



# Financial Fraud Law Report

AN A.S. PRATT & SONS PUBLICATION

MARCH 2014

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POSTMASTER: Send address changes to the *Financial Fraud Law Report*, LexisNexis Matthew Bender, 121 Chanlon Road, North Building, New Providence, NJ 07974. Direct inquiries for editorial department to [catherine.dillon@lexisnexis.com](mailto:catherine.dillon@lexisnexis.com). ISBN: 978-0-76987-816-4

# Top Five SEC Enforcement Events in 2013

WILLIAM R. McLUCAS, DOUGLAS J. DAVISON, AND LESLEY R. FREDIN

*This article reviews a selection of the top five Securities and Exchange Commission Enforcement events of 2013.*

**T**his past year saw significant activity by the Division of Enforcement at the U.S. Securities and Exchange Commission (“SEC”). While the overall number of enforcement actions filed in fiscal year 2013 declined, the SEC collected a record amount of penalties and disgorgement, reaching approximately \$3.4 billion.<sup>1</sup> Moreover, setting aside the statistical data, the public statements and actions emanating from both the agency Chair Mary Jo White and Enforcement Director Andrew Ceresney suggest an increasingly hostile environment for those facing SEC scrutiny. This article reviews a selection of the top five SEC Enforcement events of 2013.

## **CHAIR WHITE PROMOTES AN AGGRESSIVE PROGRAM**

Mary Jo White became the SEC Chair in April, 2013.<sup>2</sup> This is the first time that both an SEC Chair and the enforcement director had previously served as criminal prosecutors, and as they acknowledge, a number of key initiatives draw on their prior experiences as trial lawyers in the criminal arena.<sup>3</sup>

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Chair White's public statements, and the public statements by the senior enforcement staff in 2013, are particularly noteworthy in that they all reflect an extremely aggressive posture.

For example, in September 2013, in a speech entitled "Deploying the Full Enforcement Arsenal," Mary Jo White discussed her vision for ensuring that investors know that there is a "strong and effective cop on the beat..."<sup>4</sup> In that speech, she explained her view that SEC Enforcement "must be aggressive and creative," and she outlined a range of ways in which the SEC would implement her vision. Chair White said that the SEC will: bring more negligence cases when there is insufficient evidence to charge intentional wrongdoing; make aggressive use of civil penalties; seek admissions in settlements in certain cases, rather than allowing parties to settle on the traditional "neither admit nor deny" basis; shift the investigative focus to individuals first, rather than entities; be "everywhere bringing enforcement actions against violators in every market participant category and in every market strata;" and litigate more trials.<sup>5</sup>

In another speech, delivered just two weeks later in October, 2013, Chair White provided more details about her goal that SEC Enforcement be everywhere, "pursuing all types of violations of our federal securities laws, big and small."<sup>6</sup> She compared her vision for SEC Enforcement to the "broken windows" strategy emphasized in the 1990s by then-New York City Mayor Rudy Giuliani, intended to make clear that no violation was too small to be uncovered and punished.<sup>7</sup> Chair White also identified other steps the Enforcement Division is taking, such as: enhancing its work with examiners; encouraging whistleblowers to come forward; collaborating with other regulators; harnessing new technologies; and pursuing "gatekeepers."<sup>8</sup> Clearly, Chair White expects the Enforcement Division to be tough, strong, aggressive, and creative.

## DEMANDING ADMISSIONS

Under Chair White, the SEC has undergone a major shift in its policy to require admissions in certain cases, even where the party has not pled guilty in a related criminal matter. Chair White has stated: "there are certain other cases not involving any parallel criminal case where there is a special need for public accountability and acceptance of responsibility."<sup>9</sup> The Commission may require admissions where:

- a large number of investors have been harmed or the conduct was otherwise egregious;
- the conduct posed a significant risk to the market or investors;
- admissions would aid investors deciding whether to deal with a particular party in the future; or
- reciting unambiguous facts would send an important message to the market about a particular case.<sup>10</sup>

The SEC has secured admissions in a total of five cases following this June 2013 change in policy.<sup>11</sup>

Notably, Enforcement Director Ceresney indicated that the Commission will not consider a defendant's cooperation in determining whether to seek an admission, as the SEC does not view an admission as a sanction.<sup>12</sup> Despite the shift in policy, Chair White and Mr. Ceresney have indicated that "the majority of cases will continue to be resolved on a no admit no deny basis, as the interest in quick resolutions and settlements will, in most cases, outweigh the interests in obtaining admissions."<sup>13</sup>

In reality, such admissions have the potential to be enormously damaging in parallel proceedings and effectively amount to sanctions, which brings us to our next highlight for 2013: an increased willingness to litigate.

## **MORE LITIGATION**

Consistent with Chair White's pledge to be more aggressive, she welcomed the prospect of more cases proceeding to the courtroom.<sup>14</sup> Chair White explained that "a strong enforcement regime is only effective if we have the ability to back it up on court."<sup>15</sup> There have been both high profile victories<sup>16</sup> and defeats.<sup>17</sup> According to a recent report, the SEC won 55 percent of its trials since October 2013, down from three consecutive years when it won more than 75 percent of the time.<sup>18</sup> At least according to the rhetoric, it does not appear that the trial defeats will impact the SEC's intentions to try more cases — Mr. Ceresney recently stated: "If we're not losing trials, we're not being aggressive enough. It's obviously important that we win to ensure that we have credibility. But just because we lose a case it doesn't mean we

shouldn't have brought the case or that we didn't try it well."<sup>19</sup> Nevertheless, it has been reported that the SEC's trial unit has been restructured recently to allow the SEC employees who investigate matters to work closer with SEC employees who litigate the matters as a case develops.<sup>20</sup> The trial unit also has been broken into four groups to be more closely aligned with the structure in the investigative division.<sup>21</sup>

It is difficult to draw any reliable conclusions that can be applied going forward from the results of the trials, as many cases turn on evidentiary assessments by fact-finders, who are influenced differently by presentations at trial. One thing is crystal clear, however, and that is that those facing potential SEC enforcement actions need to be ready to do battle in court.

## **FOCUS ON HEDGE FUNDS AND ADVISORS**

The SEC's largest specialized enforcement unit, the Asset Management Unit, is coordinating with the Division of Economic Risk and Analysis and the Office of Compliance Inspections and Examinations to identify funds and advisors for investigation.<sup>22</sup> As a result, 2013 saw an ongoing emphasis on the asset management industry, including on cases involving insider trading, valuation, custody, fee arrangements, conflicts of interest, and compliance.

The many cases related to SAC Capital showcase the breadth of the SEC's efforts to address insider trading. For example, in March, SAC Capital entered a \$602 million settlement with the SEC related to insider trading charges against affiliated fund CR Intrinsic.<sup>23</sup> That is a record for an SEC insider trading settlement.<sup>24</sup> In November, SAC Capital itself agreed to plead guilty and pay \$1.2 billion to resolve DOJ's insider trading charges.<sup>25</sup> SAC's founder, Stephen Cohen, faces civil SEC charges for failure to supervise employees.<sup>26</sup> Relatedly, in December, Michael Steinberg, a former portfolio manager at SAC, was convicted of criminal insider trading charges.<sup>27</sup>

The SEC has also focused on valuation issues in enforcement actions, and valuation remains a key area of focus for its examination staff. On this issue, for example, the SEC charged former hedge fund advisory firm Yorkville Advisors LLC, its founder, and CFO, with scheming to overvalue assets under management and exaggerate the reported returns of hedge funds they managed in order to hide losses and increase the fees collected from investors.<sup>28</sup> The case

is being litigated, and it is worth noting that the conduct on which this matter is premised was apparently flagged as part of an initiative associated with the SEC's Aberrational Performance Inquiry, a proprietary risk analytics program designed to identify hedge funds with suspicious returns.<sup>29</sup>

## **RENEWED FOCUS ON FINANCIAL FRAUD**

This year also saw the announcement of an intention to have a renewed focus on accounting fraud, which had received less agency focus in recent years. In announcing the creation of the Financial Reporting and Audit Task Force (the "Task Force"), Mr. Ceresney noted that he doubted whether fraud in financial reporting by public companies declined along with accounting fraud investigations and cases.<sup>30</sup> At a recent panel, Margaret McGuire, Vice Chair of the Task Force, highlighted five different goals of the Task Force:

- (1) to develop a deep understanding of financial fraud;
- (2) to develop state-of-the-art methodologies to identify financial fraud, including utilizing the SEC's new Accounting Quality Model;
- (3) to share information and resources within the agency;
- (4) to collaborate beyond the agency with fellow regulators; and
- (5) to engage the public, academics, and whistleblowers to inform the Task Force's work.<sup>31</sup>

The Task Force will focus on early detection of accounting fraud, according to David Woodcock, Chair of the Task Force, including possible red flags such as accounting revisions, differences between recorded book earnings and taxable income, large numbers of off-balance-sheet transactions, non-GAAP performance measures, and audit deficiencies such as material weaknesses in their internal controls.<sup>32</sup>

## **LOOKING AHEAD**

Chair White recently noted that 2014 "promises to be an incredibly active year in enforcement," as the SEC continues to "vigorously pursue wrong-

doers and bring enforcement actions across the entire industry spectrum.<sup>33</sup> There is ample room to debate some of the pronouncements surrounding the drumbeat for more and tougher enforcement, more litigation, the insistence on admissions in settlements, and the shrugging off of court room defeats. Given these statements, however, it is reasonable to expect that we will see many of the developments we have identified — more trials, additional admissions, targeting of gatekeepers, and a focus on accounting cases — to be important features of the results for 2014.

## NOTES

<sup>1</sup> The SEC brought 686 enforcement actions in fiscal year 2013, ending on September 30, 2013, a decrease of approximately seven percent from the 734 enforcement actions filed in fiscal year 2012. That said, as the SEC explained at the time it announced its results, there were 908 investigations opened last year (an increase of 13 percent) and 574 formal orders of investigation issued (an increase of 20 percent). Year-by-Year SEC Enforcement Statistics, available at <http://www.sec.gov/news/newsroom/images/enfstats.pdf>; *see also* Press Release, SEC, SEC Announces Enforcement Results for FY 2013 (Dec. 17, 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/13705403617>.

<sup>2</sup> Press Release, SEC, Mary Jo White Sworn in as Chair of SEC (Apr. 10, 2013), <https://www.sec.gov/servlet/Satellite/News/PressRelease/Detail/PressRelease/1365171514548>.

<sup>3</sup> *See, e.g.*, Mary Jo White, Chairman, SEC, The Importance of Trials to the Law and Public Accountability (Nov. 14, 2013), <http://www.sec.gov/News/Speech/Detail/Speech/1370540374908>; Andrew Ceresney, Co-Director of the Division of Enforcement, SEC, Financial Reporting and Accounting Fraud (Sept. 19, 2013), <http://www.sec.gov/News/Speech/Detail/Speech/1370539845772>.

<sup>4</sup> Mary Jo White, Chairman, SEC, Deploying the Full Enforcement Arsenal (Sept. 26, 2013), <http://www.sec.gov/News/Speech/Detail/Speech/1370539841202> (hereinafter White, Deploying the Full Enforcement Arsenal).

<sup>5</sup> *Id.*

<sup>6</sup> Mary Jo White, Chairman, SEC, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), <https://www.sec.gov/servlet/Satellite/News/Speech/Detail/Speech/1370539872100>.

<sup>7</sup> *Id.*



<sup>8</sup> *Id.* The SEC's renewed focus on gatekeepers, including auditors, CFOs, board members, and lawyers, along with the SEC Chair's direction that the Staff make a "subtle shift" by assessing first in investigations whether individuals could be charged before looking to bring a case against an entity, are also significant developments for 2013. See White, *Deploying the Full Enforcement Arsenal and Remarks at the Securities Enforcement Forum*. Even though we have not included them in our "Top 5," these are important components of the Enforcement Division's approach intended to send a "get tough" message to market participants.

<sup>9</sup> White, *Deploying the Full Enforcement Arsenal*.

<sup>10</sup> *Id.*

<sup>11</sup> See, e.g., Michael Bobelian, *SEC Extracts Admission of Wrongdoing In Settlement With Credit Suisse*, FORBES, Feb. 24, 2014, <http://www.forbes.com/sites/michaelbobelian/2014/02/24/sec-extracts-admission-of-wrongdoing-in-settlement-with-credit-suisse>.

<sup>12</sup> Yin Wilczek, *SEC Enforcement: In Renewed Accounting Focus, SEC to Target Reserves, Revenue Recognition, Other Areas*, SECURITIES LAW DAILY, (Sept. 20, 2013).

<sup>13</sup> Andrew Ceresney, Co-Director of the Division of Enforcement, SEC, *Financial Reporting and Accounting Fraud* (Sept. 19, 2013), <http://www.sec.gov/News/Speech/Detail/Speech/1370539845772>.

<sup>14</sup> White, *Deploying the Full Enforcement Arsenal*.

<sup>15</sup> *Id.*

<sup>16</sup> See, e.g., Justin Bear et al., *'Fab' Trader Liable in Fraud*, WALL ST. J., Aug. 2, 2013, available at <http://online.wsj.com/news/articles/SB10001424127887323681904578641843284450004> (former Goldman Sachs trader Fabrice Tourre found liable for securities fraud).

<sup>17</sup> See, e.g., Steven Perlberg, *Mark Cuban Found Not Liable for Insider Trading*, BUSINESS INSIDER, Oct. 16, 2013, <http://www.businessinsider.com/mark-cuban-not-guilty-2013-10>.

<sup>18</sup> Jean Eaglesham, *SEC Takes Steps to Stem Courtroom Defeats*, WALL ST. J., Feb. 13, 2014, <http://online.wsj.com/news/articles/SB10001424052702304703804579381310253258646> (hereinafter Eaglesham, *SEC Takes Steps to Stem Courtroom Defeats*).

<sup>19</sup> Dina Elboghday, *Here's how the SEC is preparing for life after financial crisis*, WASH. POST, Jan. 29, 2014, <http://www.washingtonpost.com/blogs/wonkblog/wp/2014/01/29/sec-enforcement-chief-gears-up-for-post-financial-crisis-era/>.

<sup>20</sup> Eaglesham, *SEC Takes Steps to Stem Courtroom Defeats*.

<sup>21</sup> *Id.*

<sup>22</sup> Chair White recently explained SEC examiners' use of the National Exam Analytics Tool to analyze 17 million transactions in 36 hours, noting that the technology can and will be used to identify signs of anomalous trading behavior. Mary Jo White, Chairman, SEC, *The SEC in 2014* (Jan. 27, 2014), <http://www.sec.gov/News/Speech/Detail/Speech/1370540677500>.

<sup>23</sup> Press Release, SEC, *CR Intrinsic Agrees to Pay More than \$600 Million in Largest-Ever Settlement for Insider Trading Case* (Mar. 15, 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171513308>.

<sup>24</sup> *Id.*

<sup>25</sup> Michael Rothfeld, *SAC Agrees to Plead Guilty in Insider-Trading Settlement*, WALL ST. J., Nov. 4, 2013, [http://online.wsj.com/news/articles/SB10001424052702303482504579177602847708162?mod=WSJ\\_hps\\_LEFTTopStories](http://online.wsj.com/news/articles/SB10001424052702303482504579177602847708162?mod=WSJ_hps_LEFTTopStories).

<sup>26</sup> Press Release, SEC, *SEC Charges Steven A. Cohen With Failing to Supervise Portfolio Managers and Prevent Insider Trading* (July 19, 2013), <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539726923>.

<sup>27</sup> Kara Scannell, *DOJ Victory in SAC Insider-Trading Trial*, FIN. TIMES, (Dec. 18, 2013), <http://www.ft.com/intl/cms/s/0/e6477666-676c-11e3-a5f9-00144feabdc0.html#axzz2nt3hS2Wb>. Additionally, in February 2014, Mathew Martoma, another former SAC employee, was convicted of criminal insider trading charges. Alexandra Stevenson & Matthew Goldstein, *Ex-SAC Trader Convicted of Securities Fraud*, N.Y. TIMES (Feb. 6, 2013), <http://dealbook.nytimes.com/2014/02/06/former-sac-trader-found-guilty-of-insider-trading/?hp>.

<sup>28</sup> Richard Vanderford, *Hedge Fund Co. Calls SEC Fraud Claims Unfounded*, LAW360, Apr. 4, 2013, <http://www.law360.com/articles/430269>.

<sup>29</sup> Press Release, SEC, *SEC Charges Hedge Fund Adviser and Two Executives* (Oct. 17, 2012), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171485332>.

<sup>30</sup> Andrew Ceresney, Co-Director of the Division of Enforcement, SEC, *Financial Reporting and Accounting Fraud* (Sept. 19, 2013), <http://www.sec.gov/News/Speech/Detail/Speech/1370539845772>.

<sup>31</sup> Margaret McGuire, DC Bar Panel Discussion regarding the SEC's Financial Reporting and Audit Task Force (Feb. 11, 2014).

<sup>32</sup> Emily Chasan, *Five Accounting Red Flags the SEC is Watching*, WALL ST. J. (Dec. 12, 2013), <http://blogs.wsj.com/cfo/2013/12/12/five-accounting-red>

flags-the-sec-is-watching/.

<sup>33</sup> Mary Jo White, Chairman, SEC, 41st Annual Securities Regulation Institute (Jan. 27, 2014), <https://www.sec.gov/News/Speech/Detail/Speech/1370540677500>.