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When the Inevitable Happens: When to Self-Report Securities Law Violations and What to Expect When You Do

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An anonymous compliance hotline within your investment adviser suddenly receives complaints about a market-beating portfolio manager. Your in-house compliance and legal team investigate and learn this portfolio manager may have been the beneficiary of some particularly timely information in advance of certain corporate announcements, leading to his highly successful year trading in the fund he manages. He denies doing anything wrong and accuses the (still anonymous) whistleblower of being jealous of his success. As images from episodes of “Billions” scroll through your mind, you try to decide what to do. Do you self-report? Do you tell the Securities and Exchange Commission (SEC)?

Since at least 2001, the SEC has issued numerous public statements encouraging self-reporting and cooperation. Yet clarity about the actual benefits to an entity deciding whether to self-report misconduct can be elusive, in particular for investment advisers, mutual funds and other investment companies, private equity funds, and hedge funds. As a member of the board of trustees for a fund, an officer, or a principal for one of these entities, determining whether to self-report a discovered violation can be difficult.¹ Self-reporting exposes the entity to an expensive and reputation-damaging investigation, at a minimum.

The SEC generally does not take a self-reporting company’s word as sufficient explanation of what occurred. Instead, they want to obtain facts confirming what took place and who bears responsibility. Responding to this investigation requires money and time while simultaneously creating a substantial disruption to normal business operations. Then the entity almost always faces an enforcement action, including a resolution imposing substantial financial penalties and potentially additional relief, such as undertakings or an independent compliance consultant. In fact, in its first public statement encouraging entity cooperation, the SEC itself acknowledged, “... there may be circumstances where conduct is so egregious, and harm so great, that no amount of cooperation ... can justify a decision not to bring any enforcement action at all.”²

Yet the new administration at the SEC has high incentives to find mechanisms to encourage more self-reporting by entities and individuals alike.³ The SEC has long recognized that “[w]hen businesses seek out, self-report and rectify illegal conduct, and otherwise cooperate with Commission Staff, large expenditures of government and shareholder resources can be avoided and investors can benefit more promptly.”⁴ In this time of intense federal budget scrutiny and potential reductions of federal

spending, the SEC should be highly motivated to find more efficient ways to fulfill its mission to protect investors. Understanding the potential benefits from self-reporting and the likelihood of realizing those rewards in a particular case can assist in making this decision. Further, there are steps the SEC could take to clarify rewards associated with self-reporting and cooperation that would incentivize greater numbers of entities to come forward.

Benefits of Self-Reporting

Any discussion of self-reporting begins with the SEC's publicly stated standards for measuring cooperation credit by entities—self-policing, self-reporting, remediation, and cooperation.⁵ Self-policing considers entity governance before the misconduct came to light, including maintenance of an effective compliance program and an appropriate tone at the top.⁶ Self-reporting includes conducting a thorough review of the nature, extent, origins, and consequences of the misconduct, and making a complete disclosure to relevant regulators and the public.⁷ Remediation refers to actions taken to correct the misconduct, whether firing or disciplining responsible individuals, improving internal controls, or repaying harmed investors and clients.⁸ Cooperation requires providing everything to the government relevant to the misconduct.⁹

The SEC has several means through which to reward self-reporting and cooperation—including closing an investigation without action, entering into deferred prosecution agreements or non-prosecution agreements, lowering or eliminating payment of civil penalties, as well as negotiating language in a public document about the matter or agreeing to bring an administrative settlement instead of a federal court injunctive order. Self-reporting has played a critical role in the SEC's assessment of whether to close an investigation, reduce financial penalties, or enter into deferred prosecution and non-prosecution agreements—demonstrated by reviewing recent SEC settlements with cooperating entities, some of which self-reported and others that did not.

