Summary of Selected Sessions From “The SEC Speaks in 2013”

TABLE OF CONTENTS

I. The Commissioners’ Remarks
   A. Chairman Walter’s Remarks
   B. Commissioner Aguilar’s Remarks
   C. Commissioner Paredes’s Remarks
   D. Commissioner Gallagher’s Remarks

II. Panel Sessions and Workshops
   A. Division of Corporation Finance
      1. Corporation Finance Panel
      2. Corporation Finance Workshop
   B. Division of Trading and Markets
      1. Trading and Markets Panel
      2. Trading and Markets Workshop
   C. Division of Enforcement
      1. Enforcement Panel Session
      2. Enforcement Workshop
   D. Division of Investment Management
      1. Investment Management Panel
      2. Investment Management Workshop
   E. Office of Compliance Inspections and Examinations
      1. OCIE Panel
      2. OCIE Workshop
F. Other Panels

1. Accounting
2. Risk, Strategy and Financial Innovation
3. Judicial and Legislative Developments
4. Ethics

The Practising Law Institute, in cooperation with the U.S. Securities and Exchange Commission, recently held the annual “SEC Speaks” conference featuring the Commissioners and senior SEC Staff discussing the SEC’s accomplishments in 2012 and its agenda for 2013. The conference, held in Washington, D.C. and co-chaired by Carlo V. di Florio, Director of the Office of Compliance Inspections and Examinations, and Craig M. Lewis, Director and Chief Economist of the Division of Risk, Strategy and Financial Innovation, was a unique opportunity for members of the industry and legal and compliance practitioners to interact directly with SEC Staff. This Legal Alert summarizes the remarks of the Commissioners and participants in several of the panel sessions and workshops.

I. The Commissioners’ Remarks

SEC Chairman Elisse B. Walter and three other Commissioners provided remarks at the conference. Their remarks are briefly summarized below. Please note that full transcripts of the Commissioners’ remarks can be viewed on the SEC’s website.

A. Chairman Walter’s Remarks

Chairman Walter noted that the current global regulatory focus on prudential regulation, which is “designed to minimize systemic risk and maximize safety and soundness,” is important. However, she stated that an equally important regulatory goal is “minimizing unnecessary risks to those who provide capital for [projects that transform economies and create jobs]—our nation’s investors.” Chairman Walter explained that minimizing risks to investors involves “[r]egulation that is focused on detecting and preventing fraud”; a “regulatory system that is capable of detecting and deterring market manipulation”; “[r]egulation focused on assuring that companies make available the information investors need for educated decision-making”; and “regulation that supports investor confidence in the architecture and technology of the exchanges and other large players in the markets. . . .”

Using the fictional “Aunt Millie” as a stand-in for the average investor, Chairman Walter explained that, while investors understand that risk is involved in investing, “investors will not take risks if they are not confident that they will be protected from fraud and market abuse.” She noted that last year, the amount of money raised in public debt and equity offerings rose by 22%, the first increase since the financial crisis and a positive sign of returning investor confidence. Although investments were once made on the basis of personal relationships, investors now must be able to trust the information provided in filings to learn about a business. Chairman Walter stated that the Commission “work[s] to ensure that Aunt Millie has access to the information she needs to make truly informed investment decisions.” Chairman Walter closed by stating that, by promoting investor confidence, the Commission “set[s] the stage for entrepreneurs and investors to change our economy and our lives.”
B. Commissioner Aguilar’s Remarks

“I must admit being frustrated that we haven’t done more to protect investors,” Commissioner Luis A. Aguilar told the audience. “I am growing increasingly concerned about the stability of our market structure as we lurch from one crisis to another,” Commissioner Aguilar said as he commented on recent problems that affected the capital markets, such as the May 2010 flash crash and the Knight Capital Group Inc.’s $440 million trading loss in August 2012. “Market failures of this magnitude and significance are unacceptable,” he said and these failures “may have eroded investor confidence and impacted the stability and price-discovery function of our capital markets.” Commissioner Aguilar referenced recent data that shows that since the May 2010 flash crash, investors have pulled more than $377 billion from mutual funds that invested in U.S. stocks. Commissioner Aguilar focused his remaining remarks on the “need to protect investors through robust and effective market oversight.”

The markets have radically changed over the last two decades. Commissioner Aguilar pointed to the fact that we have gone from a small handful of mostly manual markets to a large number of high-tech, fully electronic trading centers, including alternative trading systems. Because of these new fully automated systems, the speed and volume of trades have dramatically increased. Commissioner Aguilar shared with the audience that in 1990, the average daily volume on the New York Stock Exchange was 162 million shares. Today, that number is 2.6 billion shares. “The rise in the number of trading venues – on exchanges and off-exchanges – and the fragmentation of trading volume, and the reliance on automated systems have increased the potential for system failures to spread quickly and affect the entire market.”

While Commissioner Aguilar commended the Commission for taking steps in the right direction toward effective market oversight—including the implementation of single-stock circuit breakers, the ban on stub-quotes, rules banning naked access, and rules requiring large traders to identify themselves—he identified two market stability measures that the Commission should seriously consider:

(1) A “kill switch” to immediately limit or shut down orders and prevent market disruption. While Commissioner Aguilar does not “believe that any one individual safeguard will comprehensively eliminate risk in all situations; [he does] believe that a multi-layered approach to market structure with multiple, independent, coordinated, and overlapping risk checks are critically important, and that a kill switch would be one such important safeguard.”

(2) Live simulations and robust and routine testing of business continuity plans and trading software at exchanges and other liquidity centers. Two days before Hurricane Sandy devastated the East Coast in October 2012, the securities industry conducted its annual test for trading firms and market operators. Although there were business continuity plans in place and no issues were uncovered during these tests, the trading markets were still closed for two days in the wake of the storm. Commissioner Aguilar commented that “[i]t is clear these business continuity plans were not considered sufficiently robust to keep the markets open. I believe that market participants must be confident enough in their back-up plans to utilize them when the needs arise.”

