K&L GATES
LEGAL INSIGHT

07 December 2015

Practice Group(s):

Government Enforcement

Global Government Solutions

Broker-Dealer

Securities Enforcement

SEC Enforcement Actions Against Broker-Dealers

By: Jonathan Eisenberg

In its 2015 Financial Report, the SEC repeated its view that one of the two principal purposes of the Securities Act of 1933 and the Securities Exchange Act of 1934 is to ensure that "people who sell and trade securities — brokers, dealers and exchanges — must treat investors fairly and honestly, putting investors' interests first."[1] Broker-dealers have been and remain a critical focus of the Commission's enforcement program.[2] In the first 11 months of 2015, the SEC brought enforcement actions against broker-dealers in approximately two dozen distinct areas, with sanctions ranging from less than $100,000 to nearly $180 million.

In the vast majority of these cases, the central theme was that broker-dealers did not put investors' interests first or otherwise failed to comply with safeguards (such as registration provisions) designed to protect investors. Nevertheless, because broker-dealers engage in such a wide range of activities, the variety of cases is striking. They cover the waterfront of broker-dealer practices. We discuss the more significant cases below under the following categories:

1. Alternative Trading System Violations
2. Best Execution Failures
3. Blue Sheet Inaccuracies
4. Broker-Dealer Registration Violations by Overseas Firms
5. Broker-Dealer Registration Violations by U.S. Firms
6. Complex Product Disclosures
7. Cybersecurity Compliance and Controls
8. Excessive Markups
9. Foreign Corrupt Practices Act Violations
10. Immigrant Investment Programs
11. Improper Extensions of Credit for Securities Purchases
12. Inadequate Supervision of Outside Business Activities
13. Insider Trading and Material Nonpublic Information
14. Investment Fraud
15. Manipulative Trading: Spoofing and Layering
16. Market Access Rule Violations
17. Misappropriation of Client Funds
18. Municipal Bond Disclosures
19. Municipal Bond Pricing

20. Penny Stock Fraud and Registration Violations
21. Ponzi Schemes
22. Pricing-Related Misrepresentations
23. Short Sale Violations
24. Underwriting Practices
25. Unfair/Collusive Bidding Practices.

I. Alternative Trading System Violations: Failure to Disclose Proprietary Trading, Failure to Protect Confidential Customer Trading Information, and Selective Disclosure of Certain Favorable Order Types

An increasing number of Commission enforcement actions address market structure issues. The SEC's focus is on creating a level playing field, ensuring that operators of the alternative trading systems are transparent about how their systems work, including the order types that are available, prohibiting them from unfairly advantaging themselves or a select group of subscribers, and requiring them to disclose any conflicts they have.

In January 2015, the SEC charged a broker-dealer that operated dark pool with allowing certain subscribers to enter orders in increments smaller than a penny. [3] It did so despite the fact that orders in sub-penny increments violate Rule 612 of Regulation NMS and were contrary to the firm's general statement to subscribers that it would only accept orders priced in penny increments. By allowing certain subscribers to enter orders in sub-penny increments, those subscribers were able to get execution priority over other subscribers for a fraction of a penny. The Commission also charged that the firm failed to provide all subscribers with notice of a feature that could prevent an order from executing in the dark pool against orders from subscribers whose orders were designated as "non-natural" (typically orders from market makers and/or high-frequency trading firms). The Commission also charged that the firm should not have given access to confidential trading information of dark pool subscribers to 103 information technology personnel, who neither operated the dark pool nor had responsibility for compliance functions. As part of the settlement, the firm agreed to pay a $12 million civil money penalty, disgorgement of $2.2 million, and prejudgment interest of $236,000. In announcing the settlement, the enforcement staff ("Staff") stated, "The [firm's] dark pool was not a level playing field for all customers and did not operate as advertised. Our action shows our continued commitment to policing the equity markets to ensure fairness and compliance with all laws and rules."

In August 2015, the SEC charged the owner and operator of a dark pool with misrepresenting to the public that it was an "agency-only" broker that did not have conflicts of interest with its customers and that protected the confidentiality of customers' trade information.[4] According to the SEC, during the period at issue, the respondents operated an undisclosed proprietary trading desk that accessed live feeds of customer order and execution information and traded based on that information in other market centers. The Commission charged, among other violations, violation of Rule 301(b)(10) of Regulation ATS, which requires alternative trading systems to establish adequate safeguards and procedures to protect confidential trading information, and violation of disclosure provisions of the Securities Act. As part of the settlement, respondents agreed to pay an $18 million civil money penalty, $2.1 million in disgorgement, and $256,000 in prejudgment interest. In

announcing the settlement, the SEC stated that the firm "created a secret trading desk and misused highly confidential customer order and trading information for its own benefit. In doing so, [the firm] abused the trust of its customers and engaged in conduct justifying the significant sanctions imposed in this case."

The Commission has also proposed new rules to enhance transparency and oversight of alternative trading systems.[5] Under the proposed rule, alternative trading systems would have to disclose information regarding trading by the broker-dealer operator and its affiliates on the alternative trading systems, the types of orders and market data used, and the execution and priority procedures.

II. Best Execution: Failure to Obtain the Most Favorable Prices Reasonably Available

The Commission relies on best execution concepts to require broker-dealers to seek the best terms reasonably available for their customers and to rigorously review their execution practices.

In October 2015, the SEC charged two registered reps of a now-defunct brokerage firm with failing to obtain best execution for customer orders.[6] In those cases, the registered reps had a customer who was a proprietary trader at another firm. They unnecessarily inserted him into trades with their other customers, resulting in those customers often trading at unfavorable prices. The SEC stated that they violated their duty of best execution, which required them to "obtain the most favorable terms reasonably available under the circumstances" to "conduct a regular and rigorous review of its practices in light of market and technology changes" and to "assess which competing markets, market makers, or electronic communications networks offer the most favorable terms for customers' orders." The Commission's orders barred the reps from the securities industry, imposed civil money penalties of $125,000 and $50,000, and required disgorgement of $6,300. In announcing the settlements, the Staff stated, "These brokers repeatedly shirked their obligation to seek best execution for their customers so they could get extra commissions for their firm and better prices for favored customers. They are now paying the price for putting the interests of favored customers and themselves ahead of the interests of their other customers."

III. Blue Sheets: Providing Inaccurate Customer Trading Data to Regulators

Firms routinely provide responses to SEC and Financial Industry Regulatory Authority ("FINRA") requests for detailed information about trades by the firm and its customers. The term "blue sheet" stems from the color of the forms originally used to make the requests and has persisted even though the requests have been made electronically since the 1980s. Regulators often use blue sheet requests as part of their investigations into insider trading and market manipulation.

In September 2015, the Commission fined a firm $4.25 million for submitting deficient information over a two-year period about trades done by its customers.[7] In announcing the settlement, the Staff stated, "Accurate and complete blue sheet data is essential to the Commission's efforts to detect many forms of unlawful conduct. We will continue to hold broker-dealers who fail to comply with their obligation to provide the Commission with reliable blue sheet data accountable for their failure."

IV. Broker-Dealer Registration Violations by Overseas Firms Doing Business in the United States

The Commission views broker-dealer registration requirements as a core protection for investors. In most years, it brings multiple enforcements actions against broker-dealers that engaged in the business of effecting transactions in securities but failed to register as broker-dealers.