Closed Investigations

Determining the likelihood of the SEC closing an investigation without action based on a self-report can be challenging. Most of the time when the SEC closes a case, it does so without any public notice at all—much to the detriment of the agency's desire for increased self-reporting. Typically, if an entity self-reports a matter to the SEC and the SEC declines to charge the entity, the public learns nothing from the SEC's decision not to charge or about the underlying conduct that had been self-reported. On rare occasions, the SEC closes some matters with a corresponding public statement. In 2012, the SEC charged four traders at Credit Suisse Group with a scheme to fraudulently overstate the prices of \$3 billion in subprime mortgage bonds during the height of the subprime credit crisis.¹⁰ Despite these allegations against the four traders, the SEC did not charge their employer, Credit Suisse Group, at all. In the press release announcing the SEC's action against the traders, the SEC stated, “[t]he SEC's decision not to charge Credit Suisse was influenced by several factors, including the isolated nature of the wrongdoing and Credit Suisse's **immediate self-reporting** to the SEC and other law enforcement agencies as well as prompt public disclosure of corrected financial results.” (emphasis added)¹¹

In contrast, the United States Department of Justice (DOJ) has found a mechanism to reinforce the value of self-reporting, among other cooperation concerns, by publicizing certain declinations without a formal non-prosecution agreement. In April 2016, the DOJ Criminal Division, Fraud Section announced a Foreign Corrupt Practices Act (FCPA) enforcement pilot program (FCPA Pilot Program) establishing certain requirements to qualify for credit and the specific rewards for meeting these criteria.¹² Assistant Attorney General Leslie Caldwell stated when announcing the FCPA Pilot Program, “... if a company chooses not to voluntarily disclose its FCPA misconduct, it may receive limited credit if it later fully cooperates and timely and appropriately remediates—but any such credit will be markedly

less than that afforded to companies that do disclose wrongdoing.”¹³ As of June 29, 2017, the DOJ has announced seven declinations pursuant to the FCPA Pilot Program—all of which acknowledge the entity’s self-reporting.¹⁴

Deferred Prosecution Agreements and Non-Prosecution Agreements

The SEC’s use of non-prosecution agreements (NPAs) and deferred prosecution agreements (DPAs) provide additional means for the agency to reward self-reporting and cooperation, yet they have been somewhat lightly used.¹⁵ In these agreements, the SEC agrees to either defer filing an enforcement action regarding certain factual findings (DPAs) or not to pursue an enforcement action at all (NPAs), as long as the parties accept certain criteria, including continued cooperation in ongoing investigations of individuals, tolling of applicable statutes of limitations, or agreeing to undertakings. Until June 2017, the SEC had not availed itself of these tools in matters involving investment advisers, hedge funds, private equity funds, or investment companies, with a single exception. In one matter, an individual reporting misconduct at the hedge fund where he had been employed received a DPA from the SEC pursuant to its cooperation program.¹⁶ Even though the DPAs and NPAs the SEC has entered with entity respondents to date involve publicly traded companies, it is clear from these matters that the SEC views self-reporting as essentially mandatory to receive one of these agreements. Four of the NPAs agreed to by the SEC with corporate entities included statements acknowledging the respondent for self-reporting the conduct.¹⁷ Two DPAs between the SEC and corporate entities contained a similar acknowledgment.¹⁸ Indeed, the SEC’s Division of Enforcement announced in August 2016 that going forward it would no longer recommend DPAs or NPAs at all in FCPA cases unless the company self-reported the violations.¹⁹ In contrast, the DOJ has used DPAs and NPAs with SEC-regulated entities that failed to self-report, possibly in recognition of the serious

consequences to such an entity of either a criminal indictment or plea agreement.²⁰