Commissioner Aguilar closed by stating that “the SEC must be at the forefront of proactively addressing changes in our capital markets structure, and not merely responding to events that have occurred…. Our investors deserve a proactive regulator.”

C. Commissioner Paredes’s Remarks

Commissioner Troy A. Paredes described the Dodd-Frank Act as a “disquieting expansion of the federal government's control over the economy” and called for a “top-to-bottom” review of the SEC’s disclosure regime. Commissioner Paredes began his remarks by noting that “[d]isclosure is the cornerstone of the
federal securities laws” because “investors, when armed with information, are well-positioned to evaluate their investment opportunities and to allocate their capital as they see fit.” Commissioner Paredes then discussed two threats to the disclosure regime: (1) the Dodd-Frank Act and (2) over-disclosure of information.

Speaking on the Dodd-Frank Act, Commissioner Paredes stated that “it should be apparent that disclosure regulation stands in sharp contrast to the extensive regulatory burdens, commands, and restrictions that make up the Dodd-Frank Act,” which he described as “sweeping legislation that is spawning reams of new rules and regulations.” Commissioner Paredes’s fear is that Dodd-Frank’s regulations and rules will stunt U.S. economic growth. Rather than leaving decision making to the federal government, Commissioner Paredes advocated for leaving investment decisions to market participants, even though they are imperfect decision makers.

Commissioner Paredes then set his sights on over-disclosure, resulting in “information overload.” His concern is that “investors will have so much information available to them that they will sometimes be unable to distinguish what is important from what is not.” To combat the over-dissemination of information, Commissioner Paredes called for shorter, more manageable SEC filings, simplifying or eliminating current disclosures, and presenting information in a more accessible manner, such as charts, graphs, tables, and summaries. Commissioner Paredes also opined that social media and mobile devices may also change how disclosures are made. In short, Commissioner Paredes is seeking disclosures that are more succinct and understandable than what investors receive under the current disclosure regime to empower investors to make informed investment decisions.

D. Commissioner Gallagher’s Remarks

In his second year addressing the conference as a Commissioner, Daniel M. Gallagher emphasized his concerns over recent events (e.g., the Dodd-Frank Act) that have negatively impacted the Commission’s ability to focus on its core mission—securities regulation. Commissioner Gallagher noted that although the Commission has set priorities regarding what it should be doing, the Commission is sometimes hindered in executing those priorities due to external influences: “The constant stream of external influences on the Commission’s work serves as a significant impediment to its ability to focus on the core mission, including the vital, basic ‘blocking and tackling’ of securities regulation.”

Commissioner Gallagher provided an overview of the Commission’s origin and role as “an expert, independent agency.” He explained, “the difficult task of administering the federal securities laws required the creation of a new independent, bipartisan agency with a high level of technical expertise in securities matters that could focus exclusively on the nation’s capital markets.” The creation of the Commission signaled a change in the regulatory framework of the United States.

In light of the SEC’s role as an independent, expert agency, Congress traditionally stayed out of the way of the Commission. Commissioner Gallagher expressed deep concern about the specific mandates contained in the Dodd-Frank Act (approximately 400): Many of the mandates are “highly prescriptive” with “short deadlines” that run counter to the established role of the agency, “while occupying time and resources that could be better spent fulfilling the Commission’s other important responsibilities.”

Specifically, Commissioner Gallagher gave examples of matters intruding on the role of the Commission as an independent expert: (1) Section 619 of Dodd-Frank requires that the three Federal banking agencies, the SEC, and the Commodity Futures Trading Commission (CFTC) work together to adopt regulations to implement the Volcker Rule’s prohibitions on banking entities; (2) the Financial Stability Oversight Council (FSOC) operates as a “safety and soundness regulator” and permits the Chairman of the Commission to vote on behalf of the entire Commission without oversight; (3) the Federal Reserve’s
proposed regulations regarding U.S. operations of foreign bank organizations; and (4) the Commission’s participation in international regulatory bodies, like the International Organization of Securities Commissions (IOSCO).

II. Panel Sessions and Workshops

Below are highlights from the panel sessions and workshops concerning the Division of Corporation Finance, the Division of Trading and Markets, the Division of Enforcement, the Division of Investment Management, and the Office of Compliance Inspections and Examinations as well as highlights from the panel sessions relating to Accounting; Risk, Strategy and Financial Innovation; Judicial and Legislative Developments; and Ethics.

A. Division of Corporation Finance

1. Corporation Finance Panel

Following the remarks of SEC Chairman Walter, the conference started in earnest with a report from the Division of Corporation Finance, led by Acting Director Lona Nallengara, who was joined on the panel by Thomas J. Kim, Michele M. Anderson, Paul M. Dudek, Felicia H. Kung, and Gerald J. Laporte. The panel focused on rulemaking, the JOBS Act, and proxy matters and mergers and acquisitions. (A discussion of the Division’s disclosure operations, which Mr. Nallengara described as making up 80% to 85% of the Division’s workload, was addressed later in the Corporate Finance workshop (see below).)

Highlights from the morning session included updates on rulemaking under the Dodd-Frank Act and the JOBS Act and comments on various aspects of the JOBS Act. While the Division does not know when it will complete its rulemaking under Dodd-Frank or the JOBS Act, Mr. Nallengara stated that completing rulemaking under those acts was a top priority within the Division. On the Dodd-Frank side, the Division has adopted all but two of the corporation finance rules, including rules running the gamut from asset-backed securities to conflict minerals. Regarding the JOBS Act, Mr. Nallengara reported that it still had “lots of work to do.” While the Division works through its rulemaking under the JOBS Act, the Staff suggests that people refer to the Frequently Asked Questions section on its website. One area that generated considerable interest on the panel, especially from Mr. Nallengara, was crowd funding under Title III of the JOBS Act. The Division is busily working on putting forth a recommendation on crowd funding to the Chairman.

Other items of interest that were discussed during this session included: (a) using more economic analysis for guidance when making decisions and (b) removing the option for shareholders to vote by proxy in favor of management by pressing a single button. This latter practice was viewed as non-neutral because there was not a similar button for voting against management.

2. Corporation Finance Workshop

The Corporation Finance panelists referred to this session colloquially as the “Disclosure Workshop” because it focused on the Division’s disclosure operations. True to their word, the panelists touched upon disclosure issues including: (1) petitions filed by emerging growth companies; (2) stock compensation disclosures; (3) “magic page” disclosures relating to estimate dividends; (4) debt registration; (5) legal opinions and tax opinions; (6) variable interest entities; and (7) Management’s Discussion and Analysis (MD&A) disclosures.
Other areas of discussion included: (1) cyber security; (2) non-GAAP reporting; and (3) metrics companies used to value themselves, especially companies in the technology sector.

At the end of the session, each of the panelists was given an opportunity to give one piece of advice to the audience.

- Kathleen Collins, Accounting Branch Chief, Disclosure Operations – when the Division issues comments, respond to all points raised in the comments.

- Justin Dobbie, Legal Branch Chief, Disclosure Operations – (1) refer to the guidance on the website for the JOBS Act and (2) file legal opinions with the Staff early in the process because the Staff does review and comment on legal opinions. Therefore, if there are comments, there would be time for the registrant to address the Staff’s comments.

- Daniel Gordon, Accounting Branch Chief, Disclosure Operations – if a registrant is facing an unusual issue in registration, it should seek pre-clearance from the Division.

- James Lopez, Legal Branch Chief, Disclosure Operations – before drafting MD&A disclosures, registrants should read the Division’s 2003 interpretive release (at a minimum the overview section). See here.

B. Division of Trading and Markets

1. Trading and Markets Panel

The Acting Director of the Division of Trading and Markets, John M. Ramsay, started the session by remarking that the Division has been working at a breakneck pace for the past year and will continue to do so over the next year. Similar to other panels at the conference, Mr. Ramsay emphasized a continued focus on rulemaking as a result of the Dodd-Frank Act and the JOBS Act. Other speakers detailed the SEC’s response to increasingly computerized trading and the implementation of “circuit breakers” to automatically stop a market spike or drop that fits predefined parameters. Within the year, the Division expects to test the expanded use of circuit breakers in the market.

The panel acknowledged seeing a substantial increase in the number of trades and types of exchange-traded products in the market, like inverse and leveraged exchange-traded funds (ETFs). Associate Director Heather A. Seidel commented on how the evolution of exchange-traded products has increased their complexity. Given the increased demand and complexity of ETFs, the Division remains focused on these products. In response to a question about what the Division looks for when reviewing disclosures regarding ETFs, Ms. Seidel emphasized the importance of clearly articulating what the product is, its structure, and the nature of the underlying basket of securities.

The SEC’s new Office of Analytics and Research was introduced by its recently appointed director, Gregg Berman, a senior adviser to the Director of the Division of Trading and Markets since June 2010. The Office of Analytics and Research employs experts on various platforms and products to add to the overall level of financial market expertise within the SEC. The Office of Analytics and Research will also work to implement technological systems to provide forensic analysis, monitoring, and research in market structure.
2. Trading and Markets Workshop

The Division of Trading and Markets workshop delved into further detail regarding the Division’s primary missions. Panelists discussed the Frequently Asked Questions provided on the JOBS Act, including how the Act affects firms and their obligations with respect to securities analysts and research reports. The panelists also discussed product-specific issues, reiterated their emphasis on exchange-traded products, and cited the high number of letters the Division receives concerning the difficulty of pricing ETFs.

C. Division of Enforcement

1. Enforcement Panel Session

Acting Director George S. Canellos and other Division of Enforcement senior officials led a panel that reported on the Division’s many recent successes and discussed its priorities for 2013. With the departure of Enforcement Director Robert Khuzami in early January 2013 as well as the nomination of Mary Jo White, former U.S. Attorney for the Southern District of New York, to succeed Chairman Walter, Mr. Canellos described this new era as a “period of reflection.” After more than five years since the credit crisis, the Division has implemented new systems to avoid the problems of the past. Mr. Canellos emphasized the Division’s overall priorities in 2013. The Division will, among other things:

- Continue to aggressively investigate and prosecute matters
- Maintain a strong focus on the role of gatekeepers
- Use all of the tools and remedies it has at its disposal
- Continue to increase the utilization of more powerful, conduct-specific injunctions
- Look to increase its use of Section 21(a) orders
- Investigate and/or file actions under the new laws and rules in the post-Dodd-Frank era
- Focus on new technologies
- Focus on new businesses

A new “Enforcement Advisory Committee” was created and is co-chaired by Acting Deputy Director David P. Bergers to respond to the changes in the market and industry. According to Mr. Bergers, the goals of the Committee are to (1) improve the Division’s investigations and litigated cases, (2) evaluate priorities to better utilize limited resources, and (3) seek ways to empower Staff to investigate and conduct business. The Division’s priorities include:

- Identifying additional areas where the Division should focus resources (such as technology like its new forensic lab located in Washington, D.C., which is designed to find fraud through electronic data)
- Collaborating with Enforcement’s accountants and using a predictive risk modeling program to identify risks by highlighting outliers
- Addressing the untimely production of documents or not receiving documents in electronic format and aggressively pursuing subpoena actions
Continuing to cooperate with the National Exam program and receiving referrals where Staff believes there is misconduct

Jane A. Norberg, Deputy Chief of the Office of the Whistleblower, highlighted some of the successes of the Whistleblower Program, including the first award to a whistleblower who received 30% of monetary sanctions collected after providing documents and information that led to shutting down a multi-million dollar fraud. In fiscal year 2012, there were 3,001 whistleblower tips, from all 50 states, the District of Columbia, the U.S. territory of Puerto Rico, and 49 countries outside of the United States. Additional information and statistics about the program are featured in the November 2012 Annual Report on the Dodd-Frank Whistleblower Program Report to Congress, available online.

In 2013, the Whistleblower Program will continue to reach out to whistleblower counsel, respond to all calls to the hotline within 24 business hours, and respond to tips. Ms. Norberg raised a concern about agreements where a person signs away his or her right to go to the SEC or receive an award, which has a chilling effect on the program. Ms. Norberg reminded the audience of Section 240.21F-17 of the Dodd-Frank Act that prohibits all persons from taking any action to impede an individual from communicating directly with the Commission about a possible securities law violation.

Eric I. Bustillo, Regional Director of the Miami Regional Office, highlighted recent successes of the Cooperation Program implemented in January 2010, which allows the Commission to bring better cases and faster. Since inception, the Commission has entered into 51 cooperation agreements in cases involving financial statements, insider trading, and Ponzi schemes/offering fraud. These agreements have resulted in 40 enforcement matters. Mr. Bustillo reminded the audience that there are substantial and tangible benefits to cooperating. For example, in one recent case, an executive provided substantial information to the Commission which decided not to bring an individual action against the cooperator.

Joseph K. Brenner, Chief Counsel, discussed the “modest” impact that the U.S. Supreme Court’s decision in Janus Capital Group, Inc. v. First Derivative Traders had on Enforcement. According to Mr. Brenner, the decision does not necessarily affect “who” gets charged, only “what” the person is charged with. As a result, in practice, the Division has seen an increase in the number of aiding and abetting and controlling person liability claims. Further, as a result of the U.S. Court of Appeals for the Second Circuit decision in SEC v. Apuzzo, the Commission’s burden in proving aiding and abetting liability has been eased. The Division does not view these secondary liability claims as inferior to primary liability claims. In light of these two recent decisions, Mr. Brenner cautioned the audience that when submitting a Wells submission, a party should not waste significant time and space by arguing against Rule 10b-5 violations where Janus would clearly apply and instead should focus on directly refuting secondary liability charges.

Mr. Brenner also emphasized that Section 304 of the Sarbanes-Oxley Act of 2002 is often used by the Division. Under that Section, it has brought 50 claims against CEOs. The Division believes that the case law under Section 304 is developing favorably for the Commission. Matthew T. Martens, Chief Litigation Counsel, reviewed some recently litigated cases and touted the Commission’s recent success. In fiscal year 2012, the SEC won 23 of its 24 cases against defendants.

Daniel M. Hawke, Regional Director of the Philadelphia Regional Office and Chief of the Market Abuse Unit, and Sanjay Wadhwa, Senior Associate Regional Director of the New York Regional Office, discussed recent actions taken by the Unit as well as new priorities. The Market Abuse Unit continues to

---

1 131 S. Ct 2296 (2011).
2 689 F.3d 204 (2d Cir. 2012).
focus on insider trading (including hedge fund insider trading) but it is also broadening its focus on market structure investigations given the proliferation of trading venues and off-exchange trading.

2. **Enforcement Workshop**

The Staff of the Division of Enforcement discussed a wide variety of enforcement priorities including accounting and financial disclosure, asset management, Foreign Corrupt Practices Act (FCPA) and cross-border cases, structured and new products, municipal securities and public pensions, and securities offerings and market manipulation. Some highlights from the workshop are listed below:

- The Staff emphasized that it was increasingly pursuing cases against gatekeepers including accountants and attorneys.
- The Staff expressed concern that mutual fund managers were chasing yield and not necessarily abiding by investment strategies. The Staff also noted that it had filed a number of cases in 2012 relating to valuation issues, fee arrangements, conflicts of interest, and oversight against mutual funds.
- In the private equity space, the Staff is focused on improper assessment of fees, conflicts of interest, and fraud in raising successor funds.
- The majority of the Staff's FCPA cases involve third-party arrangements. The Staff observed that the most successful compliance programs are intertwined with the company's internal financial controls.
- In the municipal securities and public pensions area, the Staff is focused on offering and disclosure fraud, tax and arbitrage fraud, pay-to-play schemes, public pension accounting disclosures, and valuation and pricing fraud.
- With respect to banks, the Staff is focused on overvaluation of loans and other assets, adequate documentation of loan losses, reasonable assumptions, accurate disclosure of loans held for sale versus investment, and disclosure of valuation methods.

D. **Division of Investment Management**

1. **Investment Management Panel**

Senior members of the Division of Investment Management discussed a variety of topics including the Division's priorities. In the near term, the Division will focus on money market mutual funds, identity theft red flags, and valuation guidance. Some of the Division's longer-term priorities include extending summary prospectus rules for variable annuities, a new ETF rule, mutual fund data collection, private funds, and derivatives. Some highlights from the panel are listed below:

- ETFs are becoming increasingly specialized and many have substantial investments in derivatives. The Staff noted that it has seen boilerplate disclosures with respect to derivatives and often ask for elaboration on how the funds are using derivatives.
- Traditionally, disqualification has been triggered by SEC settlements, but the Staff is seeing more and more disqualifications as a result of settlements with other regulators.
The Division is currently analyzing data to identify money market funds that are not in compliance with Rule 2a-7.

The Dodd-Frank Act significantly changed the registrant population to include managers of private funds; accordingly, the Division is evaluating what rules are appropriate for private fund managers.

The Staff is currently evaluating whether to adopt a uniform fiduciary duty for investment advisers and registered representatives and is seeking data to assist it in developing rules.

2. Investment Management Workshop

The Investment Management workshop focused on two principal issues: (1) informal guidance and (2) notable enforcement actions.

With respect to guidance, the Staff of the Division of Investment Management discussed a number of ways in which the Staff provides its views to the industry outside of the rulemaking context, including the following:

- No-Action Letters: The Staff explained that no-action letters can provide the Staff flexibility in responding to various situations, such as where a regulatory regime is being developed, where new laws eliminate exceptions, and where the facts simply do not fit the existing standards. The Staff highlighted a number of no-action letters, including the following:
  - Investment Company Act No-Action Letters
    - A series of no-action letters provided to the Chicago Mercantile Exchange (CME) and ICE Clear Credit LLC (ICE), among others, relating to custody issues
    - A no-action letter issued to Xplornet Communications Inc. relating to its status as an investment company. See here.
    - A no-action letter issued to Columbia Funds relating to loan participation. See here.
  - Investment Adviser Act No-Action Letters
    - Two no-action letters issued to TACT Asset Management, Inc. and Industrial Alliance, Investment Management, Inc., relating to the definition of “insurance company.” See here and here.

- Guidance on the Division of Investment Management’s Homepage: The Staff explained that it frequently is asked a question by a firm but, for whatever reason, the firm does not want the response to be public. To further its interests in providing guidance to the industry, the Staff has made a concerted effort to provide additional information on its homepage. The Staff recently provided its thoughts on a provision of the Dodd-Frank Act and on advisers whose advice relates solely to non-securities.

With respect to enforcement actions, the Staff noted that 2012 was a busy year, and that it is working closely with the Division of Enforcement’s Asset Management Unit to ensure that the Staff’s priorities are reflected in enforcement actions. The Staff highlighted several prominent categories of cases brought within the last year.
- **Investment Adviser Act Enforcement Actions**
  
  - Registered funds:
    - *In the Matter of Claymore Advisors, LLC*, Admin. Proc. File No. 3-15139 (Dec. 19, 2012) (settled proceeding) (fund adviser and administrator failed reasonably to supervise sub-adviser, causing failure to provide adequate disclosures of risk relating to derivatives strategies)
  
  - Adviser fraud:
    - *In the Matter of Martin Currie Inc.*, Admin. Proc. File No. 3-14873 (May 10, 2012) (settled proceeding) (fund management group used one client fund to bail out another client fund and failed to disclose information regarding transaction to one fund’s board of directors when seeking conflict waiver)
  
  - Adviser compliance issues:
    - *In the Matter of Morgan Stanley Investment Mgmt., Inc.*, Admin. Proc. File No. 3-14628 (Nov. 16, 2011) (settled proceeding) (adviser conducted inadequate oversight of sub-adviser and prepared and filed false information in public filings by stating that sub-adviser actually provided services when it did not)
    - *In the Matter of Focus Point Solutions, Inc.*, Admin. Proc. File No. 3-15011 (Sept. 6, 2012) (settled proceeding) (investment adviser and owner failed to disclose to customers revenue-sharing agreement with brokerage firm and to disclose conflicts of interest while seeking to be added as a sub-adviser to a fund)

- **Investment Company Act Enforcement Actions**
  
  - Valuation
    - *In the Matter of KCAP Fin., Inc.*, Admin. Proc. File No. 3-15109 (settled proceeding) (business development company failed to properly value assets)

The Staff also noted that, in the coming year, it will be looking at issues relating to valuation, side-by-side asset management, best execution, and fraudulent personal trading by portfolio managers.
E. Office of Compliance Inspections and Examinations

1. OCIE Panel

Carlo V. di Florio, Director of the Office of Compliance Inspections and Examinations (OCIE) kicked off the second day of SEC Speaks in 2013 with the OCIE panel. The panel included several other senior members of the OCIE Staff and covered many of its examination priorities for 2013, including the areas of investment adviser examinations, investment company examinations, broker-dealer examinations, transfer agent examinations, clearing house examinations, and market oversight. These exam priorities were published online and are available here.

Andrew J. Bowden, Deputy Director of OCIE, discussed some of the Office’s recent activities and its focus in 2013. The Office continues to hire a large number of specialists and currently has nine specialist groups, including trading, municipal bonds, and private equity among others. He also highlighted a team to focus on large firms as well as a quantitative unit. The Office continues to strengthen its own policies and procedures for consistency. One of the themes that ran throughout the entire conference was the continued technology revolution and several market events, such as Hurricane Sandy, that impacted technology and the market. Mr. Bowden briefly discussed the continuing implementation of some technology tools within the Office, including the Tracking and Reporting Examination National Documentation System (TRENDS) which was rolled out to the broker-dealer and investment adviser exam programs. The Office also continues to work on its long-standing goal of developing a certified examiner training program.

a. Market-Wide Exam Priorities for 2013

Mr. Bowden then launched into the published exam priorities for 2013. He presented four of the risks and exam priorities for 2013 that cover all Office programs and registrants. They are:

- Fraud detection and prevention
- Corporate governance and enterprise risk management
- Conflicts of interest
- Technology

Below are some of the exam priorities that were discussed by the panel. For a complete list of anticipated priorities in 2013 as well as more detailed descriptions of each, please see the published list here.

b. Investment Adviser-Investment Company Exam Program Priorities

Mr. Bowden identified the following key priorities in 2013 for the investment adviser-investment company exam program:

- Ongoing risks, including safety of assets, marketing and performance advertising, and conflicts of interest related to compensation arrangements
- New and emerging risks, including the influx of new Dodd-Frank registrants, dually registered investment advisers and broker-dealers, fees and expenses deficiencies, and alternative investment companies (which now comprise 3% of all mutual fund assets)
c. Broker-Dealer Exam Program Priorities

Julius Leiman-Carbia, Associate Director of the Office of Broker-Dealer Examinations, stated that the Broker-Dealer Program would continue to apply a risk-based approach to its exams and he identified the following key broker-dealer exam priorities:

- Exchange Act Rule 15c3-5 (the Market Access Rule): The Staff will pay particular attention to master/sub-accounts and supervision of registrants’ technology system controls and governance
- AML
- Fraud detection, including a focus on microcap securities and unregistered securities. Private placements are also a key area of focus for the Staff because of the high risks involved in these investments. The Staff believes that inadequate due diligence of private placements is performed by firms and if due diligence is performed, it is not being communicated to the sales force.
- Supervision of associated persons
- Investment offerings of higher yields, including non-traded REITs and oil and gas offerings
- Trading risk, including a focus on market manipulation, high frequency trading, and alternative trading systems
- Large firms, including firms with a significant impact
- New and emerging regulatory risks

d. Market Oversight Exam Program Priorities

John Polise, Associate Director of OCIE’s Office of Market Oversight, presented his group’s top priorities for 2013:

- Rulemaking progress
- Examinations of new registered exchanges
- Supervision of regulatory progress
- SRO monitoring
- Systems compliance
- Order type assessments

e. Transfer Agent and Clearing Agency Exam Program Priorities

Dawn A. Patterson, Associate Director of OCIE’s Office of Clearing and Settlement, outlined some of her group’s exam priorities for 2013.
Transfer Agent Program – besides the ongoing risks identified in OCIE’s published exam priorities, the Staff anticipates it will focus on the following issues in 2013:

- Microcap securities and private offerings
- Conflicts of interest
- Complex, hybrid securities
- Outsourcing
- Third-party administration

Clearing Agency Program

- Performance of annual exams mandated by the Dodd-Frank Act
- Ongoing supervision and monitoring
- Informing policy and process

Also participating on the OCIE panel was Paula Drake, Chief Counsel for OCIE, who discussed the growing role of OCIE working with other divisions and offices of the Commission in rulemaking and OCIE’s increased cooperation with other regulators where there is a common supervisory interest. Finally, Thomas J. Butler, Director of the Office of Credit Ratings, discussed the Nationally Recognized Statistical Rating Organizations (NRSRO) examinations, policy monitoring and rulemaking, and specialized initiatives, including certain international efforts.

2. OCIE Workshop

In its workshop, several senior members of OCIE identified some key areas of focus in the examination process.

a. Investment Adviser/Investment Company Examination Program

Steven R. Dittert, Assistant Regional Director of the Investment Adviser/Investment Company Examination Program, said one of the key focuses for exams is safety of client assets, where examiners often find deficiencies. Mr. Dittert provided additional observations from IA/IC examiners and areas on which they will focus: (1) advisers do not always realize that they may have custody of a client’s assets (for instance where the adviser is a trustee or has power of attorney) and therefore they do not comply with the custody rule; (2) advisers do not always provide the independent accountant with all of the client accounts they may have custody over so the reports are not always accurate; and (3) where there are private funds involved, the adviser does always send the audits to the clients on a timely basis and/or the funds are not audited pursuant to the rules.

New and emerging areas that the Investment Adviser/Investment Company Examination Staff will focus on in 2013 include the following:

- Alternative mutual funds – these are more complex investments with higher risk and greater liquidity concerns and operational back office issues. Staff will look at how the investments are
marketed to investors, how they are described, whether there are adequate disclosures, and whether they are suitable for investors.

- Distribution fees

b. Broker-Dealer Examination Program

James T. Giles, Assistant Director of OCIE’s Office of Broker-Dealer Examinations, stated that the Staff is focusing on control functions. The Staff is also working on the need for increased coordination with fellow regulators on certain issues and is focused on technology and operational risk areas.

New and emerging areas that the Broker-Dealer Examination Staff will focus on in 2013 include the following:

- Understanding the potential risks of regulatory changes
- New products and new ways to interact with clients (this is a continuing focus of the Staff)
- Examining firm cost-cutting measures and the impact on firm controls

c. Market Oversight Examination Program

Jon D. Hertzke, Assistant Director of OCIE’s Office of Market Oversight, said his Staff has a “laser focus” on risk assessment and does not go into each exam using a soup to nuts approach. To perform an effective risk assessment, the Staff has implemented several processes, including the following:

- Meet with and monitor SROs
- Review market events
- Develop MERT (Market Event Response Team)
- Oversight of FINRA
- Systems compliance so that the exchange systems operate as advertised
- Risk assessment of new registrants

New and emerging areas that the Market Oversight Staff will focus on in 2013 include the following:

- Order types and order type assessment – the Staff will examine, among other things, how orders are created and how they interact with each other
- Business continuity planning – the Staff will examine systems and procedures of exchanges to determine whether they can survive disasters, such as Hurricane Sandy
• Regulatory service agreements

  d. Office of Risk Analysis and Surveillance

James R. Reese, Assistant Director of OCIE’s Office of Risk Analysis and Surveillance, discussed how his office is focused on technology including disaster recovery and high volume trading. During exams, the Staff will also focus on other areas of technology, such as protocol for situations in which web servers or service providers are hacked. Examiners will look at how firms are testing these and other scenarios as well as what contingencies, reporting, and notification requirements have been implemented to respond to these disaster scenarios.

New and emerging areas that the Office of Risk and Surveillance Analysis Staff will focus on in 2013 include the following:

• Structured products – Staff will examine disclosures and valuations
• Exchange-traded products – Staff will examine disclosures and suitability
• Other investor accounts – investors may no longer have the same disposable money as in prior years for investments and therefore fraudsters may tap into other types of accounts like self-directed retirement accounts

  e. Office of Clearance and Settlement

Paula C. Sherman, Senior Special Counsel of OCIE’s Office of Clearance and Settlement, said her office’s focus is on risk assessment of transfer agents (TAs). As for clearing agencies, the Staff continues to focus on the governance framework.

New and emerging areas that the Office of Clearance and Settlement Staff will focus on in 2013 include the following:

• Outsourcing certain activities – the Staff will examine whether books and records are maintained when transfer agent activities are outsourced and whether information is adequately backed up and properly archived. Further, the Staff will consider whether the transfer agent who wants to change an outsourcer still has access to the records.
• Ensure that outsourcers have an understanding of the rules (including books and records and timely transfer requirements)

  f. Office of Credit Ratings

Michele B. Wilham, Branch Chief of the Office of Credit Ratings, reviewed the key areas that the Staff looks at in its exam program, focusing on the three exam priorities for 2013 that Mr. Butler discussed earlier: NRSRO examinations, monitoring policy and rulemaking, and specialized initiatives. Ten NRSROs are registered, two of which are international. The Staff conducts an exam each year of each NRSRO.

New and emerging areas that the Office of Credit Ratings Staff will focus on in 2013 include working with NRSRO boards of directors (required pursuant to the Dodd-Frank Act) and the designated compliance officers to ensure that they are effective and that policies are being complied with. The Office will eventually conduct exams outside of the annual exam process.
F. Other Panels

1. Accounting

The Accounting panel discussion was led by Paul A. Beswick, Chief Accountant, Office of the Chief Accountant, who emphasized that the Office provides accounting advice on a pre-filing basis. He explained the important function of pre-filing advice: it is easier to address issues and may be more time and cost effective to address issues through pre-filing. Mr. Beswick then gave an update on the impact of the Sarbanes-Oxley Act of 2002 on market regulation after 10 years. He explained that as a result of the Act, which requires enhanced internal control over financial reporting, investors receive better, more accurate information concerning material financial information relating to companies, like the disclosure of material off-balance sheet information.

The Division of Corporate Finance also emphasized that it has a pre-filing process to answer questions. The Division recognizes that unusual circumstances do occur and welcomes the submission of information requests or informal requests submitted by telephone. Craig C. Olinger, Acting Chief Accountant, Division of Corporate Finance, explained that the Division receives frequent comment requests on issues pertaining to International Financial Reporting Standards (IFRS) application issues and reporting issues on Form 20-F. Jaime L. Eichen, Chief Accountant, Division of Investment Management, described the Division as a “consultation office” and welcomed questions to the Division. She went over hot topics in the investment management arena including fair valuation, the consolidation of wholly owned subsidiaries, formation of business development companies by acquisition of private fund assets, and mergers (among others). The Division of Enforcement explained that cross-border China cases and Section 106 of the Sarbanes-Oxley Act, which requires that foreign audit firms issuing reports to clients with SEC-registered securities submit to Public Company Accounting Oversight Board inspections, are some of its areas of focus.

2. Risk, Strategy and Financial Innovation

The Risk, Strategy and Financial Innovation panel focused on the SEC’s use of a quantitative analysis to enhance rulemaking and the role of quantitative research in making the SEC more efficient and informed. The Staff cited the Title VII Intermediaries Release as an example of its use of quantitative analysis and showed some of the various tools the Staff used to analyze the credit default swap market. The Staff also discussed the requirements that filers submit eXtensible Business Reporting Language (XBRL) supplements. The Staff discussed the benefits of XBRL to investors including improving transparency, accessibility, timeliness, and completeness but also acknowledged the additional work for filers and quality concerns. The Staff hopes to increase usage of XBRL by improving the quality, implementing inline XBRL, and simplifying definitions.

3. Judicial and Legislative Developments

Speakers from the Office of the General Counsel provided summaries and updates on various litigation and administrative actions.

- Court Approval of Consent Judgments
  - **SEC v. Citigroup:** On February 2, 2013, the U.S Court of Appeals for the Second Circuit heard oral argument on interlocutory appeals filed by the SEC and Citigroup from an order issued by U.S. District Court Judge Jed Rakoff rejecting a settlement agreement...
between the SEC and Citigroup. One of the notable disputes between the SEC and the attorney appointed to represent Judge Rakoff is how many supporting evidentiary facts are necessary for entry of a consent judgment under Judge Rakoff’s decision.

- **Statute of Limitations for Civil Penalties**
  - *SEC v. Gabelli*: At the time of the panel, the U.S. Supreme Court had yet to issue an opinion in *Gabelli*. On February 27, 2013, the Supreme Court unanimously held that the five-year statute of limitations under 28 U.S.C. § 2462 does not incorporate an implied discovery rule for claims of fraud.

- **Post-Janus Rule 10b-5 Developments**
  - *SEC v. Pentagon Capital Mgmt. PLC*: In the Southern District of New York, defendants argued that they were not primarily liable under Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act under *Janus*. The district court disagreed, explaining that: (1) *Janus* was a private suit; (2) Rule 10b-5(a) and (c) use different and broader operative language than 10b-5(b); and (3) *Janus* did not interpret Section 17(a). An appeal before the Second Circuit is pending.

- **Aiding and Abetting the Violation of Antifraud Provisions**
  - *SEC v. Apuzzo*: The Second Circuit, reversing a lower court decision, held that the “substantial assistance” element of an aiding and abetting charge did not require a showing of proximate cause. The Second Circuit held that proximate cause does not apply to government enforcement actions, and that the appropriate test was whether the defendant “in some sort associate[d] himself with the venture, that he participate[d] in it as in something that he wishe[d] to bring about, [and] that he [sought] by his action to make it succeed.” An application for an extension of time to file a writ of certiorari with the Supreme Court was granted, extending the deadline to March 13, 2013.

- **Insider Trading Liability**
  - *SEC v. Obus*: The Second Circuit vacated a district court’s entry of summary judgment in favor of defendants. The Second Circuit held that with respect to tipper scienter, the tipper (1) must tip deliberately or recklessly; (2) must know, or be reckless in not knowing, that the information is material and non-public; and (3) must know, or be reckless in not knowing, that tipping would violate a fiduciary duty. For tippee scienter, the tippee (1) must know, or be reckless in not knowing, that the information is material and non-public; and (2) must have some level of knowledge that by trading on the information the tippee is a participant in the tipper’s breach of fiduciary duty. “Thus, tippee liability can be established if a tippee knew or had reason to know that confidential information was initially obtained and transmitted improperly (and thus through deception), and if the tippee intentionally or recklessly traded while in knowing possession of that information.”

- **Brokerage Firm Liability for Sales Representatives’ Misrepresentations**
  - *Roland v. Green*: The U.S. Court of Appeals for the Fifth Circuit considered how the “in connection with” element of the Securities Litigation Uniform Standards Act (SLUSA) should be construed. The Fifth Circuit adopted the standard set forth in the Ninth Circuit, under which a “misrepresentation is ‘in connection with’ the purchase or sale of securities
if there is a relationship in which the fraud and the stock sale coincide or are more than tangentially related. . . .” The Supreme Court has granted certiorari.

- Application of Dodd-Frank Act Collateral Bars to Pre-Dodd-Frank Conduct
  
  - In the Matter of Lawton: The Commission held that “collateral bars imposed pursuant to Section 925 of Dodd-Frank are not impermissibly retroactive as applied in follow-on proceedings addressing pre-Dodd-Frank conduct because such bars are prospective remedies whose purpose is to protect the investing public from future harm.”

- Scope of Whistleblower Protection Under Sarbanes-Oxley
  
  - Lawson v. FMR LLC: The U.S. Court of Appeals for the First Circuit held that the whistleblower protections under the Sarbanes-Oxley Act did not apply to employees of advisers or sub-advisers of Fidelity mutual funds because they were only employees of contractors for, but not direct employees of, public companies. A petition for a writ of certiorari has been filed with the Supreme Court.

4. Ethics

Members of the Office of the General Counsel discussed various proceedings against attorneys practicing before the Commission. Thomas J. Karr, Assistant General Counsel, began the session by providing various statistics on the Rule 102(e) orders issued against attorneys. Since the beginning of 2012, more than 30 orders have been issued against attorneys under Rule 102(e). There have been 11 orders involving Rule 102(e)(2), 3 20 orders involving 102(e)(3), 4 and two orders involving improper professional conduct. Common subject matters involve false statements to investors, fraudulent opinion letters, and insider trading. With respect to the length of the suspensions imposed, by far the most common was a permanent bar against practicing before the Commission. Mr. Karr noted that, while usually one or two cases are actively litigated at any given time, in 2012 there were eight cases being litigated. Mr. Karr said that the increase was due in part to the increasing number of attorneys being named in enforcement actions. He also noted that there are an increasing number of investigations of attorneys with respect to their representation of others before the Commission (and not in transactions), but those numbers overall remain small in proportion to other investigations.

The panelists, Mr. Karr, Geoffrey F. Aronow, General Counsel, and Donna McCaffrey, Special Trial Counsel, then highlighted a number of recent cases and issues:

---

3 Rule 102(e)(2) provides, in relevant part, that “[a]ny attorney who has been suspended or disbarred by a court of the United States or of any State; or any person whose license to practice as an accountant, engineer, or other professional or expert has been revoked or suspended in any State; or any person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission.”

4 Rule 102(e)(3)(i) provides, that “The Commission, with due regard to the public interest and without preliminary hearing, may, by order, temporarily suspend from appearing or practicing before it any attorney, accountant, engineer, or other professional or expert who has been by name: (A) permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder; or (B) found by any court of competent jurisdiction in an action brought by the Commission to which he or she is a party or found by the Commission in any administrative proceeding to which he or she is a party to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.”

© 2013 Sutherland Asbill & Brennan LLP. All Rights Reserved. This article is for informational purposes and is not intended to constitute legal advice.
Attorney misconduct not limited to smaller firms

- In the Matter of David Tamman, Esq., Admin. Proc. File No. 3-14207 (Jan. 27, 2011) (ongoing proceeding) (attorney at national law firm altered documents before they were provided to examination and enforcement Staff)

The scope of “appearing or practicing before the Commission”

- In the Matter of William J. Reilly, Esq., Admin. Proc. File No. 3-15126 (Dec. 6, 2012) (ongoing proceeding) (attorney previously suspended from practicing before the Commission drafted legal opinion letter incorporated as exhibit to public company filing)

Whether neither admitting nor denying allegations affects a Rule 102(e) proceeding

- In the Matter of Mitchell Segal, Esq., Admin. Proc. File No. 3-14945 (July 10, 2012) (ongoing proceeding) (without admitting or denying allegations, attorney consented to federal district court judgment finding that he provided false documents to another attorney who used such documents in drafting opinion letter)

Multiple representations and potential conflicts

- Oregon State Bar actions against Barnes Ellis and Lois Rosenbaum

  - The Oregon State Bar alleged ethical violations by two attorneys in connection with their representation of a company and 40 employees and executives. The Oregon State Bar alleged that they favored and protected the corporation by blaming two employees represented by them. The trial was held in November 2012 and a decision is pending.

Former SEC employees

- In the Matter of Spencer Barasch, Admin. Proc. File No. 3-14891 (May 24, 2012) (settled proceeding) (former Division of Enforcement Associate District Director who participated in decisions while at the Division relating to Robert Allen Stanford entities later represented one of the entities after joining private firm, despite being informed by Commission’s Ethics Office that he should not do so)
If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

**Authors**
Brian L. Rubin 202.383.0124 brian.rubin@sutherland.com
Carmen L. Brun 202.383.0258 carmen.brun@sutherland.com
Jaliya Stewart Faulkner 404.853.8192 jaliya.faulkner@sutherland.com
Michael K. Freedman 404.853.8093 michael.freedman@sutherland.com
Kurt Lentz 404.853.8134 kurt.lentz@sutherland.com
Jae C. Yoon 202.383.0835 jae.yoon@sutherland.com

**Related Attorneys**
Peter J. Anderson 404.853.8414 peter.anderson@sutherland.com
Eric A. Arnold 202.383.0741 eric.arnold@sutherland.com
Keith J. Barnett 404.853.8384 keith.barnett@sutherland.com
Bruce Bettigole 202.383.0165 bruce.bettigole@sutherland.com
Steven B. Boehm 202.383.0176 steven.boehm@sutherland.com
Olga Greenberg 404.853.8274 olga.greenberg@sutherland.com
Cheryl L. Haas 404.853.8521 cheryl.haas@sutherland.com
Deborah G. Heilizer 202.383.0858 deb.heilizer@sutherland.com
Gregory S. Kaufman 202.383.0325 greg.kaufman@sutherland.com
Clifford E. Kirsch 212.389.5052 clifford.kirsch@sutherland.com
Michael B. Koffler 212.389.5014 michael.koffler@sutherland.com
Susan S. Krawczyk 202.383.0197 susan.krawczyk@sutherland.com
Cynthia M. Krus 202.383.0218 cynthia.krus@sutherland.com
Neil S. Lang 202.383.0277 neil.lang@sutherland.com
Harry S. Pangas 202.383.0805 harry.pangas@sutherland.com
S. Lawrence Polk 404.853.8225 larry.polk@sutherland.com
Stephen E. Roth 202.383.0158 steve.roth@sutherland.com
Holly H. Smith 202.383.0245 holly.smith@sutherland.com
John H. Walsh 202.383.0818 john.walsh@sutherland.com
Bryan M. Ward 404.853.8249 bryan.ward@sutherland.com