In November 2014 (which is part of the Commission's 2015 fiscal year), the Commission charged that, between 2003 and 2011, relationship managers of a Swiss private banking unit of a UK bank travelled to the United States on at least 40 occasions to solicit new clients or service existing clients by providing investment advice or soliciting or attempting to solicit securities transactions.[8] The bank maintained as many as 368 U.S. client accounts with as much as $775 million in securities assets under management, and it received $5.72 million in transaction-based compensation or advisory fees in connection with these activities. The Commission concluded that these activities required the bank to register as both a broker-dealer and investment adviser in the United States. The matter was settled for disgorgement, civil money penalties, and prejudgment interest of $12.5 million.

V. Broker-Dealer Registration Violations by Unregistered U.S. Firms Engaged in the Business of Effecting Transactions in Securities

In January 2015, the SEC charged that a lender that accepted penny stocks as collateral and then routinely sold the penny stock collateral violated U.S. broker-dealer registration requirements.[9] The Commission's order stated that, unlike a traditional lender, the firm generated relatively little of its cash flow from its customers' payment of interest, fees, or repayment of principal and instead depended on the proceeds from the sale of the penny stock collateral for its profits. As part of the settlement, respondents agreed to pay $2.2 million in civil money penalties, $2.1 million in disgorgement and prejudgment interest, and, in one case, to be barred from the securities industry and penny stock offerings for three years. In announcing the settlement, the Staff stated, "By selling billions of shares of penny stocks without registering with the SEC, [the firm] and its principals subverted core protections provided to investors by the broker-dealer registration provisions."

In March 2015, the Commission charged nearly two dozen companies and individuals with failing to register as broker-dealers.[10] The Commission charged that in order to increase its allocation of new issues of corporate bonds, a corporation transferred money to the accounts of 20 entities and individuals to purchase the bonds in their own names but in reality on behalf of the corporation. Over a three-year period, they purchased $2.5 billion in new issues on the corporation's behalf and $2.3 billion in securities on the secondary market on the corporation's behalf. They were compensated based on the corporation's profits when the shares were sold. As part of the settlement, respondents agreed to pay $2.4 million in disgorgement and $1,005,000 in civil money penalties.

In April 2015, the Commission charged 12 companies and six individuals with defrauding investors in connection with investments in a company that prepared applications for Federal Communications Commission cellular spectrum licenses.[11] The Commission charged that by soliciting investors to purchase membership interests or units through one-on-one meetings, live presentations, video presentations, a radio show, conference calls, and email; discussing the merits of the investment with potential investors; and receiving compensation

from investor funds, six of the defendants violated the broker-dealer registration requirements of the federal securities laws. The matter is in litigation.

In July 2015, the SEC charged 15 individuals and 19 entities (some of which were located in the United States and some of which were located in Costa Rica) with acting as unregistered broker-dealers in connection with a scheme to manipulate the market for microcap securities. The complaint alleged that by soliciting customers, handling customer funds or securities, maintaining customer accounts, placing orders at customers' instruction, holding securities through accounts they controlled, providing online access to information about trades and the ability to log in and enter transactions, as well as by charging commissions, the defendants provided brokerage services that required registration.

VI. Complex Products: Offering Materials that Failed to Disclose an Affiliate's Actions that Adversely Affected Performance

Complex products have grown significantly over the last decade as investors reached for yield in a low interest rate environment. They often involve embedded derivatives and may include, for example, structured products, equity-indexed annuities, leverage and inverse exchange-traded funds, principal protected notes, reverse convertibles, and commodity futures-linked securities. The SEC has a separate unit within the Enforcement Division that conducts investigations into complex financial instruments. It is particularly focused on ensuring that firms clearly disclose the risks of the products that they sell and have supervisory controls designed to ensure that recommendations of complex products are suitable.

In October 2015, the Commission brought its first case charging a broker-dealer issuer of structured notes with issuing misleading offering materials.[12] In that case, the performance of the structured notes was based on a hypothetical trading strategy designed to identify and exploit trends in certain foreign exchange foreign rates. The offering materials, however, did not disclose that the returns could be adversely affected by actions taken by an affiliate, including the markups in the firm's hedging transactions, the firm's discretionary spot desk spreads, and the firm's trading ahead of its hedging transactions. It stated that the firm failed to implement effective policies and procedures to ensure that the individuals responsible for drafting and reviewing the offering materials in the United States were aware that the overseas parent company's employees were engaged in conduct that negatively impacted, or had the potential to negatively impact, the returns on the notes. It required the firm to pay $10 million in disgorgement, an $8 million civil money penalty, and $1.5 million in prejudgment interest. It imposed the penalty despite acknowledging the firm's "substantial cooperation" in conducting an internal investigation, providing information and analysis to the Commission's Staff, making arrangements for overseas witnesses to travel to the United States for interviews with the Staff, and voluntarily implementing remedial measures. In announcing the settlement, Chair White stated, "This first-of-its-kind case involving misstatements and omissions by a structured note issuer shows that the SEC continues its commitment to pursue wrongdoing across the securities industry in order to better protect investors. It is critical that large global financial institutions have and implement policies and procedures designed to ensure that all facts relevant to investors are made known to individuals responsible for disclosure." Further, she said, "We will remain focused on protecting investors who are not in a position to protect themselves by virtue of their limited access to information, the complexity of the product, or both."

SEC Enforcement Actions Against Broker-Dealers

In January 2015, the Commission also issued an investor bulletin on structured notes, setting forth the types of risks involved in the purchase of such notes and the questions investors should ask before purchasing structured notes.[13] In August 2015, the SEC's Office of Compliance Inspections and Examinations ("OCIE") National Examination Program staff issued a risk alert on "Broker-Dealer Controls Regarding Retail Sales of Structured Securities Products."[14] The risk alert, based on the examination of 10 broker-dealer branch offices, found that firms failed to maintain and/or enforce adequate controls relating to determining the suitability of structured product recommendations, and also failed to conduct both compliance and supervisory reviews of representatives' determinations of customer suitability for structured products, as required by their internal controls.

VII. Cybersecurity: Inadequate Compliance and Controls

The SEC did not bring any cybersecurity cases against broker-dealers in 2015, but in February 2015, OCIE published a summary of the results of its cybersecurity examination of 57 registered broker-dealers and 49 registered investment advisers to assess their vulnerability to cyber-attacks.[15] Among other findings were that written policies and procedures generally failed to address how firms determine whether they are responsible for client losses associated with cyber incidents, most firms reported that they had been the subject of cyber-related incidents, approximately two-thirds of broker-dealers had a chief information security officer, and over half of broker-dealers have insurance for cybersecurity incidents, but only one broker-dealer had filed a claim. On September 15, 2015, the Commission announced a second round of cybersecurity examinations and provided guidance with respect to governance and risk assessment, access rights and controls, data loss prevention, vendor management, training, and incident response.[16] Cybersecurity compliance and controls remain a key examination priority.[17] As examinations increase, the likelihood of future enforcement actions increases as well.

VIII. Excessive Markups

Most excessive mark-up cases are brought by FINRA rather than the SEC. Nevertheless, in February 2015, the Commission announced that the former CEO of a brokerage firm had agreed to pay more than $783,000 and admit wrongdoing in connection with a case in which the firm routed trading orders to an offshore affiliate in order to take hidden mark-ups and mark-downs.[18] The Commission's complaint alleged that steps taken by the firm included suspending hidden mark-ups and mark-downs when customers were monitoring execution prices, using an algorithm and anonymous broker code when trading in a transparent market to prevent a customer from discovering the hidden charges, taking charges that kept the customers' prices within the high and low of the market for the day, and refraining from taking hidden mark-ups on trades of customers who notified employees that they might request detailed trade execution price data. In a prior action, the firms involved paid $107 million and admitted wrongdoing to settle the charges. In announcing the settlement against the executive, the Staff said, "Senior executives cannot permit deceptive practices by their subordinates. [The executive] not only condoned such conduct, but he specifically authorized practices that kept customers in the dark."

IX. Foreign Corrupt Practices Act and Similar Anti-Corruption Violations: Providing Student Internships to Family Members of Foreign Government Officials and Making Payments to Influence a Government's Choice of Underwriters

The Foreign Corrupt Practices Act ("FCPA") prohibits the payment of anything of value to foreign officials to assist in obtaining or retaining business. It also requires issuers to maintain a system of internal controls sufficient to provide reasonable assurances that transactions are executed and assets are accounted for in accordance with management's authorization. The Commission did not bring any FCPA cases against broker-dealers in 2015. Nevertheless, because the FCPA remains a high priority for the Enforcement Division and the Division has a specialized unit focused on FCPA enforcement actions, we mention two matters below that should be of particular interest to broker-dealers.

In August 2015, the SEC charged that a financial institution violated the FCPA by providing student internships to family members of foreign government officials affiliated with a sovereign wealth fund in order to retain and win business managing and servicing the assets of the fund.[19] The Commission alleged that the foreign officials requested the internships for their family members, and that providing the internships was seen by certain employees of the firm as a way to influence the officials' decisions with respect to the sovereign wealth fund business. It also alleged that the firm provided the internships without following its standard hiring procedures for interns and that the interns were not qualified under the existing internship programs. Under the terms of the settlement, the firm paid $8.3 million in disgorgement, a $5 million civil money penalty, and $1.5 million in prejudgment interest. The Commission imposed a civil money penalty despite acknowledging the firm's cooperation and remedial acts, including, prior to the Commission's investigation, explicitly addressing the hiring of government officials' relatives in its anti-corruption policy. In announcing the settlement, the Staff stated, "The FCPA prohibits companies from improperly influencing officials with 'anything of value,' and therefore cash payments, gifts, internships, or anything else used in corrupt attempts to win business can expose companies to an enforcement action."

In November 2015, the Commission charged a London-based underwriter, which acted as lead manager in a debt offering by the Government of Tanzania, with failing to disclose a $6 million payment made by an affiliate to a Tanzanian firm that performed no substantive role in the transaction.[20] The complaint alleged that the $6 million payment was intended to induce the Government of Tanzania to select the firm to manage the offering. The SEC did not charge an FCPA violation because the firm was not an "issuer" within the meaning of the FCPA; instead it accomplished the same thing indirectly by charging disclosure violations and requiring the firm to disgorge $8.4 million and to pay a $4.2 million civil penalty. Simultaneously, the United Kingdom's Serious Fraud Office announced a settlement that brought the total monetary relief to $36.9 million. In announcing the SEC settlement, the Staff stated, "This action …demonstrates that when suspicious payments made anywhere in the world result in tainted securities offerings in the United States, the SEC is fully committed to taking action against the responsible parties."

X. Immigrant Investment Programs: Failure to Register as a Broker-Dealer

The EB-5 Immigrant Investor Program allows foreign applicants to qualify for a visa by investing $1 million in an approved U.S. commercial enterprise. In June 2015, the SEC brought its first case against brokers handling investments in the government's EB-5 program. [21] The Commission charged that the respondents used their website to solicit EB-5 investors by offering to assist them in choosing the right EB-5 investments, and putting them in touch with regional centers that paid referral fees to the respondents. Ultimately, over 158 foreign investors invested $79 million through the regional centers. The respondents agreed to a cease and desist order against violating the broker-dealer registration requirements and agreed to have a hearing officer conduct additional proceedings to determine whether disgorgement or civil money penalties should be awarded. In announcing the action, the Staff stated, "While raising money for EB-5 projects in the U.S., these two firms were not registered to legally operate as securities brokers. The broker-dealer registration requirements are critical safeguards for maintaining the integrity of our securities markets, and the SEC will vigorously enforce compliance with these provisions."

XI. Improper Extension of Credit for Securities Transactions: Use of Non-Purpose Lines of Credit to Purchase Securities and Extension of Margin Based on Speculative Collateral

Broker-dealer customers often purchase securities on margin, but the Commission has brought enforcement actions where they used other forms of credit to purchase securities and when brokers accepted speculative collateral in extending margin loans.

In September 2015, the SEC charged a broker-dealer with failing to supervise a registered rep who permitted customers to use non-purpose lines of credit from the broker-dealer's affiliated bank to invest in affiliated closed-end funds.[22] The bank itself prohibited the use of the loans to purchase, carry, or trade securities. The SEC alleged that the registered rep advised clients to transfer money from their accounts with the affiliated bank to an outside bank account, wait a few days, deposit the money from the outside bank account into the customer's brokerage account, and then use the proceeds to purchase the closed-end funds. The Commission charged that the firm failed to establish or implement reasonable procedures to prevent and detect the rep's misconduct, stating that the firm failed to monitor the use of loans that were first transferred to an outside bank before being deposited with the broker-dealer and used to purchase securities. As part of the settlement, the firm agreed to pay a civil money penalty of $13.6 million, disgorgement of $1.2 million, and $174,000 in prejudgment interest. In announcing the settlement, the Staff stated, "[The firm] lacked reasonable systems for ensuring compliance with the firm's prohibition on loan recycling and to ensure that brokers adequately conveyed the risks involved in lines of credit." In a separate action, the Commission imposed a $25,000 penalty on the supervisor and suspended him from acting in a supervisory role for one year.[23] In a third proceeding, which is being litigated, the Commission charged the broker with engaging in a fraudulent scheme by soliciting customers to improperly use proceeds from non-purpose lines of credit to purchase shares of closed-end funds.[24]

In September 2015, the Commission charged four officials from a clearing broker-dealer (which subsequently filed for bankruptcy) for their role in the firm providing customers nearly $100 million in margin loans that were secured by risky, unrated municipal bonds, and, when

the loans became impaired, improperly accounting for the losses rather than liquidating the collateral.[25] The individuals settled by paying $175,000 in civil money penalties and being suspended or barred from the securities industry. In announcing the settlements, the Staff stated, "[The firm] took on extraordinary risks as a broker-dealer by making margin loans to certain customers backed by speculative collateral. When these loans became impaired, [the firm's] leadership improperly placed more of [the firm's] critical capital at risk to bail out these customers instead of timely recording the losses and disclosing the truth about the loans."

XII. Inadequate Supervision of Outside Business Activities

Most outside business activities cases are brought by FINRA rather than the SEC. The Commission, however, brought one outside business activities case against a broker-dealer in 2015 because the outside business activities were used to defraud investors.