Reduced Monetary Relief

Perhaps the most frequent method used by the SEC to credit cooperation and self-reporting or reflect the absence of such cooperation is in reducing monetary relief. Self-reporting acknowledged by the SEC has correlated with reduced penalties²¹ or, even in certain cases, no penalties being assessed.²² By contrast, SEC settlements describing remedial actions²³ and even acknowledging “extensive cooperation”²⁴ without self-reporting generally correlated to higher ordered civil penalties. In 2015, the SEC settled with three private equity fund advisers within The Blackstone Group, pursuant to which the entities agreed to pay \$26.2 million in disgorgement, prejudgment interest of \$2.6 million, and a \$10 million civil penalty—amounts reflecting cooperation credit but no self-reporting.²⁵ The SEC’s order references “remedial acts taken by Blackstone **prior to contact** from the Commission’s Staff and cooperation afforded the Commission Staff **after Blackstone was contacted** (emphasis added).”²⁶ Notably, the SEC stated in the Blackstone Group press release, “... self-reporting is one factor that the Commission considers when evaluating cooperation and determining whether and to what extent to extend credit in settlements”²⁷—even though no self-reporting had occurred in that case.

Yet disgorgement has traditionally been excluded from the calculus of self-reporting or cooperation credit. As stated by former Division of Enforcement Director Andrew Ceresney in a speech discussing the SEC’s cooperation program at its fifth anniversary, “To be clear, this flexibility [to reduce monetary relief] ordinarily does not extend to disgorgement... Where someone is in possession of what clearly are the proceeds of wrongdoing, the Commission typically seeks to disgorge it.”²⁸ This thinking could significantly change after the United States Supreme Court’s June 5, 2017 ruling in *Kokesh v. Securities and Exchange Commission*.²⁹

Prior to *Kokesh*, disgorgement arose out of the court's "inherent equity power to grant relief ancillary to an injunction"³⁰ and, as such, courts and the SEC typically defined disgorgement as requiring defendants to "give up 'those gains... properly attributable to the defendant's interference with the claimant's legally protected rights.'"³¹ As far back as the 1970s, courts and the SEC used disgorgement in SEC enforcement proceedings to restore the status quo prior to the securities law violation—by requiring the violator to repay profits or benefits obtained from the misconduct in order to remove any "...monetary reward for violating securities laws."³² Based on this pre-*Kokesh* theory of disgorgement, the SEC rarely if ever negotiated disgorgement amounts in settlements.

Under certain circumstances, the SEC negotiated the methodology or theory underlying a disgorgement calculation to provide a certain flexibility in the assessment of ill-gotten gains, but once landing on a metric for measuring disgorgement in the matter, there was little room provided to negotiate the amount. Again, Mr. Ceresney continued in the same speech about cooperation credit, "...in some cases, there is flexibility as to how to calculate disgorgement, and the Enforcement Staff might take a narrower view of what should be disgorged in recognition of cooperation."³³ Evidence of the SEC's position on disgorgement can be seen in SEC settlements involving FCPA violations where entities receiving non-prosecution agreements have been ordered to pay disgorgement.³⁴

Going forward, this assessment of disgorgement and its ability to be ordered in matters where the SEC has not charged an underlying violation may be at issue. Now that the Supreme Court has found that disgorgement as ordered in SEC enforcement proceedings constitutes a penalty, it appears rational to negotiate the amount of disgorgement just as one would negotiate civil penalty amounts. All of the ramifications of *Kokesh* have yet to be considered and fall beyond the scope of this article, but it is worth noting that disgorgement, once off the

table as a point of negotiation for cooperating entities with the SEC, may now fairly be considered a penalty and, as such, should be negotiable as part of any settlement negotiation.

Three Cases, Three Outcomes— Distribution-in-Guise Initiative

Three enforcement actions from the SEC's Distribution-in-Guise Initiative provide some additional illustration for the impact of self-reporting on civil penalties assessed in SEC settlements.³⁵ In 2013 and 2014, the SEC's National Examination Program announced it would look at "payments for distribution in guise" defined as "...the wide variety of payments made by advisers and funds to distributors and intermediaries..." to assess whether these payments were made for distribution and preferential treatment outside of the regulations governing distribution payments, including Investment Company Act Rule 12b-1.³⁶ The SEC acknowledged cooperation by the entities in each of these settlements, yet the penalty amounts imposed ranged from \$1 million to \$12.5 million. The SEC imposed the lowest such penalty (\$1 million) where the entity had self-reported the conduct, as the SEC order makes clear:

The Commission has agreed to impose a reduced penalty that reflects the Respondents' **self-reporting** of the improper fee payments, significant cooperation, and prompt remediation. For instance, upon discovery of some of the improper fees referenced herein, Respondents initiated an in-depth review of intermediary agreements and promptly **self-reported** their findings to the Commission Staff.³⁷ (emphasis added)

For comparison, the SEC imposed a \$4.5 million penalty in another distribution-in-guise matter, notably filed just the day before, only acknowledging "remedial measures" taken by the entity, without mention of a possible self-report.³⁸ In 2015, nearly

two years prior to these two settlements, the SEC imposed a \$12.5 million penalty in the first of the distribution-in-guise matters, citing cooperation and remedial efforts but no self-reporting.³⁹

All three matters involved allegations of similar conduct, the mischaracterization of fees by advisers and funds as sub-advisory payments instead of distribution payments requiring additional tracking and reporting. The SEC also assessed large disgorgement amounts alongside both the smallest penalty of these three cases and the largest—the \$1 million penalty was imposed alongside nearly \$18 million in disgorgement, and the \$12.5 million penalty accompanied an assessment of nearly \$25 million in disgorgement—thus demonstrating that the SEC’s views on size of the ill-gotten gain, or potential harm, did not alone explain the amount of civil penalties assessed.

Practical Considerations Before Self-Reporting

Among the SEC’s cooperation factors, the decision to self-report presents the greatest risk. An entity with a fiduciary duty to its investors and clients can, and should, self-police (catch the conduct and stop it), remediate the harm (repay investors, discipline or fire individuals responsible, and update compliance procedures), and provide the SEC with information it could otherwise obtain under subpoena. But revealing undisclosed misconduct or potential violations to the government involves exposing the entity to ongoing government investigations and expensive settlements. Further heightening the stakes, the decision to self-report, once made, cannot be undone. Giving the SEC information about the potential violation followed by cooperation throughout the investigation leaves an entity little room to contest any underlying facts should it disagree with a conclusion reached by the Staff. Worst yet, this decision must be made quickly, because once the SEC learns of the potential violation from another source, any credit for self-reporting is lost. If the best cooperation cannot deflect an enforcement

action entirely, how should an entity assess whether to self-report?

(1) *Legal Obligation to Self-Report*

As an initial matter, the entity needs to evaluate whether any pre-existing requirement to disclose the misconduct to its investors, clients, or to the government exists. If the entity has a fiduciary duty to its investors or clients, and the misconduct is material creating a disclosure obligation to its clients,⁴⁰ then the entity should consider self-reporting to the SEC at the same time as or just prior to disclosing the conduct to clients. Other statutory obligations to self-report, such as rules imposed upon auditors,⁴¹ or on broker-dealers in certain contexts,⁴² must be considered and complied with. Finally, any contractual agreements with any clients requiring disclosure of the underlying facts, thereby causing public disclosure, also likely warrant self-reporting to the government at the same time.

(2) *Seriousness and Type of Violation*

The severity of the violation impacts any decision to self-report, with the most serious and most minor violations presenting the greatest potential reward. If an entity discovers technical violations, particularly without investor harm, it should consider whether self-reporting can position the entity to obtain a termination letter closing the investigation from the SEC. Entities evaluating whether to self-report a minor or technical violation, even a more significant violation, should also consider whether it can tie the misconduct to particular individuals within the entity and provide information on those individuals. When the SEC can charge culpable individuals and the entity has self-reported and otherwise cooperated, including remediating any issues, it has a stronger argument for the SEC to decline to charge the entity at all.⁴³

With serious violations, the greater risk of discovery by the SEC and the certainty that the SEC will investigate a serious violation regardless of whether

it is self-reported or discovered during an examination weigh in favor of self-reporting. Weighing the risk of discovery by the SEC when a significant or serious violation has occurred almost always tilts in favor of self-reporting to at least control the message and means of communication with the government. Given the SEC's robust whistleblower program and the high incentives offered to individuals to provide information to the Commission, the chances of a large or severe violation remaining undiscovered are small. These chances diminish further when the entity in question is a regulated entity subject to the SEC's powers of examination. Stopping a serious problem at an entity from continuing, correcting the issue, and addressing any investor harm, if possible or necessary, should also be a priority for an entity—particularly an entity with a fiduciary duty to its investors. Correcting a massive breakdown in compliance or massive intentional wrongdoing will likely attract notice also, or increase risk of discovery. Also, by self-reporting an issue, the entity can attempt to manage the issue and its presentation to the SEC and to its clients or investors by getting ahead of it. Also, self-reporting assists with creating trust and credibility with the SEC Staff from the outset of the matter. Improving the relationship with the SEC Staff when there is a significant violation can mitigate some of the pain during the investigation and can position the entity for a more favorable resolution to the matter.

Careful consideration of self-reporting is particularly warranted where the misconduct involves criminal conduct or known DOJ priorities. In particular, FCPA matters must be treated differently than other types of misconduct. As noted previously, both the DOJ and the SEC have announced that entities discovering FCPA violations and failing to self-report those to the government will not receive full cooperation credit.⁴⁴ For example, the DOJ and SEC each obtained financial payments from Och-Ziff Capital Management LLC (Och-Ziff) in the first case against a hedge fund for FCPA violations. Och-Ziff did not self-report and

the SEC learned of the FCPA violations through a proactive investigation.⁴⁵ The SEC settled with Och-Ziff and its affiliated investment adviser for a total of \$199,045,167 in disgorgement plus prejudgment interest, and stated it was “foregoing” a \$173,186,178 civil penalty because of the larger penalty assessed by the DOJ.⁴⁶ DOJ entered a three-year deferred prosecution agreement with Och-Ziff, a plea agreement with a wholly-owned subsidiary, and imposed a \$213 million criminal penalty and a compliance monitor.⁴⁷ The DOJ, in a press release, cited the factors involved in resolving this matter:

[t]he department entered into this resolution in part due to Och-Ziff's **failure to voluntarily self-disclose** the companies' misconduct to the department. The resolution also reflects the **seriousness of the companies' conduct**, including the high value of the bribes paid to the foreign officials and the involvement of a high level employee within Och-Ziff. (emphasis added)⁴⁸

This resolution illustrates the risks faced, particularly in the FCPA arena, if the adviser or fund does not self-report serious violations and the SEC or DOJ learn of the misconduct. In FCPA matters, self-reporting significantly benefits the entity with both government entities.

(3) *Recidivism*

If the entity has previously been charged by the Commission for the same or similar issues, it is almost always beneficial to self-report new problematic conduct. Simply put, a recidivist entity will receive the least amount of cooperation credit and will face the most severe sanctions—making self-reporting critical to obtaining any credibility with the SEC Staff and any possible credit for cooperation. Self-reporting indicates that the entity's existing compliance structure functioned well enough for the issue to bubble up within the entity. Also,

without a self-report, recidivist entities risk losing important waivers allowing it to conduct business.⁴⁹ Establishing credibility through self-reporting, and showing that the compliance function worked to some degree (sufficient to allow the issue to be known), may provide some support for waivers to be granted.

(4) *Take All Remedial Steps Possible*

Although often unreported and non-public, the SEC does close investigations or decline to pursue matters when there has been complete remediation prior to the Staff beginning an investigation, especially combined with self-reporting. As soon as a potential issue that may have violated the securities laws is discovered, an entity should begin assessing remedial steps to resolve or repair the damage caused by this potential violation. If the entity can remediate prior to self-reporting, it should do so. By prioritizing remedial action, the entity demonstrates that it is capable of self-regulation and self-compliance. