Morgan Lewis

2020 YEAR IN REVIEW AND A LOOK FORWARD

SELECT SEC AND FINRA DEVELOPMENTS AND ENFORCEMENT CASES

www.morganlewis.com

Table of Contents

EXECUTIVE SUMMARY

The Morgan Lewis Year in Review highlights key US Securities and Exchange Commission (SEC or the Commission) and Financial Industry Regulatory Authority (FINRA) enforcement and examination developments, and summarizes selected cases regarding broker-dealers, investment advisers, and investment companies.[1]

THE SEC

On February 25, 2020, we issued our 2019 Year in Review, where the focus was on the continuation of several initiatives that had dominated the SEC Enforcement Division (Enforcement) under Chairman Jay Clayton, including protecting Main Street investors, cyberissues, initial coin offerings (ICOs), and the culmination of the "Share Class Initiative." SEC Enforcement had weathered a government shutdown and, by the end of fiscal year (FY) 2019, raw case numbers had rebounded to previous years' levels.

Thirteen days later, on March 10, 2020, the SEC moved to mandatory telework due to the coronavirus (COVID-19) pandemic. In the following months, the SEC and the industry were faced with an unprecedented crisis that in many ways changed the way Enforcement investigates and prosecutes actions. The Commission was forced to adapt examination and investigation techniques, more efficiently allocate resources, and concentrate on matters that were of immediate importance in light of the crisis. These adaptations manifested themselves in, among other things, increased whistleblower activity, more direct and disclosed use of data analytics, and the use of remote investigative tactics such as informal interviews and testimony by video conference.

With the election of President Joe Biden, it is our view that change at the SEC will only accelerate in 2021. In January 2021, the Biden administration announced that Gary Gensler would be nominated as the next chairman of the SEC.[2] As of February 25th, Mr. Gensler's hearing before The Senate Committee on Banking, Housing and Urban Affairs was set to commence on March 2, 2021.

Commentary on the selection of Mr. Gensler uniformly predicts that he will be an aggressive enforcer.[3] The raw Enforcement numbers from FY 2020 reflect that, if confirmed, Mr. Gensler will take over a division experiencing a multiyear decline in the number of standalone enforcement actions and a corresponding surge in new investigations, tips, complaints, and referrals. The headwinds on Enforcement standalone actions are partly driven by a sharp decline in headcount as well as the FY 2019 government shutdown and the FY 2020 COVID-19 pandemic. Regardless of the cause, these competing trends and limited resources will demand a thorough evaluation of efficiencies and areas pf emphasis for Enforcement going forward. Understanding Mr. Gensler's past history as a regulator and observed trends in Enforcement matters allows for educated predictions of what registrants may face in 2021.

---

[1] 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 SEC and FINRA, and as otherwise expressly noted. This outline was prepared by partners G. Jeffrey Boujoukos, Ben A. Indek, Ariel Gursky, Timothy W. Levin, Christine M. Lombardo, Ivan P. Harris, T. Peter R. Pound, Jason S. Pinney, and Susan D. Resley; of counsel Russell M. Fecteau; and associates Jillian Harris and Zoe Phillips; with assistance from partner Michèle A. Coffey, of counsel Mana Behbin and Elizabeth Belanger, and associates Dana N. Bach, Kathryn Ball, Brian J. Baltz, Jeremy P. Esperon, Jessica L. Joy, Brian T. London, David E. Marvin, Amy C. McDonald, Christine M. Nassauer, and Kyle Whitehead.

[2] *See* Tory Newmyer, Biden choices for CFPB, SEC signal pivot to robust enforcement, *The Washington Post* (Jan. 18, 2021).

[3] *See* Tory Newmyer, Biden choices for CFPB, SEC signal pivot to robust enforcement, *The Washington Post* (Jan. 18, 2021); Paul Kiernan and Scott Patterson, An Old Foe of Banks Could Be Wall Street's New Top Cop, *The Wall Street Journal* (Jan. 16, 2021); Matthew Goldstein, Lauren Hirsch and Andrew Ross Sorkin, Gary Gensler Is Picked to Lead S.E.C., *The New York Times* (Jan. 17, 2021).

As discussed more fully below, Enforcement standalone actions filed in FY 2020 declined year over year from 526 to 405.[4] Despite the decline in actions, the SEC obtained a record-high amount of disgorgement and civil penalties, totaling more than $4.6 billion in FY 2020.[5] However, the vast majority of this money came from a small number of cases involving large awards. The top 5% of cases with the largest financial remedies ordered accounted for more than 80% of the $4.6 billion total.[6]

Tips, complaints, and referrals (TCRs), a primary source for SEC Enforcement investigations, rose from 16,850 in FY 2019 to more than 23,650 in FY 2020.[7] This growth was well beyond the estimated 19,000 TCRs predicted in the Commission's FY 2021 Congressional Budget Justification,[8] and was apparently driven by the pandemic. From mid-March 2020 through September 2020, SEC Enforcement received 16,000 TCRs, a 71% increase over the same time period in 2019.[9]

The SEC whistleblower program experienced a similar surge in submissions. In FY 2020, the Commission received more than 6,900 whistleblower tips as compared to 5,212 in FY 2019.[10] Further, awards to whistleblowers increased substantially, demonstrating the maturation of the program from its inception in 2010. In FY 2020, the Commission awarded approximately $175 million to 39 individuals.[11] This dollar amount and the number of individual awards were the highest in any fiscal year.[12] The FY 2020 awards represented 31% of the total awarded to whistleblowers in the history of the program.[13] Further, after the close of FY 2020, the Commission issued a $114 million award to a whistleblower, the largest to date.[14]

Much like Enforcement, the Division of Examinations (Examinations), formerly the Office of Compliance Inspections and Examinations (OCIE), substantially modified its operations due to the COVID-19 pandemic. With Examinations staff and registrants working remotely, Examinations moved to conducting 100% of exams by correspondence.[15] Historically, Examinations conducted between 30% and 40% of exams in this manner.[16] In addition, Examinations engaged in outreach to hundreds of registrants, "discussing with firms their business continuity plans and their overall operational adaptations."[17] During FY 2020, Examinations completed nearly 3,000 exams, covering 15% of all registered investment advisers.[18] This was almost the same as the 3,089 exams conducted in FY 2019.

---

[4] Securities and Exchange Commission, Division of Enforcement 2020 Annual Report, at 16 (Nov. 2, 2020) (Enforcement Annual Report).
[5] *Id.* at 17.
[6] *Id.* at 18.
[7] *Id.* at 19.
[8] Securities and Exchange Commission, Fiscal Year 2021 Congressional Budget Justification and Annual Performance Plan, Fiscal Year 2019 Annual Performance Report, at 29 (Feb. 10, 2020) (SEC 2019 Annual Performance Report).
[9] Enforcement Annual Report at 19.
[10] Securities and Exchange Commission, Whistleblower Program 2019 Annual Report to Congress, at 27 (Nov. 16, 2020) (Whistleblower Annual Report).
[11] *Id.* at 2.
[12] *Id.*
[13] *Id.*
[14] Press Release, Securities and Exchange Commission, SEC Issues Record $114 Million Whistleblower Award (Oct. 22, 2020).
[15] Peter B. Driscoll, Director, Division of Examinations, Securities and Exchange Commission, Remarks at SEC Speaks 2020 (Oct. 8, 2020).
[16] *Id.*
[17] *Id.*
[18] Oversight Hearing Before the Senate Banking Committee, Testimony of Securities and Exchange Commission Chairman Jay Clayton, 116th Cong. (Nov. 17, 2020).

FINRA

Last year was one of change and adaptation for FINRA's examination and enforcement programs. The Department of Enforcement got a new leader and the COVID-19 pandemic caused FINRA to move to a virtual examination program. In other respects, the approach remained the same. For example, FINRA continued to be focused on providing restitution to harmed customers.

In January 2020, Jessica Hopper, previously the deputy head of Enforcement, was promoted to lead the Department of Enforcement. In September, FINRA announced that after many years of service, Michael Rufino would retire as the head of Member Regulation (Sales Practice). FINRA also created a new National Cause and Financial Crimes Detection Program that combined several departments and programs under a new leader (Greg Ruppert) who came from outside the organization.

Of course, like every regulator and broker-dealer, FINRA devoted considerable time, effort, and resources to dealing with the impact of COVID-19 on the securities industry. Changes FINRA made included temporarily amending and/or extending compliance timelines related to certain rules, establishing remote examination processes, and forming the COVID Fraud Task Force to establish a coordinated response to potential COVID-19-related fraud. FINRA also issued several Regulatory and Information Notices to provide guidance to the industry regarding issues to consider during the pandemic, such as business continuity planning, cybersecurity measures, and the transition to remote work and remote supervision.

On the enforcement front, almost two years after announcing its voluntary self-reporting initiative, the 529 Share Class Initiative, FINRA reported its first formal and informal actions in this area. In late December 2020, FINRA issued a press release stating that the initial results of the 529 Initiative included 17 cautionary action letters and two formal actions that led to more than $2.7 million in restitution payments to approximately 3,900 customer accounts. Consistent with the terms in the announcement of the 529 Initiative, the formal matters were settled without imposing fines.

Last year, Ms. Hopper highlighted several key priorities that continue to be hallmarks of FINRA's Enforcement program. They include Enforcement's number one objective: obtaining restitution for harmed customers. Other focus areas are identifying brokers who engage in egregious misconduct that affects customers, and protecting senior and vulnerable investors.

In 2020, FINRA issued two Targeted Examination Letters. The first involved a review of firms' decisions not to charge commissions for customer transactions, and the impact that not charging commissions has or will have on firms' order-routing practices and decisions. The second asked for information regarding firms' systems and procedures for providing customers waivers and rebates available through rights of reinstatement on mutual fund purchases.

FINRA continues to try to use data and technology resources to augment its examination and risk monitoring programs. These include efficient and effective data ingestion and predictive analytics. Information about these efforts was highlighted by FINRA's Senior Vice President of Member Supervision Data Analytics and Technology Kerry Gendron in a May 2020 podcast released by the organization.

The 2021 Report on FINRA's Examination and Risk Monitoring Program (Report) was issued last month. The Report combines and replaces two reports that FINRA previously published separately: the Report on Examination Findings and Observations and the Risk Monitoring and Examination Priorities Letter. The new Report (i) identifies rules and related key considerations for firm compliance programs; (ii) summarizes noteworthy findings from recent examinations, including effective practices FINRA has observed; and (iii) sets forth additional resources for firms to use in developing and implementing their compliance and supervisory programs. The Report highlights six key areas that FINRA believes impact compliance programs at many firms across the industry: Regulation Best Interest and Form CRS; Consolidated Audit Trail; Cybersecurity; Communications with the Public; Best Execution; and Variable Annuities.

Finally, as of the date of publication of this report, FINRA has not yet announced its 2020 enforcement statistics.

US SECURITIES AND EXCHANGE COMMISSION

PERSONNEL: COMMISSIONERS AND THE DIVISION OF ENFORCEMENT[19]

The November 2020 election of President Biden signaled a number of changes in the composition of the SEC at the commissioner level and for the directors of Enforcement. 2020 began with a vacancy on the Commission resulting from the February 14, 2020 resignation of Commissioner Robert J. Jackson Jr. At the time, it was reported that Senate Democrats had identified Caroline A. Crenshaw, an attorney in Commissioner Jackson's office, as the replacement nominee.[20] However, the Trump administration did not formally nominate Commissioner Crenshaw until mid-June 2020,[21] with Senate confirmation on August 6, 2020.

Prior to her confirmation, Commissioner Crenshaw served as counsel to both Commissioner Stein and Commissioner Jackson. Before those roles, Commissioner Crenshaw served as a "career SEC staff attorney" in the Division of Examinations (then the Office of Compliance, Inspections and Examinations) and the Division of Investment Management. Commissioner Crenshaw also currently serves as a captain in the United States Army Reserve, Judge Advocate General's Corps. Prior to her time at the SEC, Commissioner Crenshaw was in private practice where she represented public companies, broker-dealers, and investment advisers.

With the election of President Biden, Chairman Clayton announced the conclusion of his tenure as chairman on December 23, 2020. Commissioner Elad L. Roisman was named acting chair for the remainder of the Trump presidency. On January 21, 2021, the SEC announced that President Biden had designated Commissioner Allison Herren Lee as the acting chair. Acting Chair Lee was sworn in as an SEC commissioner on July 8, 2019, having been nominated to the SEC by President Donald J. Trump and unanimously confirmed by the US Senate. She has more than two decades of experience as a securities law practitioner. Acting Chair Lee served for more than a decade in various roles at the SEC, including as counsel to Commissioner Kara Stein, senior counsel in the Division's Complex Financial Instruments Unit, and an Enforcement staff attorney in the Denver Regional Office. Prior to government service, Acting Chair Lee was in private practice, focusing on securities, antitrust, and commercial litigation. Acting Chair Lee's term as a commissioner expires on June 5, 2022.

In August 2020, Co-Director of Enforcement Steven Peikin announced that he would depart the Commission after serving for three years. Stephanie Avakian remained as director of Enforcement until announcing her departure effective December 31, 2020. Former Director of the SEC's New York Regional Office Marc P. Berger was named deputy director of Enforcement and later acting director of Enforcement before announcing his departure effective January 31, 2021.

On January 22, 2021, the SEC announced Melissa R. Hodgman as acting director of Enforcement. Ms. Hodgman is a former associate director of Enforcement in the Commission's Home Office in Washington DC, a position she has held since October 2016. Ms. Hodgman began working in the Enforcement Division in 2008 as a staff attorney. She joined the Enforcement Division's Market Abuse Unit in 2010 and was promoted to assistant director in the Division of Enforcement in 2012.

On February 5, 2021, Kelly L. Gibson was announced as acting deputy director of Enforcement. Ms. Gibson most recently served as the regional director of the SEC's Philadelphia Regional Office. Ms. Gibson joined

---

[19] Unless otherwise noted, the information regarding these personnel changes was drawn from SEC press releases and biographies available on the Commission's website.

[20] *See* Katanga Johnson, White House expected to nominate SEC lawyer for Democratic commissioner seat – sources, *Reuters* (Dec. 20, 2019).

[21] *See* Paul Kiernan, Trump Nominates Caroline Crenshaw to Democratic SEC Seat, *The Wall Street Journal* (June 18, 2020).

the SEC in 2008 as a staff attorney in the Division of Enforcement in the Philadelphia office, and joined the Enforcement Division's Market Abuse Unit when it was established in 2010. She was promoted to assistant regional director in 2013 and to associate regional director of Enforcement in 2017.

In addition to new leadership, the agency elevated supervisory trial counsel Nichola Timmons to be chief of the newly formed Office of Bankruptcy, Collections, Distributions and Receivership.[22] Housed within the Division of Enforcement, the new office seeks to centralize the process by which the SEC collects outstanding monetary judgments and returns money to harmed investors.[23]

THE EFFECT OF THE PANDEMIC ON SEC ENFORCEMENT[24]

The COVID-19 pandemic had a profound effect on the productivity and emphasis of the Enforcement Division in FY 2020. The Division's annual report recognized that the initial "regrouping amid mandatory telework necessarily slowed investigations,"[25] and we discuss the quantitative effects below. In addition, Enforcement "reallocated resources to address near-term investor protection concerns related to COVID-19."[26] From mid-March 2020 through the end of FY 2020 in September, the Enforcement staff recommended 492 enforcement actions and 36 COVID-19-related trading suspensions, and opened approximately 640 inquiries and investigations (over 150 of which were COVID-19 related).[27]

The pandemic also resulted in Enforcement employing different techniques to move investigations and actions forward while working remotely. The staff adapted by seeking proffers from entities and individuals early in the process, issuing "interrogatory-based document requests" and seeking information directly from third parties to the conduct under investigation, among other approaches.[28] Enforcement also pressed ahead with investigations and litigation, seeking direction from the courts where appropriate. For example, the SEC successfully opposed a defendant's request to stay discovery due to COVID-19, where the court imposed a number of conditions to allow remote discovery to proceed.[29]

Enforcement also created the "Coronavirus Steering Committee to coordinate its response to coronavirus-related enforcement issues."[30] The Steering Committee is composed of approximately two dozen leaders from across Enforcement, including representatives from specialized units, from the Washington, DC office and various regional offices, and from the Office of Market Intelligence. "The Steering Committee's mandate is to proactively identify and monitor areas of potential misconduct, ensure appropriate allocation of our resources, avoid duplication of efforts, coordinate responses as appropriate with other state and federal agencies, and ensure consistency in the manner in which the women and men of the Division address coronavirus-related matters. The Steering Committee is focused on identifying key areas of potential market and investor risk."[31]

In October 2020 at the Practicing Law Institute program "SEC Speaks," Enforcement staff also highlighted the importance of cooperation during the pandemic. In an action involving a German-based manufacturer alleging the disclosure of inaccurate and misleading information in violation of Sections 17(a)(2) and (3),

---

[22] Press Release, Securities and Exchange Commission, SEC Names Nichola L. Timmons Chief of New Office of Bankruptcy, Collections, Distributions, and Receiverships (Oct. 7, 2020).
[23] *Id.*
[24] For more analysis of some of the considerations and issues, please see our Morgan Lewis LawFlashes, SEC Examinations and Enforcement in the Covid-19 Era (Apr. 21, 2020), and SEC Enforcement Division: COVID-19-Related Enforcement Matters and What Lies Ahead (May 15, 2020).
[25] Enforcement Annual Report at 6.
[26] *Id.*
[27] *Id.* at 8.
[28] Anita Bandy, Associate Director, Division of Enforcement, Securities and Exchange Commission, Remarks at SEC Speaks 2020 (Oct. 9, 2020).
[29] *SEC v. Commonwealth Equity Services,* Case No. 19-cv-11655 (D. Mass. Sept. 16, 2020).
[30] Steven Peikin, Co-Director, Division of Enforcement, Securities and Exchange Commission, Keynote Address: Securities Enforcement Forum West 2020 (May 12, 2020).
[31] *Id.*

the company was given significant credit for its cooperation.[32] "The SEC's order notes BMW's significant cooperation during the investigation amid challenges posed by the COVID-19 pandemic, including travel restrictions, work-from-home orders, and office closures, and that this cooperation was taken into account in imposing a penalty."[33] At SEC Speaks, Associate Director of Enforcement Anita B. Bandy noted that the "cooperation included things like producing documents from Germany within a matter of weeks of getting the request. Which, otherwise, would have been difficult and time consuming for the staff to obtain. It included quickly producing witnesses for interviews on our timeline."[34]

What to Expect

Continued Use of Informal Interviews: We have witnessed a higher incidence of requests for informal interviews at the outset of investigations during the pandemic. However, the tactic of speaking to those under investigation at the outset of a matter, in part to speed the staff's understanding of the basic facts, likely is a method that will continue beyond the pandemic.

More Comfort with Remote Testimony: As the staff has become more adept and comfortable with remote testimony, we anticipate that the staff will use remote testimony to conserve resources and avoid scheduling conflicts caused by travel that in the past might have delayed investigations.

Steering Committee Success in Marshaling Resources: One of the apparent successes of the Coronavirus Steering Committee is an ability to marshal resources in multiple regions to move matters forward. As noted in the Enforcement FY 2020 Annual Report, "many staff redirected newly-freed-up time elsewhere, including by taking on whistleblower claims and distributions to injured investors, or strategically pivoting to cases and aspects of investigations that could be advanced while we were finding ways to adjust to the move away from in-person work."[35] Look for this type of coordination across regional offices and tasks to continue after the pandemic.

SEC ENFORCEMENT UNDER THE BIDEN ADMINISTRATION

Nomination of Gary Gensler

As of the date of this report, the Biden administration's nominee for SEC chairman, Gary Gensler, has yet to be confirmed by the Senate. Assuming that Mr. Gensler is ultimately confirmed by the Democratic majority in the Senate, his past work at the Commodity Futures Trading Commission (CFTC) and elsewhere provides a window into how he may confront the issues facing the SEC, including the belief by many Democrats that the SEC under Chairman Clayton was too "light" on Wall Street.[36]

Background

Currently Mr. Gensler is a professor of the practice of global economics and management at the Massachusetts Institute of Technology (MIT) Sloan School of Management, co-director of MIT's Fintech@CSAIL, and a senior advisor to the MIT Media Lab Digital Currency Initiative, where he "conducts research and teaches on blockchain technology, digital currencies, financial technology, and public policy."[37] His MIT biography further provides that "[f]ormerly Gensler was chairman of the U.S. Commodity Futures Trading Commission, leading the Obama Administration's reform of the $400 trillion swaps market. He also was senior advisor to US Senator Paul Sarbanes in writing the Sarbanes-Oxley Act (2002) and was Under

[32] Press Release, Securities and Exchange Commission, SEC Charges BMW for Disclosing Inaccurate and Misleading Retail Sales Information to Bond Investors (Sept. 24, 2020).
[33] *Id*.
[34] Anita Bandy, Associate Director, Division of Enforcement, Securities and Exchange Commission, Remarks at SEC Speaks 2020 (Oct. 9, 2020).
[35] Enforcement Annual Report at 2.
[36] *See* Ted Knutson, Congress Should Do More to Raise Number Of IPOs, Says Potential Senate Banking Chair, *Forbes* (Nov. 11, 2020); Matthew Goldstein, Lauren Hirsch and Andrew Ross Sorkin, Gary Gensler Is Picked to Lead S.E.C., *The New York Times* (Jan. 17, 2021).
[37] Massachusetts Institute of Technology, Faculty Directory – Gary Gensler.

Secretary of the Treasury for Domestic Finance, and Assistant Secretary of the Treasury during the Clinton Administration."[38] Prior to serving in government, Mr. Gensler worked at Goldman Sachs from 1979 to 1997 where he was a "partner in the Mergers & Acquisition department, headed the firm's Media Group, led fixed income & currency trading in Asia, and lastly co-headed Finance, being responsible for the firm's worldwide Controllers and Treasury efforts."[39]

Congressional Expectations

The progressive wing of the Democratic party certainly anticipates a more aggressive SEC under Mr. Gensler. After Mr. Gensler's nomination, Senator Elizabeth Warren (D-MA) tweeted: "For too long, our banking regulators have behaved like they work for the financial institutions they regulate – not the American people. But big change is coming. President-elect Biden couldn't have made two better picks to lead the SEC and CFPB: Gary Gensler and Rohit Chopra." Senator Sherrod Brown (D-OH), the chairman of the US Senate Committee on Banking, Housing, and Urban Affairs, released a statement in the wake of Mr. Gensler's nomination, remarking:

> Mr. Gensler brings a unique combination of government service and experience from the financial sector and academia to this role. His prior work at the Treasury Department and as Chair of the Commodity Futures Trading Commission demonstrates that he will hold bad actors accountable and put the interests of working families first.[40]

In Mr. Gensler, the Biden administration has a nominee who is familiar with how to operate a financial industry regulator charged with increasing enforcement, the promulgation and implementation of rules, and the balancing resources due to budgetary constraints. During his tenure as chairman of the CFTC from 2009 to 2013, commentators characterized his work as "steamroll[ing] the opposition to write rules from scratch governing the markets for hundreds of trillions of dollars of derivatives"[41] and noted that "[h]e also gained a reputation as a tough regulator by issuing hefty fines over the Libor currency manipulation scandal."[42]

The CFTC

When Mr. Gensler was appointed chair of the CFTC, it was an agency operating somewhat in the background. The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act changed that by tasking the CFTC with regulating the swaps marketplace.[43] These efforts included writing rules requiring the disclosure of swap activity, establishing data repositories, mandating centralized clearing, expanding enforcement authority to prosecute misconduct, creating a whistleblower program, and regulating dealers.[44]

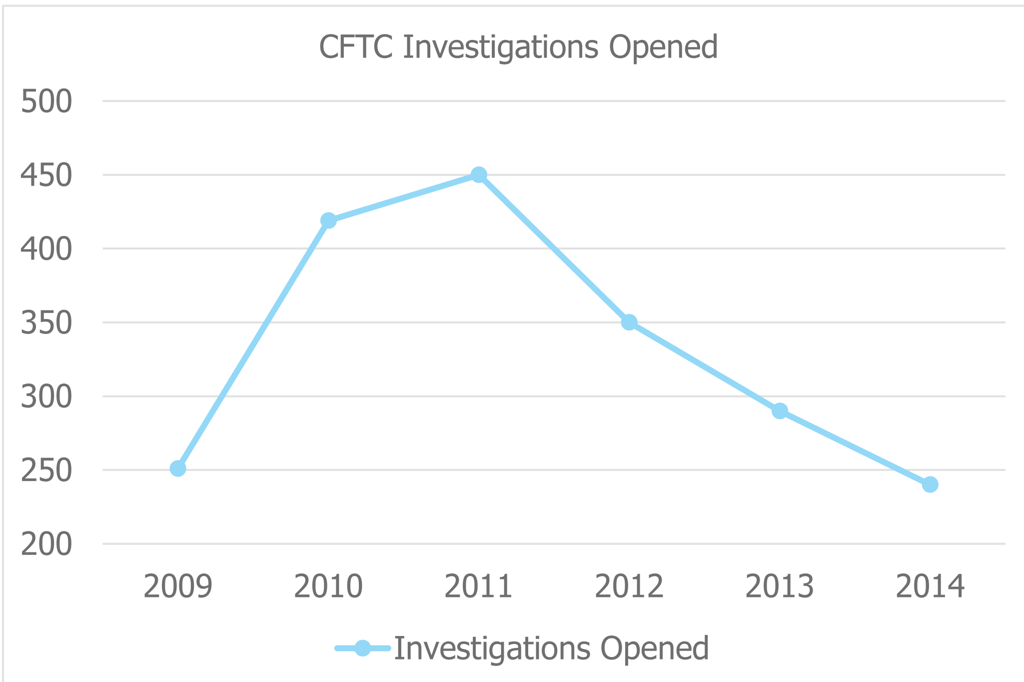
With regard to enforcement, Mr. Gensler's vision for the CFTC was reflected in its 2011–2015 Strategic Plan issued in February 2011.[45] Goal 3 of the Strategic Plan was to "Protect the Public and Market Participants through a Robust Enforcement Program."[46] Success in reaching this goal was measured in three ways: (i) the percentage of enforcement investigations concluded within one year of opening—with an initial goal of 65%; (ii) civil monetary penalties, undertakings, and restitution that have "the highest impact on and

---

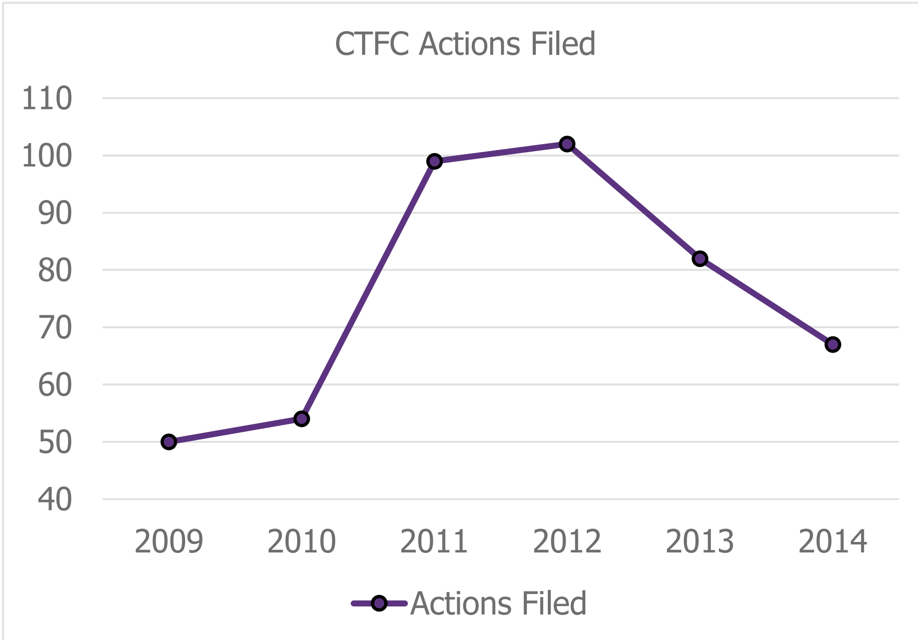
[38] *Id.*
[39] *Id.*
[40] United States Senator Sherrod Brown, Statement on the Selection of Gary Gensler to Be Chair of the Securities and Exchange Commission (Jan. 18, 2021).
[41] Paul Kiernan and Scott Patterson, An Old Foe of Banks Could Be Wall Street's New Top Cop, *The Wall Street Journal* (Jan. 16, 2021).
[42] Jeff Stein, Biden likely to tap Gary Gensler to lead SEC, but the decision isn't final, *The Washington Post* (Jan. 12, 2021).
[43] CFTC, Performance and Accountability Report Fiscal Year 2020, at 4 (Nov. 2010).
[44] CFTC, Agency Financial Report Fiscal Year 2011, at 3-6 (Nov. 14, 2011).
[45] CFTC, Strategic Plan FY 2011-2015 (Feb. 28, 2011).
[46] *Id.* at 24.

greatest deterrent effect against potential future violations;" and (iii) the percentage of CFTC filed actions that include referrals to domestic civil and criminal authorities.[47]

As reflected in the below charts, Mr. Gensler's implementation of these enforcement goals had a dramatic effect on the number of investigations opened, the number of actions filed, and ultimately the size of monetary sanctions. One commentator reported that "his hard-charging style left some staff exhausted and ultimately contributed to a push to unionize."[48] By the end of FY 2011, CFTC investigations had risen by 79% over FY 2009 and filed actions by 98%.

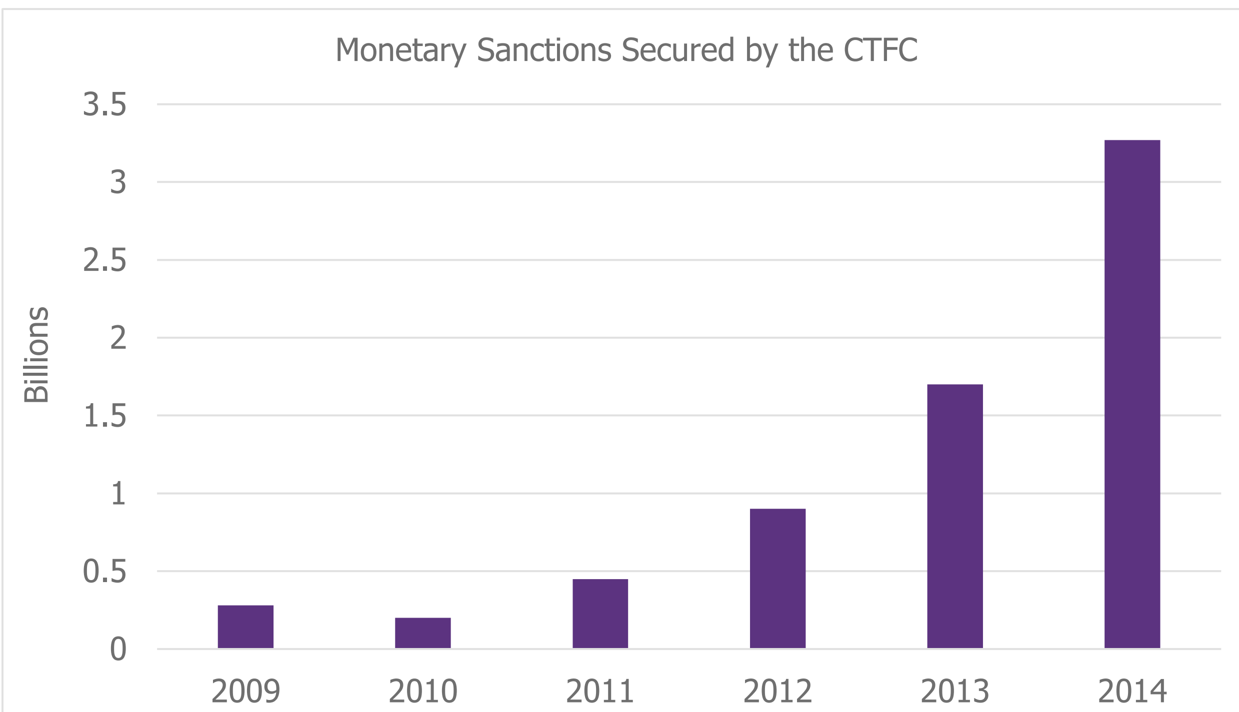


[47] *Id.* at 25.
[48] Benjamin Bain, From Goldman to SEC: Gensler's Next Stop Worries Wall Street, *Bloomberg* (Jan. 14, 2021).



Sources[49]

When compared to FY 2009, monetary sanctions secured by the CFTC grew by 221% in FY 2012, 507% in FY 2013, and 1,067% FY 2014.



[49] The information set forth in this chart and the following chart on remedies is taken from CFTC Agency Financial Reports for 2010 through 2014 and CFTC Enforcement year end press releases found on the CFTC website for the years 2009 through 2014.

While Mr. Gensler's term at the CFTC was marked by increased enforcement activity, it should also be noted that this was accomplished with significantly fewer resources than available to Enforcement at the SEC. Further, while congressional oversight for the CFTC is vested in the House and Senate Agriculture Committees, oversight for the SEC is vested in the House Committee on Financial Services and the Senate Committee on Banking, Housing and Urban Affairs.

What to Expect

Pressure to Conclude SEC Investigations More Quickly: After setting a performance measure calling for 65% of investigations to be concluded within a year, in 2011 the CFTC concluded 81% of its investigations within a year.[50] While this measure declined in subsequent years due to increasingly complex matters, it remained above 62% through FY 2013 and the departure of Mr. Gensler from the CFTC.[51] The SEC does not provide statistics for the length of time all investigations remain open; however, in FY 2020 the average SEC enforcement case was commenced 24 months after the investigation was opened.[52] We expect Mr. Gensler to set goals that will accelerate the pace of SEC investigations and filing of enforcement actions.

Streamlining the SEC Enforcement Process: In February 2017, then Acting SEC Chairman Michael S. Piwowar removed the sub-delegation of authority to senior officers in the Enforcement Division to issue formal orders of investigation.[53] Many identify such delegation as a way to speed investigations. On February 9, 2020, Acting Chair Lee restored this "vital tool" to senior officers to "enable investigative staff to act more swiftly to detect and stop ongoing frauds, preserve assets, and protect vulnerable investors."[54] Look for Mr. Gensler to evaluate other internal processes to decrease the length of investigations.

Voluntary Reporting Initiatives: Enforcement's Share Class Selection Disclosure Initiative was met with strong opposition from the industry amid claims that the initiative was inappropriate "regulation by enforcement." In recent testimony before the Senate Committee on Banking, former Chair Clayton defended the initiative, stating: "From a cost perspective, you have two choices, one has a higher cost, one lower, the others are exactly the same, there is no doubt that that's a violation of that obligation. I'm also comfortable that the Enforcement Division pursued this believing and having that belief based on rigorous analysis they were on the right side of the law."[55] Many at the Commission viewed the initiative as a tremendous success and former Director of Enforcement Avakian noted, "The same principles and disclosure obligations can apply in other circumstances. Because of that, we are not resting on the success of the Share Class Initiative. Let me assure you, we are looking for other undisclosed material conflicts—and we are finding them," and identified revenue sharing, cash sweep arrangements, and unit investment trusts (UITs) as examples.[56] As discussed more fully below, voluntary initiatives have added significantly to Enforcement's bottom-line number of filed actions and disgorgement. With an increased focus on aggressive enforcement, Enforcement may turn again to a voluntary reporting initiative.

Significant Increase in Financial Remedies Sought in Settlement: At the CFTC, Mr. Gensler's stated goal was to obtain penalties, disgorgement, and restitution that had "the highest impact on and greatest deterrent effect against potential future violations."[57] In contrast, many, including Commissioner Hester M. Peirce, have characterized the approach under former Chairman Clayton as less focused on civil penalties

[50] CFTC, Agency Financial Report Fiscal Year 2011, at 42 (Nov. 14, 2011).
[51] CFTC, FY 2014 Annual Performance Report, at 52 (Feb. 25, 2015).
[52] Enforcement Annual Report at 6.
[53] Memorandum, Carl W. Hoecker, Inspector General, Review of Certain Actions Taken by Commissioner Michael Piwowar as Acting Chairman, at 3 (Aug. 24, 2017).
[54] Statement, Acting Chair Allison Herren Lee, Statement of Acting Chair Allison Herren Lee on Empowering Enforcement to Better Protect Investors (Feb. 9, 2021).
[55] Oversight Hearing Before the Senate Banking Committee, Testimony of Securities and Exchange Commission Chair Jay Clayton, 116th Cong. (Nov. 17, 2020).
[56] SEC Division of Enforcement Co-Director Stephanie Avakian, Keynote Remarks at the 2019 SEC Regulation Outside the United States Conference: What You Don't Know Can Hurt You (Nov. 5, 2019).
[57] CFTC, Strategic Plan FY 2011-2015, at 24-25 (Feb. 28, 2011).

and raw enforcement numbers. "I commend Chairman Clayton and our co-directors of the Enforcement Division, Stephanie Avakian and Steven Peikin, for trying to lead the enforcement program in a direction that focuses on serious violations and deemphasizes penalties and case counts."[58] As discussed more fully in the Enforcement results section, while the SEC had a record year for money ordered in FY 2020, now more than any time in the last several years, those numbers are driven by a relatively small number of large cases. We expect Enforcement to seek larger penalties across the board regardless of the size of the case.

POSSIBLE LEGISLATION AND RULEMAKING

While the Democrats have secured the majority in the Senate by operation of a tiebreaking vote to be cast by Vice President Kamala Harris, legislative activity in the financial services area is likely to meet substantial headwinds. However, senators have indicated that they expect to implement change through SEC rulemakings, which only require a majority of the SEC commissioners.[59]

What to Expect

Revisiting Regulation Best Interest (BI): Senator Sherrod Brown is a vocal critic of Regulation BI, writing to the Chairman Clayton on June 1, 2020, "I reiterate my concern that Reg. BI fails to provide a fiduciary standard as authorized by Congress in Section 913(g) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and to require that broker-dealers put investors' interest first, placing investors at a disadvantage when planning and saving for their future."[60] The nonbinding Democratic Party Platform went a step further, stating, "Democrats believe that when workers are saving for retirement, the financial advisors they consult should be legally obligated to put their client's best interests first. We will take immediate action to reverse the Trump Administration's regulations allowing financial advisors to prioritize their self-interest over their clients' financial wellbeing." In a December 4, 2020, letter to then President-elect Biden, Representative Maxine Waters (D-CA), chair of the House Committee on Financial Services, asked the incoming administration to prioritize a number of administrative and regulatory actions, including the rescission of Regulation BI.[61] Given the significant cost and expense incurred by registrants to implement Regulation BI, wholesale changes appear unlikely. However, there certainly will be debate. Moreover, much of Regulation BI is principles based, giving the SEC significant interpretive and enforcement latitude. This includes the ability to bring actions for inadequacies in broker-dealer policies and procedures without proving a violation of underlying law—as it has done under Section 204A of the Advisers Act, Advisers Act Rule 206(4)-7, and Section 15(g) of the Exchange Act in the case of insider trading procedures.

Reevaluation of Waivers in the Enforcement Settlement Process: It was not that long ago that waivers of automatic disqualification provisions in the securities laws dominated discussion among the SEC commissioners. On February 11, 2021, Acting Chair Lee thrust the issue once again to the forefront. In the 2014–2015 time period, Commissioner Kara M. Stein was intensely critical of several instances where the Commission issued waivers to registrants who otherwise would have been automatically ineligible for well-known seasoned issuer (WKSI) status, as well as subjected to safe-harbor and bad actor disqualifications. In one dissent Commissioner Stein remarked, "This type of recidivism and repeated criminal misconduct should lead to revocations of prior waivers, not the granting of a whole new set of waivers. We have the

---

[58] Speech, Commissioner Hester M. Peirce, Lies and Statistics: Remarks at the 26th Annual Securities Litigation and Regulatory Enforcement Seminar (Oct. 26, 2018).
[59] *See, e.g.*, Press Release, Senator Elizabeth Warren, Senator Warren to SEC Chairman Clayton: You Have Done Nothing to Protect the Economy from Climate Change Risks (Nov. 17, 2020).
[60] Press Release, Senator Sherrod Brown, Brown to SEC: Put Investors First Now and After the Coronavirus Pandemic (June 1, 2020).
[61] Press Release, Representative Maxine Waters, Waters Provides Recommendations to President-Elect Biden on Trump Actions to Reverse (Dec. 4, 2020).

tools, and with the tools the responsibility, to empower those at the top of these institutions to create meaningful cultural shifts, yet we refuse to use them."[62]

Congress has also sought to regulate the process for waivers granted in connection with SEC Enforcement settlements. Beginning in 2015 and continuing through 2019, Representative Waters introduced a version of the Bad Actor Disqualification Act, noting that "[t]hese tools are inappropriately underutilized and waivers of the automatic disqualification provisions are disproportionately granted to the largest financial institutions on Wall Street, many of which are recidivists."[63] The act sought to eliminate the SEC staff's ability to handle disqualification waivers on a confidential basis prior to settlement of the related SEC enforcement action or other triggering event. Instead, the act sought to create a three-step process to request and obtain a waiver.[64]

However, one month after the introduction of the Bad Actor Disqualification Act of 2019, then Chairman Clayton fired back with a "Statement Regarding Offers of Settlement."[65] While not rulemaking per se, the statement described a process where, once settlement terms were agreed upon and the Commission staff made a recommendation regarding the requested waivers for a settling entity, the Commission would then consider the Enforcement settlement simultaneously with any requests for waivers. Former Chairman Clayton said, "Considering a settlement offer and a related waiver request as if they are two separate and unconnected events can add complexity, including because such a formulaic separation often is inconsistent with appropriate consideration of the substance and interconnected nature of the matters at issue and undermines factors that drive appropriate settlements."[66]

On February 11, 2021, Acting Chair Lee, once on the staff of former Commissioner Stein, reversed former Chair Clayton's Statement, noting: "To ensure that these processes remain fair and serve investors' interests, the Division of Enforcement will no longer recommend to the Commission a settlement offer that is conditioned on granting a waiver."[67] The question that remains unanswered is whether this move will lead to more denials of waivers and more resulting litigation of enforcement matters due to a lack of certainty. As former staffers in Commissioner Stein's office, both Commissioner Crenshaw and Acting Chair Lee are well versed in these issues.

Buybacks and Reformation of Rule 10b5-1: Company stock buybacks and executive Rule 10b5-1 plans (which allow an executive to structure his or her trades in advance of stock sales) have drawn considerable recent focus from Congress. On October 15, 2020, the SEC waded into the fray, charging a company with violating the internal controls provisions of Exchange Act Section 13(b)(2)(B) by engaging in a $250 million stock buyback while in possession of material nonpublic information.[68] This action is an aggressive departure from traditional insider trading cases, and the first time that the SEC has ever charged a non-registrant issuer with violating Section 13(b)(2) in connection with controls against insider trading. We expect further scrutiny of buybacks from Congress. While Rule 10b5-1 plans are designed to provide protections for prearranged trades, questions have arisen concerning the need to further clarify the requirement that an executive entering into the plan does not possess material nonpublic information at the time that he or she enters into the plan. In an oversight hearing before the Senate Banking Committee on November 17, 2020, both former Chairman Clayton and Democratic members of the Senate appeared to agree that additional rulemaking is necessary to prevent timing trades in a fortuitous manner for that

---

[62] *Id.*; Public Statement, Commissioner Kara M. Stein, Dissenting Statement Regarding Certain Waivers Granted by the Commission for Certain Entities Pleading Guilty to Criminal Charges Involving Manipulation of Foreign Exchange Rates (May 21, 2015).
[63] Bad Actor Disqualification Act of 2019, at 2 (Discussion Draft of June 5, 2019).
[64] For more analysis of some of the considerations and issues, please see our Morgan Lewis LawFlash, Bad Actor Disqualification Act of 2019 Introduced in House (July 1, 2019).
[65] Public Statement, Securities and Exchange Commission Chairman Jay Clayton, Statement Regarding Offers of Settlement (July 3, 2019).
[66] *Id.*
[67] Public Statement, Securities and Exchange Commission Acting Chair Allison Herren Lee, Statement of Acting Chair Allison Herren Lee on Contingent Settlement Offers (Feb. 11, 2021).
[68] Press Release, Securities and Exchange Commission, SEC Charges Andeavor for Inadequate Controls Around Authorization of Stock Buyback Plan (Oct. 15, 2020).

executive, such as a "cooling-off period" between the date the plan is adopted and the first trade. In response to a question for Senator Sherrod Brown asking if "clear standards to follow and avoid abuses" were necessary, former Chair Clayton stated: "For executives, I am a proponent of a cooling-off period. When you put your plan in place, say you do it in June, there are no purchases or sales, in most cases it is sales, for a period of time. Whether that is three months or six months whatever that is, that gives everybody comfort that timing was not planned ahead. That fortuity was an intent. I think that is something we all should explore."[69]

THE CURRENT STATE OF DISGORGEMENT AS AN SEC REMEDY

The SEC remedy of disgorgement continued to evolve in 2020. The SEC held its collective breath awaiting a challenge to disgorgement before the US Supreme Court in *Liu v. SEC* and disgorgement survived. While the Court confirmed that disgorgement was a remedy available to the SEC, despite the absence of express authorization in governing statutes, the decision imposed restrictions that are certain to trouble the Commission going forward. Also, the end of 2020 brought a holiday gift from the 116th United States Congress to SEC Enforcement. In a rare New Year's Day session, the Senate overrode a presidential veto and passed into law the National Defense Authorization Act for Fiscal Year 2021. Within its 1,400-plus pages was a section dedicated to disgorgement under the federal securities laws that is a partial fix of a statute of limitations dilemma exposed in *Kokesh v. SEC.*[70]

Liu v. SEC[71]

In an 8–1 decision, the US Supreme Court held on June 22, 2020, that the SEC could seek disgorgement as an equitable remedy under the Exchange Act. However, while recognizing the remedy, the Court identified a number of ways that historic SEC disgorgement requests and lower court jurisprudence were inconsistent with principles of equity and the applicable statute.

To understand the origins of *Liu*, one must begin with the Supreme Court's June 5, 2017 decision in *Kokesh v. SEC*.[72] In *Kokesh*, the Supreme Court unanimously held that the five-year statute of limitations in 28 USC § 2462 applies to claims for disgorgement in enforcement actions brought by the SEC. In reaching this result, the Court concluded that disgorgement is a penalty under 28 USC § 2462 because it seeks to redress a wrong against the United States instead of a private individual and because its primary purpose is to serve as a deterrent and is not compensatory. The Court expressly declined to consider whether, having found disgorgement to be a penalty for the purpose of the statute of limitations, it was an appropriate equitable remedy under the Exchange Act, stating, "Nothing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context." This limitation set the stage for *Liu*.

In May 2016, the SEC brought a civil action against petitioners Charles Liu and his wife, Xin Wang, alleging that they violated the terms of a private offering memorandum by misappropriating more than $27 million of funds that foreign nationals invested through the EB-5 Immigrant Investor Program. The bulk of the investor funds were supposed to go toward the construction costs of a cancer treatment center, but (according to the SEC) only a fraction of those investor funds was put toward the cancer treatment center. Nearly $20 million of investor money was spent on ostensible marketing expenses and salaries, and a sizeable portion of the funds was diverted to Liu's personal accounts and a company under Wang's control.[73]

The district court found in favor of the SEC in April 2017 and ordered, among other things, that petitioners pay disgorgement equal to the full amount that they raised from investors, less the $234,899 that remained

---

[69] Oversight Hearing Before the Senate Banking Committee, Testimony of Securities and Exchange Commission Chair Jay Clayton, 116th Cong. (Nov. 17, 2020).
[70] *Kokesh v. SEC*, 137 S. Ct. 1635 (2017).
[71] *Liu v. SEC*, No. 18-1501, 2020 WL 3405845, at *4 (U.S. June 22, 2020).
[72] *Kokesh v. SEC*, 137 S. Ct. 1635 (June 5, 2017).
[73] *Liu*, 2020 WL 3405845, at *4.

in the corporate accounts for the project. The petitioners objected that the "disgorgement award failed to account for their business expenses," but the district court disagreed and ordered the petitioners jointly and severally liable for the full amount raised from investors.[74]

In deciding *Liu*, the Supreme Court answered the question that it left open in Kokesh: "[W]hether, and to what extent, the SEC may seek 'disgorgement' in the first instance through its power to award 'equitable relief' under 15 U.S.C. § 78u(d)(5)."[75] The Supreme Court held that a "disgorgement award that does not exceed a wrongdoer's net profits and is awarded for victims . . . , [and] is considered equitable relief under § 78u(d)(5)."[76] However the Court did not stop there, it continued to examine the nature of the remedy and imposed certain limitations.

Disgorgement Must Be for the Benefit of Investors: Under 15 USC § 78u(d)(5), equitable relief is restricted to that which "may be appropriate or necessary for the benefit of investors."[77] The Supreme Court rejected the SEC's contention that the element is satisfied by simply "depriving wrongdoers of profits," which "den[ies] them the fruits of their ill-gotten gains."[78] The Court concluded that the "SEC's equitable, profits-based remedy must do more than simply benefit the public at large by virtue of depriving a wrongdoer of ill-gotten gains. To hold otherwise would render meaningless the latter part of § 78u(d)(5)"—"the phrase 'appropriate or necessary for the benefit of investors' must mean something more than depriving a wrongdoer of his net profits alone."[79]

Distribution of disgorgement paid by a defendant to the victims of the subject fraud will satisfy the requirement that disgorgement be for the benefit of investors. However, the opinion left open the question of whether the SEC's practice of depositing a portion of disgorgement proceeds into a Treasury fund when it is infeasible to distribute the collected funds to investors satisfies the statute.

Joint and Several Disgorgement Liability: Citing specifically to insider trading cases, the Supreme Court recognized that the SEC's practice of imposing disgorgement liability on a wrongdoer for benefits that accrue to his affiliates, sometimes through joint and several liability, is "seemingly at odds with the common-law rule requiring individual liability for wrongful profits."[80] The Supreme Court cautioned that this "practice could transform any equitable profits-focused remedy into a penalty" and also runs contrary to "holding defendants 'liable to account for such profits only as have accrued to themselves . . . and not for those which have accrued to another, and in which they have no participation.'"[81]

Legitimate Expenses Must Be Deducted from Disgorgement Award: The Supreme Court held that "courts must deduct legitimate expenses before ordering disgorgement under § 78u(d)(5)."[82] Recognizing that "when the 'entire profit of a business or undertaking' results from the wrongdoing, a defendant may be denied 'inequitable deductions,'" the Supreme Court went on to find that this exception still "requires ascertaining whether expenses are legitimate or whether they are merely wrongful gains 'under another name.'"[83] Thus, while the district court declined to deduct expenses from the SEC's disgorgement award on the theory that they were "incurred for the purposes of furthering an entirely fraudulent scheme," the Supreme Court noted that some of the expenses from the petitioners' scheme went toward lease payments and cancer treatment equipment, which "arguably have value independent of fueling a fraudulent scheme."[84]

---

[74] *Id.*
[75] *Id.* at *2.
[76] *Id.*
[77] *Id.* at *9.
[78] *Id.* at *10.
[79] *Id.*
[80] *Id.*
[81] *Id.* at *11.
[82] *Id.*
[83] *Id.*
[84] *Id.* at *12.

The result in *Liu* is yet another Supreme Court decision that will force the SEC to reevaluate traditional practices and adapt moving forward.

Section 6501: Investigations and Prosecution of Offenses for Violations of the Securities Laws

In the past we have written on *Kokesh v. SEC*,[85] and the Supreme Court's holding that the five-year statute of limitations in 28 USC § 2462 applies to claims for disgorgement in SEC enforcement actions.[86] This decision significantly limited the SEC's ability to seek disgorgement for aged misconduct, and former Chair Clayton pushed Congress for legislative relief.[87] In a rare New Year's Day session, the Senate overrode a presidential veto and passed into law the National Defense Authorization Act for Fiscal Year 2021, including Section 6501, titled, "Investigations and Prosecution of Offenses for Violations of the Securities Laws."[88]

Section 6501 addressed the issue of disgorgement in two primary ways: (i) by amending the Securities Exchange Act of 1934 (Exchange Act) to expressly recognize disgorgement as a statutory remedy; and (ii) extending the statute of limitations for claims of disgorgement to 10 years where the underlying violation is pursuant to Section 10(b) of the Exchange Act, Section 17(a)(1) of the Securities Act of 1933 (Securities Act), Section 206(1) of the Investment Advisers Act of 1940 (Advisers Act), or "any other provision of the securities laws for which scienter must be established."[89] In addition the amendments set a 10-year statute of limitations for any other equitable relief such as an injunction, bar, suspension, or cease and desist order. Time spent by a person charged by the Commission outside the United States will not count toward the accrual of time against the limitations period. Finally, the extension of the limitations period applies to all actions pending on, or commenced on or after, the date of enactment of the National Defense Authorization Act.

While Section 6501 does extend the time to bring a claim for disgorgement, it is important to note the limitation to instances where the violation involves "scienter" or the intent to defraud (as opposed to negligence). Often SEC actions against registrants are resolved without scienter-based charges. However, the dichotomy between levels of intent may have the consequence of causing Enforcement to pursue scienter-based charges to allow for disgorgement over the more extended period of 10 years.

What to Expect

SEC Elects Not to Pursue Disgorgement in Insider Trading Cases: When we wrote on *Liu* at the time of its issuance in June 2020, we anticipated that the mandate that disgorgement must be for the benefit of investors could affect claims for disgorgement in insider trading cases where it is typically paid to the Treasury.[90] Recent cases suggest that the SEC has conceded this point. For example, in a straightforward insider trading case filed on February 5, 2021, the Commission did not demand the disgorgement of almost $50,000 in illicit profits.[91]

Continued Litigation Exploring *Liu*'s Limitations: Defendants in pending SEC actions have been relying on *Liu* to attack Commission requests for disgorgement with mixed success so far. One district court denied without prejudice an SEC request for disgorgement that did not affirmatively "identify whether the disgorgement award would be for 'the benefit of investors.'" *SEC v. Bevil,* Case No.: 2:19-cv-0590-RFB-DJA, 2020 WL 7048263, at *2 (D. Nev. Nov. 30, 2020). However, other district courts have left the fundamental burdens of quantifying disgorgement unchanged, with the Commission needing only to present a reasonable approximation and the defendant then required to provide evidence supporting any

---

85 Morgan Lewis LawFlash, US Supreme Court: Five-Year Statute of Limitations Applies to SEC Disgorgement (June 6, 2017).
86 *Kokesh v. SEC*, 137 S. Ct. 1635 (2017).
87 Testimony, Securities and Exchange Commission, Chairman Jay Clayton, *Testimony on Oversight of the US Securities and Exchange Commission* (Dec. 11, 2018).
88 National Defense Authorization Act for Fiscal Year 2021, H.R. 6395, 116th Cong. § 6501 (2019-2020).
89 *Id.*
90 Morgan Lewis LawFlash, US Supreme Court: SEC Can Still Seek Disgorgement but with Limitations (June 29, 2020).
91 *SEC v. Ahn*, Case 1:21-CV-10203 (D. Mass.).

deductions from that calculation. *See, e.g.*, *SEC v. Faulkner*, Civil Action No. 3:16-CV-1735-D, 2021 WL 75551 (N.D. Tex. January 8, 2021).

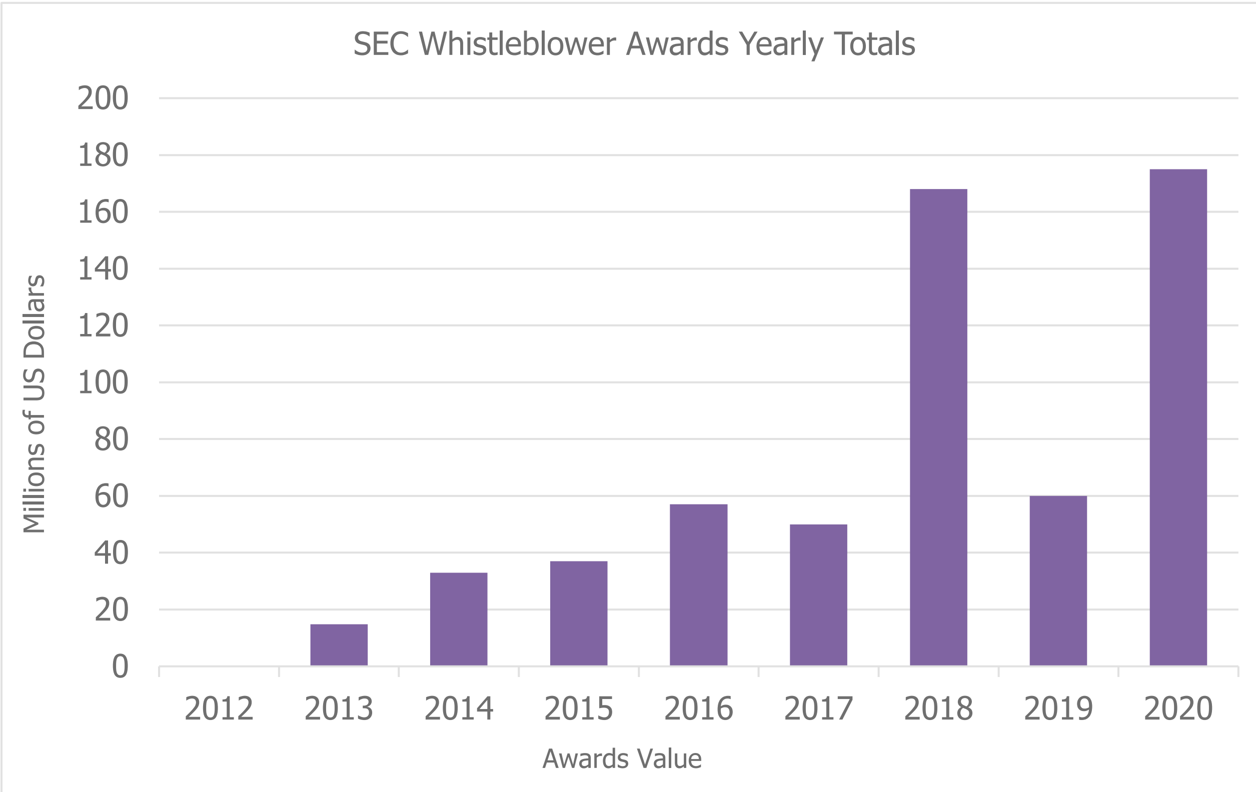
More Discovery and Litigation Regarding Use of Proceeds: Both the SEC and defendants are more focused on use of proceeds to determine if payments benefited the defendants. However, in some instances this has led to an increased burden on defendants to demonstrate that the money was used for the business in question, rather than expenses that ultimately benefited the defendants and not the business. *See, e.g.*, *SEC v. Slowinski*, No. 1:19-CV-03552, 2020 WL 7027639, at *4 (E.D. Ill. Nov. 29, 2020) ("Because Slowinski had an interest in the profitability of those [other] companies, cost offsets to their general operations still amount to his personal gain.").

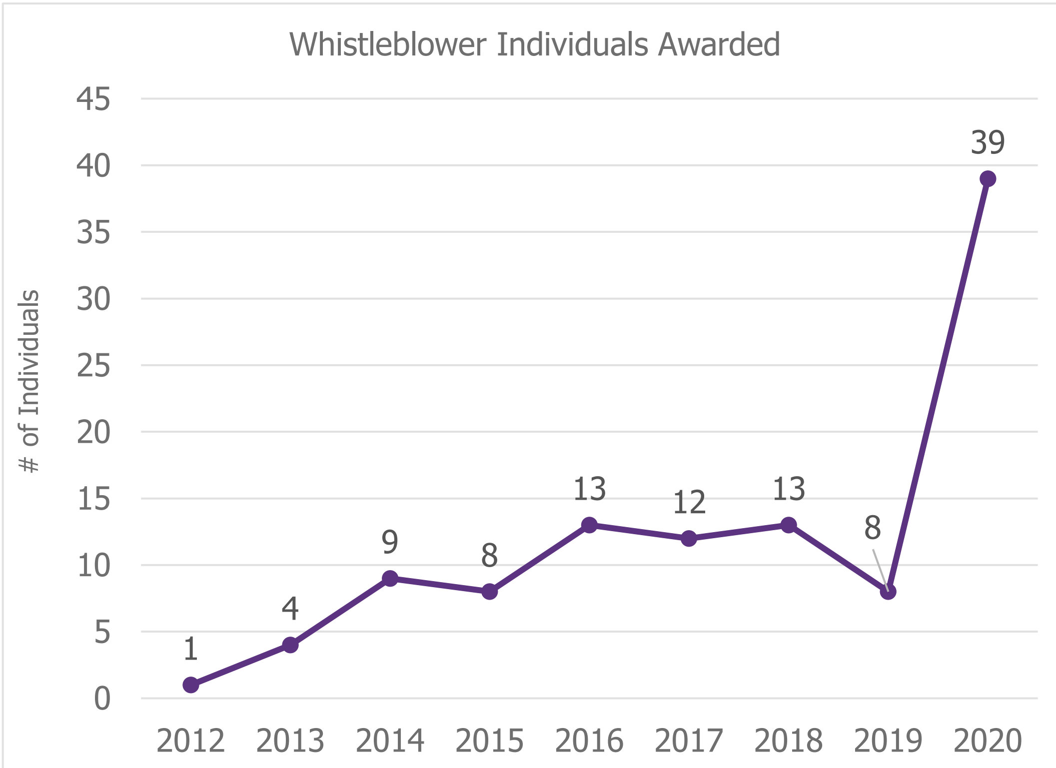
Civil Penalties in Lieu[92] of Disgorgement: In the wake of *Liu*, there was speculation that the SEC might seek greater civil penalties rather than become embroiled in litigation over disgorgement. Former Director Avakian confirmed this approach in remarks made on September 17, 2020, stating: "Once again, we are dedicating resources to evaluating the impact of this decision and how the questions the Court left open will affect us going forward. As a result, you should expect to see some changes in the balance between the penalties and disgorgement that we seek and recommend to the Commission. Penalties may be higher in some cases where the statutory scheme permits us to do so. We will make our recommendations consistent with the Court's decision. But we will also seek the relief necessary to achieve our mission of protecting investors and maintaining market integrity."[93] In a brief filed recently in a microcap fraud case, the SEC opted to forgo disgorgement in its entirety and seek only civil penalty, stating that "disgorgement in this particular case would present significant practical obstacles, and the SEC therefore urges the Court to adopt the solution that the Court itself envisioned—i.e., to eliminate disgorgement and to increase the penalty amounts against each Defendant."[94]

THE SEC WHISTLEBLOWER PROGRAM COMES OF AGE

FY 2020 was a record year for the SEC whistleblower program on several fronts. In FY 2020, the agency awarded 39 individuals approximately $175 million, representing a 200% increase in the amount awarded over the next highest fiscal year and the most individuals ever awarded in a given year.[95] In the decade since its creation, the SEC whistleblower program has awarded approximately $730 million to 134 individuals,[96] with FY 2020 alone representing (at the time) 31% of the total amount of dollars awarded, and 37% of the individuals awarded.[97] The whistleblower program has become a "critical component of the Commission's efforts to detect wrongdoing and protect investors in the marketplace, particularly where fraud is concealed or difficult to detect."[98] Enforcement actions based on whistleblower tips have resulted in more than $2.5 billion in ordered financial remedies, including more than $1.4 billion in disgorgement over the history of the program.[99]

[92] Pun intended.
[93] Speech, Securities and Exchange Commission Director of Enforcement Stephanie Avakian, Protecting Everyday Investors and Preserving Market Integrity: The SEC's Division of Enforcement (Sept. 17, 2020).
[94] Plaintiff SEC's Reply Regarding the Impact of *Liu v. SEC* on the Final Judgment, at 1-2; *SEC v. Lek*, Case 1:17-cv-01789-DLC (S.D.N.Y. Jan. 29, 2021).
[95] Whistleblower Annual Report at 2.
[96] Press Release, Securities and Exchange Commission, SEC Awards Nearly $600,000 to Whistleblower (Jan. 14, 2021).
[97] *Id.*
[98] Enforcement Annual Report at 20.
[99] *Id.*


SEC Whistleblower Awards Yearly Totals
Millions of US Dollars
0
20
40
60
80
100
120
140
160
180
200
2012
2013
2014
2015
2016
2017
2018
2019
2020
Awards Value



Sources[100]

This last fiscal year reflects the whistleblower program's coming of age, working with an increased efficacy in processing claims and issuing the largest number of final orders resolving whistleblower award claims, including both award and denial orders, of any fiscal year. The Commission issued final orders for 197 individual awards, representing a 140% increase from the previous fiscal year. In addition, the office processed 315 claims to preliminary determination, representing the largest number of preliminary determinations issued in a fiscal year, and a 167% increase from FY 2019.[101]

In September 2020, the Commission adopted new rule amendments aimed to further streamline and enhance the transparency around the awards process. This included the following amendments: a presumption that the whistleblower award will be the maximum amount possible where the Whistleblower rules call for an award of $5 million or less; allowing awards based on deferred prosecution agreements and nonprosecution agreements; and adopting a definition of whistleblower requiring a written claim to the Commission for statutory protections (reflecting the Supreme Court's *Digital Realty* decision).[102]

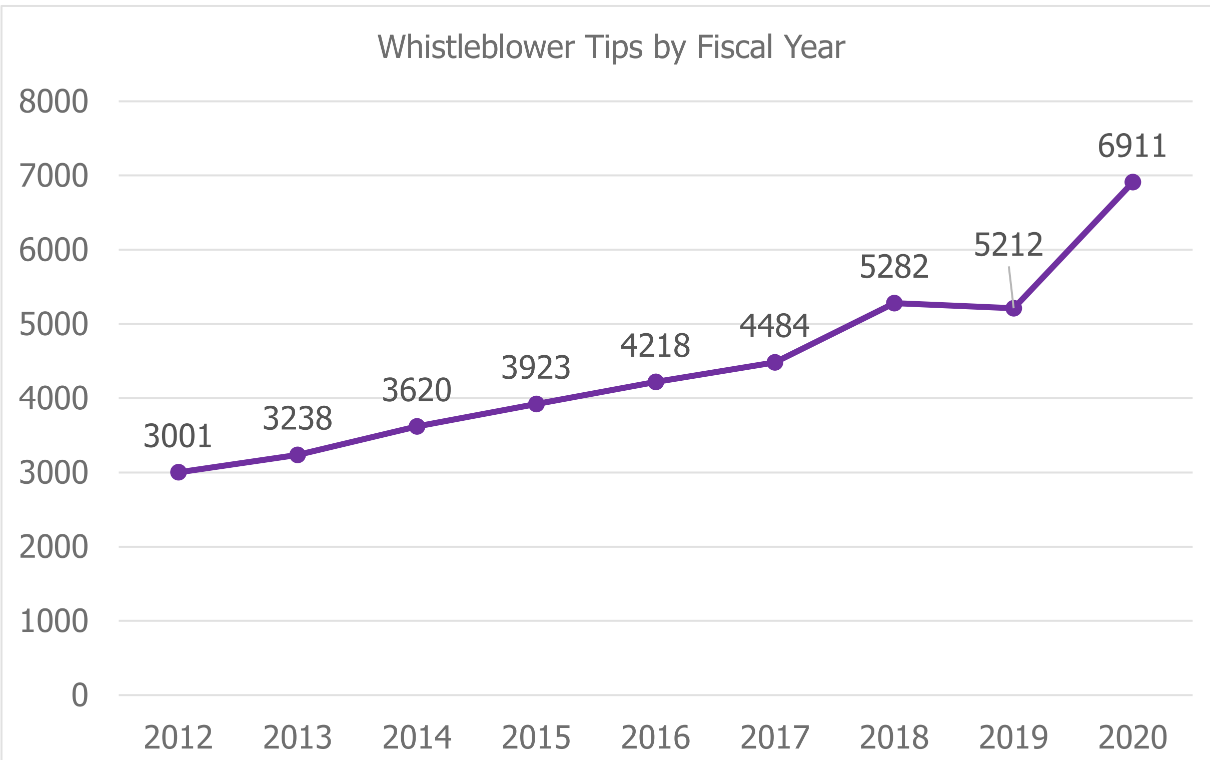
The Commission also made some notable individual awards in 2020, including an award of $50 million, at the time the largest award in the program's history. That pace has continued into FY 2021. Shortly after the close of the fiscal year, on October 22, 2020, the agency awarded a whistleblower $114 million, the largest single award in the program's history.[103] In total, between October 2020 and January 2021, the SEC awarded an additional 28 individuals more than $176 million in whistleblower awards.[104]

---

[100] The information used to create these charts is derived from SEC Office of the Whistleblower Annual Reports for 2012 through 2020.
[101] *Id.*
[102] *See* Public Statement, Securities and Exchange Commission Chair Jay Clayton; *see also*, Whistleblower Annual Report at 33-37.
[103] *Id.*
[104] Press Release, Securities and Exchange Commission, SEC Awards Nearly $600,000 to Whistleblower (Jan. 14, 2021).

Despite limitations on whistleblower awards for employees whose "principal duties involve compliance or internal audit responsibilities,"[105] the Commission has approved awards to such individuals pursuant to a limited exception within the Whistleblower Rules. In December 2020, the Commission awarded $300,000 to a whistleblower with "audit-related responsibilities" who provided the SEC with "high-quality information and continued assistance" that led to a successful enforcement action. [106] In the press release announcing the award, the SEC noted that the individual fell within an exception because he or she "had a reasonable basis to believe that the entity would impede the Commission's investigation." The press release further remarked that "[t]his award is an example of the important role that audit and compliance professionals can play in assisting the Commission's enforcement efforts, especially when the entity is attempting to thwart an investigation."[107] This was the fourth time the Commission paid a whistleblower award to an individual with internal audit or compliance responsibilities.[108]

FY 2020 also witnessed a surge in tips year over year, likely driven by the pandemic and resulting effects on employment and business. The Commission received more than 6,900 whistleblower tips in FY 2020, a 31% increase over FY 2018, the second highest tip year on record, and a 130% increase since the program began in 2012.[109]



Source: Whistleblower Annual Report.

105 17 CFR § 240.21F-4(b)(4)(iii)(B).
106 Press Release, Securities and Exchange Commission, SEC Awards More Than $300,000 to Whistleblower with Audit Responsibilities (Dec. 14, 2020).
107 *Id.*
108 *Id.*
109 Whistleblower Annual Report at 27.

Despite the increase in whistleblower activity, the trends on the types of whistleblower tips (as selected by the whistleblowers themselves) have stayed the same, with corporate disclosures and financials, offering fraud, and manipulation ranking among the top three allegation categories. In FY 2020, the most common complaint categories broke down as follows: corporate disclosures and financials (1,710 tips), offering fraud (1,078 tips), manipulation (942 tips), insider trading (369 tips), and initial coin offering and cryptocurrencies (345 tips).[110] It should be noted that 1,689 tips were submitted with no category selected.

The FY 2020 Office of Whistleblower Annual Report further disclosed that in the history of the program, approximately 68% of all whistleblowers who received an award were insiders and approximately 84% of those insiders "raised their concerns internally to their supervisors, compliance personnel, or through internal reporting mechanisms, or understood that their supervisor or relevant compliance personnel knew of the violations, before reporting their information of wrongdoing to the Commission."[111] In addition, approximately 33% of the defendants and respondents in cases in which a whistleblower received an award involved entities registered with the Commission, including broker-dealers, investment advisers, or other registered market participants.[112]

What to Expect

More Press Releases: In FY 2020 not only did the number of awards increase dramatically, so did the number of press releases by SEC Enforcement announcing the awards. This is by design and is an attempt to advertise the prospect of awards for providing tips.

A Growing Exception for Compliance and Audit Employees: When the SEC whistleblower rules were promulgated, the Commission recognized that "there are good policy reasons to exclude information from consideration as 'independent knowledge' or 'independent analysis' in the hands of certain persons, and in certain circumstances, where its use in a whistleblower submission might undermine the proper operation of internal compliance systems."[113] A whistleblower seeking an exception to this limitation under Rule 21F-4(b)(4)(v) must show a "reasonable basis for believing that the entity is about to engage in conduct that is likely to cause substantial injury to the financial interests of the entity or investors, and that notification to the Commission is necessary to prevent the entity from engaging in that conduct." Where the exception in Rule 21F-4(b)(4)(iii) is relied upon, the whistleblower must have a "reasonable basis to believe that the entity is destroying documents, improperly influencing witnesses, or engaging in other improper conduct that may hinder our investigation."[114] The recent $300,000 award to an employee with audit-related responsibilities where the individual had a reasonable basis to believe that the entity "would impede" the SEC investigation seems at the edge of the contemplated exemption.

SEC ENFORCEMENT IN FY 2020 BY THE NUMBERS[115]

By all measures but sheer magnitude of monetary remedies, SEC Enforcement performance declined year over year, understandable with the pandemic. However, when we look behind the numbers, we see a steady decline in cases overall—and against investment advisers and broker dealers—that may be attributable to the overall drag of a declining enforcement headcount and the 2019 government shutdown as well as the COVID-19 pandemic. The difficulty facing SEC Enforcement is that the pandemic also drove a significant surge in TCRs that will lead to increased investigations and pull significant resources.

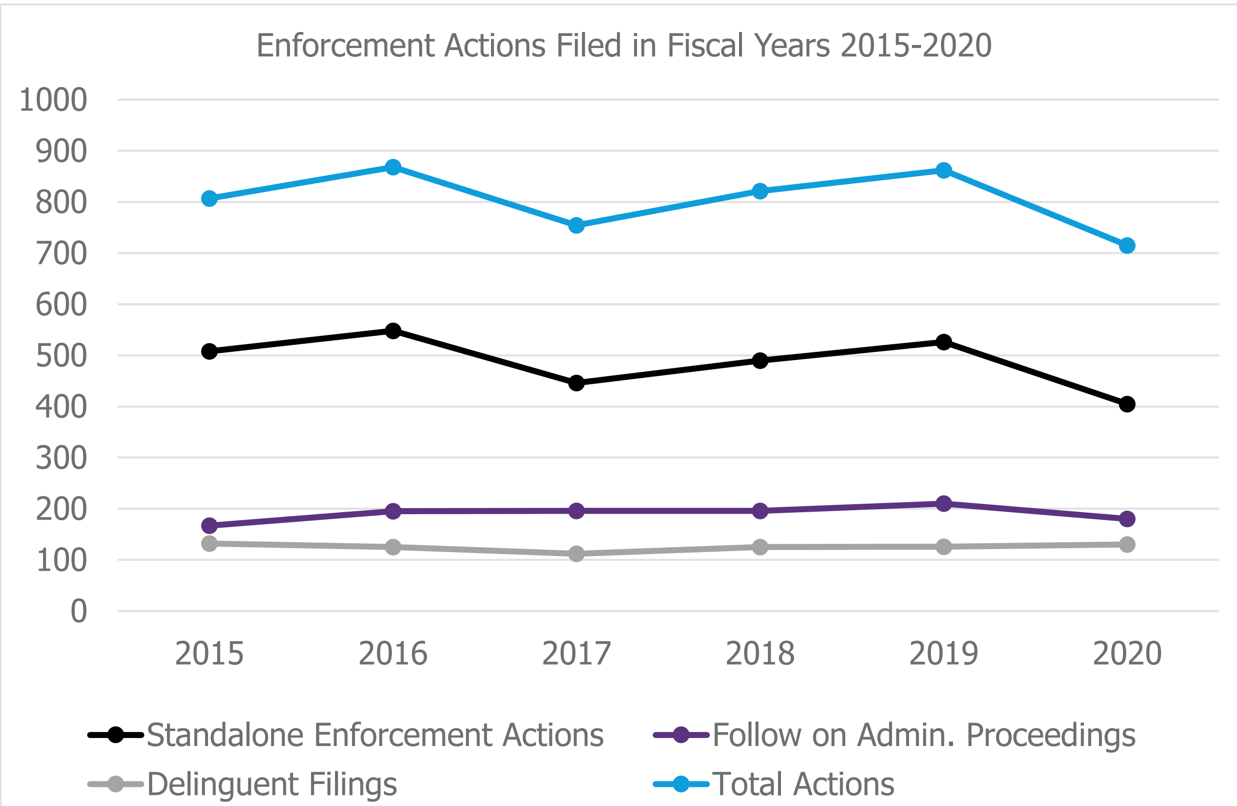
---

[110] *Id.* at 28.
[111] *Id.* at 25.
[112] *Id.*
[113] Final Rule, Securities and Exchange Commission, Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 69.
[114] *Id.* at 75.
[115] Unless otherwise noted, the information in this section is drawn from the Commission's Division of Enforcement Annual Report, Annual Report Division of Enforcement 2020 (ENF 2020 Annual Report). The SEC's fiscal year 2020 ended on September 30, 2020.

Trends in SEC Enforcement Actions

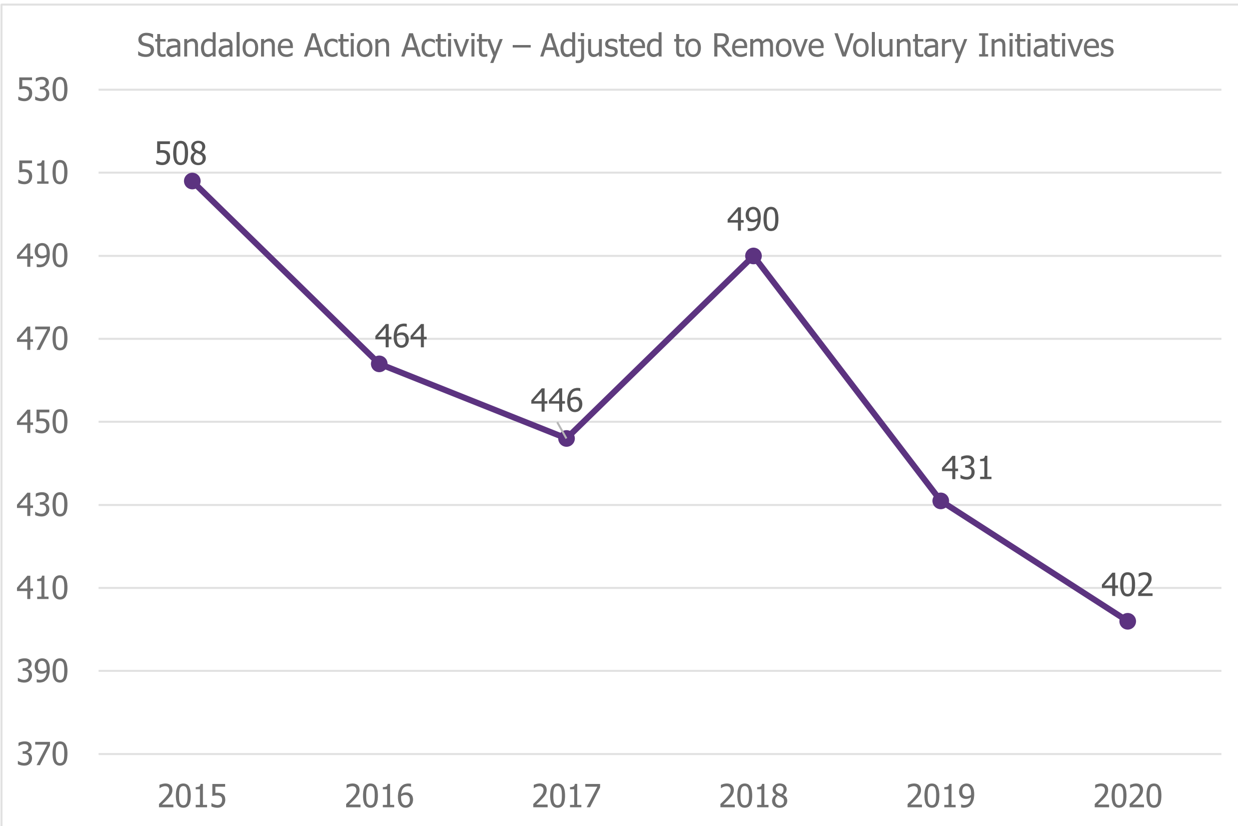
In FY 2020, the Commission brought a total of 716 enforcement actions, composed of 405 standalone cases (independent actions for securities laws violations), 180 "follow on" administrative proceedings seeking associational bars against individuals, and 130 deregistration actions against issuers that were delinquent in making required filings.[116] In those cases, the Commission obtained orders and judgments ordering the payment of more than $4.6 billion in penalties and disgorgement.[117] According to the ENF 2020 Annual Report, $602 million was returned to investors in 2020, a decline from $1.197 billion in FY 2019.[118]

Year-over-year cases filed reflects a significant decline from the four prior years. The drop in total actions for FY 2020 is likely even more acute because, for the first time, SEC Enforcement filed individual delinquent filings actions rather than combining multiple issuers in a delinquent filing action. In FY 2019 the SEC suspended trading in 271 issuers, as compared to 130 in FY 2020.[119]



[116] ENF 2020 Annual Report.
[117] *Id.* at 17.
[118] *Id.* at 18.
[119] Securities and Exchange Commission, Division of Enforcement 2019 Annual Report, at 9 (Nov. 6, 2020).

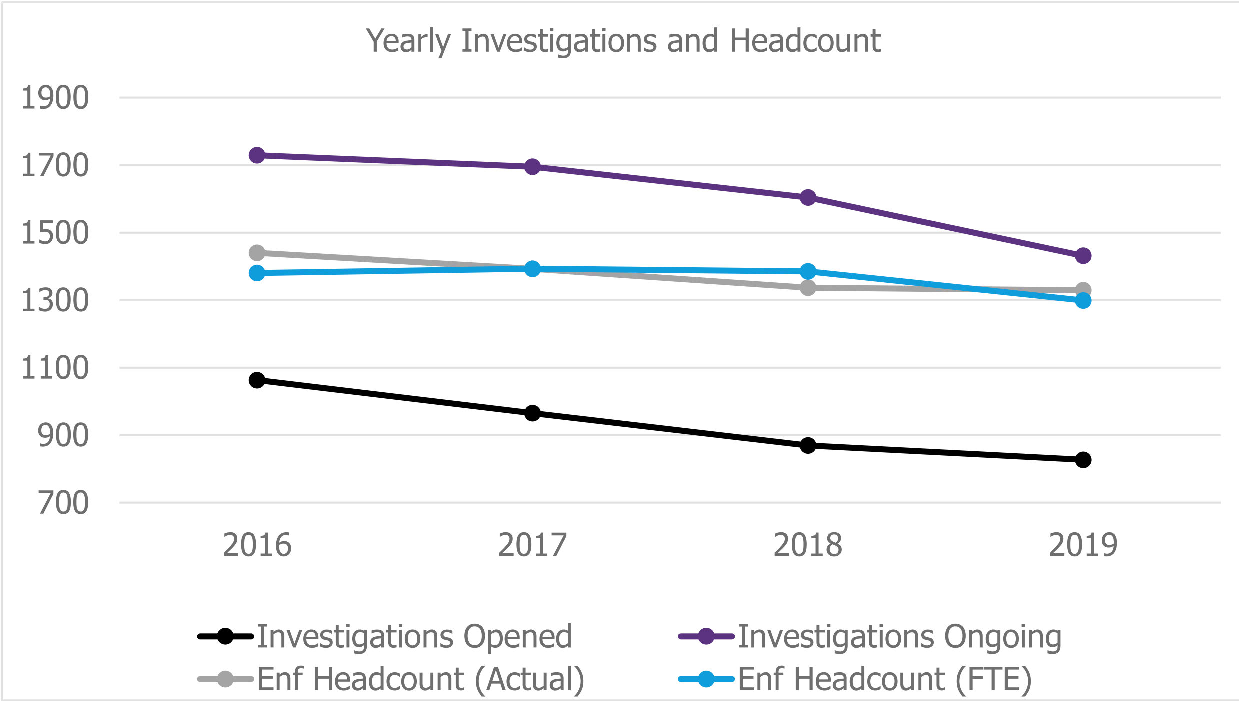
However, looking behind these numbers suggests a more gradual decline in the traditional measure for SEC enforcement activity, the standalone action. In 2017 SEC Enforcement was faced with a similar steep decline in standalone actions, but that year the Enforcement Annual Report provided an alternate view that removed actions arising from the Commission's Municipalities Continuing Disclosure Cooperation (MCDC) Initiative, "a voluntary self-reporting program that targeted material misstatements and omissions in municipal bond offering documents."[120] This adjustment was made because such initiatives can "skew the results for a particular year."[121] If we do the same for the Share Class Initiative, also a "voluntary self-reporting program," the following results:



A Deeper Look into Investigations and Case Categories

It may be too simple to attribute this decline to downward pressure from the previous administration on enforcement cases. Looking deeper into the numbers through a review of several years of the SEC's yearly Congressional Budget Justification, Annual Performance Plan, and Annual Performance Report reflects a decline in new investigations, ongoing investigations, and most importantly enforcement headcount.

[120] Securities and Exchange Commission, Division of Enforcement 2017 Annual Report, at 6 (Nov. 14, 2020).
[121] Securities and Exchange Commission, Division of Enforcement 2018 Annual Report, at 9 (Nov. 2, 2020).



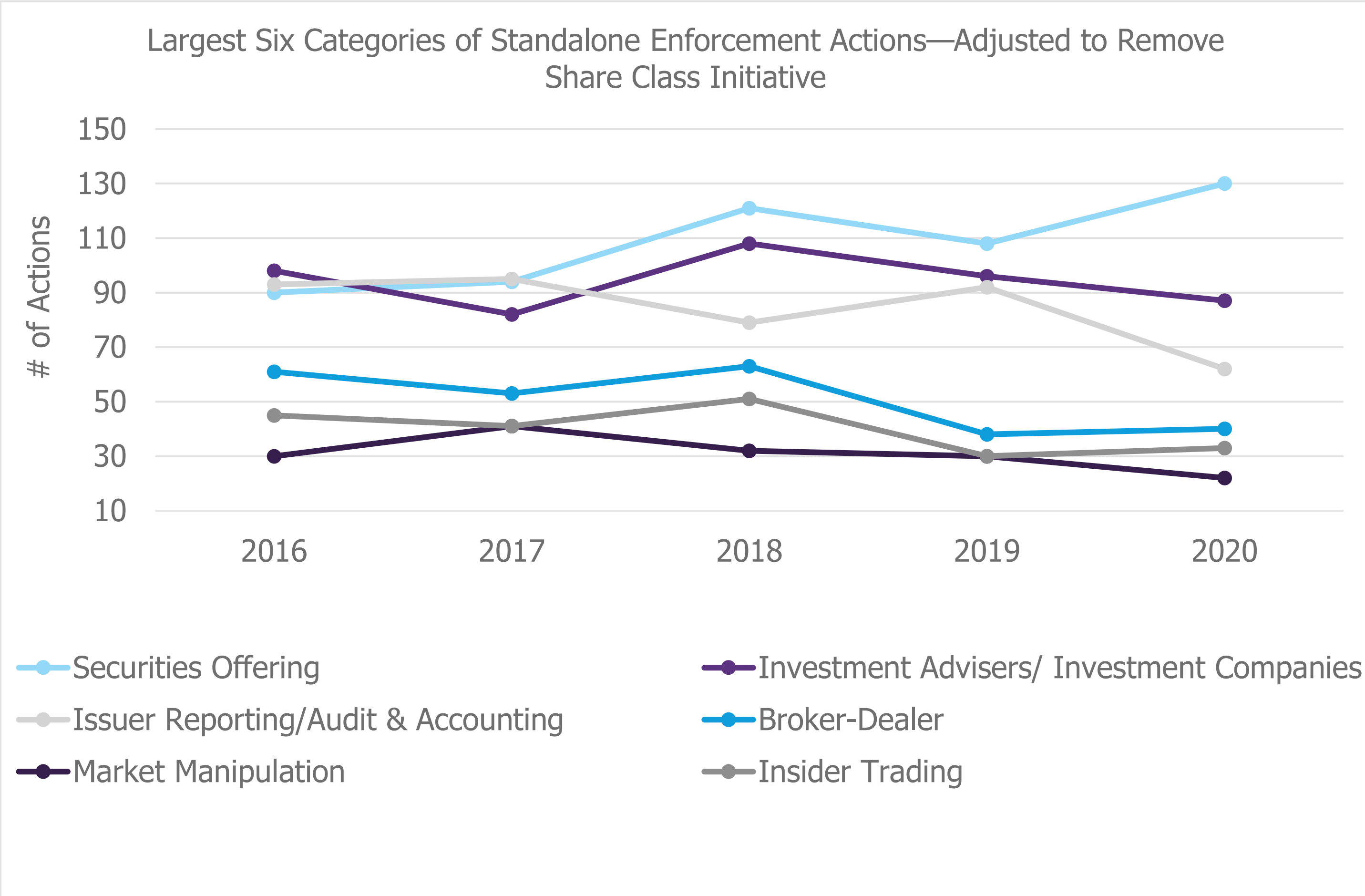
The last three years also evidence a change in the mix of cases pursued by SEC Enforcement, although the FY 2020 statistics are certainly affected by the pandemic and the need to commit "substantial resources to protecting retail investors by actively looking for misconduct."[122]

Year-over-year statistics for categories of cases are as follows:

Type of Case	Number of Actions	Percentage of Total Actions	Number/Percentage in 2019
Securities Offering	130	32%	108 cases/21%
Investment Advisers/ Investment Companies	87	21%	191 cases/36%
Issuer Reporting/Audit & Accounting	62	15%	92 cases/17%
Broker-Dealer	40	10%	38 cases/7%
Market Manipulation	33	8%	30 cases/6%
Insider Trading	22	5%	30 cases/6%
Public Finance Abuse	12	3%	14 cases/3%
FCPA	10	2%	18 cases/3%
Miscellaneous	5	1%	1 case/0%
National Recognized Statistical Ratings Organization (NRSRO)	3	1%	0 cases/0%
Transfer Agent	1	0%	1 case/0%
SRO or Exchange	0	0%	3 cases/1%
TOTAL	**405**	**100%**	**529 cases/100%**

[122] Enforcement Annual Report at 2.

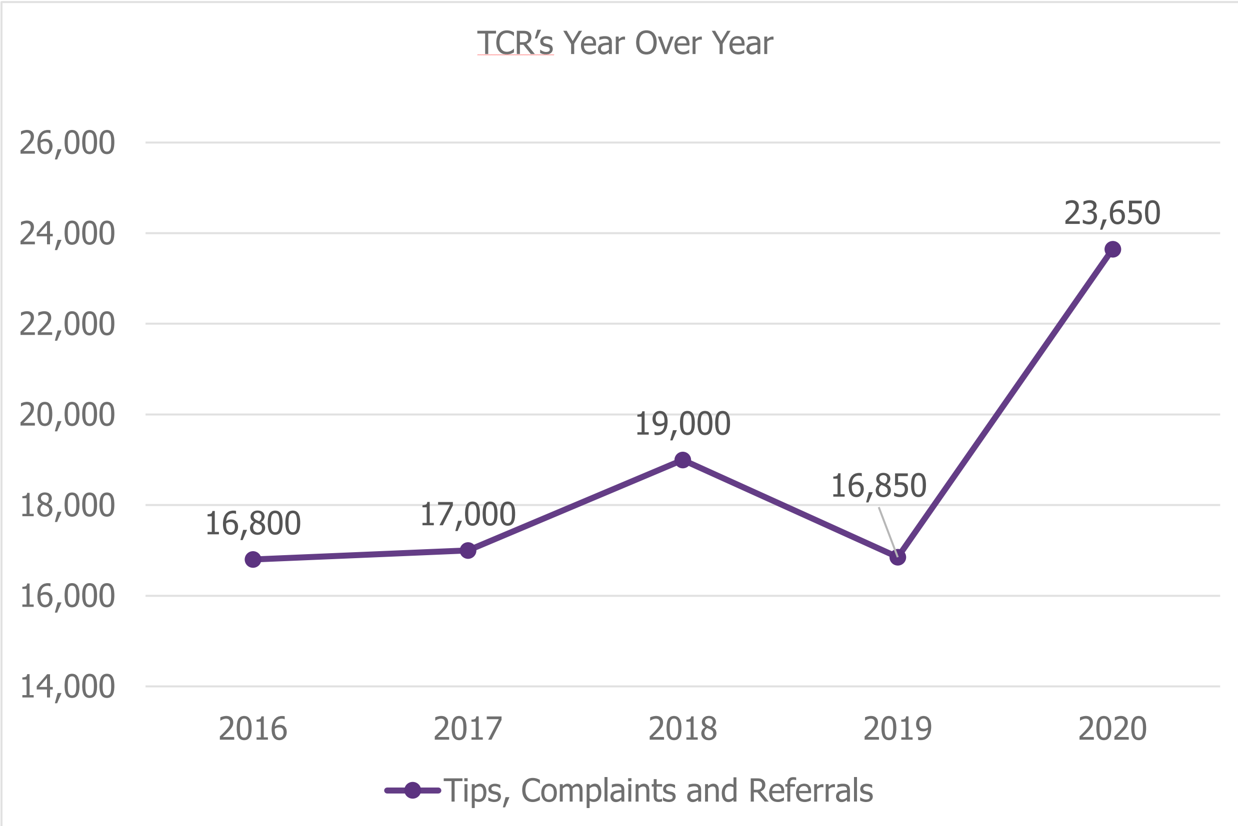
The following chart reflects yearly trends for the six largest categories:



What to Expect

Increase in Investigations and Cases Filed: The number of standalone enforcement actions is in large part a function of headcount and open investigations. Investigations are driven by TCRs which, as former Director of Enforcement Avakian remarked, form a "pipeline for future enforcement actions."[123] Given the 40% increase in TCRs year over year, we expect an increase in the number of investigations and ultimately the number of cases filed, particularly given the more aggressive enforcement stance of the Biden administration.

[123] Enforcement Annual Report at 19.



Enforcement has stated that the average investigation takes approximately two years from inception to the filing of an enforcement action. Thus, the first indication of increased activity will be seen in subpoenas and other investigative steps, not necessarily filed actions, which typically follow years later.

Review of Aged Matters: If Mr. Gensler is confirmed by the Senate, we expect a full review of aged investigations with possible closings of many. Given the limited SEC Enforcement resources, aged investigations will otherwise create a significant drag on going-forward initiatives.

DATA ANALYTICS UNDER CHAIRMAN CLAYTON AND INTO THE NEXT ADMINISTRATION

Data analytics certainly was an area of focus at the Commission before the arrival of Chairman Clayton. However, with reduced resources due to a hiring freeze that saw a significant decline in headcount, the Division of Enforcement leaned into the efficiencies that data-driven investigations can provide. The result was collaboration among different divisions and increasing emphasis on identifying potential securities law violations by harnessing data found in public filings and on trading blotters. These efforts of Chairman Clayton and his Commission may be its lasting legacy. Further, in nominee Gary Gensler the SEC would have a chairman who not only is experienced in constructing a regulatory regime designed to harness data for surveillance purposes (the CFTC regulation of swaps) but is also versed in artificial intelligence, algorithmic trading, and the benefits of blockchain technology.

Data Analysis as Part of the Commission's Strategic Plan

In 2018 the Commission announced a new strategic plan for fiscal years 2018 through 2022, and Goal 3 was to "[e]levate the SEC's performance by enhancing our analytical capabilities and human capital development."[124] Further, one initiative under this goal was to "[e]nhance [the SEC's] analytics of market and industry data to prevent, detect, and prosecute improper behavior."[125] "Data analytics are essential to rooting out wrongdoing in our markets. The SEC will continue to invest in the data and tools needed for our enforcement and examination programs to uncover and prosecute violations of the federal securities laws." A second initiative involved collaboration and "[u]nder this initiative, the SEC will explore new ways to promote effective collaboration and information sharing across the agency, and will review the collaborations connected to the SEC's major functional areas, such as examination of registered entities for compliance with our rules, investigating potential violations of our rules, and writing and proposing new rules."[126]

Data Analytics Within the Division of Enforcement

The tenure of Chairman Clayton and Co-Directors of Enforcement Avakian and Peikin was marked by a number of organizational initiatives focused on data analytics, including the creation of the Cyber Unit and the Retail Strategy Task Force, as well as a newly formed Division of Enforcement Office of Investigative and Market Analytics. FY 2020 saw the filing of a number of Enforcement cases grounded in data analytics. While not all of these cases involved registrants, the techniques used certainly have application in the regulation and investigation of investment advisers and broker-dealers. Some specific examples:

Data Analytics to Surveil Markets and Detect Unsuitable Sales of Products: As discussed more fully below, on November 13, 2020, the Commission announced a series of five cases involving the alleged unsuitable sales of complex exchange-traded products to retail investors.[127] Chief of the Enforcement Division's Complex Financial Instruments Unit Daniel Michael remarked in the press release that "[t]hese cases demonstrate the importance of data analytics in our efforts to surveil the market and pinpoint unsuitable sales of complex financial products . . . . We will continue to use these tools to protect retail investors."[128] The press release went on to recognize the collaboration of "data analytics specialists" and staff from a number of SEC Regional Offices, as well as the Division of Economic Risk Analysis and the Enforcement Division's Center for Risk and Quantitative Analytics.

Data Analytics Used to Analyze Public Filings: During 2020, Enforcement signaled that it would more aggressively use data analytics to aid in its investigation of public company financial reporting, risk disclosures, and insider trading. A newly created Enforcement Coronavirus Steering Committee worked "with the Division's Market Abuse Unit to monitor trading activity around announcements made by issuers in industries particularly impacted by COVID-19 and to identify other suspicious market movements for possible manipulation."[129] Further, Enforcement cautioned that it would use a "systematic process to review public filings from issuers in highly-impacted industries, with a focus on identifying disclosures that appear to be significantly out of step with others in the same industry."[130] Such peer-related review has been used in the past by the Commission to detect securities violations by overperforming investment advisers and to expose Ponzi schemes.

Risk-Based Analytics to Uncover Accounting Violations: On September 28, 2020, the SEC filed settled actions against two public companies originating from a self-described "EPS Initiative" that

---

[124] Securities and Exchange Commission, Strategic Plan FY 2018-FY 2022 (Mar. 9, 2019).
[125] *Id.* at 10.
[126] *Id.*
[127] Press Release, Securities and Exchange Commission, SEC Charges Investment Advisory Firms and Broker-Dealers in Connection with Sales of Complex Exchange-Traded Products (Nov. 13, 2020).
[128] *Id.*
[129] Speech, Securities and Exchange Commission, Steven Piekin, Co-Director of Enforcement, Keynote Address: Securities Enforcement Forum West 2020 (May 12, 2020).
[130] *Id.*

"utilize[d] risk-based data analytics to uncover potential accounting and disclosure violations caused by, among other things, earnings management practices."[131] In the press release, Enforcement credited the recently formed Division of Enforcement Office of Investigative and Market Analytics with providing valuable assistance.

Identification of Improper Perquisite Payments: In recent enforcement actions, the SEC has sanctioned companies that have omitted discussion of perks paid to executives from their compensation discussion and analysis for violating the requirements of Item 402 of Regulation S-K, as well as the companies' obligations to file proxy statement and annual reports that do not contain materially false or misleading statements or materially misleading omissions. In the press release for a September 2020 perquisite case, Enforcement announced the action "was generated by the Division of Enforcement's use of risk-based data analytics to uncover potential violations related to corporate perquisites."[132]

In the press release announcing her departure, it was noted that "[u]nder Ms. Avakian's leadership, the Division significantly enhanced its ability to conduct sophisticated data analysis, including to detect insider trading, 'cherry-picking' schemes, and potential accounting or disclosure violations."[133]

Data Analytics in the Division of Examinations

Historically the Division of Examinations has employed proprietary tools to aid in its inspections and examinations. These include the National Exam Analytics Tool (NEAT) and the High-Frequency Analytics Lab (HAL), which gives examiners the ability to analyze large datasets and identify potentially problematic activity around trading records, anti-money laundering (AML) activity, and market behavior around major events.[134] In July 2020, the Division announced the creation of the Event and Emerging Risks Examination Team (EERT).[135] The mission of the EERT is to "proactively engage with financial firms about emerging threats and current market events and quickly mobilize to provide expertise and resources to the SEC's regional offices when critical matters arise."[136] Adam D. Storch was named the associate director of the EERT with responsibility to oversee a "dedicated, multidisciplinary team of specialized examiners, industry experts, accountants and quantitative analysts."[137] Mr. Storch was previously a senior advisor to the director of the Division of Examinations, where he focused on risk, strategy, and innovation, and led several initiatives. He first joined the Commission as the managing executive and chief operating officer of the Division of Enforcement.

Gary Gensler

If nominee Gary Gensler is confirmed as chairman of the Commission, expect data analytics to be a continued emphasis for the Commission. At the CFTC Mr. Gensler recognized in the agency's goals that IT investment supports a "robust enforcement program" by "improving staff productivity, providing staff with a level IT playing field with those it investigates and effective tools to collaborate internally with oversight and clearing staff as well as with other regulators, and facilitating the use of information to identify high impact enforcement actions."[138] Further, since departing the CFTC, as discussed above, Mr. Gensler has served as a professor of the practice of global economics and management in the MIT Sloan School of

[131] Press Release, Securities and Exchange Commission, SEC Charges Companies, Former Executives as Part of Risk-Based Initiative (Sept. 28, 2020).
[132] Press Release, Securities and Exchange Commission, SEC Charges Hospitality Company for Failing to Disclose Executive Perks (Sept. 30, 2020).
[133] Press Release, Securities and Exchange Commission, Enforcement Director Stephanie Avakian to Conclude Tenure After Four Years Leading the Division (Dec. 10, 2020).
[134] Jay Clayton, Chairman, Securities and Exchange Commission, Keynote Remarks at the Mid-Atlantic Regional Conference (June 4, 2019).
[135] Press Release, Securities and Exchange Commission, SEC Announces Creation of the Event and Emerging Risk Examination Team in the Office of Compliance Inspections and Examinations and the Appointment of Adam D. Storch as Associate Director (July 28, 2020).
[136] *Id.*
[137] *Id.*
[138] CFTC, Strategic Plan FY 2011-2015, at 24 (Feb. 28, 2011).

Management, as well as co-director of MIT's Fintech@CSAIL, and a senior advisor to the MIT Media Lab Digital Currency Initiative.

His work at MIT has included teaching classes such as Blockchain and Money, which is described as beginning "with a review of Bitcoin and an understanding of the commercial, technical, and public policy fundamentals of blockchain technology, distributed ledgers, and smart contracts. The class then continues on to current and potential blockchain applications in the financial sector." He also taught FinTech: Shaping the Financial World, described as exploring "AI, deep learning, blockchain technology and open APIs. Students will gain an understanding of the key technologies, market structure, participants, regulation and the dynamics of change being brought about by FinTech." MIT has made Mr. Gensler's lectures available online, and lectures such as Artificial Intelligence in Finance with its discussion of pattern recognition are particularly relevant to many of the recent SEC data analytics efforts.

DIVISION OF EXAMINATIONS 2021 EXAM PRIORITIES

As of publication, Examinations had yet to release its 2021 exam priorities. However, Examinations did give some indication of what to expect during SEC Speaks in October 2020. Deputy Director of Examinations Kristin A Snyder noted that the Division would continue to focus on its investor protection mission and matters of importance to retail investors. Registrants should expect this to be manifested in an ongoing focus on senior investors and individual saving for members of the military and educators. With regard to Regulation BI, Ms. Snyder noted that Examinations would be "taking a careful look at advisors' Form CRS filings to ensure that the appropriate information is included and that forms are actually being created, delivered, and updated with respect to the information that's required."

Conflicts of interest will remain an area of emphasis, and particularly conflicts of interest and related disclosure issues as they relate to fee and expense issues. Broadly speaking, Ms. Snyder remarked that Examinations would look at "revenue sharing arrangements that firms may have with issuers, service providers, or others to make sure that those are adequately disclosed to investors so that they have all the information they need to determine whether an investment is appropriate for them." Further, Ms. Snyder stated that she expected increased attention on the use of turnkey asset management platforms that provide investment research, technology, portfolio management, and other outsourcing services to ensure that appropriate disclosures are being made to investors.

Due to increased proliferation and popularity with investors, Examinations will remain concentrated on environmental, social, and governance funds (ESG funds). Examinations' attention will be on ensuring that advisors are managing ESG funds in a manner consistent with the disclosures provided to investors and that the practices, policies, and procedures are in place to ensure that the strategies are consistent with the disclosures.

Examinations will also look at matters that are perennial risks such as liquidity, and likely will focus on "funds that are concentrated in sectors that were more impacted by the market disruption—energy, real estate and then certain asset-backed investments."

In the private fund space, Ms. Snyder noted that managers to one or more private funds constitute approximately 40% of the adviser population and she expected these advisers to be an area of priority, particularly with regard to "conflicts of interest, fees, and expenses, controls around material non-public information. There was an incredible body of work that we had done in the private fund space, and so we were able to put out a risk alert over the summer that highlighted exam observations from hundreds of exams that we had done over the last few years in the private fund space." In addition, expect examinations of private fund advisers to also seek information about allocation of fees and expenses among funds to determine whether such activities are consistent with disclosures to investors.

SEC ENFORCEMENT ACTIONS[139]

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

Anti-Money Laundering (AML)

In re Biltmore International Corporation, Exchange Act Rel. No. 88744, 2020 SEC LEXIS 1096 (April 24, 2020)

The Commission accepted an Offer of Settlement from Biltmore International Corporation (Respondent), a registered broker-dealer. The Commission alleged that Respondent had violated Rule 203(b)(1) of Regulation SHO, which prohibits a broker or dealer from accepting a short-sale order from another person, or effecting a short sale in an equity security for its own account, unless the broker or dealer has borrowed the security, has entered into a bona fide arrangement to borrow the security, or has reasonable grounds to believe that the security can be borrowed so that it can be delivered on the delivery date (the "locate requirement"). Further, the Commission alleged that Respondent violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder for failing to comply with the reporting, recordkeeping and record-retention requirements of the BSA and failing to file SARs as required under the SAR rule (31 C.F.R. § 1023(a)(2)). Specifically, the Commission alleged that Respondent routinely executed a series of short sales throughout the day for its own account in the stocks being sold by customers, then later covered the short positions by purchasing shares from the customers on a "net" basis, charging the customers an average price at a prenegotiated markdown, while failing to locate shares of those stocks as required by Rule 203(b)(1) of Regulation SHO. "The order finds that, for at least several thousand of these short sales, Respondent failed to locate shares of those stocks that it could borrow, as is required by the federal securities laws." The Commission also alleged that Respondent engaged in facilitating high-volume liquidations of low-priced, thinly traded, over-the-counter (OTC) stocks without adequately implementing its anti-money laundering policies and procedures so as to reasonably address the risks associated with its business model. The result was a finding by the SEC that Respondent "failed to adequately monitor its customers' trading in low priced over-the-counter stock, did not look for risk indicators or red flags as specified in its policies and procedures, and failed to file SARs for numerous transactions that it had reason to suspect involved fraudulent activity or had no business or apparent lawful purpose." Respondent was ordered to cease-and-desist from future violations, was censured, and was required to pay a civil money penalty of $125,000.

In re BNP Paribas Securities Corp., Exchange Act Rel. No. 89177, 2020 SEC LEXIS 2774 (June 29, 2020)

The Commission accepted an Offer of Settlement from BNP Paribas Securities Corp. (Respondent). The Commission alleged that Respondent had violated Rule 203(a)(1) of Regulation SHO, which prohibits lending shares to settle sale orders marked as "long." Specifically, the Commission alleged that, from April 2016 through July 2016, Respondent, on at least 35 occasions, improperly loaned a hedge fund prime brokerage customer securities on settlement date to settle purported "long" sales. The Commission alleged that Respondent had, in total, loaned the hedge fund more than eight million shares in the securities of three different issuers to settle the purported "long" sales that had been submitted to Respondent for clearing. As a result, the Commission found that Respondent violated Rule 203(a)(1) of Regulation SHO. Respondent provided an undertaking to cooperate with any subsequent SEC investigation regarding the matter and with any subsequent enforcement action. Respondent was ordered to cease-and-desist from future violations, was censured, and was required to pay a civil money penalty of $250,000.

---

[139] The cases described herein are settlements in which the respondents neither admitted nor denied the allegations against them, unless the description explicitly states otherwise. Further, any quotation is taken from the related administrative order unless otherwise noted.

***Interactive Brokers LLC*, Exchange Act Rel. No. 89510, 2020 SEC LEXIS 2474 (Aug. 10, 2020), FINRA Letter of Acceptance, Waiver and Consent, No. 2015047770301 (Aug. 10, 2020)**

In the first parallel actions brought by the Commission, the CFTC and FINRA for violations of the Anti-Money Laundering Act (AML), Interactive Brokers LLC (Respondent) entered into a settlement relating to allegations that it failed to investigate red flags and monitor suspicious activity relating to, among other things, potential insider trading and manipulative trading in microcap securities. Respondent was sanctioned for failing to file suspicious activity reports (SARs) as required under the AML and for failing to establish and implement a reasonably tailored AML compliance program to detect and prevent suspicious activity.

Broker-dealers (and investment companies) are required to file SARs when they suspect fraud or a lack of an apparent lawful business purpose. The Commission alleged that during a one-year period, Respondent failed to recognize numerous red flags and file SARS on at least 150 occasions relating to (i) the deposit, sale, and withdrawal of funds in a short period; (ii) customers whose trades accounted for a substantial percentage of the trading volume in a particular security; and (iii) trades in securities whose issuers were subject to regulatory trading suspensions. The Commission's Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order) also noted that on at least three occasions Respondent identified red flags and restricted trading by customers who had previously violated securities or other federal laws, but failed to timely file SARs. In its Order, FINRA concluded that during a five-year period Respondent failed to (1) reasonably surveil third-party money transfers to customers in high-risk countries, including China, Hong Kong and Macau; (2) file SARs even after a customer had informed the firm that it had been "scammed" by a broker or when Respondent learned about suspicious conduct from a regulator or law enforcement agencies; (3) reasonably investigate potentially suspicious activity; and (4) develop a reasonably designed surveillance tool to identify insider trading and manipulative microcap securities trading. During the course of the investigations, Respondent undertook some remedial measures including retaining third-party consultants to conduct a thorough review of its AML processes and systems. It also increased its legal and compliance resources devoted to AML and developed a case management system for AML surveillance.

The parallel actions against Respondent make clear that AML remains a significant regulatory area of focus. In the SEC's release announcing the actions, Marc Berger, then Director of the SEC's New York Regional Office, stated: "Today's multi-agency settlement reflects the seriousness we place on broker-dealers complying with their SAR reporting obligations and maintaining appropriate anti-money laundering controls." Both the SEC and FINRA identified AML compliance as 2020 examination priorities. Firms should, therefore, ensure that their AML compliance policies and programs are robust, tailored to the business, and sufficiently resourced and tested, particularly to ensure that SARs are timely filed where appropriate.

As a result of its conduct, Respondent paid civil penalties totaling $38 million (of which $11.5 million was paid to the SEC, $15 million to FINRA, and $11.5 million to the CFTC). Additionally, the SEC ordered Respondent to cease-and-desist from future violations, censured Respondent and determined that its failure to file SARs violated the reporting, recordkeeping, and record-retention requirements of the Bank Secrecy Act (BSA) in violation of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. FINRA similarly found that Respondent violated the BSA for failing to file SARs in contravention of FINRA Rules 3310(a) and (b) and 2010 and failing to conduct annual testing of its AML program in contravention of FINRA Rules 3310(c) and 2010. Additionally, FINRA imposed an undertaking that required the third-party consultant engaged by Respondent to provide FINRA with periodic reports of its recommendations and Respondent's implementation of a more robust AML program.

Electronic Blue Sheets

***In re Credit Suisse Securities (USA) LLC*, Exchange Act Rel. No. 89947, 2020 SEC LEXIS 4294 (Sept. 22, 2020); *In re SG Americas Securities, LLC*, Exchange Act Rel. No. 89143, 2020 SEC LEXIS 3247 (June 24, 2020); *In re Cantor Fitzgerald & Co.*, Exchange Act Rel. No. 88567, 2020 SEC LEXIS 934 (Apr. 6, 2020)**

The Commission accepted Offers of Settlement from Credit Suisse Securities (USA) LLC (Credit Suisse), SG Americas Securities, LLC (SGAS), and Cantor Fitzgerald & Co. (Cantor), 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 Electronic Blue Sheets (EBS). 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, over a four-year period, Credit Suisse submitted EBS data for 135 fixed-income securities to the Commission, nearly half of which were deficient in one or more ways, resulting in the misreporting of trade data for 2,460 transactions. Specifically, Credit Suisse's EBS submissions contained inaccurate execution times, incorrect exchange codes and incorrect average price account data because the submissions included only allocation-level information and did not include execution-level information.

The Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order) against SGAS alleged that it made 16,422 EBS submissions to the Commission over a five-and-a-half-year period, 13,656 of which contained deficient trade data for approximately 27.6 million transactions. The inaccuracies were due to an undetected coding error either in SGAS's process of transmitting data to a vendor for production to the Commission or in the vendor's system.

Finally, the Order against Cantor found that over a nearly six-year period, the firm submitted 14,868 EBS to the Commission containing trade data for 34,884,409 transactions, all of which were deficient in one or more ways. Cantor's deficient submissions resulted from an undetected coding error, software issues and human error in maintaining certain EBS data fields.

In each case, the Commission found that the incorrect reporting occurred, in large part, because the broker-dealers lacked processes to detect errors in their EBS submissions. For example, the Commission noted that firms should have presubmission controls, such as periodic sampling or manual validation and comparison against the firm's own data, to validate that the information in their EBS submissions is complete and accurate. Firms should also ensure that their validation procedures apply to fixed-income as well as equity securities.

As a result of the inaccurate submissions, the Commission found that each broker-dealer violated Section 17(a)(1) of the Exchange Act and Rules 17a-4(j) and 17a-25 thereunder. Credit Suisse, SGAS and Cantor were each censured and ordered to cease-and-desist from future violations and required to pay civil penalties as follows: Credit Suisse, $600,000; SGAS, $1.55 million; Cantor, $3.2 million. The Commission considered the cooperation and remedial efforts by each broker-dealer in accepting their Offers of Settlement.

Exchange-Traded Funds

***In re Morgan Wilshire Securities, Inc.*, Exchange Act Rel. No. 89979, 2020 SEC LEXIS 4316 (Sept. 24, 2020)**

The Commission entered into a settlement with Morgan Wilshire Securities (Respondent) based on allegations that the firm's registered representatives recommended that a number of their retail brokerage customers buy nonleveraged, inverse exchange-traded funds (ETFs), without regard for holding periods, without having a reasonable basis for believing those recommendations were suitable, and, in certain cases, without making suitable recommendations in light of certain of these customers' risk profiles and investment objectives. Because Respondent's policies and procedures regarding inverse ETFs were insufficient, the Commission sanctioned the firm for failing to supervise its registered representatives.

The action against Morgan Wilshire continues the Commission's enforcement scrutiny of inverse and other nontraditional ETF products, as the Commission has charged numerous other firms in the last several years over their supervision of sales of such products. The Commission observed in its Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order) that because inverse ETFs reset daily, they are designed to achieve their stated objectives of tracking their respective underlying indices only on a daily basis, and thus are typically not suitable for retail clients who plan to hold them for more than one trading session.

In this action, the Commission alleged that the firm did not adequately train its registered representatives and supervisors regarding inverse ETFs or adopt processes to educate registered representatives about inverse ETFs and their risks. The Commission found that Respondent's registered representatives made recommendations to a number of retail customers to buy inverse ETFs without regard to holding periods and without a reasonable basis for believing the recommendations were suitable. The Order further alleged that certain representatives did not fully understand all of the potential risks of holding inverse ETFs for longer than one day, and that certain customers held those products in their accounts for extended periods. Finally, the Order found that Respondent's supervisory policies and procedures were inadequate because, among other things, the firm failed to develop any alerts or exception reports that would identify unsuitable recommendations of inverse ETFs.

Based on its conduct, Respondent was found to have failed to supervise its registered representatives within the meaning of Section 15(b)(4)(E) of the Exchange Act. The settled Order censured Respondent and ordered it to pay disgorgement of $87,609.09 plus prejudgment interest and a civil money penalty of $75,000. The Order noted that the Commission considered the firm's current financial condition in determining whether to accept the firm's settlement offer.

Municipal Bond Flipping

***In re Boenning & Scattergood, Inc., Craig Burdulis, and Brian Gillespie*, Exchange Act Rel. No. 88662, 2020 SEC LEXIS 1056 (Apr. 16, 2020); *In re UBS Financial Services, Inc.*, Exchange Act Rel. No. 89348, 2020 SEC LEXIS 2888 (July 20, 2020); *In re Roosevelt & Cross, Inc.*, Exchange Act Rel. No. 89854, 2020 SEC LEXIS 4181 (Sept. 14, 2020)**

The Commission accepted an Offer of Settlement from each of the respondents in the above-captioned administrative proceedings, which relate to municipal bond "flippers." In each proceeding, the Commission alleged that respondents violated retail order period restrictions in new-issue municipal bond offerings by (i) allocating bonds intended for retail customers to "flippers" who did not qualify for retail priority (because they would immediately flip the bonds to other broker-dealers at a profit); and/or (ii) purchasing bonds for the respondents' own inventory from "flippers" in order to purchase more bonds in the allocation process. These settlements are the latest in a string of settled actions that the Commission brought against "flippers" beginning in 2018. The cases rest on the theory that the respondents knew or should have known that the "flippers" were posing as retail customers in order to obtain better bond allocations. The Commission also alleges that in some instances the respondents placed orders for "flippers" that contained inaccurate zip codes, which gave the orders retail priority.

In the press release regarding the July action, LeeAnn G. Gaunt, Chief of the SEC Enforcement Division's Public Finance Abuse Unit, remarked that "[r]etail order periods are intended to prioritize retail investors' access to municipal bonds and we will continue to pursue violations that undermine this priority[.]"[140]

According to the orders, respondents' conduct included willful violations of Section 17(a)(3) of the Securities Act; Sections 15(a)(1), 15(b)(4)(E), and 15B(c)(1) of the Exchange Act; and/or MSRB Rules G-11(k), G-17, and G-27. The corporate respondents were ordered to pay disgorgement and civil monetary penalties of $110,395/$75,000 (Boenning & Scattergood, Inc.), $681,037/$200,000 (Roosevelt & Cross, Inc.), and $6,740,000/$1,750,000 (UBS Financial Services, Inc.). Each individual respondent was ordered to pay civil monetary penalties of $30,000, and respondent Burdulis was barred from acting in a supervisory capacity for a period of 12 months. Respondents were also censured and required to cease-and-desist from future violations. In each order the Commission considered the respondent's remedial efforts, which included the hiring of new compliance personnel, training enhancements, improved monitoring systems, and/or the retention of an independent consultant.

Order Routing and Filling

In the Matter of Bloomberg Tradebook LLC, Exchange Act Rel. No. 88830, 2020 SEC LEXIS 1264 (May 6, 2020)

The Commission accepted an Offer of Settlement from Bloomberg Tradebook LLC (Respondent), an agency broker-dealer, stemming from an "undisclosed order routing arrangement" that Respondent referred to as "the Low Cost Router." Pursuant to this arrangement, which was active from about November 2010 to September 2018, Respondent allegedly partnered with three outside broker-dealers known as the "Routing Partners." Respondent allegedly transmitted customer orders to the Routing Partners, who then transmitted them to market centers. Due to their trading volume, the Routing Partners were generally able to obtain more favorable pricing on these trades than Respondent. The Commission alleged that this arrangement contradicted Respondent's marketing materials, which said that Respondent made routing decisions based on its own "advanced" technology, which would route orders based on price and liquidity. In reality, the Commission alleged, Respondent permitted the Routing Partners to determine how customer orders were routed, which meant the Routing Partners could make use of their own alternative trading systems for execution. In addition, the Commission alleged that Respondent gave its customers "unverified execution venue information" for trades involving one of the Routing Partners. Respondent allegedly failed to disclose that the routing information it provided to customers was not verified by the Routing Partner, and therefore potentially incorrect.

The order alleges that Respondent made materially misleading statements and omissions and "willfully violated" Section 17(a)(2) of the Securities Act. Respondent was censured and ordered to cease-and-desist from future violations and pay a $5 million civil penalty. The Commission credited Respondent's "significant cooperation" in accepting the Offer, which included retaining an outside expert to undertake a complex data analysis and providing the results to the staff.

Potamus Trading LLC et al., Exchange Act Rel. No. 89190, 2020 SEC LEXIS 2869 (June 30, 2020)

The Commission entered into a settlement with registered broker-dealer Potamus Trading LLC (Respondent) and its CEO, Eric Pritchett, based on allegations that Respondent misrepresented how it would handle and fill its customers' orders. While Respondent and Pritchett represented that the firm filled clients' orders from its own inventory or from a proprietary liquidity pool or a dark pool that it managed,

[140] Press Release, Securities and Exchange Commission, UBS to Pay $10 Million for Violating Rules Which Give Priority to Retail Investors in Municipal Offerings (July 20, 2020), https://www.sec.gov/news/press-release/2020-159.

Respondent filled the vast majority of its clients' orders through net trading. As a result, the Commission sanctioned Respondent and Pritchett for violating the anti-fraud provisions of the federal securities laws.

The Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order) underscores the Commission's priority in protecting investors from firms that misrepresent their size, sophistication, and trading methodologies. Here, the Commission observed that Respondent described itself as a high-speed algorithmic trading firm that acted as principal, either by trading from its own inventory or risking its own capital in the market. The Order found that prior to making such representations, Respondent had determined that it was unprofitable to handle and fill orders in this manner and, unbeknownst to clients, began utilizing net trading to profit from the order flow.

In the Respondent's case, the Commission pointed to marketing materials that stated that, in addition to trading from its own inventory, Respondent had access to a "proprietary liquidity pool" and was a "registered market maker" that provided access to a "unique pool of liquidity." The Commission alleged that, contrary to these representations, Respondent rarely filled orders from its own inventory and was neither the operator of a dark pool nor a market maker. Instead, and according to the Commission, when Respondent received client orders, it typically did not fill them until it searched for and obtained executions for its own account within, and often at the midpoint of, the National Best Bid and Offer. If Respondent successfully obtained an execution in its own account, it filled the client's order at the National Best Bid or the National Best Offer; if it did not, Respondent canceled the order.

The Commission found that Respondent's and Pritchett's actions and conduct violated Section 17(a)(2) and (3) of the Exchange Act. The settled Order censured Respondent and Pritchett, ordered both to cease-and-desist from future violations and imposed civil money penalties of $50,000 each. Additionally, the Commission suspended Pritchett from associating with a registered entity or person and participating in any offering of a penny stock for 12 months.

Pre-Release American Depository Receipts Borrowing

In the Matter of ABN AMRO Clearing Chicago LLC, **Exchange Act Rel. No. 88139, 2020 SEC LEXIS 2842 (Feb. 6, 2020)**

On February 6, 2020, the Commission accepted an Offer of Settlement from ABN AMRO Clearing Chicago LLC (Respondent), a broker-dealer, stemming from its practices in borrowing pre-released American Depository Receipts (ADRs) from other brokers. According to the Commission, from January 2013 to December 2015 Respondent's securities lending desk borrowed pre-released ADRs from brokers when it "should have known" that those brokers did not own the foreign shares needed to support those ADRs. This conduct allegedly violated Section 17(a)(3) of the Securities Act. The Commission further alleged that Respondent had no existing applicable supervisory procedures or policies or system of implementation that could potentially have prevented or detected the alleged Section 17(a)(3) violations by its personnel. The Commission also determined that Respondent failed to reasonably supervise its associated persons in accordance with Section 15(b)(4)(E) of the Exchange Act. The Commission censured Respondent and ordered disgorgement in the amount of $326,097 and a civil money penalty of $179,353. This is the Commission's 15th enforcement action against a broker-dealer or bank arising from ADR pre-release practices. To date, monetary penalties ordered in these cases exceed $432 million.

Recordkeeping

JonesTrading Institutional Services LLC, Exchange Act Rel. No. 89975, 2020 SEC LEXIS 4369 (Sept. 23, 2020)

The Commission entered into a settlement with JonesTrading Institutional Services LLC (Respondent), a registered broker-dealer, arising from allegations that it failed to preserve the firm's business-related text messages that were exchanged on the personal devices of several of the firm's registered representatives. Respondent maintained a policy that expressly prohibited its registered representatives from using text messaging or personal devices to conduct firm business. The Commission found that the policy was not enforced and was, in fact, ignored by senior management and compliance personnel who themselves used text messages to conduct business. The firm's Electronics Communication Policy required that (1) electronic communications be accessed and transmitted only through firm-sponsored systems and (2) business communications be retained pursuant to regulatory requirements. In the course of responding to a document request concerning an ongoing enforcement investigation involving a third party, Respondent produced documents that referenced text messages involving its personnel; however, it could not produce the underlying messages. These missing text messages discussed matters such as order size, trade timing, and product offerings. Despite annual attestations and trainings to monitor compliance with its policies, the Commission found that the widespread noncompliance with the Electronics Communications Policy was in violation of the recordkeeping provisions of Section 17(a) of the Exchange Act and Rule 17a-4 promulgated thereunder. The Respondent settled the matter agreeing to a censure, cease-and-desist order and a civil money penalty of $100,000.

The Commission placed particular emphasis on the fact that senior management was aware that employees were using text messages to communication, noting that "senior management, including compliance personnel, themselves sent and received business-related text messages with others" at the firm. However, the Commission also recognized the Respondent's subsequent remedial measures that included additional compliance training, emails to all employees reminding them of the obligation to record and retain communications along with the admonition that "employees are not permitted to communicate via text messaging either with colleagues or customers if the content of the message involves business related communications." In addition, for employees interested in using their personal devices for business purposes, Respondent offered to provide a firm-sponsored software solution that would preserve such text messages.

Regulation SHO

In re Celadon Financial Group LLC, Exchange Act Rel. No. 89404, 2020 SEC LEXIS 2883 (July 27, 2020)

The Commission accepted an Offer of Settlement from Celadon Financial Group LLC (Respondent), a registered broker-dealer, arising from the alleged violation of Rule 203(b)(1) of Regulation SHO, specifically the "locate requirement." In addition, the SEC alleged that Celadon violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder for failing to comply with the reporting, recordkeeping and record-retention requirements of the BSA and failing to file SARs as required under the SAR rule (31 C.F.R. § 1023(a)(2)). In the Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order), the Commission found that Celadon would receive from certain broker-dealers "not held" orders to sell low-priced microcap securities, which Celadon would execute in a series of principal short sales throughout the day. Celadon allegedly did not "locate" shares to cover its short sales prior to execution as required by Rule 203(b)(1) of Regulation SHO. Further, the Commission found that Celadon was engaged in facilitating high-volume liquidations of low-priced and often thinly traded OTC stocks and did not adequately implement its anti-money laundering policies and procedures so as to reasonably address the risks associated with this aspect of its business. Respondent's "implementation of its written AML Policies was deficient and, as a result, [Respondent] failed to file SARs or conduct a review of numerous transactions and patterns of activity that raised red flags under its AML Policies. These red flags concerned the issuers, price movements, and volume of the trades by [Respondent's] broker-dealer customers and the customers of the broker-dealers on whose behalf the trades were being made." Respondent was ordered to cease-and-desist from future violations, was censured, and was required to pay a civil money penalty of $125,000.

***In re Morgan Stanley & Co. LLC*, Exchange Act Rel. No. 90046, 2020 SEC LEXIS 4436 (Sept. 30, 2020)**

The Commission accepted an Offer of Settlement from Morgan Stanley & Co. LLC (Respondent), a registered broker-dealer, concerning alleged violations of Rule 200(g) of Regulation SHO, which requires a broker or dealer to mark sales of a security as "long" only if it is deemed to own the security being sold, among other requirements. The Commission alleged that the overall structure of Respondent's prime brokerage swaps business caused the violations of Regulation SHO, as the structure facilitated the hedging of synthetic exposure to swaps by purchasing or selling the securities referenced in the swaps, and it separated its hedges into two aggregation units—one holding only long positions and the other holding only short positions. However, the SEC's Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order) found that these two units "failed to qualify for a Reg SHO exception permitting broker-dealers to establish aggregation units because they were not independent and did not have separate trading strategies."[141] The Order further found "that the units had identical management structures, locations, and business purposes as well as the same strategy or objective." Thus, the Commission concluded that Respondent sold its hedges on the long swaps and marked them as "long" sales without concern for Regulation SHO's short-sale requirements. The Order sets forth a violation of Rule 200(g) of Regulation SHO. Morgan Stanley was ordered to cease-and-desist from future violations, was censured, and was required to pay a civil money penalty of $5 million. In addition, Respondent consented to an "above the line" undertaking wherein it agreed to operate its aggregation units as a single independent trading unit and aggregate positions in a security to determine its net position, and that it would complete the ongoing process of implementing all necessary system recoding, testing, and migration by no later than December 15, 2020.

Spoofing

***J.P. Morgan Securities LLC*, Exchange Act Rel. No. 90035, 2020 SEC LEXIS 4407 (Sept. 29, 2020)**

The Commission entered into a settlement with J.P. Morgan Securities LLC (Respondent) based on allegations that Respondent, the broker-dealer subsidiary of JP Morgan Chase & Co., engaged in a six-year "spoofing" scheme involving US Treasury (Treasury) cash securities. In parallel actions brought on the same day as the Commission's action against JPMS, the Department of Justice (DOJ) entered into a three-year deferred prosecution agreement with JP Morgan Chase & Co. and the Commodity Futures Trading Commission (CFTC) announced a settlement with JP Morgan Chase & Co. and certain affiliates for manipulative trading in Treasury futures, cash markets, and precious metals.

The Commission alleged that certain desk traders placed bona fide orders to buy or sell a particular Treasury security on one side of the market and simultaneously or nearly simultaneously placed non–bona fide orders (which the traders did not intend to execute) on the opposite side of the market to buy or sell for those same series of Treasury securities. According to the Commission, the non–bona fide trades created a false impression of buy or sell interest in order to raise or depress the prices of those securities, thus enabling the traders to obtain opposite-side executions on the bona fide trades at a more advantageous price.

[141] Press Release, Securities and Exchange Commission, Morgan Stanley Agrees to Pay $5 Million for Reg SHO Violations in Prime Brokerage Swaps Business (Sept. 30, 2020), https://www.sec.gov/news/press-release/2020-238.

Following the successful execution of the more favorably priced orders, the traders typically canceled the non–bona fide orders.

The Commission concluded that Respondent engaged in the manipulative "spoofing" conduct between at least February 2009 and January 2016, in violation of the firm's policies. Respondent was found to have willfully violated Section 17(a)(3) of the Exchange Act. The settled Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order) censured Respondent, ordered it to cease-and-desist from future violations, and ordered it to pay disgorgement of $10 million and a civil money penalty of $25 million. Consistent with the Commission's practice of seeking admissions where there are parallel criminal proceedings, Respondent also admitted facts set forth in the Order. According to the SEC's press release, the civil penalty would be offset by amounts paid to the DOJ and CFTC in the parallel actions.

Swaps

In re Tradenet Capital Markets Ltd. (d/b/a Tradenet), Exchange Act Rel. No. 90261, 2020 SEC LEXIS 4678 (Oct. 23, 2020)

The Commission accepted an Offer of Settlement from Tradenet Capital Markets Ltd. (d/b/a Tradenet), a private company based in Israel (Respondent). The Commission alleged that Respondent had violated Section 5(e) of the Securities Act, which makes it unlawful for any person to offer to sell, offer to buy, or purchase or sell a security-based swap from or to any person who is not an eligible contract participant without an effective registration statement, and Section 6(l) of the Exchange Act, which makes it unlawful for any person to effect transactions in security-based swaps with any person who is not an eligible contract participant unless the transaction is effected on a registered national securities exchange. The Commission specifically alleged that agreements through which Respondent provided "funded trading accounts" that were sold as part of "Day Trading Education Packages" were security-based swaps because they provided for the exchange of contingent payments based on the value of U.S. securities without conveying ownership in the underlying securities. As a result, the Commission found that Respondent violated Section 5(e) of the Securities Act and Section 6(l) of the Exchange Act. Respondent was ordered to cease-and-desist from future violations and required to pay a civil money penalty of $130,000. The Commission credited Respondent's remedial acts and cooperation with the Commission staff in determining to accept the Offer of Settlement.

Trading Costs and Disclosure

In re Robinhood Financial LLC, Exchange Act Rel. No. 90694, 2020 SEC LEXIS 5199 (Dec. 17, 2020)

The Commission entered into a settled action with Robinhood Financial, LLC (Respondent), a registered broker-dealer, arising from the alleged failure to disclose its receipt of payments from trading firms for the routing of customer orders and failing to seek "the best reasonably available terms to execute customer orders."[142] The SEC's Order Instituting Administrative Cease-And-Desist Proceedings in this action alleges that Respondent made misleading statements and omissions when communicating with customers about the manner in which it made money as well as the quality of its execution in comparison with competitors. The Commission asserted that claims of transactions being "commission free" were misleading because Respondent was receiving payment for order flow that resulted in customers' orders being executed "at prices that were inferior to other brokers' prices."[143] The SEC Order also alleged that in FAQs on its website and in certain communications with customers, Respondent omitted payment for order flow when

[142] Press Release, Securities and Exchange Commission, SEC Charges Robinhood Financial with Misleading Customers About Revenue Sources and Failing to Satisfy Duty of Best Execution (Dec. 17, 2020), https://www.sec.gov/news/press-release/2020-321.
[143] *Id.*

describing sources of revenue out of a concern that it might be viewed as controversial. The Commission further asserted that Respondent's claims that its execution quality meets or beats that of its competitors were not true.

The Commission found that Respondent willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act. In addition, the Commission also found that Respondent failed to maintain the required records setting forth modifications to its website FAQ pages, and the approvals of those modifications, relating to payment for order flow, in violation of Section 17(a) of the Exchange Act and Rule 17a-4 thereunder. Finally, the Commission alleged that that Respondent violated its common law duty to secure "best execution" for its clients.

Respondent agreed to a cease-and-desist order imposing a censure and requiring it to pay a $65 million civil penalty. Respondent also agreed to retain an independent consultant to review its policies and procedures relating to payment for order flow, customer communications, and best execution of customer orders and to ensure that it is following such procedures.

Cases Relating to Investment Advisers/Investment Companies and Their Employees/Affiliated Persons[144]

Allocation of Investments

***SEC. v. Donald J. Kellen*, Litig. Rel. No. 24808, 2020 SEC LEXIS 3945 (Apr. 28, 2020)**

The Commission filed a civil complaint in the US District Court for the Central District of California against Donald J. Kellen (Kellen), an investment adviser representative for approximately 40 clients of Laurel Wealth Advisors, Inc. (LWA). The Commission's complaint alleges that, from May 2012 through September 2015, Kellen engaged in a "cherry-picking" scheme, purchasing securities in an omnibus account but delaying the allocation of those securities to individual client accounts until after he had observed the securities' price movement during the rest of the trading day—according to the complaint, if the relevant security's price closed higher, Kellen generally allocated the trade to two nonretirement personal accounts in his name, and if the security's price went down over the course of the day, Kellen generally allocated the purchase to his clients' accounts, leaving those accounts with unrealized first-day losses. According to the complaint, in some instances, Kellen purchased and sold the securities on the same day, thus locking in a realized gain or loss, and then disproportionately allocated profitable trades to his own accounts and unprofitable trades to his clients' accounts. The complaint further alleges that after the compliance department of LWA's brokerage provider communicated concerns about Kellen's trading, Kellen signed a letter stating that he would not day-trade in securities held by his clients and would place his personal trades directly in his own accounts, rather than through the omnibus account. According to the complaint, even after signing this letter, Kellen continued to use the omnibus account for personal trading. According to the complaint, this alleged misuse of the omnibus account enabled Kellen to engage in riskless day-trading. As a result, the Commission alleges that Kellen violated the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder and Section 17(a)(1) and 17(a)(3) of the Securities Act of 1933. The Commission is seeking the disgorgement of funds received from the illegal conduct, together with prejudgment interest thereon, as well as civil penalties. As of the date of this publication, the matter remains pending.

Cash Sweep Vehicles and Other Fee-Related Issues

***In re Voya Financial Advisors, Inc.*, Advisers Act Rel. No. 5651, 2020 SEC LEXIS 5241 (Dec. 21, 2020)**

On December 21, 2020, the SEC filed settled charges against Voya Financial Advisors, Inc. (Respondent), a dually registered investment adviser and broker-dealer, arising from various alleged fee-related issues including compensation in connection with cash sweep accounts, mutual fund share class practices, and the sale of illiquid alternative investment products. With regard to cash sweeps, the SEC alleged that the unaffiliated clearing broker that Voya used for its client accounts paid Respondent a portion of the revenue that the clearing broker received from the cash sweep products selected for investment advisory clients by Respondent. However, the SEC asserted that Respondent did not disclose to its clients the revenue-sharing arrangement or the conflict of interest such arrangement created. As to the share class selection issues, the Commission alleged that Respondent received 12b-1 fees, and in some instances avoided paying

[144] Because of dual registration or multiple parties, a number of the cases previously discussed 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.

transaction fees, when it recommended certain mutual funds while other lower-cost share classes were available and not disclosed. The Commission further asserted that certain of Respondent's disclosures misstated the availability of lower-cost shares, the monitoring of such purchases and the rebate of fees (which Respondent did but not in all occasions). Finally, with regard to illiquid alternative investments, the SEC asserted that "[Respondent] caused certain advisory clients to pay higher fees, in the form of upfront commissions, when purchasing Illiquid Alt products when those same investments were available with commissions waived for advisory clients. [Respondent] did not disclose this practice or the related conflicts of interest."

The Commission found that Respondent violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, ordering Respondent to cease-and-desist from future violations, a censure, disgorgement of $11,547,820 plus prejudgment interest of $2,371,335, and a civil penalty of $9 million. Respondent also agreed to comply with certain undertakings, including that it retains an independent compliance consultant.

In re Pruco Securities, LLC, **Advisers Act Rel. No. 5657, 2020 SEC LEXIS 5274 (Dec. 23, 2020)**

On December 20, 2020, the SEC filed settled charges against Pruco Securities, LLC (Respondent), a dually registered investment adviser and broker-dealer, concerning various alleged fee-related issues including the suitability of wrap-fee programs, revenue sharing from both cash sweep vehicles and mutual funds, and the avoidance of transaction fees. With regard to the wrap-fee programs, the Commission alleged that Respondent breached its fiduciary duty by failing to conduct promised monitoring of accounts to determine whether wrap-fee accounts remained suitable for clients. While Respondent ultimately addressed this issue in 2017, the Commission found that from January 2014 through September 2017 the firm received an additional $1.7 million in fees. As to mutual fund share class selection, the Commission alleged that Respondent received undisclosed 12b-1 fees totaling over $7.1 million. Further, the Commission asserted states that a clearing firm used by Respondent shared over $4.3 million in revenue with Respondent that the clearing firm received from mutual funds in return for the clearing firm offering the mutual funds' programs. This was accomplished in part through a "no transaction fee program" where the revenue sharing was used by the clearing firm to offset Respondent's transaction fees, creating what the SEC alleged was a conflict of interest. The SEC also alleged that when Respondent caused investment advisory clients to invest in mutual funds with higher expenses than other share classes of the same fund that were available to the clients, Respondent violated its fiduciary duty to seek best execution for those transactions.

With regard to bank sweep vehicles, the SEC alleged that Respondent received revenue-sharing payments from its clearing firm, and those payments "created a conflict of interest because Respondent had an incentive to recommend that clients hold uninvested cash in the Bank Sweep Program versus other cash sweep vehicles that did not provide for revenue sharing payments." After the Commission's investigation began, Respondent reimbursed affected customers for some of the conduct ultimately identified in the Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order).

The Commission found that Respondent violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. Respondent consented to a cease-and-desist order and a censure, and agreed to pay disgorgement of $12,690,585, prejudgment interest of $3,061,786 and a civil penalty of $2,500,000. In addition, Respondent agreed to an above-the-line undertaking to, among other things, correct all relevant disclosures and, within 30 days of the Order, evaluate the firm's policies and procedures regarding share class selection and transaction fees in wrap accounts.

Conflicts of Interest

SEC v. Criterion Wealth Management Insurance Services, Inc., et al., Litig. Rel. No. 24738, 2020 SEC LEXIS 3836 (Feb. 13, 2020)

The Commission filed a civil complaint in the United States District Court for the Central District of California against Criterion Wealth Management Insurance Services, Inc. (Criterion), a former SEC-registered investment adviser, and its then co-owners, Robert Allen Gravette (Gravette) and Mark Andrew MacArthur (MacArthur, and together with Criterion and Gravette, the Defendants), charging the Defendants with breaching their fiduciary duty and defrauding their advisory clients by failing to disclose their significant financial conflicts of interest when recommending investments in private real estate investment funds. The complaint alleges that from 2014 to 2017 the Defendants recommended that their advisory clients invest more than $16 million in four private real estate investment funds whose managers had paid the Defendants more than $1 million in nonadvisory compensation, which compensation was on top of the fees that the Defendants were already charging their clients directly. The complaint notes that because this additional side compensation was recurring, and was in exchange for and depended on the Defendants' clients remaining invested in the funds, the Defendants not only had a financial incentive to recommend that their clients invest in the first instance, but were also incentivized to keep their clients in the funds going forward, rather than allocating their capital elsewhere. In addition, the compensation arrangements caused the manager of certain of the funds to reduce the profit participation that the Defendants' clients would have otherwise received, and resulted in the Defendants' clients being placed in a separate share class or feeder fund that paid such clients lower returns than the returns paid to all other investors in the same funds. The complaint alleges that the Defendants knew the impact of the arrangements on their clients' investment returns. The complaint alleges that despite the conflicts of interest created by the compensation arrangements, the Defendants allegedly failed to disclose the existence, extent, nature, or details of the compensation arrangements to their clients, in Criterion's Form ADV filings with the Commission or otherwise. Further, the complaint alleges that these undisclosed compensation arrangements rendered Criterion's Form ADV filings with the Commission materially misleading, and no policies and procedures had been adopted and/or implemented at Criterion to prevent these compliance failures. As a result of such conduct, the Commission alleges that (i) the Defendants violated the antifraud provisions of Section 206(1) and 206(2) of the Advisers Act; (ii) Criterion and Gravette violated Section 207 of the Advisers Act; (iii) Criterion violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder; (iv) Gravette and MacArthur aided and abetted Criterion's violations of Section 206(1) and 206(2) of the Advisers Act; and (v) Gravette aided and abetted Criterion's violation of Section 207 of the Advisers Act. The complaint seeks permanent injunctions from future violations of the federal securities laws, disgorgement and prejudgment interest, and civil penalties from all defendants.

In re Morgan Stanley Smith Barney LLC, Exchange Act Rel. No. 88856, Investment Advisers Act Rel. No. 5499 [NEED LEXIS CITE] (May 12, 2020)

The Commission accepted an Offer of Settlement from Morgan Stanley Smith Barney LLC (Respondent), a dually registered investment adviser and broker-dealer, related to its disclosures and policies and procedures regarding the "trade-away" or "step-out" practices of third-party managers in Respondent's wrap-fee programs. The Commission alleged that Respondent permitted managers to trade away from Respondent to seek best execution for trades and was aware that many managers traded away large program trades and only executed their small maintenance trades with Respondent. The Commission further alleged that as a result of this conduct, wrap-fee clients incurred transaction-based execution costs, in addition to the wrap fee, for trades placed through some third-party broker-dealers. Because these execution costs were not disclosed to clients, the SEC found that Respondent provided materially misleading information regarding the trade execution services provided by Respondent and costs incurred by certain wrap-fee program clients. In addition, the Commission alleged that although Respondent prohibited the managers participating in its wrap-fee program from executing trades with affiliates to prevent clients from paying transaction-based compensation to another Morgan Stanley affiliate in addition to Respondent's wrap fee, Respondent did not adopt and implement written policies reasonably designed to monitor managers for compliance with these restrictions. As a result, some managers circumvented these restrictions without detection by Respondent, causing certain clients to pay a Morgan Stanley affiliate for order execution in addition to the wrap fee paid to Respondent. Among other remedial acts undertaken by Respondent, the Commission considered that Respondent enhanced its account statements and trade confirmations to (i) reflect when a trade is a "step-out trade"; (ii) include language that explains to clients that when a trade is marked as a "step-out trade," the client may have been assessed trading-related costs by another broker-dealer, which are in addition to the wrap fee; and (iii) direct clients to Respondent's Annual Investment Strategy Step-Out Disclosure to obtain additional information. The Commission found that, as a result of this conduct, Respondent willfully violated Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. The Commission censured Respondent and ordered Respondent to cease-and-desist from committing or causing any violations and future violations of Section 206(2) and 206(4) and Rule 206(4)-7 thereunder, and to pay a civil money penalty of $5 million.

Conflicts of Interest – Payment for Order Flow

In the Matter of WBI Investments, Inc. and Millington Securities, Inc., **Exchange Act Rel. No. 89481, Investment Advisers Act Rel. No. 5557, 2020 SEC LEXIS 2753 (Aug. 5, 2020)**

The Commission accepted an Offer of Settlement from two affiliated investment advisers, WBI Investments, Inc. (WBI) and Millington Securities, Inc. (Millington) arising out of alleged materially misleading statements made to clients and fund boards regarding payments received from executing brokers. WBI is the investment adviser for certain funds and client accounts. Millington acts as introducing broker on trade orders for these funds and client accounts. The Commission alleged that, for a period of more than two years, Millington received payments from executing brokers for order flow. As part of the order flow payment arrangements with executing brokers, the executing brokers routinely incorporated the value of the payments made to Millington into final trade execution prices received by clients. Although WBI and Millington disclosed the order flow payment arrangements to clients and fund boards, they allegedly did not disclose that the payments impacted the execution prices that clients ultimately received, and instead represented that the arrangements did not affect execution prices, making the disclosures inaccurate or incomplete in violation of Section 206(2) of the Advisers Act. WBI and Millington also allegedly failed to adopt and implement policies and procedures to ensure that information about brokerage practices conveyed to clients was accurate and complete. The Commission found that WBI's and Millington's conduct violated Section 206(2) of the Advisers Act. WBI and Millington were censured, required to cease-and-desist from future violations, and required to pay civil monetary penalties totaling $1,000,000.

Disclosure of Risk

In re Catalyst Capital Advisors, LLC and Jerry Szilagyi, **Investment Advisers Act Rel. No. 5436, 2020 SEC LEXIS 3160 (Jan. 27, 2020)**

The Commission accepted an offer of settlement from Catalyst Capital Advisors, LLC, a registered investment adviser (Respondent), and its principal owner, President and Chief Executive Officer, John Jerry Szilagyi (Executive), in connection with allegations that Respondent failed to implement disclosed risk-management procedures with respect to the investment program of a registered mutual fund managed by

Respondent (Fund), and Executive failed to cause Respondent to implement the disclosed risk-management procedures. Contemporaneously with the settlement with Respondent and Executive, the Commission filed a complaint in federal court against the senior portfolio manager for the Fund (Portfolio Manager) that alleged violations of law based on substantially the same facts as those set forth in the settled proceeding.

The Commission's allegations follow substantial investment losses in the Fund during the period December 2016 through February 2017, which the Commission contended derive from the absence of risk-management controls and stop-loss measures in Registrant's investment program, notwithstanding disclosures in the Fund's prospectus regarding such risk-management controls and stop-loss measures. The Commission alleged that Respondent and Portfolio Manager made material misstatements in investor-facing marketing documents and in telephone calls with investment advisers that it utilized stop-loss measures and triggers to exit positions that would limit the Fund's losses when, in fact, Respondent had no stop-loss measures that operated to cap or otherwise limit losses. The Commission also alleged that Respondent represented to investors that it had "strict" procedures governing risk in the investment process and mandating corrective measures when, in fact, Portfolio Manager often declined to abide by or follow those procedures, and corrective measures were not taken even when triggered. The Commission alleged that Executive had responsibility for supervising Portfolio Manager and that Executive had reason to know that Portfolio Manager was not managing the Fund's risk levels as represented to investors. Further, the Commission alleged that, upon learning of excessive risks in the Fund, Executive did not take steps to ensure that Portfolio Manager took steps to reduce risks in the Fund.

As a result of the conduct, the Commission found that Respondent willfully violated Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8, thereunder. Further, the Commission found that Executive failed to reasonably supervise the Portfolio Manager within the meaning of Section 203(e)(6) and therefore caused the Respondent's violation of Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. The Commission ordered an undertaking, censured Respondent and Executive and ordered them to cease-and-desist from committing or causing any violations and any future violations of Section 206(2) and 206(4) of the Advisers Act, as well as Rule 206(4)-8 thereunder. The Commission also ordered Respondent to pay disgorgement plus interest of approximately $8.9 million and a civil penalty of $1.3 million and ordered Executive to pay a civil penalty of $300,000, which amounts are to be distributed to harmed shareholders of the Fund by establishment of a "Fair Fund" to be administered by Respondent and Executive.

This matter affirms the obligations of investment advisers to implement investment processes, particularly risk-management processes, in a manner consistent with disclosures to clients and investors. It also illustrates that persons exercising supervisory responsibilities over those with day-to-day management responsibilities may be held liable when either they do not take appropriate steps to determine whether investment processes are being executed in a manner consistent with disclosures or, upon learning that such investment processes are not being so executed, they do not take appropriate steps to ensure that the processes are appropriately executed thereafter.

Exchange Traded Products

In re Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC, **Investment Advisers Act Rel. No. 5451, 2020 SEC LEXIS 2606 (Feb. 27, 2020)**

The Commission accepted an offer of settlement from Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC (Respondents), each a dually registered investment adviser and broker-dealer, in connection with Respondents' recommendations to certain retail clients that they buy and hold single-inverse ETFs. The Commission alleged that Respondents failed to adopt and implement adequate compliance policies and procedures addressing the suitability of single-inverse ETFs for their retail investor clients. Specifically, the Commission alleged that Respondents did not require training for their financial advisors and supervisors about single-inverse ETFs, did not adopt any other process to sufficiently educate financial advisors so they sufficiently understood the products to recommend to clients, and did not establish procedures for supervisors so they could review single-inverse ETF recommendations and monitor positions over time. The Commission further alleged that Respondents failed to adequately implement their existing compliance and procedures for financial advisors. For instance, the Commission alleged that Respondents failed to adequately implement their policy requiring that financial advisors consider clients' financial ability and willingness to absorb potentially significant losses, and alleged that Respondents failed to adequately implement their policy requiring financial advisors to closely monitor single-inverse ETF positions. As a result of this conduct, the Commission stated that Respondents' investment advisers and registered representatives made unsuitable recommendations to certain clients to buy single-inverse ETFs for months or years. The Commission also stated that Respondents were previously sanctioned by FINRA for similar conduct occurring prior to July 2009. As a result, the Commission found that Respondents violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, and failed to reasonably fulfill their supervisory responsibilities within the meaning of Section 203(e)(6) of the Advisers Act and Section 15(b)(4)(E) of the Exchange Act with a view to preventing its financial advisors' unsuitable recommendations in violation of Section 17(a)(3) of the Securities Act. The Commission censured Respondents and ordered them 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)-7 promulgated thereunder. The Commission also ordered Respondents to pay a civil penalty of $35,000,000, on a joint-and-several basis.

***In the Matter of Summit Financial Group, Inc.*, Investment Advisers Act Rel. No. 5626, 2020 SEC LEXIS 4877 (Nov. 13, 2020); *In the Matter of Securities America Advisors, Inc.*, Investment Advisers Act Rel. No. 5627, 2020 SEC LEXIS 4876 (Nov. 13, 2020); *In the Matter of American Portfolios Financial Services, Inc. and American Portfolios Advisers, Inc.*, Investment Advisers Act Rel. No. 5628, 2020 SEC LEXIS 4871 (Nov. 13, 2020); *In the Matter of Royal Alliance Associates, Inc.*, Investment Advisers Act Rel. No. 5629, 2020 SEC LEXIS 4873 (Nov. 13, 2020); and *In the Matter of Benjamin F. Edwards & Company, Inc.*, Investment Advisers Act Rel. No. 5630, 2020 SEC LEXIS 4872 (Nov. 13, 2020)**

In five unrelated actions, the Commission accepted offers of settlement from Summit Financial Group, Inc. (Summit Financial) and Securities America Advisors, Inc. (Securities America), each a registered investment adviser; Royal Alliance Associates, Inc. (Royal Alliance) and Benjamin F. Edwards & Company, Inc. (Benjamin Edwards), each a dually registered broker-dealer and investment adviser; and affiliates American Portfolios Advisers, Inc. (APA) and American Portfolios Financial Services, Inc. (together with APA, American Portfolios), a registered investment adviser and a registered broker-dealer, respectively. The actions were the first to arise out of the Division of Enforcement's "Exchange-Traded Products Initiative." The actions alleged improper sales of volatility-linked exchange-traded products (ETPs), which attempted to track short-term volatility expectations in the market. The Commission alleged that, although the offering documents relating to the ETPs specified that the products were intended for short-term holding, were likely to experience a decline in value when held long-term and had correspondingly limited potential upside if held over a longer period, representatives of the five firms nevertheless recommended that certain clients buy and hold the products for extended periods (including, in some circumstances, for months and years) to hedge against downward market turns. The Commission further alleged that the firms did not have adequate policies and procedures to ensure that their registered representatives were properly trained on, or adequately understood, the nature of the complex products at issue to safeguard retail advisory clients against unsuitable recommendations. Accordingly, the Commission alleged that the firms violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder in failing to adopt or properly implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules. The Commission also found in its Orders Instituting Administrative Cease-And-Desist Proceedings against American Portfolios and Benjamin Edwards that each of the two firms failed to adequately supervise certain brokerage representatives who recommended that their customers buy and hold the products at issue and, accordingly, alleged that these firms violated Section 15(b)(4)(E) of the Exchange Act for failing to reasonably supervise their respective registered representatives with a view to preventing and detecting their violations of Section 17(a)(2) and 17(a)(3) of the Securities Act. Importantly, in the press release announcing the Orders Instituting Administrative Cease-And-Desist Proceedings in this action, the Commission emphasized its use of data analytics to identify potential unsuitable sales of complex financial products, and its intent to continue utilization of such tools to surveil the market and protect retail investors. In connection with the settlements, each firm was censured and required to cease-and-desist from committing further violations, and to pay disgorgement, prejudgment interest, and a civil monetary penalty. Each of Summit Financial and Securities America will pay approximately $600,000, Royal Alliance will pay approximately $500,000, Benjamin Edwards will pay approximately $685,000, and American Portfolios will pay approximately $650,000. The Commission considered each firm's cooperation and remedial acts in determining to accept the offers of settlement.

Fees and Expenses

***In re Monomoy Capital Management, L.P.*, Investment Advisers Act Rel. No. 5485, 2020 SEC LEXIS 1083 (Apr. 22, 2020)**

The Commission accepted an offer of settlement from Monomoy Capital Management, L.P. (Respondent), a registered investment adviser, in connection with fees it charged to the portfolio companies of a private fund (the Fund) it managed for the services of Respondent's in-house Operations Group without fully disclosing this practice and the related conflicts in the Fund's operating documents or otherwise. The Commission stated that Respondent's Operations Group provided portfolio companies of the Fund with operationally focused services related to making business improvements for portfolio companies' operations, and that Respondent had an established practice of billing the portfolio companies for Respondent's costs of providing the Operations Group services rather than covering the costs out of its management fee. The Commission alleged that, while Respondent described the benefits of its Operations Group to potential Fund investors and generally referenced the Operations Group in the Fund's private placement memorandum, Respondent did not fully and fairly disclose that it would separately charge the Fund's portfolio companies for the Operations Group costs. The Commission further alleged that Respondent failed to provide full and fair disclosure that it would have associated conflicts of interest and did not obtain informed consent with respect thereto. In particular, the Commission alleged that no independent representative of the Fund approved such conflicts and Respondent could not effectively consent on behalf of the Fund, and yet Respondent did not provide disclosure to the Fund's limited partners that was sufficiently specific that they could understand the conflicts of interest and have a basis on which they could consent to or reject this practice. As a result, the Commission found that Respondent violated Section 206(2) of the Advisers Act. The Commission censured Respondent and ordered Respondent to cease-and-desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act. The Commission also ordered Respondent to pay disgorgement of $1,521,972, prejudgment interest of $204,606, and a civil monetary penalty of $200,000, which amounts are to be distributed to harmed limited partners of the Fund by establishment of a "Fair Fund" to be administered by Respondent.

In the Matter of EDG Management Company, LLC, **Investment Advisers Act Rel. No. 5617 (Oct. 22, 2020)**

The Commission accepted an offer of settlement from EDG Management Company, LLC (Respondent), a private equity fund adviser, in connection with management fees charged by Respondent to EDG Partners Fund II, L.P. (Fund) following the write-downs of certain private equity fund investments. The Fund was formed pursuant to a limited partnership agreement under which certain limited partners contributed capital to the Fund for purposes of making investments. The limited partnership agreement contained provisions for calculating the management fees payable to Respondent from the Fund. Respondent was generally entitled to a quarterly management fee of 1.5% per annum of the total invested capital contributions, but this fee was subject to certain reductions, including a reduction due to any write-down of portfolio securities. The Commission alleged that from January 1, 2016 through October 1, 2019, certain of the Fund's portfolio securities were subject to write-downs under the terms of the Fund's limited partnership agreement, but that Respondent did not account for such write-downs in its management fee calculations, causing the Fund, and ultimately its limited partners, to overpay management fees in the amount of $901,760.91. The Commission found that, as a result of this conduct, Respondent willfully violated Section 206(2) of the Advisers Act and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which violations do not require proof of scienter. The Commission ordered Respondent to pay disgorgement of $901,760.91 and prejudgment interest of $124,881.11. No civil penalties were assessed. The Order Instituting Administrative Cease-And-Desist Proceedings in this action noted that the Commission also considered remedial actions promptly undertaken by Respondent and cooperation with the Commission staff.

Investment Company Act

In re Franklin Advisers, Inc. and Franklin Templeton Investments Corp., **Investment Advisers Act Rel. No. 5531, Investment Company Act Rel. No. 33919, 2020 SEC LEXIS 3572 (July 2, 2020)**

The Commission accepted an Offer of Settlement from Franklin Advisers, Inc., a registered investment adviser (FAV), and its affiliate Franklin Templeton Investments Corp., also a registered investment adviser (FTIC), for allegedly causing certain funds they managed to violate the anti-pyramiding protections in Section 12(d)(1)(A) of the Investment Company Act of 1940, as amended (1940 Act). FAV and FTIC agreed to pay $325,000 in civil penalties.

According to the Commission's Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order), from October 2013 to November 2015, both FAV and FTIC purchased certain ETFs on behalf of client funds, ultimately causing the funds to exceed the Section 12(d)(1)(A) limits. The Order notes that FAV attempted to rely on Section 12(d)(1)(F) of the 1940 Act to permit certain investment companies registered with the Commission advised by FAV (the FAV Funds) to hold shares of investment companies in excess of the Section 12(d)(1)(A)(iii) limit. However, FAV's aggregate purchases of certain ETFs caused the FAV Funds to exceed the firmwide 3% ownership limits of Section 12(d)(1)(F) for each ETF. The Order also notes that FTIC attempted to rely on exemptive relief granted to the issuers of the purchased ETFs for "certain registered open-end management investment companies" to acquire the ETFs' shares in excess of Section 12(d)(1) limits to permit certain investment companies formed under Canadian law not registered with the Commission (the FTIC Funds) to hold shares of the ETFs in excess of the Section 12(d)(1)(A) limits, but as unregistered investment companies, the Commission asserted that the FTIC Funds were ineligible to avail themselves of the exemptive relief.

The Order also states that FAV was responsible for implementing certain of the FAV Funds' policies and procedures designed to prevent such violations but did not do so. The Order alleges that when FAV discovered the violations and sold shares of certain ETFs to bring the FAV Funds into compliance with Section 12(d)(1)(A), the sale of the shares of one of the ETFs resulted in losses to certain of the FAV Funds. The Order further notes that FAV did not immediately reimburse these FAV Funds for those losses because the FAV Funds profited from the sales of the other ETFs, which offset the losses in the one ETF. The Commission alleged that in addition to the violations of Section 12(d)(1), the decision not to reimburse the FAV Funds contradicted FAV's trade-error policies and procedures, and created a conflict of interest because of FAV's financial incentive to avoid having to reimburse the FAV Funds for the losses. Moreover, the Commission determined that FAV failed to immediately disclose to the FAV Funds' boards the losses incurred by the FAV Funds, FAV's decision not to reimburse the losses, the associated conflict of interest, and the deviation from FAV's trade-error policy.

The Order highlights the importance of understanding the complexities of the requirements of Section 12(d)(1) and ensuring that policies and procedures are in place to monitor for compliance with these requirements. The Order additionally highlights the importance of an adviser complying with policies and procedures as written and keeping fund boards fully informed of any proposed deviations from such policies and procedures, particularly when the deviations create conflicts of interest for the adviser.

***In the Matter of Palmer Square Capital Management LLC*, Investment Advisers Act Rel. No. 5586, Investment Company Act Rel. No. 34017, 2020 SEC LEXIS 4274 (Sept. 21, 2020)**

The Commission accepted an Offer of Settlement from Palmer Square Capital Management LLC (Respondent), a registered investment adviser, without an admission or denial, to settle charges related to its execution of 351 buys and sells of the same security in the same amount between client accounts over a two-year period. From July 2014 through September 2016, Respondent allegedly, through an independent broker-dealer, executed prearranged cross-trades between its clients. Impacted clients included registered investment companies, private funds, collateralized loan obligation vehicles, and separately managed accounts, and in each case the purchasing entity paid a markup that was retained by the executing broker-dealer. Respondent did not execute the trades pursuant to an exemptive order from the cross-trading prohibitions of Section 17(a) of the Investment Company Act, and the trades did not meet the requirements of Rule 17a-7 under the Investment Company Act (which provides certain exemptions from the prohibitions of Section 17(a)), because of the markup charged, because the prices were not based on the average of the highest independent bid and lowest independent offer as required by Rule 17a-7, and because the transactions were not reviewed by the boards of the applicable registered investment companies. According to the Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order), Respondent incorrectly believed that it did not need to comply with the requirements of Rule 17a-7 if the cross-trades were executed through an independent broker-dealer. Additionally, of the 351 trades in question, 13 were allegedly principal transactions because controlling persons of Respondent owned more than 25% of a private fund involved in each trade. These 13 trades allegedly violated Section 206(3) of the Advisers Act because Respondent did not provide prior notice, nor obtain prior consent, from other advisory clients involved in the trades. According to the Commission, Respondent failed to maintain policies, procedures, or controls to adequately identify and monitor cross-trading activity or principal transactions. The Commission found that Respondent's conduct violated Section 206(3) and 206(4) of the Advisers Act and Section 17(a)(1) and 17(a)(2) of the Investment Company Act. The Commission censured Respondent and required it to cease-and-desist from future violations. Respondent was also required to pay a civil monetary penalty of $450,000. The Commission credited Respondent's prompt remedial actions and cooperation with the Staff in reaching this resolution.

Mutual Fund Share Class Selection and Disclosure

a. Final Share Class Selection Disclosure Initiative Settlements

On April 17, 2020, the Commission filed settled charges against three investment advisers, finding violations of Sections 206(2) of the Advisers Act, and for one of the advisors, violations of Sections 206(4) and 207 of the Advisers Act. Disgorgement in the three cases ranged from just more than $89,000 to almost $370,000 (plus prejudgment interest). The Commission also imposed a penalty of $10,000 on one of the advisors, but chose not to impose penalties on the other two. The press release announcing the cases stated that they were "the final cases the Division intends to recommend under the terms of the [Share Class Selection Disclosure Initiative (the "Initiative")]."[145]

Under the Initiative, Enforcement offered to recommend favorable settlement terms for advisers who self-reported a failure to disclose in the adviser's applicable Forms ADV the conflict of interest stemming from the receipt of 12b-1 fees from mutual funds for investing advisory clients in a 12b-1 fee-paying share class in instances in which a lower-cost share class was available for the same fund from January 1, 2014 forward. Specifically Enforcement stated that it would recommend "that the Commission accept a settlement pursuant to which the firm consents to the institution of an administrative and cease-and-desist proceeding under Sections 203(e) and 203(k) of the Advisers Act for violations of Sections 206(2) and 207 of the Advisers Act based on the adviser's failure to disclose the conflict of interest."[146]

The Initiative followed several 2018 settlements with investment advisers alleging similar violations. Each investment adviser consented to the entry of a cease-and-desist order, a censure, disgorgement of certain fees (plus prejudgment interest), and an undertaking to review and correct all relevant disclosure documents, and to evaluate whether to move existing clients to a lower-cost share class. In total, the Initiative resulted in 97 settlements that involved almost $140 million in disgorgement to investors. None of the settlements involved a civil monetary penalty.

b. Settlements Outside of the Share Class Selection Disclosure Initiative

***In re BPU Investment Management, Inc.*, Investment Advisers Act Rel. No. 5444, 2020 SEC LEXIS 3483 (Feb. 13, 2020; *In re Oxbow Advisors, LLC*, Investment Advisers Act Rel. No. 5512 2020 SEC LEXIS 2668 (May 29, 2020); *In re BNB Wealth Management, LLC,* Investment Advisers Act Rel. No. 5535, 2020 SEC LEXIS 2778 (July 9, 2020); *In re VALIC Financial Advisors, Inc*., Investment Advisers Act Rel. No. 5551 2020 SEC LEXIS 3356 (July 28, 2020); *NPB Financial Group*, Investment Advisers Act Rel. No. 5562, 2020 SEC LEXIS 3735 (Aug. 20, 2020); *In re Signature Financial Services, Ltd*., Investment Advisers Act Rel. No. 5571, 2020 SEC LEXIS 4079 (Sept. 3, 2020); *Graham, Bordelon, Golson & Gilbert, Inc*., Investment Advisers Act Rel. No. 5576, 2020 SEC LEXIS 4144 (Sept. 10, 2020); *Coordinated Capital Securities, Inc*., Investment Advisers Act Rel. No. 5581 2020 SEC LEXIS 4238 (Sept 17, 2020); *Creative Financial Designs, Inc*., Investment Advisers Act Rel. No. 5596, 2020 SEC LEXIS 4371 (Sept. 25, 2020); *Capitol Securities Management, Inc.*, Investment Advisers Act Rel. No. 5625, 2020 SEC LEXIS 4787 (Nov. 5, 2020); *In re BancWest Investment Services, Inc.*, Investment Advisers Act Rel. No. 5640, 2020 SEC LEXIS 5075 (Dec. 7, 2020)**

When announcing the SCSD Initiative in February 2018, Enforcement cautioned that "for advisers that would have been eligible for the terms of the SCSD Initiative but did not participate, the Division expects

---

145 Press Release, Securities and Exchange Commission, SEC Orders Three Self-Reporting Advisory Firms to Reimburse Investors (April 17, 2020) https://www.sec.gov/news/press-release/2020-90
146Announcement, Securities and Exchange Commission Division of Enforcement, Share Class Selection Disclosure Initiative (Feb. 19, 2019) https://www.sec.gov/enforce/announcement/scsd-initiative

in any proposed enforcement action to recommend additional charges, if appropriate, and the imposition of penalties."[147] In 2020, Enforcement followed through on this statement and filed 10 cases against investment advisers and dually registered investment advisers and broker-dealers. In each of these cases the SEC alleged that the respondent, "although eligible to do so, did not self-report to the Commission pursuant to the Division of Enforcement's Share Class Selection Disclosure Initiative."

Unlike firms that participated in the Initiative, these non-self-reporting firms were charged with the failure to adopt and implement written policies and procedures reasonably designed to prevent violations related to disclosures of conflicts of interest and/or making recommendations of share classes that were in the best interest of their clients. Further, in all but one case, the Commission found that the firms violated best execution obligations by allegedly causing certain advisory clients to invest in fund share classes that charged Rule 12b-1 fees when more favorable share classes of the same funds were available to the clients. For each of the firms, the Commission found violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. In determining to accept the settlement offers for several of the firms, the Commission considered the remedial actions undertaken by the firms, as well as cooperation afforded to the Commission staff. The firms agreed to various undertakings, and the Commission censured these firms, and ordered them to cease-and-desist from committing or causing further violations.

As reflected in the chart below, these 10 firms paid civil penalties that averaged approximately 35-45% of the disgorgement amount when adjusting for outliers. It also appears that there was a slight benefit for undertaking remedial acts, although not uniform across all settlements.

Disgorgement (D)	Interest	Civil Penalty (CP)	Remedial Acts Recognized	Ratio of CP to D
$582,178	$109,929	$235,000	Yes	40%
$200,000	$31,958	$90,000	No	45%
$252,460	$24,120	$80,000	No	32%
$544,446	$22,746	$200,000	No	37%
$111,655	$14,744	$50,000	Yes	45%
$532,519	$92,668	$425,000	No	80%
$252,460	$24,120	$80,000	Yes	37%
$473,202	$38,759	$70,000*	Yes	15%
$569,516	$108,424	$212,300	Yes	37%
$286,459	$44,982	$75,000	Yes	26%

*penalty reduced due to financial condition

[147] *Id.*

c. Select Cases

In re J.P. Morgan Securities LLC, **Investment Advisers Act Rel. 5429, LEXIS (Jan. 9, 2020);** *In re RBC Capital Markets LLC*, **Investment Advisers Act Rel. 5487, 2020 SEC LEXIS 1100 (Apr. 24, 2020);**

In 2020 the Commission continued to focus on the selection of mutual funds. The J.P. Morgan Securities LLC (J.P. Morgan) settled action involved the alleged failure to provide certain retail retirement account and charitable organization brokerage customers with sales charge waivers and lower fee share classes in connection with the sale of mutual funds. In the RBC Capital Markets LLC (RBC) settled matter, the SEC alleged that RBC disadvantaged certain retirement plan and charitable organization brokerage customers by "failing to ascertain that they were eligible for a less expensive share class, and recommending and selling them more expensive share classes in certain open-end registered investment companies (mutual funds) when less expensive share classes were available." In addition, the Commission asserted that RBC failed to disclose that it would receive higher compensation for sale of the more expensive share classes. In both actions the relevant period stretched well beyond the five-year statute of limitations—J.P. Morgan 2010 through 2015 and RBC 2012 through 2017.

In both actions, the Commission found that the firms "did not have adequate systems and controls in place" to determine whether retirement plans and charitable account customers were eligible to purchase load-waived mutual fund shares. The firms were charged with violating Sections 17(a)(2) and 17(a)(3) of the Securities Act. The JP Morgan Order Instituting Administrative Cease-And-Desist Proceedings recognized the firm's prompt remedial acts, including the reimbursement of more than $7 million related to transactions within the applicable statutory limitations period and more than $8.7 million before that period. JP Morgan agreed to pay $251,083 in disgorgement, reflecting an amount that the firm was unable to return to clients, prejudgment interest of $71,355 and civil penalties of $1.5 million. The RBC Order Instituting Administrative Cease-And-Desist Proceedings also recognized the firm's remedial efforts. RBC agreed to pay disgorgement of $2,607,676, $631,331 in prejudgment interest and a $650,000 civil penalty. Finally, the respective Orders censured the firms and required that the firms cease-and-desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

SCF Investment Advisors, Inc., **Investment Advisers Act Rel. No. 5560, 2020 SEC LEXIS 3665 (Aug. 13, 2020)**

In this settled action, the Commission found that SCF Investment Advisors, Inc., an SEC-registered investment adviser (Respondent), breached its fiduciary duties in connection with its selection of mutual funds and cash-sweep vehicles for clients that provided undisclosed revenue to SCF's affiliated broker-dealer, SCF Securities, Inc. (SCF Securities), and were more expensive than other available options for the same funds. In particular, the Commission alleged that Respondent's representatives advised its clients to purchase or hold Class A mutual fund shares that resulted in SCF Securities receiving 12b-1 fees that it would not have collected had Respondent's clients been invested in available lower-cost share classes. The Commission further alleged that Respondent selected as the default cash-sweep vehicle for its clients the share class of a money market fund that would pay the highest revenue-sharing amounts to SCF Securities, including greater amounts as client assets invested in the share class increased. The Commission alleged that, despite Respondent's obligation to disclose all material facts to its clients, including any conflicts of interest that could affect the advice Respondent provided its clients, Respondent failed to provide full and fair disclosure that was sufficiently specific so that its clients could understand the conflicts of interest concerning Respondent's advice about investing in different classes of mutual funds and cash-sweep vehicles. The Commission further alleged that, after updating its Form ADV to provide disclosure regarding these practices and conflicts, Respondent did not timely notify existing clients or identify the updated disclosure as a material change. The Commission found that Respondent's practices constituted a violation of its obligation to seek best execution for client transactions.

The Commission found that as a result of its conduct, Respondent willfully violated Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. In addition to agreeing to undertakings relating to improving disclosures, evaluating whether to move clients to more economically beneficial share classes, implementing reasonable policies and procedures aimed at addressing the deficiencies, and notifying clients of the settlement terms, Respondent also agreed to cease-and-desist from further violations, a censure, disgorgement of $544,446.34, a civil monetary penalty of $200,000, and administration of a Fair Fund.

Policies and Procedures – Rule 144A of the Securities Act

In the Matter of First Western Capital Management Company, **Investment Advisers Act Rel. No. 5543, 2020 SEC LEXIS 3241 (July 16, 2020)**

The Commission accepted an Offer of Settlement from Western Capital Management Company (Respondent)relating to charges that \ Respondent failed to adopt and implement written policies and procedures governing transactions in securities purchased and sold in reliance on Rule 144A under the Securities Act of 1933 (the 1933 Act), which provides a nonexclusive safe harbor from the registration requirements of Section 5 of the 1933 Act, and failed to reasonably supervise its investment adviser representatives (IARs) in connection with such transactions. Respondent is a registered investment adviser providing investment advisory services to clients that include individuals, charitable organizations, pension plans, and corporations. Respondent allegedly, over the course of six-plus years, purchased securities being sold in reliance on Rule 144A on behalf of advisory clients that were not "qualified institutional buyers" (QIBs) as defined in and required by Rule 144A. As noted by the Commission, Rule 144A allows an exception from the registration requirements of Section 5 of the Securities Act for resales of restricted securities to certain entities deemed by the Rule to have sufficient sophistication and experience in the private resale market for restricted securities so as to not require the protections of registration under the 1933 Act. Respondent allegedly purchased restricted shares sold in reliance on Rule 144A for 81 client accounts that were not QIBs. According to the Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order), Respondent failed to adopt and implement written policies and procedures surrounding transacting in Rule 144A securities, failed to have in place supervisory policies and procedures specifically addressing Rule 144A securities, did not require any training for its IARs about Rule 144A securities, and did not adopt any other process to educate the IARs about transactions in Rule 144A securities. The Commission found that Respondent's conduct violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. The Commission censured Respondent and required it to cease-and-desist from future violations. Respondent was also required to pay a civil monetary penalty of $200,000.

Policies and Procedures – Excessive Trading

In re Gilder Gagnon Howe & Co. LLC and Bonnie M. Haupt, **Investment Advisers Act Rel. No. 5582, 2020 SEC LEXIS 4234 (Sept. 17, 2020)**

In this settled action, the Commission alleged that Gilder Gagnon Howe & Co. LLC (GGHC), a registered investment adviser and broker-dealer, and its CCO, Bonnie Haupt (Haupt, and collectively with GGHC, Respondents), failed to review GGHC's discretionary retail client accounts for excessive trading or the impact of GGHC's trading strategies or commission charges on the accounts. GGHC managed its client accounts pursuant to an active trading strategy, often using margin, and charged a majority of its accounts commissions on a per-trade basis (it charged an annualized asset-based fee to its other accounts). In 2017, FINRA exam staff found that GGHC had failed to evidence that it was actively monitoring cost-to-equity ratios and turnover rates in its client accounts, so GGHC amended its policies and procedures to require Haupt to (i) review monthly cost-to-equity ratios and turnover rates by utilizing a turnover report, (ii) document the monthly reviews, and (iii) escalate accounts with a cost-to-equity ratio above 6% to GGHC's managing members. Despite these newly adopted supervisory procedures, the Commission alleged that Respondents did not conduct these monthly reviews and that the turnover reports did not contain cost-to-equity ratios. These alleged failures were aggravated by GGHC, through Haupt, repeatedly producing to SEC examination and enforcement staff turnover reports that Haupt had altered to give the misleading appearance that she had timely reviewed them.

As a result of the conduct described above, the Commission found that GGHC willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder and Haupt willfully aided and abetted GGHC's violations. The Commission censured Respondents and ordered them to cease-and-desist from committing (GGHC) or causing (Haupt) any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. GGHC and Haupt were ordered to pay civil penalties of $1,700,000 and $45,000, respectively, and Haupt was barred from the industry.

Policies and Procedures – Use of Material, Nonpublic Information

In re Cannell Capital, LLC, **Investment Advisers Act Rel. No. 5441, 2020 SEC LEXIS 3616 (Feb. 4, 2020)**

The Commission accepted an offer of settlement from Cannell Capital, LLC (Respondent), a registered investment adviser primarily to high-net-worth individuals and pooled investment vehicles. The Commission alleged that between 2014 and 2019 Respondent failed to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of its business, to prevent the misuse of material nonpublic information (MNPI). The Commission found that, contrary to its MNPI policy, Respondent failed to maintain a reasonably designed restricted list, instead inconsistently and ineffectively relying on a combination of restrictions within an electronic order management system, documents saved to a compliance share drive, emails, and/or verbal conversations to communicate restrictions on trading to its covered persons. The Commission further alleged that, although Respondent updated its MNPI policy in response to a 2017 deficiency letter from the SEC's Office of Compliance Inspections and Examinations to require the circulation of an updated restricted list any time a change is made to such list or every seven calendar days, whichever occurs first, Respondent subsequently failed to appropriately implement this new policy because, although an updated list was circulated every Monday, an updated list was not circulated when changes were made to it. The Commission also alleged that Respondent's business model of trading in thinly traded securities with minimal analyst coverage put its covered persons at heightened risk of coming into possession of MNPI, and the Respondent's MNPI policy failed to address such business-specific risk factors or establish any specific procedures for handling common sources of MNPI, such as executing nondisclosure agreements or drafting and publishing articles about issuers. In addition, the Commission alleged that Respondent's MNPI policy also failed to include any written guidelines regarding the parameters that could be used to determine whether information constitutes MNPI to minimize the significant risks posed by the Respondent being owned, controlled, and managed by a single person. The Commission therefore found that Respondent willfully violated Section 204A of the Advisers Act. The Commission censured Respondent and ordered it to cease-and-desist from committing or causing any violations and any future violations of Section 204A. The Commission also ordered Respondent to pay a civil penalty of $150,000.

In the Matter of Ares Management LLC, **Investment Advisers Act Rel. No. 5510, 2020 SEC LEXIS 1432 (May 26, 2020)**

The Commission accepted an Offer of Settlement from Ares Management LLC (Respondent), a registered investment adviser. The Commission alleged that in 2016 Respondent invested several hundred million dollars of client funds in a public company (the Company) through a mixed loan and equity investment, the equity portion of which allowed Respondent to appoint two directors to the Company's board (the Board). As one of its two representatives on the Board, Respondent appointed a senior employee who continued to participate in trading decisions about the Company. The Commission alleged that, from time to time during Respondent's investment in the Company, Respondent's appointed director, along with others at Respondent, received potentially MNPI concerning, among other things, potential changes in senior management, adjustment to the Company's hedging strategy, and decisions regarding the Company's assets, debt, and interest payments. While Respondent's representative sat on the Board, and after it had received such information, Respondent purchased more than 1 million shares of the Company's publicly traded stock (equaling 17% of the Company's available shares). The Commission did not allege that Respondent engaged in trading on inside information, but rather that Respondent failed to implement and enforce policies and procedures reasonably designed to prevent the misuse of MNPI taking into consideration the heightened risk presented by its employee's dual role as a director of the Company and an employee who participated in trading decisions concerning the Company's stock. Respondent had in place certain written policies and procedures relevant to the treatment of MNPI, and included safeguards like requiring a stock in its portfolio to be placed on a restricted list and that any trading of such stock must be preapproved by Respondent's compliance staff if there is a Respondent employee sitting on the board of the subject company. However, the Commission alleged that the specific manner in which these policies were to be implemented was left to the discretion of Respondent's compliance staff. As a result, the Commission alleged that Respondent did not adequately or routinely comply with certain of the policies and procedures. For instance, Respondent did not routinely establish information walls with respect to publicly listed companies on whose boards it had an employee-representative. In addition, the Commission alleged that Respondent's policies and procedures did not provide specific requirements for compliance staff concerning the identification of relevant parties with whom to inquire regarding possession of potential MNPI and the manner and degree to which Respondent's compliance staff should explore MNPI issues with these parties. As a result, the Commission alleged that Respondent's compliance team failed to sufficiently document their inquiries with Respondent's employee on the Board or the members of the deal team as to whether they had obtained potential MNPI, and failed to apply a consistent practice to the inquiries made. Accordingly, the Commission found that Respondent willfully violated the compliance policies and procedures requirements of Sections 204A and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. In connection with the settlement, Respondent was censured and required to cease-and-desist from committing further violations, and to pay a civil monetary penalty in the amount of $1 million. The Commission considered Respondent's cooperation and remedial acts in determining to accept the Offer of Settlement.

Referral Arrangements

In re VALIC Financial Advisors, Inc., **Investment Advisers Act Rel. No. 5550, 2020 SEC LEXIS 3602 (July 28, 2020)**

On July 28, 2020, the Commission accepted an Offer of Settlement from VALIC Financial Advisors, Inc. (VFA), a dually registered investment adviser and broker-dealer, in connection with VFA's alleged fraudulent conduct and violations of the cash solicitation rule that were intended to increase its opportunities to sell annuities, mutual funds, and services to Florida public school K-12 teachers and other public education employees (K-12 Teachers) through school districts' 403(b) and 457(b) retirement plans. The Commission found that, from 2006 to 2019, VFA's parent, The Variable Annuity Life Insurance Company, doing business under the AIG Retirement Services, Inc. brand (VALIC), which issues fixed and variable annuity contracts, entered into agreements with a company owned by K-12 Teachers' unions (Teachers Union Entity) under which VALIC would pay the Teachers Union Entity $10,000 monthly in exchange for the Teachers Union Entity exclusively endorsing VFA as its preferred financial services partner and actively promoting VFA's financial planning services to K-12 Teachers. VALIC also provided three of its full-time, paid employees to the Teachers Union Entity (Member Benefit Coordinators, or MBCs) to work on behalf of the Teachers Union Entity and refer K-12 Teachers to VFA. These MBCs held themselves out as employees of the Teachers Union Entity. VFA's management also approved Teachers Union Entity brochures that promoted VFA's complimentary financial planning program, which was intended to result in the sale by VFA of its proprietary products and services.

The Commission found that the agreement between VALIC and the Teachers Union Entity did not include a requirement that VALIC, VFA, or the Teachers Union Entity disclose to the K-12 Teachers VALIC's payments to the Teachers Union Entity or that the MBCs were paid employees of VALIC. In addition, the Commission found that neither VFA, the MBCs, nor the Teachers Union Entity brochures disclosed to the K-12 Teachers that the MBCs were VALIC employees or that VALIC was paying the Teachers Union Entity and the MBCs to promote VFA and its financial planning services and products and refer potential clients to VFA. VFA also did not have any policy requiring disclosure of the economic relationship between VALIC and the Teachers Union Entity.

The Commission found that VFA willfully violated Section 206(2) and 206(4) of the Advisers Act and Rules 206(4)-3 and 206(4)-7 thereunder and ordered VFA to cease-and-desist from any further violations of those requirements. In addition, the Commission censured VFA and ordered VFA to pay a civil money penalty of $20,000,000. VFA also agreed to cap its management fee for one of the relevant products to the most favorable terms it offered in Florida for those K-12 Teachers who already owned the product or who might purchase VFA's fixed or variable annuities within five years of entry of the Order Instituting Administrative Cease-And-Desist Proceedings in this action.

Self-Reporting - Expenses

In re Transamerica Asset Management, Inc., **Investment Advisers Act Rel. No. 5599, 2020 SEC LEXIS 4435 (Sept. 30, 2020)**

The Commission accepted an Offer of Settlement from Transamerica Asset Management, Inc. (Respondent). The Commission alleged that Respondent had caused four money market funds to reimburse amounts that Respondent had previously waived and reimbursed to the funds on a voluntary basis, that those recaptured amounts caused the funds to charge expenses that exceeded their contractual expense limits, and that the recaptured amounts were omitted from a description of the funds' annual operating expenses in the funds' prospectuses as required by Form N-1A. The Commission alleged that Respondent had violated Section 206(4) of the Advisers Act and Section 206(4)-8 thereunder, and Section 206(4) and Rule 206(4)-7 thereunder. The Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order) also noted that [Respondent] self-reported to the Commission and took prompt remedial action including hiring a third-party consultant to quantify the recaptured amounts, ceasing any further recapture and providing the Commission staff with detailed factual summaries and substantive presentations.

Respondent was ordered to cease-and-desist from future violations, was censured, and was required to pay disgorgement and prejudgment interest totaling $5,946,782.53. However, the Order stated that the Commission was "not imposing a penalty because Respondent self-reported the [] conduct, took prompt steps to remediate the violations, including ceasing to recapture its voluntarily-waived fees and reimbursed expenses and hiring a third-party consultant to quantify the harm to affected investors, and cooperated with the Commission staff's investigation."

Trading Resources and Disclosure

***In re BlueCrest Capital Management Limited*, Advisers Act Rel. No. 5642, 2020 SEC LEXIS 5086 (Dec. 8, 2020)**

On December 8, 2020, the Commission filed settled charges against the UK-based investment adviser BlueCrest Capital Management Limited (BlueCrest), a former registered investment adviser, arising from alleged "inadequate disclosures, material misstatements, and misleading omissions concerning its transfer of top traders from its flagship client fund."[148] As set forth in the Order Instituting Administrative Cease-And-Desist Proceedings in this action (Order), BlueCrest transferred traders from BlueCrest Capital International (BCI) to a proprietary fund, BSMA Limited, and replaced those traders with an underperforming algorithm. The Order alleges that "BlueCrest created BSMA to trade the personal capital of BlueCrest personnel using primary trading strategies that overlapped with BCI's."[149] The SEC further alleged that for more than four years BlueCrest made inadequate and misleading disclosures concerning the existence of the proprietary fund, the movement of traders and the use of an algorithm for BCI. The Order also found that BlueCrest transferred many of its highest performing traders to the proprietary fund and assigned the most promising new traders to the proprietary fund, and that the algorithm used in place of the transferees generated "significantly less profit with greater volatility than the live traders."[150]

The SEC concluded that BlueCrest willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-8 and 206(4)-7 thereunder. BlueCrest agreed to a cease-and-desist order imposing a censure, disgorgement and prejudgment interest of $132,714,506 and a civil penalty of $37,285,494. The Order further created a fair fund to return the monetary relief to investors.

Valuation

***In the Matter of Semper Capital Management, L.P.*, Investment Advisers Act Rel. No. 5489 (Apr. 28, 2020)**

The Commission accepted an offer of settlement from Semper Capital Management, L.P. (Respondent), a registered investment adviser, in connection with the overvaluation of certain odd-lot positions in mortgage-backed securities held by the Semper MBS Total Return Fund (the Fund), a registered investment company managed by Respondent. The Fund invested primarily in mortgage-backed securities with a focus on nonagency mortgage-backed securities (which are generally issued by private institutions and are backed by mortgages that are not guaranteed by government agencies). Because of the size of the Fund, Respondent generally purchased these nonagency mortgaged-backed securities in odd-lot positions, meaning smaller positions that were under $1 million current face value. The Commission alleged that when Respondent would purchase an odd-lot position in a mortgage-backed security on behalf of the Fund, Respondent would initially typically price the security at its purchase price. The details of the mortgage-backed security would then be provided to a third-party pricing vendor, and such vendor's prices were

[148] Press Release, Securities and Exchange Commission, SEC Orders BlueCrest to Pay $170 Million to Harmed Fund Investors (Dec. 8, 2020), https://www.sec.gov/news/press-release/2020-308.
[149] *Id.*
[150] *Id.*

subsequently used to provide a valuation for the security for purposes of calculating the Fund's net asset value. However, the price provided by the pricing vendor was based on an institutional round-lot size, which was generally higher than the value that could be obtained upon the sale of an odd-lot position in the marketplace. As a result, pricing vendors routinely provided prices for the securities that were higher than the prices at which Respondent had just purchased the securities. The Commission alleged that from July 22, 2013 to May 31, 2014, the pricing vendors increased the valuation of each marked-up odd-lot position by 3.5% over its purchase price on average. From time to time, Respondent would issue price challenges with respect to a bond's pricing and receive the response that the bond prices provided by the pricing vendors were for round-lot positions, not odd-lot positions. Despite receiving this information, Respondent failed to challenge the use of the inflated prices for the Fund and did not attempt to seek an alternative pricing source that would account for the pricing of odd-lot positions. The Commission further alleged that Respondent made inaccurate statements in two annual reports to Fund shareholders, by attributing the Fund's excess performance over its index to the skill of portfolio management, rather than to its valuation practices for odd-lot mortgage-backed securities, as well as made similar misleading statements at an investor call that was also posted to Respondent's website. The Commission found that, as a result of this conduct, Respondent willfully violated Section 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder due to the material misstatements in the Fund's annual reports and on Respondent's website, as well as the failure to maintain procedures reasonably designed to prevent inaccurate statements from being made about the source of Fund performance. The Commission also found that Respondent willfully violated Section 34(b) of the 1940 Act because it was responsible for material misstatements in the annual reports sent to the Fund's shareholders. Finally, the Commission found that Respondent caused violations of Rule 22c-1 (the pricing rule under the Investment Company Act) that prohibits a registered investment company from redeeming its securities other than at a price based on the current net asset value. The Commission censured Respondent and ordered it to pay disgorgement of $103,228 and prejudgment interest of $25,000. In addition, Respondent was assessed a civil monetary penalty in the amount of $375,000. This enforcement action is an important reminder of an adviser's duty to monitor pricing with respect to the valuation of securities held by a registered investment company and in particular to ensure that odd-lot positions for bonds are priced appropriately, and reflect any applicable discount for an odd-lot position.

FINANCIAL INDUSTRY REGULATORY AUTHORITY

LEADERSHIP AND ORGANIZATIONAL CHANGES AT FINRA

In 2020, there were two significant personnel changes and a major organizational shift at FINRA.

In January, then Deputy Head of Enforcement Jessica Hopper was promoted to lead the Department of Enforcement. In September, FINRA announced that, after his many years of service, Michael Rufino would retire as the head of Member Regulation (Sales Practice).

Last March, FINRA announced the creation of a new National Cause and Financial Crimes Detection Program (NCFC). The NCFC includes departments that were previously housed in the Office of Fraud Detection and Market Intelligence, as well as other areas within the organization, and consists of the following: a consolidated National Cause Program; the Office of the Whistleblower and Tip Program; Fraud Surveillance; Insider Trading and PIPES Surveillance; specialist teams for anti-money laundering and cybersecurity; and the Securities Helpline for Seniors. The NCFC is led by Executive Vice President Greg Ruppert, who joined FINRA in March 2020.

COVID-19

Of course, like every regulator and broker-dealer, FINRA devoted considerable time, effort, and resources to dealing with the impact of COVID-19 on the securities industry. FINRA's actions included having its team work remotely starting in March 2020, temporarily amending and/or extending compliance timelines related to certain rules, establishing remote examination processes, using video technology for on-the-record testimony, and postponing all in-person arbitration and mediation proceedings. FINRA's Office of Hearing Officers also began the process of determining, on a case by case basis, whether it would postpone in-person disciplinary hearings or conduct them remotely using Zoom. Finally, FINRA dedicated a section of its website to COVID-related issues, which has been frequently updated during the pandemic. Several other steps taken by FINRA are described below.

COVID Fraud Task Force

In March 2020, FINRA formed the COVID Fraud Task Force to establish a coordinated response to potential COVID-19-related fraud. The Task Force is led by Mr. Ruppert and utilizes a centralized repository of information to facilitate coordination throughout FINRA.

Regulatory and Information Notices

At the outset of the pandemic, FINRA issued Regulatory Notice 20-08 (Business Continuity Planning), which reminded firms to consider pandemic-related business continuity planning and review pandemic preparedness, offered related recommendations, and provided pandemic-related guidance and regulatory relief. Shortly thereafter, FINRA issued an information notice, Cybersecurity Alert: Measures to Consider as Firms Respond to the Coronavirus Pandemic, providing firms with recommendations to help strengthen their cybersecurity controls in areas of increased risk in light of the pandemic environment.

In May, FINRA issued two additional regulatory notices. Regulatory Notice 20-13 (Heightened Threat of Fraud and Scams) highlighted common scams that may persist in the COVID-19 environment. Regulatory Notice 20-16 (Transition to Remote Work and Remote Supervision) shared common themes and best practices that FINRA observed through discussions with firms about steps they took to transition to a remote working environment, and reminded firms that they must continue to implement a reasonably designed supervisory system while working remotely and document in writing any policy or procedure adjustments.

529 SHARE CLASS INITIATIVE PROGRESS

FINRA first announced its voluntary self-reporting initiative, the 529 Share Class Initiative (529 Initiative), in January 2019 in Regulatory Notice 19-04. The 529 Initiative asked member firms to self-report any areas of concern regarding the reasonableness of their supervisory systems and procedures governing 529 plan share-class recommendations. Regulatory Notice 19-04 highlighted several potential issues about which FINRA expressed concern, including firms' failures to (i) provide training regarding the costs and benefits of different 529 share classes; (ii) assess and understand the different costs of 529 share classes for individual transactions; (iii) review data reflecting 529 plan share classes sold; and (iv) review share-class information when reviewing the suitability of 529 plan recommendations. FINRA announced a set of standardized settlement terms for firms that participate in the 529 Initiative and are subject to formal action, including restitution and a censure, but no monetary fine.

Almost two years later, on December 30, 2020, FINRA announced the 529 Initiative's first cases and that it had resulted in more than $2.7 million in restitution payments to approximately 3,900 customer accounts. Specifically, FINRA reported that it had resolved 17 matters through cautionary action letters and settled formal disciplinary matters with two firms. As FINRA had initially indicated when it announced the 529 Initiative, the two formal actions were settled without a fine.

CONTINUED FOCUS ON RESTITUTION AND PROTECTING VULNERABLE INVESTORS

During a May 12, 2020 episode of the *FINRA Unscripted* podcast, Ms. Hopper highlighted four key priorities that continue to be hallmarks of the Enforcement program. Consistent with prior statements from senior FINRA officials, Ms. Hopper reiterated that Enforcement's "first priority is obtaining restitution for harmed customers." She noted that FINRA is also focused on (i) identifying brokers who engage in egregious misconduct that affects customers; (ii) identifying brokers who are repeat offenders, or with a history of violations; and (iii) protecting senior and vulnerable investors.

Targeted Examination Letters

- **Zero Commissions**: In February 2020, FINRA posted a targeted examination letter announcing a review of firms' decisions not to charge commissions for customer transactions, and the impact that not charging commissions has or will have on firms' order routing practices and decisions. The letter covers the period from January 1, 2019 through the date of the announcement and includes 26 requests seeking information related to, among other items, the types of securities for which firms do not charge customers a commission, factors that determine whether firms charge customers a commission, disclosures concerning fees/expenses and other costs and related data, and information regarding customer brokerage account sweep programs.
- **Rights of Reinstatement (RoR)**: In November 2020, FINRA posted a targeted examination letter announcing a review of firms' systems and procedures for providing customers waivers and rebates available through RoR on mutual fund purchases. The letter covers the period from January 1, 2017 through June 30, 2020, and includes requests that seek information about (i) systems and procedures to provide eligible mutual fund customers with RoR sales charge waivers and/or fee rebates; (ii) policies that standardize the timeframe governing when RoRs apply to mutual fund purchases; and (iii) whether the firm detected any RoR sales charge waivers or fee rebates that were not provided to eligible customers. This sweep letter was issued after a June 2020 settlement related to mutual fund RoRs.

Use of Data Analytics and Technology to Augment the Exam and Risk Monitoring Program

In a September 15, 2020 episode of the *FINRA Unscripted* podcast, Kerry Gendron, head of Data Analytics and Technology, described the ways in which FINRA is using data and technology resources to augment its examination and risk monitoring programs.

Ms. Gendron highlighted four ways FINRA uses these tools: (i) efficient and effective data ingestion (e.g., collecting and processing data in whatever form firms have and using algorithms to normalize the data for review); (ii) predictive analytics (e.g., developing a model to identify registered representatives requiring further review); (iii) investigative analytics; and (iv) operational efficiency (i.e., trying to identify ways that analysts can be free to work on value-add tasks). Ms. Gendron also explained that FINRA continues to work on a research and development program that will allow for the review of unstructured data (i.e., data that does not adhere to a predefined format).

2021 REPORT ON EXAMINATION AND RISK MONITORING PROGRAM

Earlier this year, FINRA published its 2021 Report on FINRA's Examination and Risk Monitoring Program (the Report). The Report combines and replaces two reports that FINRA previously published separately: the Report on Examination Findings and Observations and the Risk Monitoring and Examination Priorities Letter. The new Report (i) identifies rules and related key considerations for firm compliance programs; (ii) summarizes noteworthy findings from recent examinations, including effective practices FINRA has observed; and (iii) sets forth additional resources for firms to use in developing and implementing their compliance and supervisory programs.

The Report highlights six areas that FINRA believes impact compliance programs at many firms across the industry:

- **Regulation Best Interest (Reg BI) and Form CRS:** FINRA will continue to focus on whether firms have established and implemented policies, procedures, and supervisory systems reasonably designed to comply with Reg BI and Form CRS. In 2021, FINRA intends to expand the scope of its review to more comprehensively evaluate related firm processes, practices, and conduct. FINRA will also focus on instances where conduct may cause customer harm, would have violated pre–Reg BI suitability standards, or disregards Reg BI/Form CRS requirements.
- **Consolidated Audit Trail (CAT):** FINRA emphasizes the CAT reporting requirements and notes that there are no exclusions or exemptions for the size or type of firm or trading activity. FINRA states that it is in the process of reviewing for compliance with CAT obligations and will provide information regarding examination findings and/or effective practices at a later date.
- **Cybersecurity:** FINRA expects firms to address new and existing cybersecurity risks, particularly in the current remote work environment. FINRA will continue to review cybersecurity programs for compliance with business continuity plan requirements, and other related rules, and encourages firms to review the recommendations described in Regulatory Notice 20-13.
- **Communications with the Public:** FINRA will continue to evaluate firms' compliance with FINRA Rule 2210 (Communications with the Public). FINRA will also focus on communications relating to certain new products and how firms supervise and comply with recordkeeping obligations, and address risks related to digital communication channels. In particular, FINRA will focus on risks associated with app-based platforms with interactive or "game-like" features and related marketing.
- **Best Execution:** FINRA will continue to review firms' compliance with Rule 5310 best execution obligations in examinations and will continue to focus on potential conflicts of interest in order-routing decisions, appropriate policies and procedures for different order/security types, and firms' reviews of execution quality.

- **Variable Annuities:** FINRA will evaluate firms' variable annuity exchanges under Rule 2330 (Members' Responsibilities Regarding Deferred Variable Annuities) and Regulation BI, as applicable. FINRA also highlights its early 2020 review of buyout written supervisory procedures, training, and disclosures for firms whose customers were impacted by a recent announcement from an insurer with sizable variable annuity assets (stating that it will terminate servicing agreements, cancel certain trail commissions, and provide buyout offers to its variable annuity customers).

ENFORCEMENT-RELATED PODCAST

Since 2018, FINRA has regularly released episodes of its podcast, *FINRA Unscripted*. This resource provides information on emerging regulatory topics that impact broker-dealers and often highlights best practices and other insights from the FINRA regulatory team. Below are a few key 2020 enforcement and examination related episodes that may be of interest:

- "FINRA Enforcement: Protecting Investors and Markets in Good Times and Bad" (May 12, 2020)
- "Protecting the Most Vulnerable: How FINRA Enforcement Prioritizes Senior Investors" (June 23, 2020)
- "Beyond Hollywood: Money Laundering in the Securities Industry" (Aug. 4, 2020)
- "Excessive Trading: When a Lot Becomes Too Much" (Sept. 29, 2020)
- "Overlapping Risks, Part 1: Anti-Money Laundering and Cybersecurity" (Oct. 27, 2020)
- "Overlapping Risks, Part 2: Anti-Money Laundering and Elder Exploitation" (Nov. 10, 2020)

ENFORCEMENT STATISTICS

As of the date of publication of this report, FINRA has not yet announced its 2020 enforcement statistics.

What to Expect

We anticipate that FINRA will conclude its 529 Initiative this year, resolving actions with restitution payments to customers, but without fining firms. Consistent with that approach and its continued focus on customer remediation, we also expect that FINRA will seek to require firms to provide restitution to customers in suitability, excessive fees, and other sales practice–related cases. Given the market volatility over the last year and the potential for COVID-19-related fraud schemes, we think that FINRA will be active in the coming year in both of those areas. Finally, as long as FINRA's staff remains working from home all or some of the time this year, we anticipate that it will continue to use video technology for testimony, conduct examinations remotely, and develop new methods to automate the ways it obtains and reviews data, documents, and information in connection with examinations, inquiries, and investigations.

FINRA ENFORCEMENT ACTIONS

529 Plans

B. Riley Wealth Management, FINRA AWC No. 2019.062526201 (Dec. 30, 2020)

Pursuant to the 529 Plan Share Class Initiative announced by FINRA Enforcement (529 Initiative) in January 2019, FINRA and B. Riley Wealth Management (BRWM) settled a matter related to allegations that BRWM failed to establish and maintain a supervisory system reasonably designed to supervise representatives' recommendations to customers to purchase particular share classes of 529 savings plans. According to the letter of Acceptance, Waiver and Consent (AWC), from January 1, 2013 through June 30, 2018 BRWM's supervisory system did not (i) provide adequate guidance to representatives about the importance of considering share-class differences when recommending 529 plans; (ii) provide supervisors with adequate guidance to evaluate the suitability of 529 share-class recommendations as part of account opening reviews; (iii) establish controls for consistent supervisory review or review tracking; (iv) maintain account information or capture trade data for 529 plan accounts; and (v) supervise 529 share-class recommendations executed through transactions made directly with plan fund companies. BRWM agreed to a censure and payment of $252,740 plus interest in restitution. In resolving this matter, FINRA credited BRWM's extraordinary cooperation through the 529 Initiative, including BRWM's substantial assistance to FINRA by voluntarily (1) conducting a qualitative review of its supervision of 529 plan share-class recommendations; (2) self-reporting; (3) providing information relevant to the assessment of BRWM's supervisory system and about corrective actions; and (4) engaging in a dialogue with FINRA about and establishing a plan for restitution.

Citigroup Global Markets Inc., FINRA AWC No. 2018057389701 (Dec. 16, 2020)

FINRA entered into an AWC with Citigroup Global Markets Inc. (CGMI) regarding allegations that CGMI failed to establish and maintain a supervisory system reasonably designed to supervise representatives' recommendations to customers to purchase particular share classes of 529 savings plans. Specifically, although CGMI's written procedures identified factors relevant to evaluating 529 plan share-class suitability, FINRA alleged that CGMI's supervisory system was not reasonably designed to supervise 529 share-class recommendations executed through transactions made directly with fund companies because the same level of supervisory review and approval was not consistently applied to those transactions. CGMI agreed to a censure and payment of $514,932 plus interest in restitution. In resolving this matter, FINRA credited CGMI's extraordinary cooperation, including that it (i) initiated an extensive review of its systems, practices and procedures related to supervision of 529 plan transactions; (ii) enhanced its system to include surveillance of share-class recommendations; and (iii) provided substantial assistance to FINRA, including by engaging an outside consulting firm to identify potentially disadvantaged customers and then establishing a plan to provide broad remediation to such customers.

Morgan Stanley Smith Barney LLC, FINRA AWC No. 2019062530701 (Dec. 30, 2020)

Pursuant to the 529 Initiative, FINRA and Morgan Stanley Smith Barney LLC (MSSB) reached a settlement regarding allegations that MSSB failed to establish and maintain a supervisory system reasonably designed to supervise representatives' recommendations to customers to purchase particular share classes of 529 plans. According to the AWC, from January 1, 2013 through June 30, 2018 MSSB's supervisory system was not reasonably designed to supervise 529 share-class recommendations executed in certain legacy Smith Barney accounts or through transactions made directly with 529 plans. With regard to the legacy accounts, FINRA alleged that certain accounts were not fully integrated with MSSB's order entry and account systems until 2016, meaning that 529 plan purchases in these accounts often were not subject to automatic or manual comparison to predetermined share-class suitability guidelines. FINRA further alleged that, although MSSB prohibited representatives from effecting 529 plan transactions directly with certain funds, it did not have a supervisory system in place to enforce the policy or detect noncompliance. MSSB agreed to a censure and payment of $1,460,515 plus interest in restitution. In resolving this matter, FINRA credited MSSB's extraordinary cooperation through the 529 Initiative, including MSSB's substantial assistance to FINRA by voluntarily (i) conducting a qualitative review of its supervision of 529 plan share-class recommendations; (ii) self-reporting; (iii) providing information relevant to the assessment of its supervisory system and about corrective actions; and (iv) engaging in a dialogue with FINRA about, and establishing a plan for, restitution.

RBC Capital Markets, LLC, **FINRA AWC No. 2016047696701 (Dec. 15, 2020)**

In a settlement with RBC Capital Markets, LLC (RBC), FINRA alleged that RBC failed to establish and maintain a supervisory system reasonably designed to supervise representatives' recommendations to customers to purchase particular share classes of 529 plans from January 1, 2008 to July 21, 2016. Specifically, FINRA alleged that RBC did not provide adequate guidance to representatives regarding the importance of considering share-class differences when recommending 529 plans. FINRA further alleged that RBC did not have procedures requiring supervisors to review the suitability of 529 plan share-class recommendations, and that when updated, the procedures failed to adequately instruct the supervisors to consider the age of the beneficiary or the time until expected withdrawals. FINRA also alleged that RBC did not consistently provide supervisors with information needed to perform their reviews. RBC agreed to a censure and payment of $685,520 plus interest in restitution. In resolving this matter, FINRA credited RBC's extraordinary cooperation, including that it (i) initiated an extensive review of its systems, practices and procedures related to 529 plan recommendations prior to the involvement of a regulator; (ii) promptly corrected supervisory deficiencies; and (iii) provided substantial assistance to FINRA, including by engaging an outside consulting firm to identify potentially disadvantaged customers and then establishing a plan to provide broad remediation to such customers.

Advertising

Prudential Investment Management Services LLC, **FINRA AWC No. 2015047966801 (Jan. 14, 2020)**

In an AWC with Prudential Investment Management Services LLC (PIMS), FINRA alleged that PIMS provided inaccurate information and omitted material information in communications to retirement plan participants and plan sponsors regarding certain investment options called Group VAs, for which it acted as principal underwriter and distributor, and that are offered in retirement plans administered and/or maintained by PIMS's affiliates. Specifically, FINRA alleged that from January 2010 to June 2017 PIMS distributed inaccurate information about Group VA expense ratios and historical performance of investment options offered in Group VAs. FINRA further alleged that from at least October 2003 to December 2018 PIMS disseminated or made available inaccurate information about third-party ratings for mutual funds underlying certain investment options. FINRA found that the material inaccuracies were included in nine different types of publications communicated to at least 73,000 retirement plan participants and hundreds of plan sponsors annually. FINRA also found that from at least January 2004 to September 2019 PIMS omitted information about the Seven Day Yield calculation from performance data of money market fund investment options in some client-facing communications. Further, FINRA found that PIMS failed to have a supervisory system, including written supervisory procedures (WSPs), reasonably designed to achieve compliance with the content standards of FINRA's advertising rules. PIMS consented to a censure, a $1 million fine, and an undertaking to retain an independent consultant.

Anti-Money Laundering (AML)

Hilltop Securities Inc., **FINRA AWC No. 2017053708001 (July 28, 2020)**

In a settlement with Hilltop Securities, Inc. (Hilltop), FINRA alleged that Hilltop's AML program was not reasonably designed to detect and cause the reporting of potentially suspicious activity, and that Hilltop failed to submit Municipal Securities Rulemaking Board (MSRB) Form G-32 Information, provide MSRB Rule G-17 required disclosure letters to issuers, and submit MSRB Rule G-37 information. Specifically, according to the AWC, from February 1, 2015 to April 30, 2016 Hilltop (i) failed to follow the Department of Treasury's standard for determining whether to file a suspicious activity report (SAR), instead applying an unreasonably high threshold for the filing of a SAR; (ii) failed to implement its AML procedures requiring associated persons to collect and complete Deposit Review Forms for receipt of low-priced securities positions, which caused Hilltop to miss red flags of potentially suspicious activity; (iii) in certain instances, failed to reasonably investigate activity after awareness of red flags; and (iv) failed to devote adequate resources to its AML program, particularly after a merger, causing it to have an unreasonable system for detection and reporting of suspicious activity. The AWC also states that Hilltop self-reported several items related to municipal securities, including that it (1) failed to submit required Form G-32 information in connection with 122 primary offerings of municipal securities for which Hilltop served as placement agent from July 2011 to October 2015; (2) made four untimely Form G-32 filings between January 2015 and March 2015; (3) failed to provide MSRB Rule G-17 disclosure letters to 119 issuers from January 2012 to September 2015; and (4) failed to submit required MSRB Form G-37 information in connection with 45 offerings from October 2014 to September 2015. Hilltop agreed to a censure, a $450,000 fine ($100,000 of which related to the MSRB conduct), and an undertaking to engage an independent consultant.

Interactive Brokers LLC, **FINRA AWC No. 2015047770301 (Aug. 10, 2020)**

FINRA reached a settlement with Interactive Brokers LLC (Interactive) regarding allegations that Interactive's AML program was deficient in several respects. According to the AWC, from January 2013 through September 2018 Interactive (i) failed to reasonably surveil certain types of money movements for money-laundering concerns by treating certain wires lacking information as first-party wires rather than third-party wires, failing to surveil transfers to customers in "high-risk" jurisdictions, and failing to confirm that customers' self-identified first-party transfers were in fact first-party wires; (ii) failed to develop and implement reasonably designed surveillance tools for certain money movements and securities transactions, including relying on blotter-based spreadsheets that were not automated, had programming "bugs," and included only summary data about the prior review period's transactions, and manually reviewing deposits and withdrawals, insider trading, and manipulative microcap securities trading; (iii) failed to reasonably investigate potentially suspicious activity and red flags because Interactive did not reasonably staff the AML compliance department as its business grew, implement a reasonable case management system to track investigations or provide sufficient technical support to AML, despite requests from the compliance manager; (iv) failed to file SARs after suspicious activity was detected or brought to Interactive's attention by a regulator; and (v) failed to conduct independent AML testing. Interactive agreed to a censure, a $15 million fine, and an undertaking to continue the retention of a third-party consultant. In settling this matter, FINRA considered that Interactive took proactive steps, invested substantial resources, and began taking meaningful steps to remediate its AML program, including new automated surveillance reports and a case management system, as well as the hiring of dozens of AML-dedicated staff, a third-party consultant, and third-party vendors. Interactive settled parallel actions with the SEC (for $11.5 million) and the Commodity Futures Trading Commission (for $11.5 million) for a total of $38 million in penalties paid to the three agencies.

INTL FCStone Financial Inc. nka StoneX Financial Inc., **FINRA AWC No. 2017053820401 (Sept. 10, 2020)**

FINRA entered into an AWC with INTL FCStone Financial Inc. (INTL), in which it alleged that INTL failed to reasonably supervise or address AML risks associated with its low-priced securities business and deficiencies associated with INTL's AML program for its clearing business. According to the AWC, between January and October 2016 INTL did not detect red flags associated with the trading of two accounts in low-priced securities, and as a result did not investigate the activity to determine whether there was manipulative trading activity. FINRA alleged that INTL's supervisory system was not reasonably designed to address the risks associated with low-priced securities liquidations, its WSPs did not address manipulation of low-priced securities or the sale of unregistered securities, and did not specify how low-priced security trading or exception reports should be reviewed. FINRA further alleged that INTL's AML program failed to reasonably address the risks associated with low-priced securities liquidations, focusing mostly on movement of funds, not securities transactions, and failing to reasonably address potentially manipulative trading activity. FINRA also alleged that the automated system INTL began using in July 2017 to help it detect and report suspicious activity was unreasonable until September 2019 because it failed to monitor ACH transactions, did not detect common addresses for foreign brokerage customers, and, until October 2018, did not cross-reference between INTL's two internal systems. INTL consented to a censure, a $375,000 fine, and an undertaking to provide a certification that it established and implemented policies, procedures, and internal controls reasonably designed to address and remediate the issues identified in the AWC.

Blue Sheets

*E*TRADE Securities LLC*, **FINRA AWC No. 2015047010401 (Sept. 2, 2020)**

FINRA settled a matter with E*TRADE Securities LLC (E*TRADE), in which FINRA alleged that E*TRADE Clearing LLC (E*TRADE Clearing) submitted inaccurate blue sheet responses to the SEC and FINRA. According to the AWC, E*TRADE Clearing, which merged into E*TRADE on October 1, 2016, submitted blue sheets with incorrect exchange codes from 2003 to February 22, 2016, incorrect transaction type identifiers from September 7, 2005 to February 22, 2016, and incorrect order execution times from November 2, 2013 to February 8, 2016. FINRA alleged that, in total, E*TRADE Clearing submitted almost 6,200 inaccurate blue sheet responses, impacting the reporting of nearly 12 million trades. E*TRADE consented to a censure and a $2.25 million fine. In determining the sanction in this matter, FINRA considered E*TRADE Clearing's relevant disciplinary history, the duration of the violations, and the number of blue sheets and transactions impacted, as well as the fact that E*TRADE Clearing conducted an internal review that discovered the order execution time error and contacted FINRA before a regulator became aware of the issue, retained a consultant in 2016 to perform initial and ongoing blue sheet assessments, and developed and implemented enhanced blue sheet protocols.

Morgan Stanley Smith Barney LLC, **FINRA AWC No. 2017052995901 (July 7, 2020)**

FINRA entered into a settlement with MSSB, in which it alleged that MSSB submitted inaccurate blue sheets to the SEC and FINRA. Specifically, FINRA alleged that from February 2014 through April 2017 MSSB submitted at least 869 inaccurate blue sheets, misreporting information on at least 156,678 options transactions. FINRA alleged that the inaccurate blue sheets resulted from human error that caused positions to show as closed when they should have been marked open, as well as two separate computer coding issues that caused MSSB to incorrectly report whether options transactions opened or closed positions. MSSB agreed to a censure and fine of $875,000.

***SG Americas Securities LLC, Newedge USA, LLC (n/k/a SG Americas Securities LLC)*, FINRA AWC No. 2015047855901 (June 24, 2020)**

FINRA settled a matter with SG Americas Securities, LLC (SGAS), in which FINRA alleged that SGAS and Newedge USA, LLC (Newedge) submitted inaccurate blue sheet responses to FINRA. According to the AWC, SGAS and Newedge, which merged into SGAS in January 2015, submitted approximately 8,400 inaccurate blue sheets to FINRA, misreporting information on approximately 4.2 million transactions. FINRA alleged that the inaccurate blue sheets were caused by a combination of errors with two of Newedge's systems and errors occurring with blue sheets processed at SGAS's third-party vendor. FINRA also alleged that between January 2012 and January 2015 Newedge did not maintain written procedures for validating blue sheet requests. SGAS agreed to a censure, a $3.1 million fine ($1.55 million of the fine amount to FINRA and $1.55 million to the SEC in connection with a concurrent settlement agreement), and a certification that it conducted a review of its policies, systems, and procedures relating to the blue sheet deficiencies alleged in the AWC.

Complex Products

***J.P. Morgan Securities LLC*, FINRA AWC No. 2018057508101 (June 22, 2020)**

In an AWC with J.P. Morgan Securities LLC (JPMS), FINRA alleged that JPMS failed to establish and maintain a supervisory system reasonably designed to achieve compliance with its obligations related to the sale of volatility-linked exchange-traded products (Volatility ETPs). According to FINRA, because of their complexity and risks, Volatility ETPs are best viewed as short-term products that should be monitored closely. FINRA found that from January 1, 2014 to May 24, 2016 JPMS made Volatility ETPs available for solicited purchases without having a reasonable system in place to verify that its brokers and customers understood the products and the risks inherent in holding them for long periods. Further, FINRA found that certain of JPMS's customers purchased Volatility ETPs on a solicited basis and held them for lengthy periods. The AWC states that JPMS had identified the risks associated with a Volatility ETP as early as 2010 and had removed the product from availability for certain non-brokerage accounts in 2011, but made it available again and solicited purchases of Volatility ETPs without taking reasonable steps to enhance its associated supervision. FINRA alleged that JPMS did not provide training or guidance to brokers or supervisors specifically regarding Volatility ETPs, identify the risks associated with Volatility ETPs in its WSPs, conduct reasonable postapproval review of the product's performance and risk profile, or take other steps to supervise solicited sales of Volatility ETPs. JPMS agreed to a censure, a $325,000 fine, and payment of $333,619.34 plus interest in restitution.

***SunTrust Investment Services, Inc.*, FINRA AWC No. 2018057530701 (May 18, 2020)**

FINRA entered into an AWC with SunTrust Investment Services, Inc. (SunTrust) regarding allegations that SunTrust failed to establish, maintain, and enforce a reasonably designed supervisory system or WSPs reasonably designed to achieve compliance with FINRA's suitability rule as it relates to non-traditional exchange traded funds (NT-ETFs). According to FINRA, NT-ETFs have unique features and risks, including the risks associated with holding NT-ETFs for extended periods. FINRA alleged that SunTrust did not have reasonable procedures or guidance to representatives or supervisors regarding how to determine whether an NT-ETF was suitable for customers. FINRA also alleged that SunTrust did not have an alert, exception report, or similar system to assist in monitoring the holding periods for these investments, nor did SunTrust's training describe how to monitor the holding periods. SunTrust agreed to a censure, a $50,000 fine, and payment of $584,466.12 in restitution. In resolving the matter, FINRA considered that SunTrust voluntarily ceased selling NT-ETFs prior to FINRA's routine examination of the firm, and that it voluntarily paid restitution to customers it identified through its own investigation.

Customer Protection

Electronic Transaction Clearing, Inc., **FINRA AWC No. 2017054054101 (June 5, 2020)**

FINRA entered into a settlement with Electronic Transaction Clearing, Inc. (ETC) in which it alleged that, among other things, ETC failed to satisfy certain of its customer protection requirements, comply with recordkeeping rules, and supervise its margin obligations. Specifically, FINRA alleged that between March 31, 2016 and August 26, 2016 ETC improperly calculated customer and proprietary broker-dealer account amounts because it failed to reduce debit balances relating to certain margin accounts. FINRA also alleged that ETC did not provide prompt written notification of the hindsight deficiencies to the SEC and FINRA. FINRA further alleged that between February 2016 and April 2017 ETC overstated debits in its customer reserve calculation when it improperly included an amount doubtful of collection. In addition, FINRA found that ETC made unsecured advances to its parent company in an amount greater than 10% of its excess net capital at that time without obtaining the required written permission from FINRA in November and December 2016. The AWC also states that between January and June 2017 ETC failed to comply with several recordkeeping requirements related to the storage of electronic records, and that between January and May 2016 ETC did not maintain records showing how affiliates were compensated through its parent company and did not accurately reflect in its expense sharing agreement monthly payment amounts sent to its parent. Finally, FINRA found supervisory failures, including that (i) from April 1, 2015 through June 30, 2017 ETC did not establish a system to supervise customer protection reserve calculations, Regulation T margin requirements, and recordkeeping requirements in a way designed to achieve compliance; (ii) ETC did not reasonably oversee, supervise, and monitor an affiliate's processes for operating and maintaining ETC's electronic storage of records; and (iii) ETC failed to establish and maintain a supervisory system reasonably designed to comply with its margin obligations from April 2016 through March 2017. ETC consented to a censure, a $450,000 fine, and an undertaking to provide a certification that it established and implemented policies, procedures, and internal controls reasonably designed to address and remediate the issues identified in the AWC.

Customer Statements

First Clearing, LLC nka Wells Fargo Clearing Services, LLC, **FINRA AWC No. 2016051352401 (Nov. 4, 2020)**

In an AWC with First Clearing, LLC (First Clearing), FINRA alleged that between April and October 2016 First Clearing distributed customer account statements containing valuations that did not comply with required rule amendments that took effect in April 2016. Specifically, FINRA alleged that First Clearing manually overrode incomplete data received from a third-party vendor regarding DPP and REIT securities with data from the prior month, resulting in 2,300 customers receiving account statements showing outdated valuations. FINRA further alleged that First Clearing failed to establish and maintain a supervisory system, including WSPs, reasonably designed to ensure compliance with the valuation rule for providing preshare estimated values for DPP and unlisted REIT securities, and that First Clearing did not confirm that appropriate supervisory personnel oversaw and reviewed the security pricing team's activities regarding these securities. FINRA also alleged that First Clearing failed to maintain accurate books and records when it created and distributed 6,851 monthly and quarterly account statements that contained noncompliant valuations for DPP and REIT securities. First Clearing agreed to a censure and a $300,000 fine.

Disclosure

Citigroup Global Markets Inc., FINRA AWC No. 2017055673701 (Nov. 10, 2020)

FINRA entered into a settlement with CGMI regarding allegations that CGMI omitted required disclosures in equity research reports stating that it was either a manager or co-manager of a public offering of equity securities for the companies covered in the reports, and that CGMI failed to establish and maintain a supervisory system and WSPs reasonably designed to achieve compliance with certain conflict-of-interest disclosure requirements. According to the AWC, from November 2012 to November 2017 CGMI relied on data feeds from a third-party service provider to identify CGMI's role in transactions for issuers covered by CGMI research reports, but did not test the accuracy and completeness of the feeds and did not test the accuracy of its manager/co-manager disclosures in the research reports it published. As a result, FINRA found that CGMI omitted approximately 24,800 required manager/co-manager disclosures in 16,850 equity research reports. FINRA further found that CGMI's failure to test the accuracy and completeness of the third-party service provider data feed or the manager/co-manager disclosures in its research reports was a failure to establish and maintain a system, including written procedures, reasonably designed to achieve compliance with manager/co-manager disclosure rules, noting that this was particularly important in light of its reliance on a third-party service provider and CGMI's prior disciplinary history. CGMI consented to a censure, a $475,000 fine, and an undertaking to provide a certification that (i) it completed a review of its systems and written procedures regarding the supervision of disclosures in research reports, and (ii) its systems and written procedures are reasonably designed to achieve compliance with the laws, rules, and regulations cited in the AWC. In resolving this matter, FINRA credited CGMI with extraordinary cooperation for (i) discovering the omitted disclosures during a planned compliance review, initiating an internal review prior to detection or intervention by a regulator, and self-reporting to FINRA; (ii) promptly correcting the cause of the issue; (iii) conducting a five-year lookback to determine the number of omitted disclosures; (iv) voluntarily employing corrective measures; and (v) providing substantial assistance to FINRA's investigation.

Form U4

Western International Securities, Inc., FINRA AWC No. 2017056511101 (May 4, 2020)

In an AWC with Western International Securities, Inc. (Western), FINRA alleged that Western failed to timely amend certain Forms U4, reasonably respond to red flags that its representatives were not timely disclosing reportable financial events, and establish, maintain, and enforce a supervisory system, including WSPs, reasonably designed to ensure the timely reporting of disclosable events. Specifically, FINRA alleged that from October 2011 through June 2018 Western failed to timely disclose 163 liens, judgments, and bankruptcies on 52 of its registered representatives' Forms U4. FINRA further alleged that Western failed to reasonably respond to red flags, including background check reports and annual compliance questionnaires. FINRA also alleged that, even after receiving letters in connection with a FINRA public records initiative notifying Western that information in public records required disclosure, Western failed to take reasonable steps to ensure that its representatives' Forms U4 were being amended as needed. Finally, FINRA alleged that Western failed to establish, maintain, and enforce a supervisory system, including WSPs, reasonably designed to achieve compliance with its obligation to timely disclose reportable financial events on Forms U4. Western consented to a censure, a $325,000 fine, and an undertaking to retain an independent consultant.

Worden Capital Management LLC, FINRA AWC No. 2017056432601 (Dec. 31, 2020)

FINRA settled a matter with Worden Capital Management LLC (WCM) and its CEO (who was also its CCO during some of the conduct) regarding allegations related to supervision, interference with transfer requests, and failures to timely disclose Form U4 and Form U5 information. According to the AWC, from

January 2015 to October 2019 WCM registered representatives made unsuitable recommendations, including active short-term trading and using margin to increase buying power, and excessively traded customer accounts, causing customers to incur more than $1.2 million in commissions. FINRA alleged that WCM failed to establish, maintain, and enforce a supervisory system, including WSPs, reasonably designed to achieve compliance with FINRA's suitability rule as it pertains to excessive trading. For example, according to FINRA, WCM's supervisory procedures did not define certain terms and personnel performing supervisory reviews were not trained on how to do so. FINRA also alleged that even when branch managers identified problematic trading, they would only take limited measures in response. In addition, FINRA found that in August 2017 WCM and the CEO interfered with customers' requests to transfer accounts from WCM to another member firm after 13 registered representatives changed employment by restricting the accounts associated with those representatives. Finally, FINRA alleged that from January 2016 to December 2020 WCM failed to timely file 59 amendments regarding the filing or resolution of customer arbitrations to Forms U4 and Forms U5 for 13 of its registered persons, and failed to establish and maintain a supervisory system reasonably designed to achieve compliance with Form U4 and Form U5 disclosure obligations. For example, according to FINRA, WCM failed to provide adequate guidance or training to the principals who made those disclosure determinations. WCM agreed to a censure, a $350,000 fine, payment of restitution of $1,246,471, and an undertaking to retain an independent consultant. The CEO agreed to a 15-business-day suspension in all capacities, a three-month suspension in all supervisory capacities, a $15,000 fine, and an undertaking to complete 20 hours of continuing education.

Market Access

BNP Paribas Securities Corp., **FINRA AWC No. 2013037641201 (July 30, 2020)**

FINRA, on behalf of itself and several exchanges (BYX, NYSE, NYSE Arca), settled a matter with BNP Paribas Securities Corp. (BNP) related to allegations that BNP failed to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial risks of its market access business activity. According to the AWC, from July 14, 2011 through the present (as of the date of the AWC) BNP's controls and supervisory system were not reasonably designed to prevent the entry of (i) orders that exceeded appropriate preset credit thresholds in the aggregate for each customer and (ii) erroneous order. Specifically, FINRA alleged that BNP did not establish aggregate credit thresholds for certain customers from November 30, 2011 to at least April 2016, even though BNP became aware of this gap as early as April 2014. FINRA further alleged that it was not until July 2018 that the pre-set credit thresholds were applied as required. FINRA also alleged that BNP failed to establish, maintain, and enforce WSPs reasonably designed to achieve compliance with the rule, noting that BNP's written procedures did not reasonably guide supervisors in determining appropriate credit thresholds. As a result, according to FINRA, BNP failed to prevent the transmission of erroneous orders to the market. FINRA also found that BNP's financial risk management controls and supervisory procedures for one of its desks were not reasonably designed to prevent the entry of erroneous orders, and that before October 2014 some parameters were set too high or were too narrow. FINRA also found that BNP began using a new vendor order management system in approximately October 2014, but that orders sent through that system were not subject to the same controls as were orders sent through BNP's market gateway system. For example, FINRA found that until July 2018 BNP did not have a control to reject the desk orders that were not reasonably related to the price of the security. Finally, FINRA alleged that BNP was aware of potential gaps in its risk-management controls as early as October 2013, but took years to fix them. BNP consented to a censure, a $650,000 fine ($260,000 to FINRA), and an undertaking to provide a certification that (i) it completed a review of its financial risk management controls and supervisory procedures, and (ii) those controls and supervisory procedures are reasonably designed to achieve compliance with the applicable rules.

Cantor Fitzgerald & Co., **NYSE Arca AWC No. 2015045163502 (Feb. 20, 2020); Cboe BZX Letter of Consent No. 20150451635 (Mar. 12, 2020); Cboe EDGEX Letter of Consent No. 20150451635 (Mar. 12, 2020); NASDAQ Stock Market AWC No. 2015045163501 (Mar. 16, 2020)**

NYSE Arca, NASDAQ Stock Market, Cboe BZX Exchange, and Cboe EDGEX Exchange reached settlements with Cantor Fitzgerald & Co. (Cantor) in which the exchanges alleged that Cantor failed to implement reasonable market access controls. In particular, the exchanges alleged that from March 3, 2015 through December 31, 2015 Cantor failed to implement risk-management controls and supervisory procedures to prevent the entry of erroneous orders. The exchanges alleged that, although Cantor's control process generated pre-trade alerts, the review of alerts was not reasonable because the control generated too many alerts for one supervisor to review in a timely manner, and Cantor failed to provide guidance to address how the supervisor should conduct the alert review. The exchanges also alleged that several of Cantor's other market access controls were not reasonably designed, including the price tolerance control and cash trading desk notational limit controls, and that until May 2017 Cantor lacked any user size limits for its traders and failed to address user size limits in its WSPs. Cantor agreed to a censure and a $450,000 fine payable to the four exchanges: NYSE Arca; the NASDAQ Stock Market, LLC; Cboe BZX Exchange, Inc.; and Cboe EDGEX Exchange.

Market Making

Citadel Securities LLC, **FINRA AWC No. 2014041859401 (July 16, 2020)**

FINRA settled a matter with Citadel Securities LLC (Citadel), in which it alleged that Citadel traded ahead of certain inactive over-the-counter equities (OTC) customer orders, failed to consistently apply its methodology to certain OTC customer orders, failed to display certain OTC customer limit orders, and failed to establish a supervisory system, including WSPs reasonably designed to achieve compliance with trading ahead and limit order display rules for OTC customer orders. Specifically, FINRA found that from September 2012 through mid–September 2014 Citadel employed pre-trade controls, settings, and processes that directed larger OTC customer orders for manual review and/or handling, rendering them inactive until completion of the manual review. FINRA further found that Citadel traded for its own account on the same side of the market at prices that would have satisfied the orders while the OTC customer orders were inactive, without immediately executing the inactive orders up to the size and at the same or better price as it traded for its own accounts. FINRA also found that during the same time period Citadel did not verify that its written methodology governing the execution and priority of all pending orders was applied consistently to OTC customer orders because of the varying time that it took to review the inactive orders subject to manual review. According to FINRA, Citadel also failed to display certain OTC customer limit orders for a variety of reasons from at least October 2012 through September 2018, including (i) the manual review of larger OTC customer orders; (ii) the ability of OTC traders to disable certain features of the system and cause marketable limit orders in disabled symbols to be handled manually; (iii) market data issues; (iv) manual trader intervention; and, (v) from February 2016 to December 2017, a systematic delay in resending outbound OTC Link messages after an expired message. Finally, FINRA alleged various supervisory failures, including the failure to (1) from November 2011 to October 2014, establish and maintain a supervisory system for the OTC Desk, including WSPs reasonably designed to comply with the Trading Ahead Rule and the consistent application of Citadel's written methodology; (2) from November 2011 to mid–June 2020, establish and maintain a supervisory system, including WSPs, reasonably designed to achieve compliance with the Limit Order Display Rule; (3) from June 2015 to mid–June 2020, perform reasonable supervisory reviews of display supervisory reports; and (4) from November 2011 to April 2018, establish any supervisory system or written procedures with respect to the implementation, review, or modification of the overrides OTC desk traders were permitted to implement. Citadel agreed to a censure, a $700,000 fine, payment of restitution, and an undertaking to provide a certification that (i) it completed a review of its systems, policies, and procedures regarding the display of OTC customer limit orders, and

(ii) its systems, policies, and procedures are reasonably designed to achieve compliance with applicable laws, rules, and regulations.

Mutual Fund Fees

***Merrill Lynch, Pierce, Fenner & Smith, Inc.*, FINRA AWC No. 2017053494401 (June 4, 2020)**

In a settlement with Merrill Lynch, Pierce, Fenner & Smith Inc. (Merrill), FINRA alleged that Merrill failed to establish and maintain a supervisory system and to establish, maintain, and enforce supervisory procedures reasonably designed to ensure that mutual fund investors received sales charge waivers to which they were entitled through rights of reinstatement. According to the AWC, from April 2011 to April 2017 Merrill relied on its registered representatives to manually identify and apply rights of reinstatement waivers and rebates. FINRA alleged that, although reinstatement requests required supervisory approval, supervisors were not required to take steps to reasonably confirm that customers eligible for such waivers and rebates received them. FINRA further alleged that Merrill did not monitor specifically for missed reinstatements, and that the alert system was not reasonably designed to detect missed reinstatements because its parameters were too narrow. As a result, FINRA found that Merrill failed to detect that 13,328 accounts were not provided with sales charge waivers and rebates to which they were entitled based on rights of reinstatement. Merrill agreed to a censure and payment of $7,225,700.12 in restitution. In resolving the matter, FINRA considered Merrill's extraordinary cooperation, including that Merrill (i) engaged an outside consulting firm to conduct a complex analysis; (ii) investigated the extent to which it did not provide rights of reinstatement; (iii) promptly established a plan to provide remediation; (iv) promptly remediated related supervisory deficiencies; and (v) provided substantial assistance to FINRA.

Order Audit Trail System (OATS)

***Morgan Stanley & Co. LLC*, FINRA AWC No. 2015044226501 (Apr. 17, 2020)**

FINRA and Morgan Stanley & Co. LLC (Morgan Stanley) entered into a settlement regarding allegations of improper submissions and inaccurate reporting to OATS, as well as related supervisory failures. Specifically, FINRA alleged that starting in January 2011 Morgan Stanley implemented programming logic that caused it to incorrectly report a cancel/replace report to OATS when a nonmaterial change was made to a customer order, impacting 7,459,169 reportable order events between January 2011 and September 2016. FINRA further alleged that internal updates to an algorithm that routed orders to Morgan Stanley's Alternative Trading System (ATS) caused Morgan Stanley to report 384,830,864 cancel/replace reports to OATS that it was not required to report between February 1, 2015 and May 11, 2016, and logic in two systems caused over-reporting of 32,271 cancel/replace reports between December 2016 and April 2019. In addition, FINRA found that order events were reported out of sequence, and 424,412,081 cancel/replace reports were submitted to OATS with an incorrect order receipt time between February 2015 and February 2016. FINRA also found that from October 2011 to July 2019 faulty programming logic caused Morgan Stanley to report several thousand new order reports with incorrect special handling codes to OATS. Finally, FINRA found that Morgan Stanley's supervisory system, including its WSPs, did not include a review for reporting violations that could only be identified from a comparison to its books and records, which would have identified over- and under-reporting and incorrect timestamps and special handling codes. Morgan Stanley agreed to a censure, a $300,000 fine ($200,000 for OATS and $100,000 for supervision), and an undertaking to revise its WSPs.

Options Rules

***UBS Securities LLC*, NYSE Arca AWC No. 2017-04-00071 (Apr. 9, 2020)**

NYSE Arca settled a matter with UBS Securities LLC (UBS) regarding allegations that UBS violated rules related to busting and adjusting trades; failed to comply with due diligence and best execution obligations; failed to create, maintain, and preserve certain records; and failed to establish and maintain adequate supervisory systems and written procedures. Specifically, according to NYSE Arca, between March 1, 2015 and May 31, 2018 UBS had a pattern and practice of nullifying executed trades through a floor broker and subsequently re-trading them, which NYSE Arca alleged circumvented exchange rules, including trade through rules. In addition, NYSE Arca found that UBS failed to comply with its due diligence and best execution obligations in three different trades. NYSE Arca also found that UBS failed to create and maintain accurate records of (i) all order modifications and cancellations; (ii) the times at which orders were transmitted for execution; and (iii) the times at which orders were received. Finally, NYSE Arca alleged that UBS failed to establish and maintain a supervisory system and procedures designed to ensure compliance with its bust and adjust obligations, best execution obligations, and the creation and retention of accurate records for its manual options orders. UBS agreed to a censure, a $490,000 fine, and an undertaking to provide a certification that it has taken reasonable steps to ensure the accurate recording of (1) times that verbal orders are received from clients; (2) times that orders are submitted to the floor for execution; and (3) any cancellations of orders and new executions. In settling the matter, NYSE Arca considered that UBS issued new guidance concerning trade nullifications and adjustments and adopted new WSPs concerning best execution of manual options orders in 2018 and 2019, and that UBS offered certain customers restitution.

Options Origin Codes

***Morgan Stanley & Co. LLC*, NYSE American AWC No. 2015048329304 (Apr. 24, 2020); NYSE Arca AWC No. 2015048329305 (Apr. 24, 2020); Cboe Letter of Consent No. 2015048329306 (Apr. 30, 2020); Nasdaq PHLX AWC No. 2015048329302 (June 2, 2020); Nasdaq ISE AWC No. 2015048329303 (June 2, 2020); MIAX Letter of Consent No. 2015048329301 (June 3, 2020)**

On behalf of NYSE Arca, NYSE American, Nasdaq ISE, Nasdaq PHLX, Miami International Securities Exchange, and Cboe, FINRA settled a matter with Morgan Stanley related to the use of Professional Customer origin codes on options orders. According to the settlement documents, Morgan Stanley failed to correctly mark certain orders with the Professional Customer origin code due to configuration issues in various order management systems from January 1, 2011 through April 27, 2017. The settlements also state that Morgan Stanley's supervisory system and WSPs were not reasonably designed to achieve compliance with recordkeeping provisions as they relate to options order origin codes from January 1, 2011 to February 19, 2020. For example, the settlements state that Morgan Stanley's supervisory system did not include any post-order entry follow-up or review of high-touch Professional Customer options orders to determine whether they had been tagged with the correct origin code. Morgan Stanley agreed to a censure and a $650,000 fine payable to the exchanges.

Recordkeeping

***Deutsche Bank Securities Inc.*, FINRA AWC No. 2017055691901 (Dec. 31, 2020)**

In a settlement with Deutsche Bank Securities Inc. (DBSI), FINRA alleged that DBSI did not establish and maintain a supervisory system reasonably designed to comply with its record retention obligations from 1998 to 2017. FINRA alleged that DBSI's procedures did not reasonably address electronic recordkeeping requirements; that DBSI did not assign responsibility for achieving compliance to any particular department, team or individual; and that its procedures did not include any guidance to personnel about, for example, the system, location, or database where documents should be stored. FINRA also alleged that DBSI stored millions of records electronically, but did not notify its designated examining authority prior to storing the records electronically, have an audit system providing for accountability in the input of the records, or retain a third-party vendor with access to the records. FINRA further alleged that DBSI failed to store certain required records in nonrewritable, nonerasable format. DBSI consented to a censure, a $2.5 million fine, and an undertaking to provide a certification that it adopted and implemented policies and procedures reasonably designed to ensure compliance with the laws and rules addressed in the AWC.

LPL Financial LLC, **FINRA AWC No. 2018059192701 (Dec. 31, 2020)**

In an AWC with LPL Financial LLC (LPL), FINRA alleged that LPL failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with requirements related to record retention, fingerprinting and screening of associated persons, and supervision of consolidated reports. According to FINRA, from January 2014 to September 2019 LPL failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with certain of its records-retention obligations, causing it to fail to retain electronic records in the required format, preserve electronic records, and notify FINRA prior to employing electronic storage media. In particular, FINRA alleged that LPL's written procedures did not provide guidance to firm personnel about what should be used for records storage, among other things. FINRA found that these failures affected at least 87 million records and led to the permanent deletion of more than 1.5 million customer communications maintained by a third-party vendor. FINRA also found that LPL failed to send account notices required to be sent to more than one million customers because it lacked a process to confirm that instructions were given to its vendor and due to a misconfiguration in its systems. In addition, FINRA alleged that, from January 2014 through the present (as of the date of the AWC), LPL failed to fingerprint more than 7,000 non-registered associated persons, and therefore did not screen them for statutory disqualifications based on criminal convictions. FINRA also alleged that LPL permitted a nonregistered associated person subject to statutory disqualification to associate with the firm from January 2017 until September 2019. Finally, from May 2015 through the present (as of the date of the AWC), FINRA found that LPL failed to establish and maintain a supervisory system reasonably designed to supervise certain consolidated reports to which its approved third-party vendors provided direct access to registered representatives, including the draft reports and manually-added assets, which enabled a former representative to create and disseminate reports containing false information. LPL consented to a censure, a $6.5 million fine, and an undertaking to continue to retain the third-party consultant.

SG Americas Securities LLC, **FINRA AWC No. 2018059389401 (Dec. 31, 2020)**

FINRA and SGAS entered into an AWC in which FINRA alleged that SGAS failed to establish and maintain a supervisory system reasonably designed to comply with its record retention obligations. According to FINRA, between 2004 and 2009 SGAS's written procedures did not address the electronic recordkeeping requirements, and in 2009 SGAS amended its procedures to include the requirements but did not include any guidance to personnel about, for example, the system, location, or database where documents should be stored. FINRA also alleged that SGAS stored millions of records electronically, but did not notify its designated examining authority prior to storing the records electronically, have an audit system providing for accountability in the input of the records, or retain a third-party vendor with access to the records. FINRA further alleged that SGAS failed to store certain required records in nonrewritable, nonerasable format. SGAS consented to a censure, a $1 million fine, and an undertaking to provide a certification that it implemented supervisory systems and written supervisory procedures reasonably designed to ensure compliance with the laws and rules addressed in the AWC.

Supervision

Cetera Advisor Networks LLC, Cetera Advisors LLC, Cetera Financial Specialists LLC, **FINRA AWC 2015046716901 (Dec. 15, 2020)**

FINRA settled a matter with Cetera Advisor Networks LLC, Cetera Advisors LLC, and Cetera Financial Specialists LLC (together, Cetera) regarding allegations that from January 2011 through December 2018 Cetera failed to establish, maintain, and enforce a supervisory system and WSPs reasonably designed to supervise certain private securities transactions conducted by their dually-registered representatives at unaffiliated or outside registered investment advisors, and failed to make and preserve related books and records. According to the AWC, among other issues Cetera did not receive all the data or information required to reasonably supervise outside transactions. FINRA found that Cetera was aware of the supervisory deficiencies, but despite several efforts to address them, failed to do so. Finally, FINRA found that Cetera failed to record dually-registered representatives' private securities transactions conducted through their outside registered investment advisors on its books and records due to its supervisory failures. Cetera consented to a censure, a $1 million fine ($750,000 for Cetera Advisor Networks LLC, $150,000 for Cetera Advisors LLC, $100,000 for Cetera Financial Specialists LLC), and an undertaking to provide a certification that it (i) reviewed and revised its systems, policies, and procedures with respect to the supervision of dually-registered representatives' transactions, and (ii) established and implemented systems, policies, and procedures reasonably designed to achieve compliance with the rules cited in the AWC.

ConvergEx Execution Solutions LLC & Cowen Executions Services LLC, **NYSE AWC No. 2019-05-00023 (Mar. 3, 2020)**

In an AWC with ConvergEx Execution Solutions LLC (ConvergEx) and Cowen Execution Services LLC (Cowen), the NYSE alleged that ConvergEx (and Cowen, after it acquired services from ConvergEx) violated a rule that prohibits members from sending and maintaining orders at the same price for the purchase or sale of the same security for the account of the same principal with more than one floor broker. According to the AWC, from March 2014 until at least December 2017 ConvergEx (and then Cowen) sent orders from a hedge fund customer to two different floor brokers on the NYSE floor, resulting in the overrepresentation of that customer in the market and that customer receiving over-allocations of executions to the disadvantage of other market participants. NYSE found that ConvergEx did not have a supervisory system or WSPs to ensure compliance with the rule. ConvergEx and Cowen agreed to a censure, disgorgement of $165,000 in commissions made in connection with the allegedly violative orders, and an $835,000 fine.

Northwestern Mutual Investment Services, LLC, **FINRA AWC No. 2017054642101 (Apr. 7, 2020)**

FINRA reached a settlement with Northwestern Mutual Investment Services, LLC (NMIS) regarding allegations that NMIS failed to establish, maintain, and enforce a supervisory system reasonably designed to review and monitor the transmittals of funds from the accounts of customers to third-party accounts and outside entities. According to the AWC, between September 7, 2005 and February 28, 2017 an NMIS representative converted $473,496 from variable annuities accounts owned by five NMIS customers through 23 distributions and transfers to his bank account, and caused $121,123 to be transferred from two customers' variable annuities to another customer's bank account. FINRA found that the representative did so through forged signatures, fake checks, and fictitious NMIS documents. FINRA further found that at certain times NMIS systems flagged the representative's activity but did not take reasonable steps to investigate. As a result, FINRA found that NMIS did not have a reasonable supervisory system to review and monitor transfers of customer funds to third-party accounts and outside entities because, for example, it failed to include a policy or procedure to review and monitor for multiple transmittals of funds from multiple customers going to the same third-party accounts. NMIS agreed to a censure, a $350,000 fine, and an undertaking to provide a certification that it enhanced its supervisory systems and written supervisory procedures in ways that are reasonably expected to address the areas of conduct discussed in the AWC.

***Royal Alliance Associates, Inc.*, FINRA AWC No. 2017056769402 (Jan. 16, 2020)**

FINRA settled a matter with Royal Alliance Associates, Inc. (Royal Alliance) in which it alleged that Royal Alliance failed supervise certain wire transfer and check requests. According to the AWC, between 2009 and 2017 two registered representatives acting independently of one another stole more than $3.8 million from four customers by directing wire transfers or checks from customer accounts into accounts for entities they created. FINRA alleged that, in connection with these activities, Royal Alliance did not enforce its procedures related to third-party wire transfers, incorrectly treating certain of the transfers as first-party transfers. FINRA further alleged that Royal Alliance did not respond reasonably to red flags of potential misconduct, including that certain of the wire transfers and checks were sent to the representatives' addresses. Royal Alliance agreed to a censure, a $400,000 fine, and an undertaking to provide a certification that it established and implemented policies, procedures, and internal controls reasonably designed to address and remediate the issues in the AWC.

***Wells Fargo Advisors, LLC nka Wells Fargo Clearing Services, LLC*, FINRA AWC No. 2015045713304 (Aug. 28, 2020)**

FINRA settled a matter with Wells Fargo Advisors, LLC (WFA) regarding allegations related to supervisory failures. According to the AWC, between November 2012 and October 2015 WFA did not reasonably investigate red flags arising from the recommendations of two of its registered representatives that caused customer accounts to be concentrated in energy securities. Specifically, FINRA alleged that WFA failed to reasonably investigate alerts generated by WFA's trade-review system, even though its WSPs addressed how to investigate the alerts, resolving them only based on the representatives' uncorroborated assurances that the customers were aware of the concentrations in their accounts. FINRA further alleged that WFA was aware that the representatives had not documented the concentration-suitability determination for certain customers as required by WFA's WSPs, and that the representatives moved energy securities from customers' advisory accounts to brokerage accounts to circumvent WFA's concentration limits in advisory accounts. The AWC notes that, prior to the settlement, WFA paid 67 of the representatives' customers more than $9.7 million based on losses related to four securities. WFA agreed to a censure, a $350,000 fine, and payment of restitution to three additional customers in the amount of $201,498 plus interest.

Trade Reporting and Compliance Engine (TRACE)

***Barclays Capital Inc.*, FINRA AWC No. 2017054054501 (Dec. 2, 2020)**

FINRA entered into a settlement with Barclays Capital Inc. (Barclays) in which it alleged several TRACE reporting violations. Specifically, FINRA alleged that from January 2017 through October 2018 Barclays reported more than 2% of its corporate transactions to TRACE more than 15 minutes after the time of execution, resulting in approximately 1,000 late reports per month, due largely to manual trade amendments or the trader or salesperson entering the trade late. FINRA also alleged that from January 2017 through February 2019 Barclays often reported more than 3% of its agency transactions to TRACE more than 15 minutes after the time of execution, resulting in approximately 26 late reports per month because of coding and technological issues. According to the AWC, Barclays also over-reported an estimated 550,000 treasury security transactions executed between Barclays and its affiliate to TRACE from July 10, 2017 through April 30, 2019 due to a coding error. In addition, FINRA found that Barclays captured in its order management system and reported to TRACE the incorrect execution times for some corporate transactions from January 1, 2017 through September 30, 2017. Finally, FINRA found that Barclays's supervisory system, including its WSPs, was decentralized and did not have procedures for the identification of over-reporting transactions with Barclay's affiliate, and was not reasonably designed to achieve compliance with TRACE reporting rules from January 2017 through April 2019. Barclays consented to a censure, a $650,000 fine, and an undertaking to revise the firm's WSPs.

Morgan Stanley Smith Barney LLC, **FINRA AWC No. 2015047758201 (Mar. 25, 2020)**

In an AWC with MSSB, FINRA alleged several violations related to late reporting to TRACE and the Real-time Transaction Reporting System (RTRS) from July 1, 2015 to December 31, 2018. Specifically, FINRA alleged that at various times MSSB failed to timely report 191 large block transactions in TRACE-eligible agency debt securities and 292 large block transactions in TRACE eligible corporate debt securities. FINRA also alleged that MSSB failed to timely report 126 large block transactions in municipal debt securities to the RTRS. FINRA also alleged that MSSB failed to report 459 transactions in TRACE-eligible agency debt securities within the required timeframe. MSSB consented to a censure, a $300,000 fine, and an undertaking to provide a certification that it (i) reviewed its systems, policies, and procedures governing its trade reporting of fixed income securities, and (ii) established and implemented systems, policies, and procedures governing the same that are reasonably designed to achieve compliance with the applicable FINRA and MSRB rules.

Unit Investment Trusts (UITs)

SagePoint Financial, Inc., **FINRA AWC No. 2018056858101 (June 10, 2020)**

FINRA entered into a settlement with SagePoint Financial, Inc. (SagePoint) in which FINRA alleged that from January 2013 through December 2017 SagePoint failed to establish and maintain a supervisory system and failed to establish, maintain, and enforce WSPs reasonably designed to supervise the suitability of representatives' recommendations to customers relating to early rollovers of UITs. According to FINRA, because of the long-term nature of UITs as well as their structures and costs, short-term trading of UITs (early rollovers) may be unsuitable. FINRA alleged that SagePoint's WSPs did not discuss early rollovers or series-to-series early rollovers or otherwise provide guidance to supervisors about how to monitor for potentially unsuitable patterns of early rollovers. FINRA also alleged that SagePoint did not use any automated reports, alerts, or similar tools to supervise for potentially unsuitable patterns of early rollovers, and SagePoint's review of UIT transactions through its order entry system was not focused on suitability concerns related to early UIT rollovers. FINRA further alleged that this may have caused customers to incur $1,315,373.01 in sales charges that they would not have incurred had they held the UITs until their maturity dates. SagePoint agreed to a censure, a $300,000 fine, and payment of restitution of $1,315,373.01 plus interest to affected accounts.

Stifel Nicolaus & Co., **FINRA AWC No. 2016050948201 (May 28, 2020)**

FINRA entered into a settlement with Stifel, Nicolaus & Company, Incorporated (Stifel) in which FINRA alleged that from January 2012 through December 2016 Stifel failed to establish and maintain a supervisory system and failed to establish, maintain, and enforce WSPs reasonably designed to supervise the suitability of representatives' recommendations to customers relating to early rollovers of UITs. According to FINRA, because of the long-term nature of UITs as well as their structures and costs, short-term trading of UITs (early rollovers) may be unsuitable. FINRA alleged that, although the firm's WSPs referenced a UIT Switch Letter that representatives could use when a client sold a position in a UIT prior to maturity to purchase another UIT or a mutual fund, the WSPs did not provide guidance about when switch letters should be sent or how supervisors should monitor for potentially unsuitable patterns of early UIT rollovers. FINRA further alleged that Stifel used an automated surveillance alert to detect potential early rollovers, but the alert failed to identify switches from one UIT to another. FINRA found that Stifel became aware of the alert failure in or around April 2012, but did not inform its branch managers who were responsible for reviewing the alert. FINRA also found that the compliance department developed an alternative system to flag switches from one UIT to another in April 2013, but it was not reasonably designed because it only flagged certain types of UITs, and it stopped functioning as intended in May 2015. FINRA further found that Stifel sent switch letters to approximately 639 customers that contained inaccurate information about the sales charge costs. As a result, the AWC alleges that Stifel may have caused customers to incur $1,891,188.13 in sales charges that they would not have incurred had they held the UITs until their maturity dates. Stifel agreed to a censure, a $1.75 million fine, and payment of restitution of $1,891,188.13 plus interest to affected accounts.

Variable Annuities

TransAmerica Financial Advisors, Inc., **FINRA AWC No. 2015048250401 (Dec. 21, 2020)**

FINRA entered into a settlement with TransAmerica Financial Advisors, Inc. (TFA) regarding allegations that TFA failed to reasonably supervise its representatives' recommendations of variable annuities, mutual funds, and 529 plans. According to FINRA, from May 1, 2010 through May 15, 2016 TFA failed to reasonably supervise its representatives' variable annuity recommendations, failing among other things to detect that certain of its representatives made thousands of misstatements to customers in recommending variable annuity exchanges. Specifically, TFA required its registered representatives to complete disclosure forms when recommending a variable annuity exchange, but FINRA found that TFA failed to provide adequate training regarding how to complete the forms and how supervisors should verify the information on the forms. In addition, FINRA alleged that TFA failed to reasonably surveil its representatives' rates of variable annuity exchanges, because the parameters of the exception report it utilized were not reasonably designed. FINRA also alleged that TFA failed to reasonably supervise variable annuity share-class recommendations by not providing reasonable training and guidance to its representatives and supervisors on the features, fees, and surrender charges of the share classes, and by lacking a system to detect red flags of inappropriate share-class recommendations. FINRA further alleged that TFA failed to take appropriate action when it became aware of red flags regarding variable annuity share-class recommendations. From January 1, 2009 through November 15, 2016, FINRA found that TFA failed to reasonably supervise its representatives' sale of certain mutual funds because it had no system or processes to detect whether available sales charge waivers were applied properly. Finally, FINRA found that TFA failed to reasonably supervise its representatives' 529 plan share-class recommendations from May 1, 2010 through May 31, 2015. In particular, FINRA found that TFA did not provide adequate guidance to its representatives regarding the importance of considering share-class differences, and failed to provide supervisors with adequate guidance for review of 529 plan share-class recommendations. TFA agreed to a censure, a $4.4 million fine, and payment of $4,354,160 in restitution ($3,594,754 related to inaccurate exchange disclosures, $438,239 related to mutual fund sales charge waivers, and $321,167, plus interest, related to 529 recommendations).

Wells Fargo Clearing Services, LLC & Wells Fargo Advisors Financial Network, LLC, **FINRA AWC No. 2016052124001 (Sept. 2, 2020)**

FINRA entered into a settlement with Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC (together, Wells Fargo) regarding allegations that Wells Fargo failed to establish and maintain a supervisory system, and failed to enforce WSPs that were reasonably designed to achieve compliance with FINRA's suitability rule related to switches from variable annuities to investment company products. According to the AWC, from January 2011 through August 2016 several of Wells Fargo's registered representatives recommended that customers surrender more than 50,000 variable annuities with a principal value of more than $5 billion, but Wells Fargo failed to verify that these switches were subject to supervisory reviews as required by its WSPs. FINRA also alleged that Wells Fargo's supervisory system did not generate switch alerts for switches from variable annuities to investment company products, and therefore Wells Fargo did not send switch letters to clients and did not subject the switches to qualified supervisor review to determine if they were suitable. Wells Fargo Clearing Services, LLC consented to a censure, a fine of $625,000, and payment of $1,355,499.19 plus interest in restitution; Wells Fargo Advisors Financial Network, LLC agreed to a censure, a $50,000 fine, and payment of $86,668.31 plus interest in restitution.

Morgan Lewis

Securities Enforcement Practice

BOSTON

Timothy P. Burke	+1.617.951.8620	timothy.burke@morganlewis.com
David C. Boch	+1.617.951.8485	david.boch@morganlewis.com
Jeff Goldman	+1.617.951.8941	jeff.goldman@morganlewis.com
Thomas J. Hennessey	+1.617.951.8520	thomas.hennessey@morganlewis.com
Jason S. Pinney	+1.617.951.8684	jason.pinney@morganlewis.com
T. Peter R. Pound	+1.617.951.8728	peter.pound@morganlewis.com

MIAMI

Ivan P. Harris	+1.305.415.3398	ivan.harris@morganlewis.com

NEW YORK

Michèle A. Coffey	+1.212.309.6917	michele.coffey@morganlewis.com
Ariel Gursky	+1.212.309.6205	ariel.gursky@morganlewis.com
Brian A. Herman	+1.212.309.6909	brian.herman@morganlewis.com
Ben A. Indek	+1.212.309.6109	ben.indek@morganlewis.com

PHILADELPHIA

G. Jeffrey Boujoukos	+1.215.963.5117	jeff.boujoukos@morganlewis.com
Laura Hughes McNally	+1.215.963.5257	laura.mcnally@morganlewis.com

SAN FRANCISCO

Joseph E. Floren	+1.415.442.1391	joseph.floren@morganlewis.com
Susan D. Resley	+1.415.442.1351	susan.resley@morganlewis.com

WASHINGTON, DC

Russell M. Fecteau	+1.202.373.6236	russell.fecteau@morganlewis.com
Ivan P. Harris	+1.202.739.5692	ivan.harris@morganlewis.com

Investment Management Practice

BOSTON

Marion Giliberti Barish	+1.617.951.8801	marion.barish@morganlewis.com
Katherine Dobson Buckley	+1.617.341.7531	katherine.buckley@morganlewis.com
Lea Anne Copenhefer	+1.617.951.8515	leaanne.copenhefer@morganlewis.com
Richard A. Goldman	+1.617.951.8851	rich.goldman@morganlewis.com
Barry N. Hurwitz	+1.617.951.8267	barry.hurwitz@morganlewis.com
Roger P. Joseph	+1.617.951.8247	roger.joseph@morganlewis.com
Jeremy B. Kantrowitz	+1.617.951.8458	jeremy.kantrowitz@morganlewis.com
Gerald J. Kehoe	+1.617.341.7840	gerald.kehoe@morganlewis.com
Daniel A. Losk	+1.617.341.7783	daniel.losk@morganlewis.com
Paul B. Raymond	+1.617.951.8567	paul.raymond@morganlewis.com
Toby R. Serkin	+1.617.951.8760	toby.serkin@morganlewis.com
Stephen C. Tirrell	+1.617.951.8833	stephen.tirrell@morganlewis.com

CHICAGO

Michael M. Philipp	+1.312.324.1905	michael.philipp@morganlewis.com

DALLAS

Carrie J. Rief	+1.214.466.4159	carrie.rief@morganlewis.com

MIAMI

Ethan W. Johnson	+1.305.415.3394	ethan.johnson@morganlewis.com

NEW YORK

Thomas V. D’Ambrosio	+1.212.309.6964	thomas.dambrosio@morganlewis.com
Christopher J. Dlutowski	+1.212.309.6046	christopher.dlutowski@morganlewis.com
Robert D. Goldbaum	+1.212.309.6161	robert.goldbaum@morganlewis.com
Christine M. Lombardo	+1.212.309.6629	christine.lombardo@morganlewis.com
Nathan R. Pusey	+1.212.309.6340	nathan.pusey@morganlewis.com
Louis H. Singer	+1.212.309.6603	louis.singer@morganlewis.com
Jedd H. Wider	+1.212.309.6605	jedd.wider@morganlewis.com
Joseph D. Zargari	+1.212.309.7020	joseph.zargari@morganlewis.com

LOS ANGELES

Ayman A. Khaleq	+1.213.612.7459	ayman.khaleq@morganlewis.com

ORANGE COUNTY

Laurie A. Dee	+1.714.830.0679	laurie.dee@morganlewis.com
Jarrod A. Huffman	+1.714.830.0633	jarrod.huffman@morganlewis.com

PHILADELPHIA

David W. Freese	+1.215.963.5862	david.freese@morganlewis.com
Sean Graber	+1.215.963.5598	sean.graber@morganlewis.com
Timothy W. Levin	+1.215.963.5037	timothy.levin@morganlewis.com
Christine M. Lombardo	+1.212.309.6629	christine.lombardo@morganlewis.com
John J. O'Brien	+1.215.963.4969	john.obrien@morganlewis.com

SAN FRANCISCO

Peter M. Phleger	+1.415.442.1096	peter.phleger@morganlewis.com
Miranda Lindl O'Connell	+1.415.442.1118	miranda.lindl-oconnell@morganlewis.com

WASHINGTON, DC

John V. Ayanian	+1.202.739.5946	john.ayanian@morganlewis.com
Gregg S. Buksbaum	+1.202.739.5080	gregg.buksbaum@morganlewis.com
Laura E. Flores	+1.202.373.6101	laura.flores@morganlewis.com
Thomas S. Harman	+1.202.373.6725	thomas.harman@morganlewis.com
Charles M. Horn	+1.202.739.5951	charles.horn@morganlewis.com
Lindsay B. Jackson	+1.202.739.5120	lindsay.jackson@morganlewis.com
Daniel R. Kleinman	+1.202.739.5143	daniel.kleinman@morganlewis.com
Amy Natterson Kroll	+1.202.739.5746	amy.kroll@morganlewis.com
W. John McGuire	+1.202.373.6799	john.mcguire@morganlewis.com
Christopher D. Menconi	+1.202.373.6173	christopher.menconi@morganlewis.com
Courtney C. Nowell	+1.202.739.5223	courtney.nowell@morganlewis.com
Ignacio Sandoval	+1.202.739.5201	ignacio.sandoval@morganlewis.com
Steven W. Stone	+1.202.739.5453	steve.stone@morganlewis.com
Donald S. Waack	+1.202.739.5277	donald.waack@morganlewis.com
Joseph (Beau) Yanoshik	+1.202.373.6133	beau.yanoshik@morganlewis.com

ABOUT MORGAN, LEWIS & BOCKIUS LLP

Morgan Lewis is recognized for exceptional client service, legal innovation, and commitment to its communities. Our global depth reaches across North America, Asia, Europe, and the Middle East with the collaboration of more than 2,200 lawyers and specialists who provide elite legal services across industry sectors from multinational corporations to startups around the world. For more information about us, please visit www.morganlewis.com and connect with us on LinkedIn, Twitter, Facebook, Instagram, and WeChat.