In March 2015, the Commission charged a brokerage firm with failing to adequately supervise the outside business activities of registered reps, who caused customers to transfer funds to the registered reps' outside business accounts.[26] According to the SEC's order, the firm had more than 4,500 registered reps working as independent contractors who also operated tax businesses outside of their securities businesses. It alleged that some of the representatives used those businesses to defraud brokerage customers, including by transferring customer brokerage funds into their outside business accounts. The Staff stated that the firm's procedures were inadequate because there were no policies and procedures in place to review third-party disbursements from customer brokerage accounts to determine whether funds were being transmitted to registered representatives' other business activities or other entities controlled by its representatives. As part of the settlement, the Commission imposed a $225,000 civil money penalty and required the firm to retain an independent consultant to review its supervisory procedures. In announcing the settlement, the Staff stated, "[The firm] lacked sufficient supervisory controls to track the transfer of customer funds to outside entities controlled by its registered representatives." It acknowledged that firms "face greater challenges in supervising their representatives in numerous small branch offices spread across the country," but concluded "that doesn't excuse the firm from establishing adequate policies and procedures to address those challenges."

XIII. Insider Trading and Procedures to Protect Material Nonpublic Information

Several of the Commission's insider trading cases involved brokers who came into possession of material nonpublic information and traded on or tipped the information to others. The Commission also charged firms with failing to enforce policies and procedures to prevent the misuse of material nonpublic information even when the Commission did not charge insider trading violations.

Three broker-dealer cases are of particular interest — one because the Commission suffered a rare loss before an administrative law judge ("ALJ") and two because they focused on the adequacy of procedures regardless of whether the Commission could show an insider trading violation.

First, in September 2015, an ALJ dismissed insider trading claims against a trader who allegedly received tips of forthcoming rating changes before they were made public.[27] The

SEC Enforcement Actions Against Broker-Dealers

ALJ held that while the Division established that the trader traded on such tips in four instances, it did not satisfy its burden of proving that the analyst tipped the trader for the personal benefit of the analyst, as required by *Dirks v. SEC*, 463 U.S. 646 (1983) and, more recently, *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), *cert. denied,* 136 S. Ct. 242 (2015). To prove an insider trading violation, *Newman* requires the Commission to show a substantial *quid pro quo* (i.e., that the tipper benefitted from the tip in a concrete, consequential way) and that the tippee knew or at least should have known of the personal benefit to the tipper.[28]

In August 2015, the Commission charged that a broker-dealer violated Section 15(g) of the Securities Exchange Act, which requires broker-dealers to establish and enforce policies and procedures to prevent the misuse of material, nonpublic information.[29] The Commission did not allege that material nonpublic information was used improperly, but instead alleged that during a 10-year period, the firm failed to review thousands of trades executed by several of its trading desks because certain data feeds used to restrict trading omitted securities trades, swap trades, and other trades that could have been prohibited. In addition, the firm failed to monitor certain trades for intra-day changes in trading position if the end-of-day position remained unchanged and also failed to monitor trades on one of the firm's legacy platforms. The firm settled for a civil money penalty of $15 million. In announcing the settlement, the Staff stated, "Today's high-speed markets require that broker-dealers and investment advisers manage the convergence of technology and compliance. Firms must ensure that they have devoted sufficient attention and resources to trade surveillance and other compliance systems."

In October 2015, the Commission charged a broker-dealer, as well as its affiliated investment adviser, with failing to maintain and enforce policies and procedures to prevent the misuse of material nonpublic information.[30] In that case, after the issuer of an exchange-traded note suspended new issuances of the note, the two shared information about their trading positions, activities and strategies. The Commission alleged that these communications were contrary to the physical separation that the written policies and procedures required to be maintained between the two entities and that, to the extent that this sharing of information was permitted under the policies and procedures, the policies and procedures were not reasonably designed to prevent the misuse of material nonpublic information. It also stated that the procedures with regard to communication to partners "above the wall" were "vague and overbroad" because the persons described as being above the wall included "other senior management." As part of the settlement, the broker-dealer and the adviser each agreed to pay civil money penalties of $375,000 and the adviser also agreed to disgorge $364,000 and pay $39,000 in prejudgment interest. In announcing the settlement, the Staff stated, "The Federal securities laws require not only careful establishment of policies and procedures to prevent the misuse of material, nonpublic information, but also vigorous maintenance and enforcement of those policies and procedures."

Two other broker-dealer insider trading cases deserve mention. In June 2015, the Commission charged that a stockbroker received material nonpublic information about two pharmaceutical trials from his brother-in-law, who was a senior director of technology at a pharmaceutical company.[31] According to the complaint, the stockbroker purchased stock of the company where his brother-in-law worked in various customer accounts based on the confidential information and also tipped his friend and another broker, who, in turn,

purchased stock for himself and tipped others. The matter is in litigation and a parallel criminal action has been filed as well.

In October 2015, the Commission announced that it had settled a case with a stockbroker who had previously been charged with insider trading in advance of more than a dozen pending corporate transactions.[32] In that case, the Commission charged that a former stockbroker received tips from a law firm employee regarding pending corporate transactions involving clients of the firm. The complaint alleged that the tips were transmitted on Post-it® notes or napkins at meetings at an information booth at Grand Central Terminal and that after showing the tips to the stockbroker, the law firm employee would then eat the notes or napkins. Under the terms of the settlement, the stockbroker was ordered to disgorge his ill-gotten gains of $1.2 million, but that payment was deemed satisfied by the entry of orders of forfeiture in a parallel criminal case in which he pled guilty. He was also ordered to pay a civil penalty of $1.2 million and prejudgment interest.

XIV. Investment Fraud

The Commission typically brings a number of investment fraud cases against broker-dealers each year, often for misrepresenting the safety of investments, failing to disclose significant risks, or misrepresenting how the proceeds would be used. The Commission has the option of charging that defendants acted with "scienter" (reckless or knowing deception), or, instead charging a non-scienter based violation. Either when the conduct does not involve scienter, however, the Commission often describes the conduct as fraudulent.

In April 2015, the Commission filed an injunctive action against an individual alleging that he solicited veterans to invest by misrepresenting that investors were guaranteed to earn exorbitant returns, including doubling or tripling investor money in less than 120 days.[33] He also claimed that his firm had more than 65,000 clients. The Commission's complaint alleged that he violated antifraud provisions and registration requirements. The SEC is seeking financial penalties, disgorgement, and injunctive relief.

In May 2015, the Commission charged a retirement planning firm and its principals, including two individuals who hosted a weekly radio show, with misrepresentations related to interests in life settlements (i.e., interests in transactions in which an owner of a life insurance policy sells the policy to a third party for more than the policy's cash surrender value but less than the policy's net death benefit). The Commission alleged that the firm claimed that the interests were "guaranteed," "safe as CDs," "risk free," one in which "you cannot lose a dollar," and "federally insured."[34] In announcing the action, which is being litigated, the Staff stated that defendants "described speculative investments as safe and secure" and that "no matter what a salesperson tells you, interests in life settlements are never guaranteed, risk-free, or federally insured."

In August 2015, the Commission charged a broker-dealer and an affiliated investment adviser with recommending two now-defunct hedge funds and another fund in which approximately 4,000 investors invested $2.9 billion before the funds went under.[35] The Commission alleged that the respondents misrepresented the funds as "safe," "low-risk," "bond substitutes" and suitable for traditional bond investors. The SEC further charged that while the risk of principal loss was disclosed in written materials, certain financial advisers and the fund manager orally minimized the risk of loss resulting from the funds' investment strategy and use of leverage. The Commission also charged that the funds had an internal risk rating as having "significant risk to principal" but that the rating was not shared with the

majority of investors and financial advisers; that back testing revealed greater risk than was disclosed to investors; and that no changes were made to the way the funds were described to investors, even as their performance significantly declined and the risk of investor losses increased. The Commission charged the respondents with non-scienter fraud and, as part of the settlement, respondents agreed to pay $140 million in disgorgement and $40 million in prejudgment interest.

XV. Manipulative Trading: Layering and Spoofing

The Commission's market abuse unit is particularly focused on manipulative trading. One form of manipulation — "spoofing" — has been described as placing multiple orders that the trader does not intend to have executed on one side of the market (for example, to sell a stock) while nearly simultaneously placing an order that the trader intends to have executed on the opposite side of the market (for example, to buy the stock). The purpose of the non-bona fide sell orders is to create a false appearance of sell interest in order to induce market participants to execute against the trader's bona fide buy order at an artificially depressed price. Once the buy order is executed at the depressed price, the trader cancels the open non-bona fide sell orders.

In January 2015, the SEC filed an unsettled complaint against a trader for layering/spoofing.[36] [37] The Commission charged that the defendant led and managed several groups of online traders, based primarily in China and Korea, and worked with a gaming software company to develop hot keys that allowed his traders to quickly place and then cancel multiple orders via their computers with only a few key strokes. According to the complaint, each of the traders used at least two accounts — in one account, the trader would place multiple non-bona fide buy or sell orders in order to create upward or downward pressure on the stock price; in the other, the trader executed bona fide trades at prices affected by the activity in the first account. The accounts were held at different clearing firms to mask the coordination between the two. The matter is in litigation. A parallel criminal action was also filed. In announcing the SEC action, the Staff stated, "Layering is a deceptive practice to trick others into buying or selling a stock at artificially inflated or depressed prices. No matter where they are located, we continue to identify and investigate those whose trading practices threaten to undermine the fair operations of the U.S. securities markets."

In October 2015, the Commission charged a proprietary trading firm and one of its co-founders with spoofing.[38] The Commission alleged that the respondent placed pre-open non-bona fide orders on the NYSE to affect perceptions of order imbalance prior to the market open, and that the firm did not intend to execute the non-bona fide orders that were entered. The Commission's order noted that he engaged in the conduct only after first complaining to the NYSE, unsuccessfully, that other market participants were engaging in manipulative conduct involving large cancelled orders. As part of the settlement, respondents agreed to pay $525,000 in disgorgement, $500,000 in civil money penalties, and $38,000 in prejudgment interest. In announcing the settlement, the Staff stated, "Spoofing is an illegal tactic where traders place fake orders to trick others into trading at inflated or depressed prices. Today's action shows our ongoing resolve to prevent all forms of market manipulation."

While outside the scope of this article, it is noteworthy that in November 2015, a jury sitting in Chicago, after deliberating less than two hours, found a futures trader guilty in the first trial of

a criminal spoofing case.[39] [40] In that case, the trader acknowledged that he cancelled tens of thousands of orders, but argued, unsuccessfully, that he initially planned to follow through on the orders that were cancelled. Chicago Mercantile Exchange Rule 575, the anti-spoofing rule, states, “All orders must be entered for the purpose of executing bona fide transactions” and “No person shall enter or cause to be entered an order with the intent, at the time of order entry, to cancel the order before execution or to modify the order to avoid execution.”

XVI. Market Access Rule Violations: Insufficient Controls Over Coding Errors that Led to Erroneous Orders

SEC Rule 15c3-5, adopted in November 2010, requires broker-dealers to “appropriately control the risks associated with market access, so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system.” Subsection (b) of the rule requires broker-dealers with market access to “establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks” of having market access. The rule covers broker-dealer’s trading activities that place their own capital at risk, as well as brokers who permit customers to use a broker’s market participant identification. The Commission often relies on the rule in enforcement actions based on erroneous automated orders.

In June 2015, the Commission charged a broker-dealer with violating the market access rule because, as a result of a configuration error in one of its options order routers, the firm sent thousands of erroneous $1.00 limit orders to the options exchanges prior to the start of regular market trading. The Commission alleged that the error cost the firm $38 million and could have caused it up to $500 million in losses.[41] The firm agreed to pay a $7 million penalty to settle the charges. In announcing the settlement, the Staff stated, “Firms that have market access need to have proper controls in place to prevent technological errors from impacting trading.”

In September 2015, the SEC charged that, as a result of a coding change, a high-frequency proprietary trading firm sent millions of orders involving over four billion shares to exchanges that violated Rule 15c3-5 and Regulation NMS because they were not executed at the best available displayed price and because the firm lacked adequate post-trade surveillance tools.[42] As part of the settlement, the firm agreed to pay a penalty of $5 million, disgorgement of $2.8 million, and prejudgment interest of $270,000. In announcing the settlement, the Staff stated, “Automated trading systems can pose significant risks to the market and must be designed and implemented correctly. Firms that do not have control over their trading systems can undermine the integrity of our markets by sending millions of orders that violate SEC and stock exchange rules that promote fair and orderly trading.…”

XVII. Misappropriation of Client Funds

Unfortunately, each year unscrupulous broker-dealer employees steal money from their clients. The SEC brought a number of those cases in 2015.

In April 2015, the Commission charged a financial adviser of stealing at least $20 million from customers over more than three years.[43] According to the complaint, the individual persuaded two customers to withdraw money from their accounts on the promise that he would use the funds to purchase safe and secure municipal bonds for their accounts but,

instead, bought himself cashier's checks and deposited them into his own brokerage account or an account he controlled in the name of his wife. He then lost the bulk of the funds in options trading. He allegedly hid his theft by creating fake account statements and transferring money from one customer's account to another's to replenish the amounts that he had stolen earlier. The matter is in litigation and a separate criminal action has been filed.

In May 2015, the Commission brought fraud charges against multiple entities and individuals who raised $6.5 million to purchase securities but then allegedly commingled investors' funds with their own money and spent those funds on lavish personal expenses.[44] The matter is in litigation. A parallel criminal proceeding was also filed.

In May 2015, the Commission also brought fraud charges against a compliance director and two of his brothers, who solicited investors to invest in various companies but who then allegedly kept the money for themselves.[45] The investors were instructed to wire their investment funds to accounts that the compliance director had set up and controlled and, in some cases, were issued phony brokerage statements showing that their investments were performing well. The matter is in litigation.

In August 2015, the Commission obtained an injunction and a permanent bar against an individual who, over a two-year period, misappropriated $4.4 million from a trust account established for the benefit of a dementia patient and a scholarship trust account established for the purpose of providing scholarships to local students.[46] The Commission also obtained an order requiring the defendant to disgorge $4.4 million, pay a civil money penalty of $4.4 million, and pay prejudgment interest of $278,000.

In November 2015, the Commission charged a former stockbroker with raising more than $1.2 million from his brokerage customers, who were told they were purchasing real estate tax lien certificates that would earn returns of 6%–9% annually, but whose money was instead used to remodel the broker's home, make car payments, and pay bills for his father-in-law. A parallel criminal proceeding is also pending.

XVIII. Municipal Bond Disclosures: Underwriting of Offerings in Which Issuers Failed to Meet Continuing Disclosure Obligations

In March 2014, the SEC announced its Municipalities Continuing Disclosure Cooperation ("MCDC") Initiative announced in March 2014.[47] Under that initiative, the Commission agreed to provide favorable settlements to firms that self-reported violations of Rule 15c2-12, which prohibits underwriters from purchasing or selling municipal securities unless the issuer has committed to providing continuing disclosure regarding the security and the issuer, including information about its financial condition and operating data.

