result of this program, which it alleged was a solicitation arrangement and therefore was required to comply with the Advisers Act cash solicitation rule. The Commission censured Respondent and ordered that it cease and desist from committing or causing any violations of Sections 204(a), 206(2), 206(4), and 207 of the Advisers Act and Rules 204-2, 206(4)-1, 206(4)-3, and 206(4)-7 promulgated thereunder. The Commission also ordered Respondent to pay a civil money penalty of $250,000.

***In re Hedgeable, Inc.*, Investment Advisers Act Rel. No. 5087, 2018 SEC LEXIS 3630 (Dec. 21, 2018)**

The Commission accepted an offer of settlement from Hedgeable, Inc. (Respondent), a formerly registered digital adviser that wound down its investment advisory business and no longer had AUM as of September 2018. The Commission alleged that, from at least 2016 through April 2017, Respondent posted on its website and social media platforms a "Robo-Index" that purportedly enabled investors to compare the performance of its clients against that of other digital investment advisers. The Robo-Index consolidated the performance of Respondent's clients in a composite. The Commission alleged that the Robo-Index and the composite were misleading in the following ways: (i) the composite only included a minor subset (less than 4%) of the total number of Respondent's clients for the relevant time frame; (ii) the calculation methodology for the Robo-Index was incorrectly based on an approximation of other digital advisers' performance sourced from their website, and not actual performance data from their underlying clients; and (iii) Respondent incorrectly calculated the annualized returns for both the composite and the Robo-Index. The Commission further alleged that Respondent failed to maintain sufficient documentation to substantiate the returns presented in each of the composite and Robo-Index. Additionally, the Commission stated that Respondent posted to its website misleading fact sheets that overstated the returns of its ETFs, as compared to benchmarks of blended index returns. The Commission censured Respondent and ordered that it cease and desist from committing or causing any future violations of Sections 204, 206(2), and 206(4) of the Advisers Act and Rules 204-2, 206(4)-1, and 206(4)-7 thereunder. The Commission also ordered Respondent to pay a civil money penalty of $80,000.

Disclosure

***In re AmericaFirst Capital Management, LLC, Rick A. Gonsalves, and Robert L. Clark*, Investment Advisers Act Rel. No. 4848, 2018 SEC LEXIS 204 (Jan. 23, 2018)**

The Commission accepted an offer of settlement from a registered investment adviser, AmericaFirst Capital Management, LLC (AFCM), and its two principals, Rick Gonsalves and Robert Clark, (collectively, Respondents), in connection with certain disclosure-related violations connected to the sale of unsecured promissory notes to individual retail investors, including Respondents' advisory clients. The Commission alleged that in response to AFCM's cash flow problems from December 2012 to 2015, Gonsalves, AFCM's CEO, decided to issue unsecured promissory notes with high interest rates in order to attract investors and raise money, and directed Clark, AFCM's President and COO, to solicit AFCM's advisory clients, friends, and family members to invest in such notes. The Commission stated that Clark gave investors the impression that AFCM was profitable and failed to fully disclose the degree of risk such investors faced in purchasing the notes given AFCM's significant financial and operational issues. As a result of this conduct, the Commission stated that Respondents violated Section 206(2) of the Advisers Act. The Commission censured AFCM and ordered Respondents to cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 206(2) of the Advisers Act. AFCM was further ordered to undertake various compliance-related undertakings. The Commission also ordered AFCM, Gonsalves, and Clark to pay civil money penalties of $50,000, $25,000, and $25,000, respectively.

Due Diligence

***In re Pennant Management, Inc.*, Investment Advisers Act Rel. No. 5061, 2018 SEC LEXIS 3093 (Nov. 6, 2018); *In re Mark A. Elste*, Investment Advisers Act Rel. No. 5062, 2018 SEC LEXIS 3094 (Nov. 6, 2018)**

The Commission accepted an offer of settlement from Pennant Management, Inc. (Respondent), an investment adviser previously registered with the SEC. The Commission alleged that Respondent negligently failed to perform adequate due diligence and monitoring of certain investments, contrary to representations it had made in its Form ADV and in certain communications with its clients. Respondent had advised clients to purchase interests in facilities and other investments containing repurchase agreements (repos) originated by a repo counterparty. The Commission alleged that Respondent did not escalate certain concerning information about the investments that was identified during initial due diligence, including poor credit history and misrepresentations by management of the repo counterparty, or conduct further due diligence. The Commission further alleged that during the relevant period, Respondent's compliance program lacked sufficient resources and did not have sufficient written controls, and its written repo allocation policy was not followed. As a result of this conduct, the Commission found that Respondent violated Sections 206(2), 206(4) and 207 of the Advisers Act and Rule 206(4)-7 thereunder. Respondent was ordered to cease and desist from further violations of the Advisers Act, was censured, and was further ordered to pay a civil money penalty of $400,000.

In a related action, the Commission accepted an offer of settlement from Mark A. Elste, the former CEO and CIO of Respondent, for aiding, abetting, and causing Respondent's violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. The Commission alleged that from 2012 to 2014, Elste, who was in a position to authorize the update of the written policies and procedures and to order amendments, failed to heed the compliance warnings from Respondent's chief compliance officer when advised that the compliance resources were insufficient and compliance failures existed. The Commission also stated that Elste learned of general issues relating to Respondent's informal process for initial and ongoing due diligence and monitoring of repo counterparties, but did not cause Respondent to amend its written controls accordingly. Elste was ordered to pay a civil money penalty of $45,000.

Expense Allocation

***In re Fifth Street Management, LLC*, Investment Advisers Act Rel. No. 5070, 2018 SEC LEXIS 3391 (Dec. 3, 2018)**

The Commission accepted an offer of settlement from Fifth Street Management, LLC (Respondent), a formerly registered investment adviser, in connection with expenses that Respondent allegedly improperly allocated to two of its business development company (BDC) clients. Specifically, the Commission alleged that Respondent improperly allocated $1,208,510 in expenses related to rent and overhead, and $118,895 in employee compensation expenses, to its BDC clients, when these expenses should have been allocated to the manager.

In addition, according to the Commission Order, Respondent was responsible for conducting a quality control review of its BDC clients' quarterly valuation models for illiquid assets whose values could not be determined by reference to market prices or quotes but allegedly failed to conduct this work in a reasonable manner, resulting in one of its BDC clients overvaluing two portfolio companies, which in turn caused that client's financial statements, which were included in its Forms 10-Q for periods ended March 31 and June 30, 2014, and Form 10-K for period end September 30, 2014, to materially misstate net increase in assets resulting from operations and earnings per share (EPS). In July 2014 and September 2014, this BDC client offered and sold additional shares of its stock while these inflated net income and EPS figures were outstanding. When these and other valuations were changed to reasonably reflect the portfolio companies' forecasted performance, the BDC's stock price dropped 15%. The Commission alleged that Respondent did not implement written policies and procedures reasonably designed to prevent violations of the Advisers Act concerning expense allocation until July 2016, did not implement procedures relating to quality control reviews, and further did not have adequate policies and procedures concerning the prevention of the use of material, nonpublic information. As a result of this conduct, the Commission found that Respondent violated Sections 206(2), 206(4), 207, and 204A of the Advisers Act and Rules 206(4)-8 and 206(4)-7 thereunder; Section 31(a) of the Investment Company Act and Rule 31a-1 thereunder; Section 17(a)(2) of the Securities Act; and Section 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder. The Commission censured Respondent, ordered it to cease and desist from further violations of the Advisers Act, and also ordered it to pay disgorgement of $1,999,116, prejudgment interest of $334,546, and a civil money penalty of $1,650,000.

***In re NB Alternatives Advisers LLC*, Investment Advisers Act Rel. No. 5079, 2018 SEC LEXIS 3585 (Dec. 17, 2018)**

The Commission accepted an offer of settlement from NB Alternatives Advisers LLC (Respondent), a registered investment adviser, in connection with the advisory services it provided to three private equity funds (Funds). The Commission alleged that Respondent failed to properly allocate expenses associated with the Funds in question, and failed to adopt and implement written compliance policies and procedures designed to prevent misallocation of expenses. Specifically, Respondent created a separate group of employees called the Business Services Platform (BSP) to assist with the strategy for the Funds, and whose related expenses were meant to be covered, in part, by the Funds. Respondent remained responsible for all compensation costs of their investment professionals. The Commission alleged that the BSP employees spent a percentage of their time on tasks unrelated to the BSP, but Respondent allocated the full cost of these employees' services to the Funds, which amounted to a misallocation of expenses. The Commission further alleged that this misallocation was due in part to Respondent's failure to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act. The Commission ordered that Respondent cease and desist from committing or causing any violations of Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 promulgated thereunder. The Commission also ordered that Respondent pay disgorgement of $2,073,988, prejudgment interest of $284,620, and a civil money penalty of $375,000.

***In re Lightyear Capital LLC*, Investment Advisers Act Rel. No. 5096, 2018 SEC LEXIS 3656 (Dec. 26, 2018)**

The Commission accepted an offer of settlement from Lightyear Capital LLC (Respondent), a registered investment adviser. According to the Commission Order, Respondent manages certain flagship private equity funds, as well as employee funds that invest alongside the flagship funds, and focuses its portfolio acquisitions on financial services companies. The Commission alleged that, in connection with the acquisition of certain portfolio companies, Respondent permitted co-investors to provide equity capital to invest in the deal. The Commission alleged that, in connection with these investments, Respondent failed to properly allocate certain expenses to the employee funds and co-investors. The Commission also alleged that Respondent failed to properly offset management fees in connection with undisclosed fee-sharing arrangements with certain co-investors. The Commission found that this conduct was due in part to Respondent's failure to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act, and policies and procedures that were outlined in each Limited Partnership Agreement of the flagship funds. The Commission ordered that Respondent cease and desist from committing or causing any violations of Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder. The Commission also ordered Respondent pay a civil money penalty of $400,000.

Form PF

***In re Bachrach Asset Management Inc.*, Investment Advisers Act Rel. No. 4919, 2018 SEC LEXIS 1275 (June 1, 2018); *In re Biglari Capital LLC*, Investment Advisers Act Rel. No. 4920, 2018 SEC LEXIS 1276 (June 1, 2018); *In re Brahma Management, Ltd.*, Investment Advisers Act Rel. No. 4921, 2018 SEC LEXIS 1277 (June 1, 2018); *In re Bristol Group, Inc.*, Investment Advisers Act Rel. No. 4922, 2018 SEC LEXIS 1278 (June 1, 2018); *In re CAI Managers & Co., L.P.*, Investment Advisers Act Rel. No. 4923, 2018 SEC LEXIS 1279 (June 1, 2018); *In re Cherokee Investment Partners LLC*, Investment Advisers Act Rel. No. 4924, 2018 SEC LEXIS 1280 (June 1, 2018); *In re Ecosystem Investment Partners LLC*, Investment Advisers Act Rel. No. 4925, 2018 SEC LEXIS 1281 (June 1, 2018); *In re Elm Partners Management LLC*, Investment Advisers Act Rel. No. 4926, 2018 SEC LEXIS 1282 (June 1, 2018); *In re HEP Management Corporation*, Investment Advisers Act Rel. No. 4927, 2018 SEC LEXIS 1283 (June 1, 2018); *In re Prescott General Partners LLC*, Investment Advisers Act Rel. No. 4928, 2018 SEC LEXIS 1284 (June 1, 2018); *In re RLJ Equity Partners, LLC*, Investment Advisers Act Rel. No. 4929, 2018 SEC LEXIS 1285 (June 1, 2018); *In re Rose Park Advisors, LLC*, Investment Advisers Act Rel. No. 4930, 2018 SEC LEXIS 1286 (June 1, 2018); *In re Veteri Place Corporation*, Investment Advisers Act Rel. No. 4931, 2018 SEC LEXIS 1287 (June 1, 2018)**

The Commission accepted separate offers of settlement from each of Bachrach Asset Management Inc., Biglari Capital LLC, Brahma Management, Ltd., Bristol Group, Inc., CAI Managers & Co., L.P., Cherokee Investment Partners LLC, Ecosystem Investment Partners LLC, Elm Partners Management LLC, HEP Management Corporation, Prescott General Partners LLC, RLJ Equity Partners, LLC, Rose Park Advisors, LLC, and Veteri Place Corporation (collectively, Respondents). The Commission alleged that each Respondent, a registered investment adviser, failed to file a report on Form PF and annual updates thereto for certain fiscal years despite its obligation to do so pursuant to Rule 204(b)-1 under the Advisers Act, which requires investment advisers registered or required to be registered under Section 203 of the Advisers Act that act as advisers to private funds with assets of at least $150 million to complete and file such reports and updates. Form PF is used by advisers to provide information to the Commission about the private funds they advise, including the amount of AUM, fund strategy, performance, and use of borrowed money and derivatives. As a result of the alleged conduct, the Commission ordered that each Respondent cease and desist from future violations of Rule 204(b)-1 under the Advisers Act. In addition, the Commission censured each Respondent and ordered that each Respondent pay a civil money penalty of $75,000.

Fraud

***SEC v. Southridge Capital Management, LLC, et al.,* Litig. Rel. No. 24049, 2018 SEC LEXIS 494 (Feb. 15, 2018)**

Resolving a matter originally filed by the Commission in October 2010, the US District Court for the District of Connecticut entered a final judgment on consent against Stephen M. Hicks, a

Ridgefield, Connecticut–based hedge fund manager, and his investment advisory businesses Southridge Advisors LLC (collectively, Southridge, and together with Hicks, Defendants).

The Commission's complaint had alleged that Defendants defrauded investors in their hedge funds by raising millions of dollars from investors between 2004 and 2007 by promising that at least 75% of their money would be invested in unrestricted, free-trading shares. The Commission also alleged that Defendants failed to keep that promise and placed the investors' money in relatively illiquid securities, such that Defendants were unable to satisfy redemptions. The Commission further alleged that Defendants significantly overvalued the hedge funds' largest single investment, allowing them to accrue more than $1.8 million in undeserved management fees for themselves. Lastly, the Commission alleged that Defendants caused two of the hedge funds to pay approximately $5 million of legal and administrative expenses incurred by three other hedge funds, and when the misappropriation came to light, they repaid the two funds with illiquid securities, not cash.

Following the Court's ruling that Defendants had misappropriated investor funds, Defendants determined to resolve the balance of the matter, consenting to the final judgment, without admitting or denying the remaining allegations. The Court's Order permanently enjoins Defendants from violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Section 17(a) of the Securities Act, and Section 206(1), (2), and (4) of the Advisers Act and Rule 206(4)-8 thereunder. The court ordered Defendants to pay $7,864,064 in disgorgement with prejudgment interest ordered in the prior partial judgment. The court also ordered Hicks to pay a $5 million civil money penalty. In a parallel administrative action, Hicks consented to entry of a bar from association with any investment adviser, broker, or dealer.

Gatekeepers

***In re Gemini Fund Services, LLC*, Investment Advisers Act Rel. No. 4847, 2018 SEC LEXIS 155 (Jan. 22, 2018)**

The Commission accepted an offer of settlement from Gemini Fund Services, LLC (Respondent), the fund administrator to a registered investment company (Fund). Respondent was responsible for calculating the Fund's daily share price, or "net asset value" (NAV) and transmitting it to the investing public via the NASDAQ securities exchange. The Commission alleged that from February 2013 to December 2014, the NAV that Respondent reported was inflated due to Respondent's inclusion of fake assets that were claimed to be worth more than $15 million but, in reality, had no value. In fact, according to the Commission Order, the assets were fictitious because a managing director of the Fund, who was arrested for securities fraud in December 2014, had instead misappropriated investors' money. Although Respondent did not know that these assets were fake at the time it was calculating the NAV, the Commission alleged that it was aware that, for months at a time, the Fund's custodian did not have adequate proof of the existence of many of these fake assets and, consequently, discrepancies existed between its own records and those of the custodian. The Commission further stated that when confronted with this fact, Respondent failed to take any further steps, such as investigating the problem with the assets, notifying the investing public or the Fund's board of directors, or reducing the share price to reflect this problem. The Commission ordered Respondent to retain the services of an independent

compliance consultant, and to cease and desist from committing or causing any further violations of Section 206(1) and 206(2) of the Advisers Act. The Commission also ordered Respondent to pay a civil money penalty of $400,000, disgorgement of $147,334, and prejudgment interest of $14,072.

***In re Holthouse Carlin & Van Trigt LLP,* Investment Advisers Act Rel. No. 5008, 2018 SEC LEXIS 2283 (Sept. 13, 2018)**

The Commission accepted an offer of settlement from Holthouse Carlin & Van Trigt LLP (Respondent), a regional CPA firm registered with the Public Accounting Oversight Board. The Commission alleged that Respondent failed to comply with the Commission's auditor independence rules by preparing and auditing its clients' financial statements, accompanying notes, and accounting entries, thereby causing its investment advisers clients' violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder in connection with 57 audits conducted under the Advisers Act custody rule; its broker-dealer clients' violations of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder; and its own violations of Rule 17a-5(i) of the Exchange Act and engagement in improper professional conduct within the meaning of Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice. The Commission alleged that, while the Custody Rule requires auditors to comply with the independence standards of Regulation S-X, Rules 2-01(b) and (c), Respondent's policies incorrectly referenced the American Institute of Certified Public Accountants independence standards, which did not include the same restrictions, and Respondent did not take any steps to determine which independence standard applied to Custody Rule audits. The Commission ordered Respondent to cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, and Section 17(a) of the Exchange Act and Rule 17a-5 thereunder; to pay a civil money penalty of $300,000; and to comply with certain undertakings.

Investment Companies

***In re SEI Investments Global Services*, Investment Advisers Act Rel. No. 33087, 2018 SEC LEXIS 991 (Apr. 26, 2018)**

The Commission accepted an offer of settlement from SEI Global Funds Services (Respondent), a fund administrator, relating to the pricing and administration of an affiliated unregistered money market fund (the Liquidity Fund). According to the Commission Order, the Liquidity Fund served as the vehicle for reinvesting cash collateral obtained in connection with the securities lending activities of certain SEI funds that chose to participate in the securities lending program (SEI Funds). The Commission alleged that from approximately mid-2008 through the end of 2012, Respondent caused the Liquidity Fund to fail to satisfy the conditions necessary for the SEI Funds to rely upon an exemption under Company Act Rule 12d1-1, which permits a fund to engage in otherwise prohibited affiliated transactions under Section 17(a)(1) and (2) of the Investment Company Act. Specifically, the Commission alleged that Respondent used improper valuation methods, causing the Liquidity Fund to have an inaccurate NAV. The Commission further alleged that Respondent improperly effectively created a de facto separately priced senior share class of the Liquidity Fund that was made available to five newly created SEI Funds that later began to

participate in the securities lending program and invested collateral in the Liquidity Fund. The Commission alleged that this senior share class was created in an attempt to exclude the Liquidity Fund from losses or gains related to impaired securities held by the Fund, and was priced at a stable NAV per share. According to the Commission, the creation of the separately priced shares resulted in a stable NAV for some SEI Funds, and a floating NAV for others, which was inconsistent with Investment Company Act Rule 2a-7. The Commission ordered Respondent to cease and desist from future violations of Section 17(a)(1) and 17(a)(2) of the Investment Company Act and to pay a civil money penalty of $225,000.

***In re KCAP Financial, Inc.*, Investment Company Act Rel. No. 33314, 2018 SEC LEXIS 3406 (Dec. 4, 2018)**

The Commission accepted an offer of settlement from KCAP Financial, Inc. (Respondent), a BDC under the Investment Company Act, in connection with alleged improper accounting procedures. The Commission alleged that Respondent received approximately $35,800,000 from its wholly owned Asset Manager Affiliates (AMAs), which it recorded and distributed entirely as taxable dividends, when in fact approximately $22,300,000 of those funds were actually returns of capital. According to the Commission Order, under generally accepted accounting principles (GAAP), distributions by investment companies can be recorded as dividends only when they are paid from current or accumulated tax basis earnings and profits. The SEC alleged that Respondent recorded the entirety of the distributions as dividends, despite the fact that it prepared quarterly tax accrual worksheets demonstrating that certain of the AMAs lacked current or accumulated tax basis earnings and profits from which to pay dividends in certain reporting periods. As a result, the Commission Order stated that Respondent had restated its financial statements for a three-and-a-half-year period, and disclosed that this error resulted from a material weakness in its internal controls over financial reporting. The Commission found that this conduct violated Section 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder as well as Section 19(a) of the Investment Company Act and Rules 19a-1 and 38a-1(a)(1) thereunder. Respondent was ordered to cease and desist from further violations of the federal securities laws. No civil money penalties were assessed.

***In re Mohammed Riad and Kevin Timothy Swanson*, Investment Advisers Act Rel. No. 5091, 2018 SEC LEXIS 3626 (Dec. 21, 2018)**

The Commission accepted an offer of settlement from Mohammed Riad and Kevin Timothy Swanson (together, Respondents), in connection with Respondents' management of a closed-end mutual fund (Fund). The Commission Order stated that, according to its registration statement, the Fund principally employed a covered call investment strategy. The Commission alleged that, in order to contribute to the Fund's performance, Respondent Riad caused the Fund to regularly employ two new types of derivative instruments, which exposed the Fund to a substantial risk of losses, depending on the market's performance. According to the Commission Order, following this change, Respondents misrepresented the Fund as "hedged" despite its elevated level of risk. The Commission further alleged that Respondents misled investors by omission, when they failed to mention the new types of derivatives as contributing to performance in the Fund's annual and semiannual reports. The Commission ordered Respondent Riad to cease and desist from committing or causing any violations of Section 10(b) of the Exchange Act and Rule 10b-5

thereunder, Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, and Section 34(b) of the Investment Company Act, and from causing any violations of Investment Company Act Rule 8b-16. The Commission also barred Respondent Riad from the industry for two years, and ordered that he pay $75,000 in disgorgement and a civil money penalty of $25,000. The Commission ordered Respondent Swanson to cease and desist from committing or causing any violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, and Section 34(b) of the Investment Company Act. The Commission also suspended Respondent Swanson from the industry for 12 months, and ordered that he pay a civil money penalty of $15,000.

Model Governance

***In re AEGON USA Investment Management, LLC, Transamerica Asset Management, Inc., Transamerica Capital Inc., and Transamerica Financial Advisors, Inc.*, Investment Advisers Act Rel. No. 4996, 2018 SEC LEXIS 2090 (Aug. 27, 2018); *In re Bradley J. Beman*, Investment Advisers Act Rel. No. 4997, 2018 SEC LEXIS 2091 (Aug. 27, 2018); *In re Kevin A. Giles*, Investment Advisers Act Rel. No. 4998, 2018 SEC LEXIS 2092 (Aug. 27, 2018)**

The Commission accepted an offer of settlement from Transamerica Asset Management, Inc. (TAM), a registered investment adviser, and its affiliates registered investment adviser AEGON USA Investment Management, LLC (AUIM), registered broker-dealer Transamerica Capital, Inc. (TCI), and dual registrant Transamerica Financial Advisors (TFA and, collectively, Respondents). The Commission alleged that between July 2011 and June 2015, Respondents offered a variety of "quantitative-model-based" mutual funds, life insurance investment portfolios, and variable annuity investment portfolios (Products) and separately managed account strategies (Strategies), each of which used models developed by an inexperienced junior analyst (Analyst). The Commission alleged that Respondents launched the Products and Strategies without first confirming that the models would work as intended, and without disclosing to investors and the Products' boards of trustees the risks of using the models or timely disclosing the role of the Analyst, initially stating instead that a senior, experienced asset manager was the sole portfolio manager for the relevant Products and Strategies. The Commission further alleged that when AUIM, the sub-adviser of the Products and Strategies, discovered that certain of the models contained errors and discontinued the use of at least one of them, Respondents failed to publicly disclose these issues. The Commission further alleged that TAM and AUIM included an undisclosed return of capital in dividend payments for a certain fund Product, and added volatility overlays to certain portfolios without first confirming the overlays' accuracy and without providing adequate disclosure of the associated risks of subsequently identified errors. The Commission also alleged that TFA negligently relied on and improperly distributed to its advisory clients (i) marketing materials relating to the models without disclosing the risks associated with using the models or verifying that the models would work as intended, and (ii) marketing materials containing materially inflated, and hypothetical and back-tested, performance information provided by third-party investment adviser F-Squared Investments, Inc.

In determining to accept the offers of settlement, the Commission considered the substantial cooperation Respondents afforded the Commission staff, including aiding the Commission in

collecting evidence and information that may not have been available to the staff, and retaining a compliance consultant to conduct an independent review of Respondents' compliance policies and procedures, internal controls, and related practices. The Commission censured Respondents, and ordered AUIM, TAM, TCI, and TFA to cease and desist, respectively, from violations of Section 17(a)(2) of the Securities Act as well as Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1(a)(5), 206(4)-7, and 206(4)-8 thereunder and Section 15(c) of the Investment Company Act (AUIM); Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder, and Section 15(c) of the Investment Company Act (TAM); Section 17(a)(2) of the Securities Act (TCI); and Sections 204, 206(2), and 206(4) of the Advisers Act and Rules 204-2(a)(16), 206(4)-1(a)(5), and 206(4)-7 thereunder (TFA). The Commission also ordered Respondents to pay a total of $97,602,040, consisting of $24,599,896 in disgorgement, $3,682,195 in prejudgment interest, and a civil money penalty of $21 million (AUIM); $15 million in disgorgement, $2,235,765 in prejudgment interest, and a civil money penalty of $10,500,000 (TAM); $12 million in disgorgement, $1,826,022 in prejudgment interest, and a civil money penalty of $4 million (TCI); and $1.7 million in disgorgement, $258,162 in prejudgment interest, and a civil money penalty of $800,000 (TFA).

In two related actions, the Commission accepted offers of settlement from two senior AUIM employees, Kevin A. Giles, its Director of New Initiatives, and Bradley J. Beman, its Global Chief Investment Officer, in connection with their respective roles in the conduct described above. Specifically, the Commission alleged that Giles and Beman had agreed to be responsible for addressing the risks relating to the models identified in AUIM's 2011 audit report, but failed to do so, and that Beman did not take sufficient steps to have AUIM confirm the accuracy of the models and did not identify the Analyst as the portfolio manager of certain Products. The Commission ordered Giles and Beman to cease and desist from violations of Section 206(4) of the Advisers Act and Rules 206(4)-7 and (solely for Beman) 206(4)-8 thereunder. The Commission ordered Giles to pay a civil money penalty of $25,000 and Berman to pay a civil money penalty of $65,000.

Pay to Play

***In re Sofinnova Ventures*, Investment Advisers Act Rel. No. 4958, 2018 SEC LEXIS 1682 (July 10, 2018); *In re EnCap Investments, L.P.*, Investment Advisers Act Rel. No. 4959, 2018 SEC LEXIS 1683 (July 10, 2018); *In re Oaktree Capital Management*, Investment Advisers Act Rel. No. 4960, 2018 SEC LEXIS 1684 (July 10, 2018)**

The Commission accepted offers of settlement from Oaktree Capital Management, L.P., EnCap Investments, L.P., and Sofinnova Ventures, Inc. (collectively, Respondent Advisers) in separate actions stemming from violations of Advisers Act Rule 206(4)-5, the investment adviser pay-to-play rule. In each action, the Commission alleged that "covered associates" of the Respondent Advisers made campaign contributions above a *de minimis* threshold to candidates for elected state or municipal office, where the office had influence over selecting investment advisers for public pension plans in those states. Within two years after these contributions, the Respondent Advisers provided advisory services for compensation to the public pension plans in the applicable states in violation of Rule 206(4)-5. Such actions caused each of the Respondent Advisers to violate Section 206(4) of the Advisers Act and Rule 206(4)-5 thereunder. The SEC censured the

Respondent Advisers, ordered them each to cease and desist from further violations of the Advisers Act, and ordered civil money penalties in the amount of $500,000 for EnCap, $120,000 for Sofinnova, and $100,000 for Oaktree.

***In re Ancora Advisors LLC*, Investment Advisers Act Rel. No. 5077, 2018 SEC LEXIS 3549 (Dec. 18, 2018)**

The Commission accepted an offer of settlement from Ancora Advisors LLC (Respondent), a registered investment adviser, in connection with allegations concerning two of its associates' campaign contributions and Respondent's subsequent advisory services to a government client. The Commission alleged that Respondent violated Advisers Act Rule 206(4)-5, the Commission's "pay-to-play" rule. Specifically, the Commission alleged that two of Respondent's covered associates made campaign contributions to candidates whose offices had influence over selecting investment advisers for their state's public pension system. The Commission found that Respondent then received compensation in connection with providing advisory services to the state's public pension system and a public university within two years after the covered associates made such contributions, thus violating the pay-to-play rule. The Commission censured Respondent, and ordered that Respondent cease and desist from committing or causing any violations of Section 206(4) of the Advisers Act and Rule 206(4)-5 thereunder. The Commission also ordered that Respondent pay a civil money penalty of $100,000.

Privacy/Information Security

***In re Voya Financial Advisors, Inc.*, Investment Advisers Act Rel. No. 5048, 2018 SEC LEXIS 2595 (Sept. 26, 2018)**

The Commission accepted an offer of settlement from Voya Financial Advisors, Inc. (VFA or Respondent), a dually registered investment adviser and broker-dealer. The Commission alleged that Respondent failed to adopt written policies and procedures reasonably designed to protect customer records and information, in violation of Rule 30(a) of Regulation S-P (the Safeguards Rule), and that it further failed to develop and implement a written Identity Theft Prevention Program as required by Rule 201 of Regulation S-ID (the Identity Theft Red Flags Rule). Specifically, according to the Commission Order, Respondent gave its independent contractor representatives (contractor representatives) access to its brokerage and advisory customers' information through a proprietary web portal. Through that portal, the contractor representatives accessed the personally identifiable information (PII) of Respondent's customers and managed the customers' brokerage accounts. The Commission alleged that one or more persons impersonating VFA contractor representatives called VFA's technical support line and requested a reset of three contractor representatives' passwords for the web portal used to access VFA customer information, in two instances using phone numbers VFA had previously identified as associated with prior fraudulent activity. The Commission alleged that, while VFA was notified of the intrusion and took certain steps to address it, VFA did not prevent the intruders from obtaining the relevant information. The Commission further alleged that VFA's policies and procedures to protect customer information and to prevent and respond to cybersecurity incidents were not reasonably designed to meet these objectives. The Commission ordered Respondent to cease and desist from committing or causing any violations and any future violations of Rule 30(a) of

Regulation S-P and of Rule 201 of Regulation S-ID, to pay a civil money penalty of $1 million, and to undertake to retain a compliance consultant.

Private Funds – Preferential Liquidity

***In re Aria Partners GP, LLC*, Investment Advisers Act Rel. No. 4991, 2018 SEC LEXIS 2049 (Aug. 22, 2018)**

The Commission accepted an offer of settlement from Aria Partners GP, LLC (Respondent), a registered investment adviser. The Commission alleged that, while the offering documents for one of the private funds managed by Respondent required 90 days' written notice for redemptions, Respondent had an informal policy that permitted some investors to redeem earlier, while similarly situated investors who were not informed of this policy were held to the 90-day redemption period, which resulted in materially different full redemption amounts for two investors in 2015 when the fund lost value in a short period. The Commission also alleged that Respondent had multiple other compliance failures, including policies and procedures not adequately tailored to the type of business it conducted over time, failing to update or conduct an annual review of its compliance manual since 2004, failing to conduct annual audits for two years in violation of the Advisers Act Custody Rule, miscalculating AUM and failing to disclose required information about its private fund clients in its Form ADV, and remaining registered with the Commission as an investment adviser despite having insufficient AUM to do so. The Commission censured Respondent and ordered Respondent to cease and desist from committing or causing any violations of Sections 203A, 206(4), and 207 of the Advisers Act and Rules 206(4)-2, 206(4)-7, and 206(4)-8 thereunder, and to pay a civil money penalty of $150,000.

Soft Dollars

***In re Knowledge Leaders Capital, LLC*, Investment Advisers Act Rel. No. 4980, 2018 SEC LEXIS 1971 (Aug. 9, 2018)**

The Commission accepted an offer of settlement from Knowledge Leaders Capital, LLC (Respondent), a registered investment adviser. The Commission alleged that Respondent used client commissions under Section 28(e) of the Exchange Act (soft dollars) to purchase approximately $1 million in research from a firm affiliated with Respondent's then–Managing Director and chief investment officer (CIO). The Commission alleged that Respondent's Management Committee approved the use of soft dollars to pay for research software to assist in investment decisions using an algorithm developed by the CIO-affiliated firm, totaling $994,000 of soft dollars in a matter of three years, without identifying (and, as a result, without disclosing to clients) the conflict of interest created by these payments. The Commission also alleged that Respondent failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act by identifying and disclosing conflicts of interest. In determining to accept the settlement offer, the Commission considered the cooperation of and remedial actions taken by Respondent, including, among other things, self-reporting the conduct to Commission staff and returning the clients' money used to pay for use of the research, with interest. The Commission ordered Respondent to cease and desist from future violations of

Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, to pay a civil money penalty in the amount of $50,000, and to comply with undertakings, including hiring an independent third-party consultant.

Trade Allocation

***In re Valor Capital Asset Management, LLC and Robert Mark Magee*, Investment Advisers Act Rel. No. 4864, 2018 SEC LEXIS 686 (Mar. 6, 2018)**

The Commission accepted an offer of settlement from Valor Capital Asset Management, LLC, a state-registered investment adviser, and its principal and sole employee, Robert Mark Magee (collectively, Respondents). The Commission alleged that from July 2012 to May 2015 Respondents defrauded clients by engaging in a cherry-picking scheme in which they disproportionately allocated profitable or less-unprofitable trades from Valor's omnibus trading account to Magee's personal account, while disproportionately allocating unprofitable or less-profitable trades to client accounts. The Commission alleged that as a result of this conduct, Respondents violated Section 206(1) and 206(2) of the Advisers Act, and Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c) thereunder. Respondents were ordered to cease and desist from committing further violations of the Advisers Act. Magee was barred from association and prohibited from acting as an employee, officer, or director of an investment adviser with a conditional right to reapply. The Commission ordered Respondents to pay disgorgement of $505,663 and prejudgment interest of $50,208.57, and a civil money penalty of $160,000.

***SEC v. Strong Investment Management,* Litigation Rel. No. 25045, 2018 SEC LEXIS 542 (Feb. 21, 2018); *In re John B. Engebretson*, Investment Advisers Act Rel. No. 4967, 2018 SEC LEXIS 1701 (July 12, 2018)**

The Commission filed a complaint against an investment adviser, Strong Investment Management, its president and sole owner, Joseph B. Bronson, and its chief compliance officer, John B. Engebretson (collectively Respondents), in connection with a "cherry picking" scheme. The Commission alleged that Bronson traded securities in Strong's account but delayed allocating those securities to client accounts until after he observed how the securities performed throughout the day, allocating the profitable trades to himself and unprofitable trades to Strong clients and thereby reaping substantial profits at the clients' expense. The Commission further alleged that Bronson and Strong misrepresented their practices in Strong's Form ADV by falsely stating that trades would be allocated in accordance with pretrade allocation statements and that no client or firm personnel account would be favored. Lastly, the Commission alleged that Engebretson aided and abetted the defrauding of investors by repeatedly disregarding red flags relating to Strong's trade allocation practices and by failing to ensure that Strong's trade allocation policies and procedures were implemented. The Commission charged Bronson and Strong with violating Section 10(b) of the Exchange Act, Section 17(a)(1) and 17(a)(2) of the Securities Act, and Sections 206(1), 206(2), and 207 of the Advisers Act. The Commission additionally charged Strong with violating Section 206(4) of the Advisers Act and Bronson and Engebretson with aiding and abetting those violations.

On June 15, 2018, the court entered a judgment on consent from Engebretson, permanently enjoining him from future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. Thereafter, in a follow-on administrative proceeding, the Commission accepted an offer of settlement from Engebretson. The Commission's order bars Engebretson from association.

The Commission brought several cases in this area, focusing on trade allocation from an adviser's omnibus account, in 2018. *See, e.g.*, *In re BKS Advisors LLC*, Investment Advisers Act Rel. No. 4987, 2018 SEC LEXIS 2018 (Aug. 17, 2018); *In re Roger T. Denha*, Investment Advisers Act Rel. No. 4988, 2018 SEC LEXIS 2017 (Aug. 17, 2018); *SEC v. World Tree Financial, LLC, et al.*, Litig. Rel. No. 24278, 2018 SEC LEXIS 2486 (Sept. 20, 2018).

Trading Practices

In re Morgan Stanley Smith Barney LLC, Investment Advisers Act Rel. No. 4953, 2018 SEC LEXIS 1603 (June 29, 2018)

The Commission accepted an offer of settlement from Morgan Stanley Smith Barney LLC (Respondent), a dually registered investment adviser and broker-dealer. The Commission alleged that Respondent failed to adopt policies and procedures reasonably designed to prevent its personnel from misusing and misappropriating funds in client accounts and that, from at least 2009 through June 2018, Respondent permitted its investment adviser representatives and registered representatives (collectively, financial advisors or FAs) to initiate third-party disbursements from client accounts of outgoing wire transfers and journals of up to $100,000 per day per account based on an FA's attestation on an internal form that the FA had received a verbal request from the client and providing certain details about such request. The Commission alleged that, while Respondent did have policies and procedures in place that provided for certain reviews prior to issuing such disbursements, those reviews were not reasonably designed to detect or prevent an FA from making a false attestation. The Commission further alleged that the insufficient policies and procedures contributed to Respondent's failing to reasonably supervise its FA Barry F. Connell, by failing to detect or prevent Connell, over the course of nearly one year, from initiating more than $7 million in unauthorized transactions and thereby misappropriating for his own personal enrichment more than $5 million from the advisory accounts of an elderly couple and their adult daughter, and a trust for which the daughter served as co-trustee. The Commission alleged that, after being contacted by a representative of the defrauded clients, Respondent conducted an internal investigation, reported the fraud to the Commission and other law enforcement agencies, fully repaid the clients with interest, and enhanced its policies, procedures, and anti-fraud staffing and surveillance to prevent conversion of client and brokerage customer funds by Respondent personnel through third-party cash disbursements. In accepting the offer of settlement, the Commission considered Respondent's cooperation with Commission staff and remedial acts. The Commission ordered Respondent to cease and desist from future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, imposed a censure and a civil money penalty of $3.6 million, and ordered Respondent to comply with undertakings. The Commission has filed a civil action against Connell, and criminal charges have been brought against him in the Southern District of New York.

***In re Ophrys, LLC*, Investment Advisers Act Rel. No. 5041, 2018 SEC LEXIS 2544 (Sept. 21, 2018)**

The Commission accepted an offer of settlement from registered investment adviser Ophrys, LLC (Respondent). The Commission alleged that Respondent failed to adequately disclose to clients the capacity in which it was acting with respect to, and obtain consent from its clients for, agency transactions for which it received compensation in addition to its advisory fee. The Commission also alleged that Respondent failed to disclose its conflicted role in a principal transaction. Specifically, the Commission stated that Respondent engaged in two agency transactions where it acted as broker within the meaning of Section 206(3) of the Advisers Act, without providing adequate prior written disclosure to the affected advisory clients that it was acting as agent in the sale of securities from one client account to another, or obtaining client consent. The Commission alleged that in a third transaction, Respondent, through its wholly owned subsidiary, purchased securities, which consisted of defaulted consumer debt, from a private fund of which it was the sole remaining investor. According to the Commission Order, Respondent then sold those same securities to another advisory client without disclosure as to the conflicted transaction, or obtaining client consent. As a result of this conduct, the Commission found that Respondent violated Section 206(3) of the Advisers Act. The Commission ordered Respondent to cease and desist from committing or causing further violations of Section 206(3) of the Advisers Act. Finally, the Commission ordered that Respondent pay a civil money penalty of $500,000.

***In re Putnam Investment Management, LLC and Zachary Harrison*, Investment Advisers Act Rel. No. 5050, 2018 SEC LEXIS 2645 (Sept. 27, 2018)**

The Commission accepted an offer of settlement from registered investment adviser Putnam Investment Management, LLC (Putnam) and Zachary Harrison, a portfolio manager and residential mortgage-backed securities (RMBS) trader at Putnam (together, Respondents). According to the Commission Order, from at least April 2011 through September 2015, Putnam served as investment adviser to numerous registered investment companies (RICs) and other clients; Harrison was a portfolio manager in Putnam's Structured Credit Group (SCG). The Commission stated that, during the relevant period, certain Putnam advisory accounts for various reasons needed to sell positions in nonagency RMBS that Harrison viewed as desirable investments and wished to transfer to other Putnam-advised accounts. Rather than attempting to sell the securities into the market, the Commission alleged that Harrison prearranged with broker-dealers to temporarily sell the securities and repurchase them at a small markup, usually the next business day.

The Commission alleged that Harrison's conduct caused Putnam to engage in cross-trades for RIC and RIC-affiliated client accounts on dozens of occasions that were not in accordance with Investment Company Act Rule 17(a)-7, Putnam's policies and procedures, and its Form ADV disclosures. The Commission further alleged that the manner in which Harrison effected the trades on behalf of Putnam resulted in undisclosed favorable treatment of certain advisory clients over others. Specifically, the Commission alleged that Harrison executed the sell side of each cross-trade at either the highest or only bid he received for the securities, and proceeded to execute the repurchases at a small markup over the sale price. Finally, the Commission alleged that Putnam did not adopt and implement policies and procedures reasonably designed to prevent

unlawful cross-trading, failed reasonably to supervise Harrison, and filed Forms ADV with the Commission that contained untrue statements of material fact and omitted to state material facts that it was required to disclose. The Commission ordered Putnam to cease and desist from further violations of Section 17(a)(1) and 17(a)(2) of the Investment Company Act and Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 promulgated thereunder, and to pay a civil money penalty of $1 million. Harrison was ordered to cease and desist from causing any violations of Section 206(2) of the Advisers Act and Section 17(a)(1) and 17(a)(2) of the Investment Company Act, and to pay a civil money penalty of $50,000. The Commission's order noted that it considered Putnam's remedial acts, including termination of Harrison; voluntarily placement of funds in escrow to compensate affected clients; and retention of a compliance consultant.

Valuation

***In re Visium Asset Management, LP*, Investment Advisers Act Rel. No. 4909, 2018 SEC LEXIS 1078 (May 8, 2018); *In re Ku*, Investment Advisers Act Rel. No. 4910, 2018 SEC LEXIS 1080 (May 8, 2018)**

The Commission accepted an offer of settlement from Visium Asset Management, LP (Respondent) in connection with an alleged mismarking scheme and claimed insider trading violations by Respondent's portfolio managers. The Commission alleged that, from at least July 2011 to December 2012, two of Respondent's portfolio managers used falsely inflated quotes to override independent prices for securities held by a fund advised by Respondent. According to the Commission Order, this caused the fund to regularly overstate its NAV during the relevant period and to overcharge NAV-based performance and management fees. The Commission alleged that this mismarking scheme also caused Respondent to make material misstatements in its Form ADV and to make other false and misleading statements regarding its valuation policies and procedures. The Commission further alleged that Respondent's portfolio managers traded on the basis of material, nonpublic information regarding clinical drug trials received from former federal healthcare agency officials and insiders, and as a result of trades placed by the portfolio managers with this information the funds reaped nearly $8 million in ill-gotten gains that in turn generated nearly $1,600,000 in performance and management fees. The Commission stated that Respondent failed to adequately enforce its policies and procedures concerning the handling of material, nonpublic information.

The Commission found that Respondent's conduct with regard to the mismarking and insider trading schemes violated Sections 204A, 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder, as well as Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Respondent undertook to withdraw its registration as an investment adviser and agreed to cease and desist from further violations of the aforementioned securities laws and rules, to be censured, and to pay a civil money penalty of $4,755,223, disgorgement of $4,755,223, and prejudgment interest thereon of $720,711. In a related action, Respondent's CFO (Ku) agreed to a suspension from association for a period of 12 months and to a civil money penalty of $100,000.

***SEC v. Premium Point Investments, LP et al.*, Litig. Rel. No. 24138, 2018 SEC LEXIS 1104 (May 9, 2018)**

In a complaint filed in the United States District Court for the Southern District of New York, the Commission charged Premium Point Investments, LP (Respondent); its CEO and CIO, Anilesh Ahuja; a former partner and portfolio manager of Respondent, Amin Majidi; and a former trader employed by Respondent, Jeremy Shor (collectively, Respondents), with allegedly misleading investors by inflating the value of several private funds advised by Respondent (Funds). The Commission alleged that Respondents employed two separate methods to inflate the value of the Funds. According to the Commission Order, first, Respondents obtained inflated broker quotes for certain mortgage-backed securities (bonds) held by the Funds in exchange for sending trades to the broker-dealers providing the inflated quotes. Second, the Commission alleged that Respondents overstated the value of certain bonds by using an "imputed mid-point valuation" methodology in which the midpoint price for a bond was calculated using the spread for the broader sector to which a given bond belonged, rather than using the spread for the bond itself. The Commission alleged that this practice was not known to most investors, and resulted in significantly inflated valuations for the bonds held by the Funds. The Commission's complaint charges Respondent with violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder; Respondent, Ahuja, and Majidi with violations of Section 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8(a)(2) thereunder; and Ahuja, Majidi, and Shor with aiding and abetting violations of Section 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8(a)(2) thereunder. The Commission also charged Respondents with violations of Section 10(b) of the Exchange Act and Rules 10b-5(a) and 10b-5(c) thereunder and violations of Section 17(a)(1) and 17(a)(3) of the Securities Act. The Commission seeks permanent injunctions, disgorgement of ill-gotten gains with interest, and civil money penalties.

***In re VSS Fund Management LLC and Jeffrey T. Stevenson,* Investment Advisers Act Rel. No. 5001, 2018 SEC LEXIS 2208 (Sept. 7, 2018)**

The Commission accepted an offer of settlement from VSS Fund Management LLC, a registered investment adviser (VSS) and Jeffrey T. Stevenson, its owner and managing partner (collectively, Respondents). The Commission alleged that VSS failed to provide material information to the limited partners of a private equity fund it advised regarding a change in the value of the fund's assets, in connection with an offer by Stevenson, the owner and managing partner of VSS, to purchase limited partner interests of the fund. Specifically, the Commission alleged that Respondents received preliminary information indicating that the NAV of the fund may have increased significantly, which they neglected to disclose to the limited partners, instead continuing to offer to purchase at the price set prior to the receipt of this information. The Commission alleged that this omission resulted in certain statements in VSS's letter to investors being misleading. The Commission censured Respondents and ordered them to cease and desist from committing or causing any violations of Section 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder and to pay a civil money penalty of $200,000.

Wrap Fee Programs – Trading Away

***In re Lockwood Advisors, Inc.,* Investment Advisers Act Rel. No. 4984, 2018 SEC LEXIS 1989 (Aug. 14, 2018)**

The Commission accepted an offer of settlement from Lockwood Advisors, Inc. (Respondent), a registered investment adviser. The Commission alleged that Respondent's policies and procedures were not reasonably designed to prevent violations of the Advisers Act in connection with gathering and disclosing information about the trading-away practices of the third-party portfolio management firms in its wrap programs. According to the Commission Order, Respondent was the sponsor of a separately managed account wrap program offered to third-party registered investment advisors (RIAs) and their clients (wrap clients), for which the wrap clients' investment advisers had the responsibility of evaluating the suitability of the portfolio managers for its individual clients. The Commission alleged that Respondent failed to provide clients and RIAs with material information about trading away and the additional costs associated with choosing certain portfolio managers in Respondent's wrap programs.

In determining to accept the settlement offer, the Commission considered both Respondent's cooperation and the voluntary remedial acts undertaken by Respondent, including improving the specificity of its policies and procedures regarding the quarterly step-out trading reviews, and improving its Form ADV disclosures regarding trading away by disclosing to wrap clients that the portfolio managers are permitted to trade away; providing a history of the portfolio managers' record or trading away; and revising certain footnotes in its Form ADV to state that there may be fees associated with trading away, and gave the overall ranges of those fees. The Commission ordered Respondent to cease and desist from committing or causing any violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, and ordered Respondent to pay a civil money penalty of $200,000.

Financial Industry Regulatory Authority

ENFORCEMENT DEVELOPMENTS

Enforcement Consolidation & New Structure

On July 26, 2018, FINRA announced the completion of the consolidation of its two previously distinct enforcement teams. This consolidation is a key outcome of the FINRA360 "self-evaluation and organizational improvement" initiative and was designed to help facilitate more consistent and foreseeable outcomes from a single, unified team of enforcement staff.

Under the overall leadership of Susan Schroeder, the FINRA Department of Enforcement's new unified structure consists of two new centralized groups: (i) the Office of the Counsel to the Head of Enforcement led by Senior Vice President Lara Thyagarajan and comprised of experienced attorneys and staff; and (ii) the Investigations unit led by Terrence Bohan that consists of non-attorney investigators with significant industry and investigative experience. Additionally, the Enforcement staff was divided and organized into specialized teams including Main Enforcement, Sales Practice Enforcement, and Market Regulation Enforcement. Senior Vice President Jessica Hopper, Deputy Head of Enforcement, leads the Main Enforcement team, which investigates and prosecutes various disciplinary matters. Senior Vice President Christopher Kelly is the leader of the Sales Practice Enforcement team, which brings disciplinary actions concerning sales practice violations and counsels Member Supervision examiners during investigations and examinations. Senior Vice President Elizabeth Hogan is the leader of the Market Regulation Enforcement team, which counsels Market Regulation examiners and analysts during investigations and examinations conducted based on FINRA's trading surveillance and prosecutes disciplinary actions that result from those investigations and examinations.

Enforcement Principles

On July 31, 2018, FINRA released a podcast addressing the principles that guide FINRA's decision-making when taking Enforcement action. This podcast supplemented information shared by Ms. Schroeder on this topic at SIFMA's Anti-Money Laundering conference in February 2018. The podcast and Ms. Schroeder's speech highlight some of Enforcement's key goals, including fairness of process, consistent and foreseeable outcomes, and effectively achieving remediation and prevention. To meet those goals, FINRA said that it looks first at whether it is appropriate to bring an enforcement action in light of the particular facts and circumstances of the matter. In doing so, FINRA focuses on harm: whether there was harm to investors, harm to the market, or a significant risk of harm to investors or the market. If it determines that formal enforcement action is not appropriate, it may issue a Cautionary Action Letter, or consider releasing guidance (for example, if it becomes clear that a particular rule is not well understood). If an enforcement action is appropriate, the Staff considers what would be an effective sanction. The podcast explained that effective sanctions are designed to remediate the particular issue in a matter, or

to prevent or deter that issue from occurring again. That said, FINRA's number one priority remains providing restitution to harmed customers.

2018 Annual Budget Summary – Use of Fine Monies

On January 18, 2018, FINRA published its first annual budget summary. The 2018 Annual Budget Summary and the accompanying cover letter describe the six Financial Guiding Principles that will inform the organization's financial planning. In explaining one of the principles, "Use Fines to Promote Compliance and Improve Markets," the Budget Summary states that, "[w]hen [FINRA] impose[s] fines, the amounts are based on the facts and circumstances of the misconduct and the principles set forth in our Sanction Guidelines; fines are not based on revenue considerations, and [FINRA] does not establish any minimum amount of fines that must be collected for purposes of [its] annual budget." The Budget Summary goes on to say that the use of fine monies is subject to special procedures and restrictions, and is not considered in determining employee compensation and benefits. The FINRA Board's Finance Committee must authorize the use of such funds and will do so for specific purposes: capital or nonrecurring expenditures to promote effective regulatory oversight, education activities, capital or new initiatives required by changes in the law, or to replenish FINRA's reserves if necessary to preserve FINRA's ability to continue to fund its operations. FINRA will publish a description of the approved use of fine monies for the prior year on an annual basis.

Revision to Sanction Guidelines

In May 2018, FINRA published Regulatory Notice 18-17 to advise firms of revisions to its Sanctions Guidelines. The notice stated that FINRA revised the Guidelines to instruct adjudicators to consider customer-initiated arbitrations that result in adverse arbitration awards or settlements when assessing sanctions. FINRA said that this should allow adjudicators to identify patterns in a respondent's disciplinary history, past arbitration awards, settlements or findings and impose more stringent sanctions as appropriate. Previously, the Guidelines instructed that a respondent's disciplinary history should result in higher sanctions when it: (i) is similar to the current misconduct; or (ii) evidences a "reckless disregard for regulatory requirements, investor protection, or market integrity." The new version replaces the term "disciplinary history" with the more broadly defined "Disciplinary and Arbitration History." The revisions took effect on June 1, 2018 and will apply to complaints filed on or after June 1, 2018. The revisions will not apply to cases filed before that date or to cases currently pending.

NEW MEMBER REGULATION APPOINTMENT AND CONSOLIDATION OF EXAMINATION AND RISK-MONITORING PROGRAMS

In April 2018, FINRA announced that it named Bari Havlik as Executive Vice President of the newly named Member Supervision team. In this role, Ms. Havlik is principally responsible for leading FINRA's Member Regulation program, which includes examination and surveillance programs for member firms. In October 2018, FINRA announced that it planned to consolidate its Examination and Risk Monitoring Programs, integrating three separate programs—Sales Practice, Risk Oversight and Operational Regulation (ROOR), and Trading & Financial Compliance Examinations (TFCE), which are responsible for business conduct, financial, and trading

compliance—into one unified, integrated program. This consolidation seeks to eliminate duplication, promote more effective oversight and greater consistency, emphasize a risk-based approach, and create a single point of accountability in examinations. Ms. Havlik is overseeing this consolidation process, which will likely last until 2020.

TARGETED EXAMINATION LETTER

In April 2018, FINRA posted a targeted examination letter announcing a review focusing on the supervisory processes followed by firms to identify and mitigate sales practice risks associated with recommendations to noninstitutional purchases of volatility-linked products (such as unsuitable recommendations, misrepresentations, and appropriateness of disclosures). The Staff requested policies and procedures, a statement of restrictions, data related to gross commissions, and data containing transactions effected in accounts of noninstitutional customers. The review period covered by the letter was from October 1, 2017 through February 28, 2018. The 2018 Report on FINRA Examination Findings highlighted the key findings of that review: (i) although prospectuses and other materials include explicit disclosures, some firms made unsuitable recommendations to retail customers and marketed volatility-linked products to them when those customers did not understand those products' unique risks; (ii) some firms conducted inadequate due diligence by not addressing the unique characteristics and risks associated with volatility-linked products that could potentially lead to steep losses; and (iii) some firms had insufficient systems and controls (or lacked such systems and controls altogether) for addressing the risks of offering volatility-linked products to customers.

FINRA REPORT ON EXAMINATION FINDINGS

On December 7, 2018, FINRA released its second annual Report on FINRA Examination Findings. The Report provides observations from recent exams of firms and is meant to serve as a resource to help firms more easily comply with securities rules and regulations and to assist in strengthening firms' compliance programs and supervisory controls. As in the 2017 report, the 2018 Report includes a section called "Highlighted Observations" discussing the issues FINRA has seen in the following areas: (i) suitability for retail customers; (ii) fixed income mark-up disclosure; (iii) reasonable diligence for private placements; and (iv) abuse of authority. As noted above, this section also summarizes the key findings from FINRA's targeted examination of volatility-linked products.

FINRA'S 2019 REGULATORY AND EXAMINATION PRIORITIES

On January 22, 2019, FINRA published its annual Risk Monitoring and Examination Priorities Letter (the 2019 Letter). This year, the 2019 Letter took a different approach by highlighting new topics that FINRA will focus on in the upcoming year (as opposed to prior years, when the annual priorities letter also included a recitation of many longstanding priorities). However, FINRA noted that it will continue to review for compliance in areas that have been a consistent focus over the years. FINRA also stated that it will focus on risks related to persons with problematic regulatory history and the adequacy of firm's cybersecurity programs. Below are the priorities outlined in the 2019 Letter.

2019 Highlighted Items

The 2019 Letter begins with a focus on three "Highlighted Items:"

Online Distribution Platforms

FINRA will review how firms address the risk of offering documents or communications with the public and meet anti-money laundering requirements when involved with online distribution platforms. FINRA will also focus on how firms address the risk of offering documents or communications that may omit material information or contain false or misleading statements.

Fixed Income Mark-up Disclosure

FINRA will assess compliance with amendments to FINRA Rule 2232 and MSRB Rule G-15, which became effective on May 14, 2018. These changes focus on firms' mark-up or mark-down disclosure obligations on fixed income transactions with customers. FINRA created a tool to help firms evaluate their compliance in this area: The Mark-up/Mark-down Analysis Report.

Regulatory Technology

FINRA will seek to better understand how firms are using regulatory technology tools in their compliance efforts and will evaluate how firms are managing risks related to supervision, third-party vendor management, customer data protection, and cybersecurity.

Other 2019 Priorities

Sales Practice Risks

- Suitability: This year, FINRA will focus on (i) deficient quantitative suitability determinations; (ii) overconcentration in illiquid securities; and (iii) inappropriate share class purchase recommendations. FINRA will also specifically look at whether firms are meeting suitability obligations for exchange-traded products.

- Senior Investors: FINRA will review firms' supervision of registered representatives serving in a fiduciary capacity, serving as a trustee, or having a beneficiary relationship with a nonfamilial customer account. FINRA will also focus on firms' controls under Rule 4512 (Customer Account Information) and Rule 2165 (Financial Exploitation of Specified Adults).

- Outside Business Activities and Private Securities Transactions: FINRA will assess firms' controls related to associated persons raising funds from their customers, and fundraising activities for entities the associated person controls or in which they have an interest (specifically those with misleading names that may be similar to established issuers).

Operational Risks

- Supervision of Digital Assets Business: FINRA will review firms' activities related to digital assets and their compliance with related securities laws and regulations. FINRA will also work closely with the SEC to determine whether specific digital assets are a security and whether firms have implemented adequate controls and supervision to comply with rules relating to the marketing, sale, execution, control, clearance, recordkeeping and valuation of digital assets.

- Customer Due Diligence and Suspicious Activity Reviews: FINRA will focus on firms' compliance with FinCEN's Customer Due Diligence Rule, which went into effect on May 11, 2018. FINRA will review the data integrity of firm's suspicious activity monitoring systems and any decisions to make changes to those systems.

Market Risks

- Best Execution: FINRA will focus on best-execution decision-making where a firm routed all or substantially all customer orders to a small number of wholesale market makers from which it received payment for order flow or an affiliated broker-dealer or an alternative trading system (ATS) in which the firm had a financial interest. FINRA will also review how firms check for potential price movement at other venues, how firms quantify customer benefit from order-routing inducements, and how firms manage conflicts of interest.

- Market Manipulation: FINRA will focus on manipulative trading in correlated ETPs and will review for potential manipulation across correlated options products.

- Market Access: FINRA will review how firms apply controls and limits to sponsored access orders, retain the sole authority to determine the boundaries for those controls and limits, and how firms test those controls.

- Short Sales: FINRA will look at whether firms' aggregation units are structured in compliance with the requirements of Exchange Act Rule 200(f).

- Short Tenders: FINRA will assess how firms account for their options positions when tendering shares in the offer and will continue to educate firms about complying with these requirements of Exchange Act Rule 14e-4.

Financial Risks

- Credit Risk: FINRA will focus on policies and procedures for identifying, measuring and managing credit risk, including risk exposures that may not be readily apparent. FINRA will also review how, and to what extent, firms identify and address all relevant risks when they extend credit to their customers and counterparties.

- Funding and Liquidity: FINRA will assess whether firms update their stress test assumptions as the market shifts. FINRA will also review the adequacy of firms' liquidity pools and how firms review their stress test assumptions in light of business activities and arrangements.

ENFORCEMENT STATISTICS

As of the date of publication of this outline, FINRA had not yet announced its 2018 enforcement statistics. The online version of this publication will include that data when it becomes available.

FINRA ENFORCEMENT ACTIONS

Anti-Money Laundering (AML)

***Meyers Associates, L.P (n/k/a/ Windsor Street Capital, L.P.)*, FINRA Compl. No. 2010020954501 (Jan. 4, 2018)**

FINRA's National Adjudicatory Council (NAC) affirmed a FINRA Hearing Panel's findings that Meyers Associates, L.P. (n/k/a/ Windsor Street Capital, L.P.) (i) failed to adequately review emails sent to and received by its Chicago office; (ii) failed to adequately review a broker's market manipulation and trading in IWEB stock despite numerous "red flags"; (iii) failed to take sufficient steps to detect whether its registered representatives in Chicago were manipulating stocks; (iv) failed to adequately review third-party research reports and other public communications disseminated by brokers in violation of NASD Rule 3010(a) and FINRA Rule 2010; and (v) failed to establish and implement adequate AML policies and procedures. The Hearing Panel fined Meyers Associates $350,000, and ordered it to retain an independent consultant to conduct a comprehensive review of the firm's policies, systems, and training. The Hearing Panel also found Meyers Associates were subject to statutory disqualification—which the NAC confirmed—because it failed to take "basic steps" to supervise an employee who engaged in securities fraud while employed at the firm. The NAC determined that a higher fine than the $350,000 the Hearing Panel imposed was "needed to adequately address Meyers' troubling and egregious violations," and increased the fine to $500,000 because Meyers failed to supervise a broker and allowed him "to engage in securities fraud that enriched [him], harmed customers, and compromised market integrity," by having supervisory deficiencies and by failing to reasonably respond to numerous red-flag warnings. The NAC further reasoned that Meyers' "lengthy and troubling disciplinary history" was "disconcerting" and warranted the increased fine amount and the need to hire an independent consultant. On January 23, 2018, Meyers Associates appealed the NAC's decision to the SEC (Admin. Proceeding File No. 3-18350). All briefing has been filed and the appeal remains pending before the SEC.

***Aegis Capital Corp.*, FINRA AWC No. 20130387509 (March 28, 2018)**

In a Letter of Acceptance, Waiver and Consent (AWC) with Aegis Capital Corp. (Aegis), FINRA alleged that, from January 2013 to November 2014, the firm failed to establish and implement an AML program reasonably designed to detect and investigate certain red flags identifying potentially suspicious transactions in delivery versus payment/receive versus payment (DVP) accounts. According to FINRA, Aegis updated its written supervisory procedures (WSPs) in December 2013 to identify specific red flags associated with low-priced securities transactions, but failed to address risks specific to DVP trading. FINRA also alleged that Aegis failed to establish, maintain, and enforce a reasonable supervisory system, including written procedures, for the sale of low-price securities in DVP accounts. Specifically, prior to November 2013, the firm's WSPs did not have adequate due diligence requirements for DVP accounts. FINRA found that, although the firm updated its WSPs in November 2013 to reflect DVP-specific requirements, it did not implement these requirements consistently. FINRA also found that Aegis's trade review mechanism to identify the red flags reflected in the firm's WSPs was insufficient, that several branch managers did not report suspicious activity as required, and that the firm's trade review

system did not analyze DVP transactions until July 2013. As a result of these issues, from January 2012 to April 2014, Aegis failed to monitor or investigate trades in seven DVP accounts that liquidated billions of shares of low-priced securities, which generated millions of dollars in proceeds. FINRA also found that Aegis did not have an adequate AML training program because, although employees were required to complete a training module, it did not address red flags in low-price securities transactions. Aegis consented to a censure and a fine of $550,000.

***Industrial and Commercial Bank of China Financial Services LLC*, FINRA AWC. No. 2015045550801 (May 16, 2018)**

FINRA settled a matter with Industrial and Commercial Bank of China Financial Services LLC (ICBCFS) regarding allegations that the firm failed to establish a reasonable AML program to monitor and detect suspicious transactions, as well as financial, recordkeeping, and operational violations. FINRA alleged that, beginning in late-2012, in connection with a new business, ICBCFS began carrying and clearing for dozens of new customers who, from January 2013 to at least September 2015, purchased and sold more than 33 billion shares of penny stocks, which were valued in excess of $210 million. FINRA alleged that prior to June 2014, ICBCFS did not have any surveillance reports designed to monitor suspicious liquidations of penny stock shares. With respect to the reports that were in place, ICBCFS's policies and procedures did not require its employees to document their reviews, nor did the firm require reviews to be tracked. In addition, according to FINRA, ICBCFS did not properly amend its AML program after it was placed on notice in June 2014 by the SEC that its AML surveillance system may have been inadequate. FINRA stated that, although ICBCFS implemented two new reports designed to detect suspicious penny stock activity, it failed to amend its AML procedures to provide its employees with guidance regarding the purpose of the new reports, how to use them, and how to escalate issues to firm management. FINRA further alleged that ICBCFS lacked systems and procedures to monitor whether certain business activities were unusual for any given customer, despite the fact that the firm's procedures specifically listed those activities as potential red flags. FINRA stated that ICBCFS also delegated important suspicious activity monitoring duties to a nonexistent employee title, and those duties were not performed in an adequate manner by any ICBCFS employees. As a result, FINRA alleged the ICBCFS failed to detect and investigate red flags of potentially suspicious penny stock liquidations that could have trigged the filing of a suspicious activity report (SAR). FINRA further alleged that the firm had inadequate AML testing and failed to reasonably describe its business to an independent AML auditor. In addition to the AML violations, FINRA alleged that in April and May 2014, the firm failed to reduce its customer debit balances by the amount of any single customer debit exceeding 25 percent of the firm's tentative net capital and improperly classified several prime brokerage accounts as noncustomer accounts, excluding approximately $5.7 million in credits and causing customer reserve hindsight deficiencies and deficient books and records. FINRA also found that the firm had inaccurate segregation calculations, possession or control violations, inaccurate FOCUS reports, failed to seek SEC approval to use a satisfactory foreign control location, and a registration violation. ICBCFS agreed to a censure and a fine of $5.3 million. In addition, ICBCFS was ordered to retain an independent consultant. ICBCFS also agreed to pay a $860,000 penalty in a separate SEC matter involving AML and other violations.

***EFG Capital International Corp.*, FINRA AWC No. 2015046020002 (May 22, 2018)**

In an AWC with EFG Capital International Corp., FINRA alleged that, from April 2010 through July 2015, the firm failed to have an adequate supervisory system or AML program related to two material areas of its international business model. EFG's international business model involved entering into transaction referral agreements with foreign introducers that would refer transactions to the firm in exchange for a referral fee and having high net worth customers who were dual customers of EFG and its Swiss bank affiliate. FINRA alleged that the firm's supervisory system failed to assess whether the firm had sufficient information about the foreign introducer to conclude that the referral fee payment was permissible under U.S. law. FINRA also alleged that the firm did not identify whether the foreign introducers were high-risk entities, or engaged in high-risk activities, and did not adequately review the referred transactions for red flags or patterns of suspicious activity. In addition, FINRA alleged that the firm's AML program was insufficient to identify and investigate certain patterns of outgoing wire transfer activity by its dual customers that should have raised red flags requiring further investigation by the firm, or potentially the filing of SARs. EFG consented to a censure, a fine of $800,000, and an undertaking to adopt and implement supervisory procedures relating to the referral agreements and dual customer accounts.

***LPL Financial LLC*, FINRA AWC No. 2016050751901 (October 29, 2018)**

FINRA and LPL Financial LLC (LPL) entered into an AWC related to allegations surrounding its AML program and its Forms U4 and U5 practices. Specifically, FINRA alleged that, from at least January 1, 2013 through May 31, 2015, LPL failed to establish and implement an AML program reasonably designed to detect and cause reporting of potentially suspicious activity, which resulted in the under-filing of SARs. For example, FINRA stated that the firm provided compliance personnel with inaccurate guidance. In total, FINRA alleged that the firm failed to investigate incidents and file more than 400 SARs. In addition, FINRA alleged that LPL failed to establish reasonable procedures regarding analysts' review of AML-related referrals sent by employees and registered representatives and failed to promptly correct issues after they had been identified by internal audit in January 2016. FINRA also alleged that, from at least March 2013 through November 2017, LPL failed to file or amend registered representatives' Forms U4 and U5 to reflect certain customer complaints and failed to establish, maintain, and enforce a supervisory system and WSPs reasonably designed to achieve compliance with Form U4 and U5 reporting requirements. According to FINRA, LPL's WSPs did not require the firm to make a good-faith estimate of customer damages in instances when the customer's complaint did not specifically allege damages, nor did they explain when LPL's compliance personnel should report a complaint on Forms U4 and U5, leading to inconsistent reporting. LPL consented to a censure, a fine of $2.75 million, and an undertaking to review customer complaints identified by FINRA and submit a report containing the conclusions from that review. FINRA stated that LPL's actions mitigated the sanction, including its decisions to: (i) begin investigating these violations itself; (ii) hire outside counsel to conduct a full internal investigation; (iii) file 418 SARs it determined that it should have filed and amend 31 Forms U4 and U5 to add customer complaints; (iv) review its AML investigations procedures and restructure its AML investigation unit; and (v) cooperate with FINRA.

***UBS Financial Services Inc./ UBS Securities LLC,* FINRA AWC No. 2012034427001 (November 29, 2018)**

FINRA entered into a settlement with UBS Financial Services Inc. (UBSFS) and UBS Securities LLC (UBSS) regarding allegations that the firms failed to establish and implement AML programs reasonably designed to detect and cause the reporting of potentially suspicious activity and did not have policies and procedures in place that were reasonably designed to monitor trading in penny stocks. More specifically, FINRA alleged that UBSFS, from 2004 to April 2012, relied on automated surveillance systems to flag suspicious foreign currency wire transfers, but the system failed to capture AML-relevant data for transfers in foreign currency to and from customers' commodities and retail brokerage accounts – leaving $6.2 billion and $3.7 billion, respectively, in foreign currency wire transfers without reasonable oversight. FINRA stated that, although UBSFS realized this error in 2012 and attempted to correct it, the system still failed to capture all of the data necessary to reasonably identify AML red flags. In addition, FINRA alleged that, from January 2013 to June 2017, UBSS did not have an AML program that was reasonably designed to detect and report potentially suspicious activity in an omnibus account that the firm used to execute penny stock transactions. UBSS oversaw the purchase or sale of over 30 billion shares of penny stocks on behalf of UBS Group AG's customers, but according to FINRA, failed to record the identity of the stocks' beneficial owner, the beneficial owner's relationship with the issuer, or how each customer obtained the stocks – all information necessary to flag potentially suspicious transactions like the illegal distribution of unregistered securities. Additionally, FINRA alleged that UBSS facilitated penny stock transactions that included the sale of 23 penny stocks when those stocks appeared to part of "pump and dump" or other potential manipulation or fraud schemes. FINRA further alleged that, for certain periods, the firms did not establish a reasonably designed due diligence program for correspondent accounts. UBSFS consented to a censure and a fine of $4.5 million and UBSS consented to a censure and fine of $500,000. UBSFS contemporaneously settled enforcement actions with the SEC and FinCEN, each carrying a fine of $5 million.

***Morgan Stanley Smith Barney LLC*, FINRA AWC No. 2014041196601 (Dec. 26, 2018)**

In an AWC with Morgan Stanley Smith Barney LLC (Morgan Stanley), FINRA alleged that the firm failed to develop and implement an AML program designed to achieve and monitor Morgan Stanley's compliance with the Bank Secrecy Act (BSA) and related regulations. Specifically, from January 2011 until at least April 2016, FINRA found that the firm failed to surveil hundreds of thousands of wire and foreign currency transfers (transmitting tens of billions of dollars) because its automated Transaction Monitoring System (TMS) had certain design limitations and programming flaws. According to FINRA, Morgan Stanley discovered these system deficiencies while responding to a FINRA inquiry, discovered other related issues independently and brought them to the Staff's attention. The AWC noted that Morgan Stanley retained a consultant in 2013 to test the data that was sent to TMS and, in August 2015, the consultant identified multiple "high-risk" issues that could impact the efficacy of TMS. In late 2016, the firm again engaged the consultant to review potential data transmission issues. FINRA found that, at that time, the consultant identified additional problems that compromised the effectiveness of TMS's surveillance of certain transactions and that the issue was not remediated until at least February 2017. FINRA also alleged that, from January 2011 to December 2013, Morgan Stanley's AML

analysts sometimes failed to conduct reasonable due diligence and/or document their reviews of TMS alerts to adequately detect and report (as necessary) suspicious transactions. FINRA further alleged that the analysts had significant workloads, which may have contributed to their insufficient reviews. During the same time period, FINRA found that Morgan Stanley failed to establish and implement policies and procedures reasonably expected to detect and lead to any necessary reporting of suspicious transactions in penny stocks. FINRA found that the firm's written procedures did not instruct registered representatives or branch management to notify the AML Department when red flags were identified and did not address the deposit and liquidation of penny stocks. FINRA also found that Morgan Stanley's AML Department did not use an automated system to surveil for potentially suspicious penny stock trades, relying instead, in part, on branch management's manual review of daily trade blotters. FINRA further alleged that, from January 2011 to December 2013, the firm failed to establish and maintain a supervisory system reasonably designed to achieve compliance with rules prohibiting the sale of any security unless a registration is in effect or there is an applicable exemption from registration requirements. According to FINRA, although the firm divided responsibility with respect to penny stocks among three groups, none of the groups conducted inquiries to determine whether the deposited penny stock was eligible for immediate resale to the public. FINRA also found that the firm also had insufficient controls to prevent or detect potentially restricted penny stock transactions without adequate review and approval. Finally, FINRA alleged that, in 2012 and 2013, Morgan Stanley failed to conduct periodic reviews of high-risk correspondent account activity to identify any inconsistency with the due diligence information obtained by the firm, as required by the BSA and the firm's policies and procedures. The AWC stated that FINRA considered that Morgan Stanley: (i) took extraordinary steps and devoted substantial resources to expand and enhance its AML policies and procedures, TMS and AML-related programs; (ii) made significant financial investments to enhance its AML programs and increase related staffing; (iii) retained a third-party vendor; (iv) developed and implemented new means to surveil penny stock transactions and potential insider trading; (v) revised its policies and procedures; and (vi) self-reported certain relevant issues. Morgan Stanley consented to a censure and a fine of $10 million.

Books and Records

Meyers Associates, L.P. & Bruce Meyers, FINRA NAC Decision for Complaint No. 2010020954501 (Jan. 4, 2018)

FINRA's National Adjudicatory Council (NAC) affirmed a FINRA Hearing Panel's decision that found that both Meyers Associates, L.P. and its CEO Bruce Meyers emailed unbalanced and misleading information to the public (and failed to disclose other material information in those emails), maintained or caused the firm to maintain inaccurate books and records, and failed to reasonably supervise the preparation of the firm's books and records. The FINRA panel also determined that Meyers Associates: (i) maintained inaccurate books and records by inaccurately recording personal expenses as business expenses; (ii) failed to have supervisory procedures in place to accurately account for personal expense reimbursements in the firm's books and records; (iii) failed to reasonably supervise the firm's electronic correspondence; (iv) failed to report or to timely report information concerning numerous customer complaints received from 2007 to 2010; and (v) failed to establish and maintain an adequate system of supervisory control policies and

procedures. The Hearing Panel fined Meyers Associates $700,000 and Meyers individually $75,000, and barred Meyers from associating with any FINRA member in any supervisory or principal capacity. The NAC affirmed the fine but modified the conduct-specific sanctions, noting aggravating factors including that the firm failed to allocate its resources to prevent or detect supervisory failures, failed to respond to FINRA's and other regulators' warnings, and was not deterred by FINRA's multiple sanctions to date. The NAC noted both Meyers Associates' and Meyers' extensive disciplinary history concerning the same or similar misconduct. The NAC noted that a FINRA action against Meyers Associates for recordkeeping violations and failing to review emails had settled just prior to the same misconduct that occurred in this case and that "[f]ailure to increase to even a minimal level its scrutiny of the firm's activities in these areas is deeply troubling." The NAC specifically noted that, with regard to the misleading communications with the public, "Meyers Associates' misconduct was decidedly egregious and merits a significant fine." On February 5, 2018, both Meyers Associates and Meyers appealed the NAC's decision to the SEC (Admin. Proceeding File No. 3-18359). All briefing has been filed and the appeal remains pending before the SEC.

Customer Protection Rule

MTG LLC d/b/a Betterment Secs., FINRA AWC No. 2015048047101 (June 20, 2018)

FINRA entered into an AWC with MTG LLC d/b/a Betterment Securities (Betterment) regarding allegations that, between October 2013 and January 2015, the firm engaged in "window dressing" in violation the Customer Protection Rule. According to FINRA, the firm sent cash proceeds to selling customers two days before the trades settled, and funded these pre-settlement withdrawals with funds from deposits from purchasing customers swept into the firm's omnibus account one day before the purchases settled. FINRA alleged that the customer deposit fund held in the omnibus account pre-settlement needed to be included in the firm's reserve calculation. FINRA further alleged that, on days when the reserve calculation was made, the firm did not move customer deposits into the omnibus account and instead carried debits on the omnibus account, and therefore did not factor such funds into its reserve calculation. According to FINRA, this constituted "window dressing" in violation of the Customer Protection Rule. FINRA also alleged that, from October 2013 through August 2014, when Betterment held the debits described above, its clearing firm, under the clearing agreement, had a claim to customer securities in the omnibus accounts up to the value of the debits. According to FINRA, these securities were thus not in good control locations as required by the Customer Protection Rule. FINRA further alleged that the firm did not maintain accurate books and records, failed to supervise its compliance with financial and operational rules, and the supervisory system and procedures were not commensurate with the volume handled by the firm. The firm consented to a censure and a fine of $400,000, and voluntarily submitted a Corrective Action Statement to FINRA.

Nomura Securities International, Inc., AWC No. 2016049864301 (Aug. 9, 2018)

In a settlement with Nomura Securities International, Inc. (Nomura), FINRA alleged that Nomura violated the Customer Protection Rule. Specifically, according to FINRA, from March 3, 2014 through February 20, 2015, the firm incorrectly calculated its Proprietary Accounts of Broker-

Dealers (PAB), resulting in a shortfall to its PAB reserve account. FINRA alleged that the miscalculation resulted from three errors. First, the firm should have consulted the Options Clearing Corporation (OCC) Margin Memo Collateral and Stock Loan Reconciliation report when preparing its calculations, instead of using the OCC Collateral in Margins Memo report. Second, the firm comingled its propriety trading activity with the activity an affiliated broker-dealer in its OCC account. Third, the firm incorrectly coded certain customer accounts of the affiliated broker-dealer and a foreign affiliate as PAB accounts. Additionally, FINRA alleged that the firm failed to have a supervisory system reasonably designed to ensure that it properly calculated its PAB reserve and that it properly coded certain accounts as either PAB accounts or customer accounts. Finally, FINRA found books and records violations related to the conduct described above. In settling the matter, the firm consented to censure and a fine of $875,000.

***Wedbush Securities Inc.*, FINRA Disc. Proc. No. 2012033105901 (Feb. 5, 2018)**

In an Order Accepting Offer of Settlement, FINRA alleged that Wedbush Securities Inc. (Wedbush) violated the Customer Protection and Net Capital Rules. Specifically, FINRA alleged that Wedbush created and/or increased deficits in its segregation requirement through deliveries or returns of securities in at least 30 separate instances (based on samples taken during the firm's 2009, 2010, and 2011 exams). According to FINRA, causes for the deficits included stock borrow returns, delivery of shares to settle a trade without sufficient excess, stock loans without sufficient excess, and the impermissible redelivery of returned stock loan shares, and the deficits involved a total of approximately 110,000 shares of stock worth approximately $7 million. Additionally, from February 2011 through June 2012, FINRA alleged that Wedbush improperly calculated its customer reserve formula on 14 occasions, causing hindsight deficiencies on eight dates, ranging from $945,000 to $77 million. FINRA stated that Wedbush improperly calculated its reserve formula because: (i) it failed to include the amount of bank loans that were collateralized by customer securities as credits; (ii) it erroneously included as debits the contract value of failed to deliver transactions that allocated as "CNS fail to deliver vs. box" but did not arise from customer sale transactions; and (iii) it failed to include as a credit customer securities that were allocated as "customer long vs. firm bank loan" that had been pledged in support of the firm's OCC margin requirements. FINRA alleged that Wedbush failed to establish and maintain a supervisory system reasonably designed to achieve compliance with both the possession or control requirement and the customer reserve account requirement of the Customer Protection Rule. Specifically, FINRA alleged that the firm relied on a manual system that did not allow for sufficient control to prevent the delivery of shares that would create or increase a segregation deficit and had no system to automatically prevent the turnaround of stock if such a delivery would create or increase a deficit. Additionally, in the firm's prior exams in 2004, 2006 and 2008, FINRA identified possession or control deficit violations and provided Wedbush with reports detailing those deficits. However, according to FINRA, Wedbush did not take action to establish a sufficient supervisory system and FINRA continued to identify deficits in exams in 2009, 2010, and 2011. Wedbush ultimately adopted an automated system to prevent the delivery of shares that would create or increase a segregation deficit in September 2011, after which no possession or control deficits were identified by FINRA. Regarding the firm's calculation of its customer reserve requirements, FINRA found that Wedbush did not have a system requiring certain firm departments to provide all relevant information to the Accounting Department to accurately compute the calculation. As additional findings, the Order also stated that Wedbush: (i) improperly computed its net capital

because it failed to take appropriate deductions for CD positions, causing the firm to be net capital deficient between November 30, 2015 and March 31, 2016 in amounts ranging from approximately $10.5 million to $59.4 million; (ii) failed to maintain an adequate customer reserve for nearly the entire period from March 1, 2013 through May 10, 2016; and (iii) violated its possession or control requirements from March 2013 through at least August 2016 by holding customers' fully paid and/or excess margin securities in locations that did not meet the requirements of a "good control" location. The firm also had no WSPs addressing the relevant rules, instead relying on internal memoranda, containing only piecemeal guidance. Although the firm revised its WSPs in February 2016, those WSPs were deficient according to FINRA. In addition, Wedbush did not adequately supervise its customer reserve calculations to ensure that the responsible individuals were properly licensed. Wedbush was censured, fined $1.5 million and agreed to submit a certification attesting to the implementation of recommendations received from an independent consultant to be retained by the firm.

Intermarket Sweep Orders (ISOs)

***Deutsche Bank Securities Inc.*, FINRA AWC No. 20130379938-01 (Apr. 25, 2018)**

FINRA, on behalf of itself and other self-regulatory organizations (SROs) (Cboe BZX Exchange, Inc.; Cboe BYX Exchange, Inc.; Cboe EDGA Exchange, Inc.; Cboe EDGX, Inc.; and NYSE Arca, Inc.) settled a matter with Deutsche Bank Securities Inc. (Deutsche Bank) pertaining to the firm's handling of intermarket sweep orders (ISOs) between August 2007 and December 2015, which, according to FINRA, revealed that the firm failed to establish, maintain, and enforce written policies and procedures reasonably designed to prevent trade-throughs of protected quotations in National Market System (NMS) stocks in violation of SEC and FINRA rules. FINRA alleged that, due to flaws and deficiencies in the firm's systems: (i) the firm routed ISOs through protected quotations; (ii) timestamps on ISOs were improperly recorded due to limitations in the firm's systems; and (iii) the firm failed to report transactions as trade-through exempt in five instances where the firm recorded an incorrect trade modifier. FINRA also alleged that the firm failed to publicly disseminate its best bids, best offers, and quotation sizes for certain NMS securities for which the firm acted in the capacity of an OTC market maker in more than 1,700 instances between January 2013 and December 2016. FINRA further alleged that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with the relevant rules. Deutsche Bank consented to a censure and a fine of $475,000, of which $100,000 was payable to FINRA and the remaining $375,000 to the other SROs. The Firm also agreed to an undertaking to revise its WSPs regarding ISOs and to correct certain system deficiencies.

IPO Sales

***Merrill Lynch, Pierce, Fenner & Smith*, FINRA AWC No. 2014043580203 (Dec. 20, 2018)**

FINRA entered into a settlement with Merrill Lynch, Pierce, Fenner & Smith Inc. (Merrill Lynch) in which it alleged that, from 2010 through March 2018, the firm made at least 1,462 prohibited sales of initial public offering (IPO) shares in 325 different offerings to 149 customer accounts in which restricted persons held a beneficial interest. As a result, FINRA found that Merrill Lynch

generated approximately $490,530 in revenue from these transactions and the restricted purchasers received transaction profits. Although FINRA found that the firm required certifications that customers were eligible to purchase new issues, the firm's tracking system did not compare these certifications to other documentation that the firm might have indicating that a customer was in fact a restricted person. Thus, for some transactions, FINRA alleged that Merrill Lynch knew or should have known that a customer was a restricted person, due to the knowledge of the firm's financial advisors, customer information, or information from other broker-dealers. Additionally, FINRA found that the firm commenced an internal review in September 2012 after identifying that it had been improperly selling IPO shares to accounts with restricted persons. According to FINRA, although Merrill Lynch made changes to its supervisory systems following this review, it continued selling IPO shares to some of the same accounts that had already been flagged. FINRA also alleged that Merrill Lynch failed to provide reasonable training to employees responsible for complying with related rules and that the firm failed to enforce its written procedures barring the sale of shares in IPOs to accounts in which a restricted person held an interest. The firm consented to a censure, a fine of $5.5 million, and disgorgement of $490,530 plus interest. FINRA stated that, consistent with the FINRA Sanctions Guidelines, the fine consists of an amount per each allegedly violative transaction plus the transaction profit attributable to each restricted buyer not subject to FINRA jurisdiction; an additional fine was imposed for the firm's alleged supervisory violations.

Market Access

***Wolverine Trading LLC*, NASDAQ PHLX AWC No. 2014041443906 (May 2, 2018).**

In an AWC with Wolverine Trading LLC (Wolverine), Nasdaq PHLX LLC (PHLX) alleged that the firm failed to establish and maintain an adequate system of risk management controls and supervisory procedures to manage the financial, regulatory, and other risks of providing market access. According to PHLX, the firm's T+1 surveillance report failed to monitor, regulate, detect, and prevent the dissemination of excessive, erroneous, and duplicative orders, quotations, and/or cancellations. In addition, PHLX alleged that the firm's quoting application was not adequately designed to identify and prevent the entry of excessive, erroneous, or duplicative quotations and cancellations to PHLX. PHLX also found that the firm's risk management controls and WSPs were inadequate. The firm consented to a censure and a fine of $450,000 ($45,000 payable to PHLX and the balance payable to Cboe BZX Exchange, Inc.; Cboe EDGX, Inc.; Boston Options Exchange LLC; NASDAQ BX, Inc.; NASDAQ Options Market LLC; NYSE Arca, Inc.; and NYSE American LLC). The firm also agreed to an undertaking to address the supervisory deficiencies and to implement controls and procedures designed to achieve compliance with the rules violated.

***Instinet, LLC*, FINRA AWC No. 2013036836015 (April 11, 2018)**

In a settlement between FINRA on behalf of a number of other SROs (The NASDAQ Stock Market LLC; NASDAQ BX, Inc., The NASDAQ Options Market LLC; Nasdaq PHLX LLC; Cboe BZX Exchange, Inc.; Cboe BYX Exchange, Inc.; Cboe EDGA Exchange, Inc.; Cboe EDGX Exchange, Inc.; Investors Exchange LLC; NYSE Arca Options, Inc.; NYSE Arca Equities, Inc.; the New York Stock Exchange LLC; NYSE American Options LLC; NYSE American Equities LLC; and Box Options Exchange LLC) and Instinet, LLC (Instinet), FINRA alleged that, from August 2012 through at least November

2017, Instinet failed to establish, document, and maintain a system of risk management controls and supervisory procedures, including WSPs and a sufficient system of follow-up and review, reasonably designed to target the risks associated the with firm's market access business. Specifically, FINRA found that Instinet failed to supervise client trading to detect layering, spoofing, and wash trading. Although Instinet had an exception report to identify potential instances of spoofing, FINRA stated that it only triggered if an individual order/cancellation exceeded 10 percent of the relevant security's average daily volume and, notwithstanding that issue, due to a programming flaw, in a number of instances, Instinet failed to detect potential spoofing in trades that should have triggered an exception. As a result, FINRA found that Instinet failed to detect 75 potential instances of pre-opening spoofing by two market access customers. FINRA also alleged that Instinet failed to enforce its written Know Your Customer procedures by failing to pre-approve individual traders utilizing the firm's market participant identifier (MPID) to access the market, meaning that the firm did not know the identity of underlying traders. Therefore, according to FINRA, the firm also could not verify representations that a particular trader had been terminated (as opposed to merely being given a new trader ID for market access). Additionally, although Instinet had two systemic controls to identify potential wash trading, FINRA stated that the firm was unable to determine whether detected exceptions were valid because it did not know the identity of underlying traders utilizing an MPID and thus could not determine if one trader was on both sides of a transaction. FINRA further alleged that Instinet relied on its market access clients to determine ownership of the trades, but failed to adequately follow-up on wash trade exceptions, and that Instinet's proprietary alert system to detect potential layering and spoofing by market access clients improperly excluded instances where a market participant enters and cancels a series of orders that improve the National Best Bid or National Best Offer. FINRA found that, although the firm's compliance department reviewed and sampled exceptions triggered by the firm's proprietary alert system, Instinet's WSPs did not adequately describe the necessary follow-up steps. As a result, six market access clients engaged in potential layering and spoofing activities even though they regularly appeared in exception reports. Instinet consented to a censure and a fine of $1.575 million ($59,500 payable to FINRA and the balance to the other SROs). Instinet also agreed to an undertaking to address the deficiencies identified in the AWC and to implement controls and procedures reasonably designed to achieve compliance with the relevant rules and regulations.

***Morgan Stanley & Co. LLC.*, FINRA AWC No. 20120346239 (Aug. 29, 2018)**

Morgan Stanley & Co. LLC entered into an AWC with FINRA acting on behalf of itself and several other SROs (Cboe BZX Exchange, Inc.; Cboe BYX Exchange; Inc.; Cboe EDGA Exchange, Inc.; Cboe EDGX Exchange, Inc.; Miami International Securities Exchange, LLC; The NASDAQ Stock Market LLC; New York Stock Exchange, Inc.; and NYSE ARCA, Inc.) regarding allegations that the firm violated market access rules. Specifically, FINRA found that, during the period of November 30, 2011 through July 2017, the firm failed to establish, document, and maintain supervisory systems and WSPs reasonably designed to prevent the entry of orders exceeding pre-set credit thresholds. According to FINRA, the firm established aggregate capital limits for its high-touch clients (i.e., those placing orders via human interaction) that were not based on the business, financial condition, trading patterns, or other individualized considerations for those high-touch clients. FINRA also alleged that the firm failed to implement automatic hard-blocks on orders breaching the firm's aggregate capital limit, instead relying on a manual review of alerts to prevent

the entry of additional orders. FINRA further alleged that, even when the firm implemented improved procedures during the review period, those procedures were not adequately described in the firm's WSPs. FINRA alleged that these failures violated the market access and supervisory rules. The firm consented to a $1.1 million fine ($280,000 of which was payable to FINRA and the balance to the other SROs) and an undertaking to represent to FINRA that it addressed the deficiencies in the AWC.

Microcap Securities

***Scottsdale Capital Advisors Corp.*, FINRA Compl. No. 2014041724601 (July 20, 2018)**

The NAC affirmed an amended extended Hearing Panel decision against Scottsdale Capital Advisors Corp. (Scottsdale), its founder, its chief compliance officer and its president. The Hearing Panel found that: (i) the firm sold unregistered and nonexempt microcap securities and that the founder acted as a participant and substantial factor in the firm's violation; (ii) the firm and its chief compliance officer violated supervision rules by failing to establish and maintain supervisory systems tailored to the firm's microcap liquidation business; and (iii) the firm and its president, chief legal counsel, and assistant corporate secretary, violated supervision rules by failing to supervise and respond to red flags concerning the firm's microcap liquidation business. The NAC agreed with the Hearing Panel that FINRA had made out a *prima facie* case that the firm had sold the relevant securities with no registration statement in effect through interstate means and that the firm failed to show that it was entitled to any exemption. It also agreed that the founder facilitated the firm's violations through his establishment, ownership, and management of a foreign broker-dealer based in the Cayman Islands and that his use of this entity to funnel microcap securities business to Scottsdale was unethical. With respect to the chief compliance officer and the firm's WSPs, the NAC affirmed the Hearing Panel's finding that he failed to fulfill his responsibility to maintain and update the firm's WSPs and that the firm's WSPs were not reasonably designed to prevent the sale of unregistered microcap securities. As to the president and the firm's failure to supervise, the NAC agreed that he and the firm failed to supervise the microcap liquidation business, including by failing to respond appropriately to indications that the relevant transactions did not qualify for exemptions. The NAC fined the firm a total of $1.5 million and ordered the firm to engage a consultant to monitor its microcap securities business; barred the founder from association in all capacities; fined the chief compliance officer and president $50,000 each and suspended them from association for two years; and affirmed the Hearing Panel's order that the firm and all of the individuals were jointly and severally liable for hearing and appeal costs totaling approximately $22,500.

Order Audit Trail System (OATS) Reporting

***Deutsche Bank Securities Inc.*, AWC No. 2014041894101 (June 27, 2018)**

FINRA entered into an AWC in which it alleged that, between June 2006 and April 2017, Deutsche Bank failed to implement reasonable supervisory procedures, causing billions of OATS reporting violations, tens of thousands of equity trade reporting (trade reporting facility (TRF)) violations, and municipal bond trade reporting (Real-time Transaction Reporting System (RTRS)) violations. According to FINRA, the firm's lack of supervisory framework around its trade reporting

obligations allowed a large number of inaccurate OATS reports to go undetected and led to the firm's failure to timely correct or address deficiencies in equity trade reports once identified. Specifically, FINRA alleged that the firm failed for years to conduct a meaningful review of its OATS reports to ensure their accuracy by, for example, reviewing an inadequate number of reports transmitted to OATS. In addition, FINRA alleged that the firm did not review for inaccuracies in customer order instructions and other informational fields necessary for compliance with OATS data requirements. FINRA also alleged that the firm's WSPs did not adequately identify the persons responsible for ensuring OATS compliance or state under what circumstances surveillance staff were required to escalate violations. As a result of these deficiencies, FINRA maintained, the firm failed to identify a significant number of inaccurate OATS submissions, transmitted billions of inaccurate reportable order events to OATS, and failed to transmit millions of reportable order events to OATS. FINRA also alleged that the firm's reporting to the TRF and RTRS was subject to inadequate supervision, resulting in significant violations. In settling the matter, the firm agreed to a censure, a fine of $1.4 million, and an undertaking to revise its WSPs and to provide a written report to FINRA.

***Electronic Transaction Clearing, Inc.*, FINRA AWC No. 2015046569001 (July 11, 2018)**

FINRA entered into an AWC with Electronic Transaction Clearing, Inc. (ETC) in which FINRA alleged that, from May 2013 through March 2017, ETC failed to establish and maintain a supervisory system reasonably designed to achieve compliance with its OATS reporting obligations; failed to enforce its WSPs concerning OATS reporting; and transmitted billions of inaccurate, incomplete, or untimely Reportable Order Events (ROEs) over a four-year period. In particular, FINRA found that, among other OATS violations, the firm (i) failed to submit over 3.1 billion route reports due to an oversight in setting up one customer's account; (ii) failed to submit more than 3.2 million ROEs due to errors during the process of setting up another customer to generate and upload OATS files to the firm's FTP site; (iii) submitted millions of ROES with the incorrect Receiving Department ID and/or Account Type Code, or Special Handling Code; and (iv) submitted millions of ROEs late. FINRA alleged that ETC's supervisory deficiencies allowed these OATS violations to occur and also contributed to its failure to timely address and correct these issues. According to FINRA, because of the firm's lack of reasonable supervision, these OATS violations went undetected until the FINRA staff identified the issue. The firm consented to a censure and a fine of $450,000 ($250,000 for supervision violations, $200,000 for OATS violations).

Regulation SHO

***Citigroup Global Markets Inc.*, FINRA AWC No. 2014041142501 (Feb. 9, 2018)**

In an AWC with Citigroup Global Markets Inc., FINRA alleged that the firm violated Rule 200(f) of Regulation SHO. Specifically, FINRA alleged that, from November 21, 2008 through December 3, 2013, the firm failed to include the positions from two proprietary trading accounts in its independent trading aggregation units and did not include the securities positions in those accounts in its aggregate calculations for any independent aggregation unit. FINRA found that this failure had an unquantifiable impact on the firm's overall Regulation SHO obligations. FINRA also alleged that the firm's supervisory system did not provide for supervision reasonably designed

to achieve compliance with the applicable securities laws and regulations to ensure that all firm accounts conducting proprietary business were appropriately included in aggregation units. The firm agreed to a censure, a fine of $450,000 (comprised of $250,000 for the Regulation SHO violations and $200,000 for the supervisory violations), and an undertaking that required the firm to revise its WSPs.

***Wilson-Davis & Co. Inc.*, FINRA Disc. Proc. No. 2012032731802 (Feb. 27, 2018)**

A FINRA Hearing Panel found that Wilson-Davis & Co. Inc. intentionally violated Rule 203(b)(1) of Regulation SHO by short selling stocks without first borrowing the securities. Specifically, the panel determined that, between July 2012 and April 2013, the firm engaged in at least 122 short sales where it failed to comply with the borrow requirement. The panel also found that the firm and its President/Chief Compliance Officer failed to create and maintain a reasonable supervisory system, including its WSPs regarding the market maker exemption to the borrow requirement. The firm was fined $1.47 million ($10,000 for each improper short sale minus $50,000 related to a fine imposed in a similar case) and ordered to pay $51,624 in disgorgement, plus prejudgment interest. For the supervisory failures, the panel fined the firm $300,000, the firm's Head of Trading $115,000, and its President/Chief Compliance Officer $140,000. Both individuals were suspended from association with any FINRA member for one year and ordered to requalify by examination before serving in any registered capacity in the securities industry.

***Interactive Brokers LLC*, FINRA AWC No. 2014043143401 (Aug. 20, 2018)**

In an AWC with Interactive Brokers LLC (Interactive), FINRA alleged that, from July 2012 through June 2015, Interactive failed to establish, maintain and enforce a supervisory system reasonably designed to achieve compliance with the requirements of Regulation SHO. As a result, FINRA alleged that Interactive failed to timely and properly close out open fail-to-deliver (FTD) positions on at least 2,329 occasions, resulting in the firm taking close-out credit for borrowed shares that were not delivered prior to market open, not tracking or otherwise confirming delivery and thus not identifying continuing fails, failing to close the open fail on close-out date, effecting effected purchases or borrows after the market open and taking late close-out actions to address earlier closeouts that were not completed. According to FINRA, the firm also routed and/or executed short sales in equity securities in which the firm had an open FTD without first borrowing or arranging to borrow the security approximately 28,000 times, due to the fact that the firm's system to took credit for invalid close-out actions, did not deliver borrow, did not cure the open FTD, and did not restrict the trading in the securities or enforce the pre-borrow requirement. In addition, FINRA alleged that Interactive executed short sales in equity securities in which the firm had an open FTD without the customer or broker-dealer having first been notified that Interactive had an open fail in the security, or having effected a pre-borrow. FINRA further alleged that Interactive's systems improperly permitted the section or display of short sale orders of a covered security at a price less than or equal to the national best bid on at least 4,709 occasions. FINRA also alleged that the firm failed to reasonably supervise short sales. Specifically, according to FINRA, the firm's automated system and WSPs were not reasonably designed, and the firm ignored red flags and other Regulation SHO supervisory systems and procedures issues identified by the firm, and failed to timely remediate those issues when the Firm was made aware. Interactive consented to a censure and a fine of $5.5 million.

Short Interest Reporting

***Merrill Lynch, Pierce, Fenner & Smith Incorporated*, FINRA AWC No. 2014040407701 (Jan. 19, 2018)**

FINRA entered into a settlement with Merrill Lynch, in which it alleged that the firm failed to comply with rules related to short interest reporting from August 15, 2012 through March 31, 2015. Specifically, FINRA found that, between July 15, 2013 and December 31, 2013, due to an undetected system logic error, the firm dropped certain symbols involved in recent corporate actions that resulted in mergers and an exchange of shares, causing it to fail to report 18 short interest positions totaling 160,934 shares on 9 settlement dates and inaccurately report 10 short positions totaling 2,045,270 shares, when it should have reported 10 short interest positions, totaling 4,992,748 shares on 8 settlement dates. In addition, FINRA alleged that, between August 15, 2012 and October 31, 2014, due to an undetected coding error that omitted certain over-the-counter foreign securities, Merrill Lynch failed to report 36,413 positions totaling 9,530,879,808 shares on 54 settlement dates. FINRA also found that, as a result of a failure to update its internal programming logic in its Master Security Database, Merrill Lynch failed to capture certain equity preferred securities involving corporate actions between September 28, 2012 and March 31, 2015, and thus failed to report 928 short interest positions totaling 52,559,012 shares. FINRA further alleged that Merrill Lynch failed to establish and maintain a supervisory system that was reasonably designed to achieve compliance with short interest reporting requirements. Merrill Lynch agreed to a censure and a fine of $525,000, consisting of $300,000 for short interest reporting violations and $225,000 for supervisory violations. The Staff took into consideration that: (i) Merrill Lynch self-reported a significant number of the violations at issue after conducting an internal investigation; (ii) provided assistance to FINRA in assessing the number and scope of violations; and (iii) promptly took remedial action to correct the deficiencies.

Suitability

***Fifth Third Securities, Inc.,* FINRA AWC No. 2013035051401 (May 8, 2018)**

In an AWC with Fifth Third Securities, Inc. (Fifth Third), FINRA alleged that Fifth Third failed to comply with an AWC that it had entered into with FINRA in 2009 regarding unsuitable Variable Annuity (VA) Exchanges and inadequate systems and procedures governing its VA Exchange business. Pursuant to the 2009 AWC, Fifth Third agreed to an undertaking to remediate customer harm and improve supervision of its VA business. FINRA found that the firm did not comply with the latter. In addition, FINRA alleged that, from 2013 to 2015, the firm, through its registered representatives, made negligent misstatements and material omissions of fact on approximately 77 percent of a sample set of variable annuity transactions randomly selected and reviewed by FINRA. FINRA further alleged that the firm failed to have a reasonable basis to conclude that the transactions were suitable because the registered representatives did not consider and compare accurate information about the costs and benefits of VA exchanges. FINRA also alleged that the firm failed to implement surveillance procedures to monitor registered representatives' rates of VA exchanges and failed to implement WSPs and training related to VA exchanges reasonably designed to comply with FINRA Rules. Fifth Third consented to a censure, a fine of $4 million, payment of approximately $2 million in restitution to affected customers, and an undertaking to

review and revise the firm's systems, policies, procedures and training related to variable annuity exchanges and provide FINRA with a certification.

***Newport Coast Secs., Inc.*, FINRA Compl. No. 2012030564701 (May 23, 2018)**

In an appeal by Newport Coast Securities (Newport) and two of its registered representatives, the NAC affirmed in part and revised in part a 2016 decision by the Office of Hearing Officers (OHO). The NAC affirmed the OHO panel's findings that: (i) the firm, through five of its registered representatives, engaged in unsuitable trading, churning, and recommendations of leveraged or inverse exchange-traded products in customers' accounts; (ii) the firm failed to properly supervise its representatives; and (iii) one of the registered representatives gave a customer inaccurate information overstating the value of the customer's account on five occasions. The NAC upheld the OHO panel's expulsion of the firm from FINRA membership, the bar of the two appealing registered representatives from association, and the order to pay restitution to affected customers. The NAC modified the monetary sanctions by linking to the amounts to the ranges set forth in FINRA's Sanction Guidelines, which the OHO panel did not do. As a result, the NAC reduced the fine to the firm from $1 million to $403,000, and to one registered representative from $400,000 to $185,000. The fine to the other registered representative was affirmed at $125,000. The NAC also required that the fines be paid separately from the customer restitution, reversing the OHO panel's decision that the fines could be set-off against such restitution.

***National Planning Corp., Investment Centers of America, Inc., SII Investments, Inc., and IFC Holdings, Inc.*, FINRA AWC No. 2015047177001 (Jul. 24, 2018)**

FINRA entered into a settlement with National Planning Corporation (NPC), Investment Centers of America, Inc. (ICA), SII Investments, Inc. (SII), and IFC Holdings, Inc. (IFC) in which FINRA alleged that the firms failed to maintain supervisory systems and written procedures in connection with the recommendation of variable annuities with multiple share classes between January 2013 and June 2015. According to FINRA, the firms' procedures failed to address suitability issues pertaining to the fees and costs or surrender period of different share classes and failed to provide sufficient training to their registered representatives and reviewing principals. FINRA stated that the firms sold a significant amount of L-shares when B-shares, which typically have lower annual fees than L-shares, may have been more suitable. Specifically, FINRA alleged that L-share contracts were unsuitable for clients with long time horizons, or when purchased in conjunction with long-term riders, such as Guaranteed Minimum Income Benefit Riders or Guaranteed Minimum Withdrawal Riders, which often require the client to hold the annuity for longer periods. FINRA also alleged that NPC, SII and IFC failed to identify a pattern of red flags presented by the sail of L-share variable annuities with long-term riders and failed to investigate the suitability of these recommendations. FINRA further alleged that ICA and SII had similar supervisory and training failures in connection with the application of sales charge discounts applicable to Unit Investment Trusts (UITs). The firms consented to fines totaling $1.69 million ($650,000 for NPC, $115,000 for ICA, $325,000 for SII, and $600,000 for IFC), and agreed to provide restitution to customers in an amount not less than $6 million.

***Cadaret, Grant & Co., Inc.*, FINRA AWC No. 2014039071101 (September 11, 2018)**

In an AWC with Cadaret, Grant & Co., Inc. (Cadaret Grant), FINRA alleged that Cadaret Grant failed to establish and maintain a reasonably-designed supervisory system with respect to a number of areas of its business from August 2012 through May 2017. Specifically, FINRA alleged that Cadaret Grant's system and procedures for supervising securities recommendations were inadequate because, among other things: (i) the firm required each representative's trades to be reviewed by their supervising principal, but employed so few principals that the policy could not possibly be effective; (ii) the firm only employed three compliance personnel to manually review the trades by the firm's more than 676 representatives spread across 450 branches; and (iii) the weekly blotter reports the compliance personnel were asked to review were inappropriately filtered such that the compliance department reviewed less than 3% of the firm's trades on average. FINRA also alleged that Cadaret Grant failed to implement an appropriate system to monitor its representatives' variable annuity recommendations because the firm: (i) did not provide its representatives with the tools to present accurate side-by-side comparisons of the fees and surrender charges of the variable annuity products it sold; (ii) had no procedures to identify inappropriate rates of variable annuity exchanges other than manual review by under-staffed supervisory principals; (iii) allowed registered representatives to prepare and share consolidated reports that they could manually alter with customers; and (iv) did not require any of their representatives to retain copies of the consolidated reports that they shared with clients so that the reports could later be reviewed for accuracy. Finally, FINRA alleged that the firm violated books and records rules because the firm allowed its registered representatives to use their personal email addresses for firm business, but did not take any steps to retain or review those emails. Cadaret Grant agreed to a censure, a fine of $800,000, and an undertaking to hire an independent consultant to review and recommend changes to Cadaret Grant's policies, systems, and procedures, which the firm would be required to adopt.

***Spencer Edwards, Inc.,* FINRA Disc. Proc. No. 2014041862701 (Nov. 14, 2018)**

In an Extended Hearing Panel Decision that was one of a number of enforcement actions stemming from a SEC securities fraud prosecution, a FINRA panel determined that Spencer Edwards, Inc. (Spencer Edwards) had: (i) recommended and sold two-year notes in a private placement without having a reasonable basis to believe that the investments were suitable for any investor; (ii) distributed false, unbalanced, and misleading communications about those notes; (iii) failed to adequately supervise due diligence of the issuer of the notes and had inadequate WSPs in place; and, (iv) failed to transmit a customer check for investment in the note offering to the issuer promptly. While Spencer Edwards had WSPs, the panel found that they were inadequate because they provided minimal detail and guidance, for example, while the WSPs required due diligence reviews to meet a minimum standard, this standard was not defined, nor did they include any specific steps that must be followed. The decision stated that Spencer Edwards failed to adequately supervise due diligence on the offering at issue because its Chief Executive Officer testified that, not only did she allow the Director of the firm's investment banking department (her direct report) to conduct due diligence on the offering without ever examining the due diligence file or confirming how exactly the Director performed the due diligence, but she also admitted that neither she, the CEO, nor anyone else at the firm was capable of determining whether or not the Director's due diligence was adequate. The panel fined Spencer Edwards

$260,000, censured the firm, ordered the firm to offer rescission to affected customers, and suspended the firm in all capacities for 45 days for recommending and selling the notes to 13 customers without a reasonable basis to believe that the investments were suitable. The panel separately imposed a fine of $100,000 and a pre-use filing requirement on all of the firm's communications with customers for distributing false, unbalanced, and misleading communications about the notes to potential investors. For failure to adequately supervise due diligence and maintaining inadequate WSPs, the panel fined Spencer Edwards $110,000, censured the firm, gave the firm a 30-day suspension (running concurrently with its 45-day suspension), and ordered the firm to hire an independent outside consult, acceptable to FINRA Enforcement, to review and revise the firm's WSPs. Finally, the firm was fined $25,000 for failing to promptly transmit a customer check for investment. In total, Spencer Edwards was fined $495,000 and suspended for 45 days.

***Cetera Advisor Networks LLC*, FINRA AWC No. 2014040951702 (Dec. 19, 2018)**

FINRA entered into a settlement with Cetera Advisor Networks LLC (Cetera) in which it alleged that, from January 2009 through January 2015, the firm failed to respond reasonably to red flags of unsuitable mutual fund switching, and unsuitable stock trading meant to conceal switching, by one of its registered representatives. Specifically, FINRA alleged that a registered representative engaged in hundreds of short-term purchases and sales of Class A mutual funds in 14 customer accounts, including senior investors, without any business purpose and diverging from customer risk tolerances and investment objectives. FINRA further alleged that, as a result, customers were charged unnecessary front-end load fees, and the registered representative generated revenue for both himself and the firm. This unsuitable trading caused approximately $700,000 in customer losses. Additionally, although supervisors detected evidence of such unsuitable trading in two different annual audits, FINRA found that no disciplinary action was taken. FINRA also alleged that Cetera failed to act on the findings of those audits because its practice was only to check that an audit had been conducted, rather than analyzing the findings of any audits and, although supervisors reviewed sample audits at branch offices each year, they never reviewed the two audit reports in question. Furthermore, according to FINRA, the firm's supervisory system allowed a Sales Manager (who was not qualified as a supervisory principal) to direct a Designated Supervisor (who was a licensed supervisory principal), including instructing the Designated Supervisor not to send a letter criticizing the offending registered representative for unsuitable mutual fund switching. FINRA also alleged that Cetera's electronic trade review system also repeatedly flagged the inappropriate trades in question, but the firm did not take any disciplinary action. The firm consented to a censure, a fine of $700,000, and $691,755.27 plus interest in restitution to customers. Cetera also agreed to certify that it had established and implemented policies, procedures and internal controls reasonably designed to address and remediate the issues identified in the AWC.

Supervision

***MBSC Securities Corporation*, FINRA AWC No. 2017054119401 (Oct. 18, 2018)**

In an AWC with MBSC Securities Corporation (MBSC), FINRA alleged that, from January 2008 through April 2017, the firm failed to establish, maintain and enforce a supervisory system and

WSPs reasonably designed to monitor the transmittal of funds from customers to third parties. Specifically, FINRA alleged that two third-party investment advisors routinely submitted requests to the firm for the payment of fees that exceeded the amounts permitted under their management agreements with customers, one such third-party investment advisor continued to submit requests for fees after he became subject to a consent order issued by a state regulator prohibiting engagement in registered advisor activities, and MBSC made disbursements following all such requests for fees. As a result, according to FINRA, MBSC disbursed $971,289.07 in fees from 75 customer accounts to advisors that exceeded the amount of fees to which the investment advisors were entitled pursuant to their management agreements with MBSC customers. FINRA also alleged that the firm had no procedures for the review of instructions from investment advisors or other third parties and it did not test and verify its procedures relating to the distribution of funds from customer accounts to third parties. MBSC consented to a censure and agreed to pay $971,289.07 plus interest of $242,955.64 in restitution to 75 customers. There was no fine in the settlement. In determining its sanction, FINRA considered the firm's extraordinary cooperation including that it initiated its own investigation prior to any detection of the issues by a regulator, promptly established a remediation plan, promptly self-reported to FINRA, promptly took action and remedial steps, and implemented additional corrective measures to revise its procedures prior to detection or intervention by a regulator.

***J.P. Morgan Securities LLC*, FINRA AWC No. 2017053493101 (Oct. 18, 2018)**

In a settlement with J.P. Morgan Securities, LLC (J.P. Morgan), FINRA alleged that the firm failed to establish and maintain a system and procedures reasonably designed to monitor and evaluate the performance of a vendor it contracted with to handle (i) the rebalancing of certain customer accounts; and (ii) the calculation of fees charged to wealth management customers. In May 2016, J.P. Morgan discovered that the vendor was not rebalancing certain accounts. The firm undertook a review of all relevant accounts and identified that certain vendor upgrades in 2013 and 2014 caused accounts to not be rebalanced at the correct time. As a result, over three years, 6,411 accounts were not rebalanced; 2,514 of those accounts sustained collective losses or missed gains of $1.3 million. J.P. Morgan did not identify this upgrade error because it did not have sufficient systems and procedures to monitor the vendor's services. Specifically, the firm did not review the vendor's exception reports, did not conduct any review or testing to assess the vendor's performance, had no procedure to review reports provided by the vendor and never conducted end-to-end testing to confirm that technology enhancements were operating correctly. FINRA also alleged that because the firm did not conduct testing after technology changes made by the vendor in July 2014, multiple billing errors went undetected for periods ranging from several months to almost three years. As a result, $3.1 million in erroneous fees were assessed in more than 150,000 accounts. The firm consented to a censure and agreed to certify that it (i) engaged in a risk-based review of vendors unacceptable to the Staff and (ii) corrected the relevant issues and established appropriate system, policies and procedures. FINRA stated that it determined not to impose a monetary sanction in this matter because the firm: (i) self-reported its discovery of certain issues before FINRA was aware and promptly began its own examination of the deficiencies, going beyond the Firm's obligations pursuant to FINRA Rule 4530(b); (ii) took extraordinary steps to correct its deficient system and procedures, including holding weekly meetings with the vendor's account team, hiring two full-time employees dedicated to managing risk and assigning a dedicated manager to oversee the vendor in question; (iii) provided

extraordinary remediation to customers on its own accord ($4,620,140 in total); and (iv) provided substantial assistance to FINRA by proactively undertaking an extensive lookback analysis.

Trade Confirmations

***Citigroup Global Markets Inc.,* FINRA AWC No. 2014039653701 (May 21, 2018)**

In an AWC with Citigroup Global Markets, FINRA alleged that between June 2006 and September 2017, the firm issued approximately 12.5 million customer trade confirmations that contained inaccurate information. FINRA alleged that certain technical issues with the firm's systems resulted in trade confirmations sent to institutional customers that contained errors regarding the firm's capacity in executing trades and incorrectly identified single execution trades as average price trades. FINRA also alleged that the firm did not have adequate supervisory procedures regarding the issuance of accurate customer trade confirmations, and its supervisory deficiencies caused the firm to fail to detect a number of systemic deficiencies. Specifically, FINRA alleged that the firm's procedures failed to ensure the accuracy of the content in the firm's customer trade confirmations, and instead only discussed whether the firm delivered trade confirmations to customers. Citigroup consented to a censure, a fine of $550,000, and an undertaking to address the deficient supervisory procedures relating to the accuracy of customer trade confirmations.

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