In June 2015, as part of the MCDC Initiative, the SEC alleged that between 2010 and 2014, 36 underwriting firms violated the securities laws by selling municipal bonds using offering documents that contained materially false statements or omissions about the bond issuers' compliance with their continuing disclosure obligations.[48] The fines ranged from $40,000 to $500,000. In announcing the settlements, Chair White stated, "The MCDC initiative has already resulted in significant improvements to the municipal securities market, including heightened awareness of issuers' disclosure obligations and enhanced disclosure policies and procedures. This ongoing enforcement initiative will continue to bring lasting changes to the municipal securities markets for the benefit of customers." In September 2015, the SEC

sanctioned 22 underwriting firms in connection with the MCDC Initiative.[49] The fines in those cases also ranged from $40,000 to $500,000.

XIX. Municipal Bond Pricing: Failure to Offer Bonds at the Initial Offering Price and Charging Excessive Markups in Secondary Market Transactions

In August 2015, the SEC brought its first-ever action charging a municipal bond underwriter and the former head of its municipal underwriting desk with overcharging customers on the sale of new bonds.[50] The Commission charged that in several offerings where the firm served as a co-manager or a member of the underwriting syndicate, the firm obtained new issue municipal bonds for its own inventory and then offered those bonds to customers for prices higher than the initial offering prices negotiated with the issuer before the bonds began trading. The Commission also charged that between January 2011 and October 2013, the firm lacked an adequate supervisory system to determine whether markups on municipal bonds sold in the secondary market were reasonable. The Commission acknowledged a number of remedial steps taken by the firm, including disclosure of markups and markdowns on fixed-income retail order trade confirmations, hiring of a dedicated compliance officer to work on its fixed-income desk in direct proximity to the municipal syndicate and secondary trading, retaining a consulting firm to review the firm's municipal business, and adopting new written supervisory procedures that stated that all bonds acquired in a new issuance may only be sold at the public offering price. Despite those steps, it imposed a $15 million penalty on top of the $4.5 million in disgorgement and $670,000 in prejudgment interest. In announcing the settlement, the Staff stated, "This enforcement action, which is the first of its kind, reflects our commitment to addressing abuses in all areas of the municipal bond market." Further, "[b]ecause current rules do not require dealers to disclose markups on municipal bonds, investors receive very little information about their dealer's compensation in municipal bond trades. It is therefore important that firms have adequate supervisory systems to ensure that they are complying with their fair price obligations."

XX. Penny Stock Fraud and Registration Violations

The SEC brought over a dozen cases in 2015 in connection with the sale of penny stocks. These cases often alleged fraud, manipulation, the sale of unregistered shares, or the failure to comply with U.S. broker-dealer registration requirements. The SEC has also issued a release on microcap fraud,[51] which comes complete with a public service announcement by Michael Douglas. We give a few examples of penny stock enforcement actions against broker-dealers below.

In January 2015, a major brokerage firm agreed to pay $10 million to settle SEC charges of improperly selling penny stocks in unregistered offerings on behalf of customers and an additional $10 million to settle a parallel action by the Treasury Department's Financial Crimes Enforcement Network.[52] The Commission alleged, and the firm admitted, that it executed sales of billions of shares of penny stocks for a Bahamian broker-dealer that was acting for its underlying customers, including many in the United States. The Commission alleged that the firm failed to file Suspicious Activity Reports; failed to properly report, withhold, and remit more than $3 million in withholding taxes; and failed to recognize the resulting liabilities and expenses on its books and records. The Commission also charged

that the firm engaged in unregistered sales of billions of shares of penny stocks on behalf of another customer and failed to respond to red flags and conduct a searching inquiry into whether the sales were exempt from registration. In announcing the settlement, the Staff stated, "Despite red flags suggesting that [the firm's] customers' stock sales were not exempt from registration, [the firm] allowed unregistered sales to occur through its account failing in its gatekeeper role."

In January 2015, the SEC charged a firm that provides stock loans collateralized by penny stocks with selling more than nine billion shares of penny stocks, through purported stock-based loans, block trades, and other transactions, without registering as a broker-dealer.[53] The Commission alleged that over a three-year period, the firm provided $35 million in at least 149 non-recourse loans to customers based primarily on microcap stock collateral. It then liquidated nearly all of the 2.2 billion collateral shares associated with the loans, generating at least $49 million in trading proceeds. The Commission's order stated that, unlike a traditional lender, the firm generated relatively little of its cash flow from interest, fees, or repayment of principal, and it expected many of the loans to default. As part of the settlement, the firm agreed to pay $1.7 million in disgorgement and prejudgment interest and a $1.5 million penalty, while the individual defendants agreed to additional disgorgement and penalties and bars from the securities industry. In announcing the settlements, the Staff stated, "By selling billions of shares of penny stock without registering with the SEC, [the firm] and its principals subverted core protections provided to investors by the broker-dealer registration provisions."

In July 2015, the SEC charged 15 individuals and 19 entities for their roles in alleged schemes to manipulate trading of microcap stocks.[54] The SEC charged six firms with acting as unregistered broker-dealers catering to customers who sought to conceal their stock ownership and manipulate the market for microcap securities and charged defendants with fraud, manipulative trading, touting, and registration violations. Nine of the defendants were also named in a criminal indictment. The matter is in litigation. In announcing the settlement, the Staff stated, "This case demonstrates the Commission's resolve to relentlessly pursue the villains behind these microcap fraud schemes wherever in the world they may be hiding." Further, "This case presents an excellent example of the capacity the Microcap Fraud Task Force has developed to pierce the layers of sham entities and nominee accounts that predators employ to harm investors and evade detection by law enforcement."

XXI. Ponzi Schemes

The SEC brought several cases against brokers for engaging in Ponzi schemes in 2015. Typically, the brokers raised money by promising it would be invested in products offering unusually high returns, and the broker then used the money not to invest but for himself or to pay off other investors. Just by way of example, in July 2015, the Commission charged a former stockbroker with fraudulently selling so-called "certificates of deposit" to his brokerage customers by falsely claiming that he could get them higher interest rates of return than were otherwise available. He raised $15.5 million from at least 50 investors, but, according to the complaint, in some instances bought no CDs, and in others he purchased CDs but secretly redeemed them and took the proceeds. Besides spending investor money on himself, he used the money for purported interest payments and principal repayments to earlier investors. The matter is in litigation and parallel criminal charges have been filed as well.

XXII. Pricing-Related Misrepresentations: Misrepresenting the Firm's Own Costs

In September 2015, the Commission accused three traders of defrauding customers by misrepresenting the firm's costs of acquiring residential mortgage-back securities ("RMBS") that it sold to clients and misrepresenting whether the clients were getting the best prices on their RMBS transactions.[55] The Commission's complaint also alleged that they coached other employees to engage in the same types of misconduct by, among other things, coaching them to lie during negotiations and instructing them as to the precise lies to tell customers in order to extract extra, concealed profits. In announcing the action, which is being litigated, the Staff stated, "The alleged misconduct reflects a callous disregard for the integrity and obligations expected of registered securities professionals." With regard to deferred prosecution agreements for three other individuals, the Staff stated, "The SEC is open to deferring charges based on certain factors, including when cooperators come forward with timely and credible information while candidly acknowledging their own misconduct." A parallel criminal proceeding is pending against the three traders.

XXIII. Short Sale Violations: Violations of Reg SHO Locate Requirements and Violations of the Prohibition Against Participating in a Public Offering Within Five Business Days of Shorting the Issuer's Securities

Rule 203(b) of Reg SHO, generally referred to as the "locate" requirement, prohibits a broker-dealer from accepting a short sale order in an equity security (or effecting a short sale in an equity security for its own account) unless it has borrowed the security, entered 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. Absent countervailing factors, easy-to-borrow ("ETB") lists may provide reasonable grounds to believe that a security is available for borrowing as required by Rule 203(b). Information used to generate the ETB list must be less than 24 hours old, and the securities on the list must be readily available such that it would be unlikely that a failure to deliver would occur.

In June 2015, the SEC fined a broker-dealer and its affiliated clearing firm $11 million and required it to admit to wrongdoing because the firm's execution platforms were programmed to continue processing short sale orders based on the firm's ETB list even when the firm had determined that "countervailing factors" recently occurred that rendered its reliance on the list as a locate source unreasonable.[56] The Commission also charged that, because of a flaw in the broker-dealer's systems, in some instances the firm used data that was more than 24 hours old for purposes of constructing the ETB lists and, as a result, securities were sometimes included on the ETB lists on days when they should not have been. In connection with the settlement, the firm agreed to pay a $9 million civil money penalty, $1.6 million in disgorgement, and $335,000 in prejudgment interest. In announcing the settlement, the Staff stated, "Firms must comply with their short-selling obligations by making sure they do not rely on inaccurate ETB lists. When firm personnel determine that a security should no longer be considered easy to borrow, the firm's systems need to incorporate that knowledge immediately."

SEC Rule 105 prohibits firms from participating in public stock offerings after selling short those same stocks within five business days of the offering. Under the SEC's Rule 105 Initiative, first announced in 2013, the Division of Enforcement has taken action on every

Rule 105 violation over a *de minimis* amount that has come to its attention. The SEC has stated that as a result of this initiative, Rule 105 violations appear to have decreased by approximately 90% over the last six years. In October 2015, the Commission announced enforcement actions against six firms for violating Rule 105 of Regulation M in connection with their short sale practices.[57] The firms agreed to pay a total of $2.5 million. With regard to one firm that failed to review its past trading to determine whether additional violations not identified by the Division of Enforcement had occurred, the Commission prohibited the firm from participating in secondary offerings for one year. In announcing the settlement, the Staff stated, "This highly successful program of streamlined investigations and resolutions of Rule 105 violations has clearly had an important deterrent impact on the market while expending a fraction of the resources that we have dedicated in the past. We will continue to target important violations that we see repeatedly with multiple actions that send important messages of deterrence."

XXIV. Underwriting Practices: Participating in an Offering Despite Indications that the Offering Materials Were False

In March 2015, the Commission charged a brokerage firm responsible for underwriting a public offering with violating the non-scienter antifraud provisions of the Securities Act because it underwrote securities despite obtaining a due diligence report indicating that the offering materials were false.[58] The Commission's complaint alleged that the issuer purported to own a coal company located in the People's Republic of China at the time of the offering, but the brokerage firm had obtained information indicating that the company no longer owned the Chinese coal company, which was its principal asset and sole source of revenue. The matter is in litigation. In announcing the case, the Staff stated, "Underwriters are critical gatekeepers who are relied upon by the investing public to ferret out the essential facts and address potential inaccuracies before marketing a public stock offering. [The firm] proceeded with this offering despite a due diligence process that exposed a false claim by [the issuer], and investors suffered massive losses when the truth publicly came to light."

XXV. Unfair/Collusive Bidding Practices

In February 2015, the SEC charged a brokerage firm and its CEO with securities fraud in connection with conducting an auction to liquidate collateralized debt obligations ("CDOs").[59] The firm allegedly waited for a majority of the bids to come in from auction participants, and then instructed a third-party broker-dealer to bid on the CDOs at prices that were often slightly higher than the highest bid from other participants. The third-party broker-dealer would then immediately sell the CDOs at a small markup to an affiliate of the brokerage firm, which was not permitted to bid under the terms of the engagement agreements. The Commission's order required the firm to pay disgorgement of $1.1 million and interest of $85,000, but did not impose a civil money penalty on the firm based on a sworn statement of financial condition. It ordered the CEO to pay a civil money penalty of $200,000 and disgorgement of $118,000, and barred him from the securities business except for the purpose of assisting in the sale, or transfer to independent managers, of securities and positions held by any funds or accounts managed by the firm. In announcing the settlement, the SEC stated that the CEO "abused a position of trust by playing the roles of both conductor and bidder during the CDO liquidation auctions to the detriment of other market participants."

Conclusion

In 2015, the SEC brought enforcement actions against broker-dealers in roughly two dozen distinct areas, including a number of "first-of-their-kind" enforcement actions, such as the first case charging a broker-dealer issuer of structured notes with issuing misleading offering materials; the first case against brokers handling investments in the government's EB-5 Immigrant Investor Program; and the first action charging a municipal bond underwriter with overcharging customers on the sale of newly-issued bonds. It imposed sanctions ranging from less than $100,000 to nearly $180 million. Full enforcement statistics for 2015 are not yet available, but the largest category of enforcement actions in 2014 (the most recent year for which the statistics are available) was enforcement actions against broker-dealers — making up 166 of the 755 total enforcement actions brought by the Commission. These are over and above the nearly 1,400 disciplinary actions that FINRA brought against broker-dealers and registered representatives in 2014.

In most cases, the Commission has to show some level of culpability when it sues a broker-dealer — typically a lack of reasonable care — but that has not proven to be a significant obstacle. The duty of best execution, principles governing excessive markups, the existence of non-scienter "fraud," registration requirements having no culpability requirement at all, and myriad technical rules related to areas ranging from alternative trading systems to market access to short sales to cybersecurity controls provide the Commission a huge arsenal of enforcement tools that it regularly uses in actions against firms and individuals. The Commission also has considerable leverage in enforcement actions against broker-dealers because 1) broker-dealers are highly regulated, and highly-regulated entities tend to resolve rather than litigate actions with their regulators; 2) actions against broker-dealers are usually filed administratively, a forum in which the Commission wins almost all its cases; and 3) the Commission's penalty authority can be draconian, which creates risks that often motivate respondents to achieve certainty through settlements rather than uncertainty through litigation. There is some division within the Commission on whether it should adopt a rule subjecting broker-dealers to yet further obligations through the creation of a fiduciary standard.[60] The results discussed above, however, strongly suggest that the current program is broad-based, vibrant, and effective, and that there is no demonstrable need to create a new regulatory paradigm based on a new fiduciary duty.

Author:

Jonathan Eisenberg
jon.eisenberg@klgates.com
+1.202.778.9348

K&L GATES

Anchorage Austin Beijing Berlin Boston Brisbane Brussels Charleston Charlotte Chicago Dallas Doha Dubai
Fort Worth Frankfurt Harrisburg Hong Kong Houston London Los Angeles Melbourne Miami Milan Newark New York
Orange County Palo Alto Paris Perth Pittsburgh Portland Raleigh Research Triangle Park San Francisco São Paulo Seattle
Seoul Shanghai Singapore Sydney Taipei Tokyo Warsaw Washington, D.C. Wilmington

K&L Gates comprises approximately 2,000 lawyers globally who practice in fully integrated offices located on five continents. The firm represents leading multinational corporations, growth and middle-market companies, capital markets participants and entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organizations and individuals. For more information about K&L Gates or its locations, practices and registrations, visit www.klgates.com.

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

© 2015 K&L Gates LLP. All Rights Reserved.

[1] U.S. Securities and Exchange Commission, Agency Financial Report Fiscal Year 2015, avail. at http://www.sec.gov/about/secpar/secafr2015.pdf, at 8.
[2] While 2015 breakdowns are not yet available, the number of SEC enforcement actions against broker-dealers rose from 70 in 2010 to 166 in 2014. "Year-by-Year SEC Enforcement Statistics (2005–2014)," avail. at https://www.sec.gov/news/newsroom/images/enfstats.pdf.
[3] Securities Act Release No. 9697 (Jan. 15, 2015).
[4] Securities Act Release No. 9887 (Aug. 12, 2015).
[5] "SEC Proposes Rules to Enhance Transparency and Oversight of Alternative Trading Systems," Press Release 2015-261 (Nov. 18, 2015).
[6] Securities Act Release Nos. 9968 and 9969 (Oct. 28, 2015).
[7] Securities Exchange Act Release No. 75992 (Sept. 28, 2015).
[8] Securities Exchange Act Release No. 73681 (Nov. 25, 2014).
[9] Securities Act Release No. 9717 (Jan. 29, 2015).
[10] Securities Exchange Act Release No. 74586 (Mar. 26, 2015).
[11] *SEC v. Janus Spectrum LLC*, Case 2:15-cv-00609 (D. Ariz. Apr. 6, 2015).
[12] Securities Act Release No. 9961 (Oct. 13, 2015).
[13] SEC Investor Bulletin: Structured Notes (Jan. 12, 2015).
[14] National Exam Program Risk Alert: "Broker-Dealer Controls Regarding Retail Sales of Structured Securities Products," (Aug. 24, 2015).
[15] OCIE, NEP Risk Alert, Cybersecurity Examination Sweep Summary (Feb. 3, 2015).
[16] OCIE, OCIE's 2015 Cybersecurity Examination Initiative (Sept. 15, 2015).
[17] OCIE, Examination Priorities for 2015 (Jan. 13, 2015).
[18] *SEC v. Lax* (D.N.J. Feb. 10, 2015).
[19] Securities Exchange Act Release No. 75720 (Aug. 18, 2015).
[20] Securities Act Release No. 9981 (Nov. 30, 2015).
[21] Securities Exchange Act Release No. 75268 (June 23, 2015).
[22] Securities Exchange Act Release No. 76013 (Sept. 29, 2015).
[23] Securities Exchange Act Release No. 76014 (Sept. 29, 2015).
[24] *SEC v. Ramirez*, Case 3:15-cv-02365 (D.P.R. Sept. 29, 2015).
[25] Securities Act Release No. 9914 (Sept. 17, 2015).
[26] Securities Exchange Act Release No. 74429 (Mar. 4, 2015).
[27] *In re Gregory T. Bolan, Jr. and Joseph G. Ruggieri*, Initial Decision Rel. no. 877 (Sept. 14, 2015).
[28] *See* Jon Eisenberg, "'Friends' Who Trade on Inside Information: How *United States v. Newman* Changes the Law," The Harvard Law School Forum on Corporate Governance and Financial Regulation (May 3, 2015).
[29] Securities Exchange Act Release No. 75729 (Aug. 19, 2015).
[30] Securities Exchange Act Release No. 76109 (Oct. 8, 2015).
[31] *SEC v. Michael J. Fefferman et al.,* 15CV1276 (S.D. Cal. June 9, 2015).
[32] "SEC Announces Settlement with Stockbroker in Grand Central Post-It Notes Insider Trading Case," Litigation Release No. 23391 (Oct. 23, 2015).
[33] *SEC v. Leroy Brown, Jr. and LB Stocks and Trades Advice LLC*, Case No. 6:15cv-119 (W.D. Tex. Apr. 13, 2015).
[34] *SEC v. Novinger, et al.,* Case No. 4:15-cv-358 (N.D. Tex. May 11, 2015).
[35] Securities Act Release No. 9893 (Aug. 17, 2015).
[36] *SEC v. Aleksandra Milrud*, 2:15-cv-00237 (D.N.J. Jan. 13, 2015).

[37] "Layering" and "spoofing" are sometimes used interchangeably to describe placing orders that the trader does not intend to have executed on one side of the market in order to trick the other side of the market to trade at an artificially depressed or inflated price. Layering may also be viewed as a discrete form of spoofing in which rather than placing one large bid, the spoofer places several orders a few ticks apart.
[38] Securities Act Release No. 9959 (Oct. 8, 2015).
[39] See Lynne Marek, "Get Ready, Chicago, for a Series of High-Speed Trading Trials," Crain's Chicago Business (Nov. 13, 2015) (reporting on the verdict and noting that a number of other prosecutions are pending).
[40] For background on the case, see Cliff Histed, "A Look at the First Criminal 'Spoofing' Prosecution: Parts 1 and 2," Law360 (Apr. 20 and 21, 2015).
[41] Securities Exchange Act Release No. 75331 (June 30, 2015).
[42] Securities Exchange Act Release No. 76029 (Sept. 30, 2015).
[43] *SEC v. Michael J. Oppenheim* (S.D.N.Y. Apr. 16, 2015).
[44] *SEC v. Robert P. DePalo et al.,* 15 CV 3877 (S.D.N.Y. May 20, 2015).
[45] Securities Act Release No. 9794 (May 28, 2015).
[46] SEC Litigation Release No. 23320 (Aug. 13, 2015).
[47] "SEC Launches Enforcement Cooperation Initiative for Municipal Issuers and Underwriters," Press Release 2014-46 (Mar. 10, 2014).
[48] "SEC Charges 36 Firms for Fraudulent Municipal Bond Offerings," Press Release 2015-125 (June 18, 2015) (collecting orders).
[49] "SEC Sanctions 22 Underwriting Firms for Fraudulent Municipal Bond Offerings," Press Release 2015-220 (Sept. 30, 2015) (collecting orders).
[50] Securities Act Release No. 9889 and 9890 (Aug. 13, 2015).
[51]U.S. Securities and Exchange Commission, "Microcap Fraud," avail. at https://www.investor.gov/investing-basics/avoiding-fraud/types-fraud/microcap-fraud.
[52] Securities Act Release No. 9711 (Jan. 27, 2015).
[53] Securities Act Release No. 9717 (Jan. 29, 2015).
[54] *SEC v. Harold Bailey "B.J." Gallison, II et al*, Case 1:115-cv-05456 (S.D.N.Y. July 14, 2015).
[55] *SEC v. Ross B. Shapiro*, Case 1:15-cv-07045 (S.D.N.Y. Sept. 8, 2015).
[56] Securities Exchange Act Release No. 75083 (June 1, 2015).
[57] "SEC Charges Six Firms for Short Selling Violations in Advance of Stock Offerings," Press Release 2015-239 (Oct. 14, 2015) (collecting orders).
[58] *SEC v. Macquarie Capital (USA), Inc. et al.,* 15CV02304 (S.D.N.Y. Mar. 27, 2015).
[59] Securities Exchange Act Release No. 74305 (Feb. 19, 2015).
[60] *See, e.g.,* Knut A. Rostad and Darren M. Fogarty, "SEC Commissioners Luis A. Aguilar's and Daniel M. Gallagher on Fiduciary Duty," Institute for the Fiduciary Standard (Sept. 8, 2015).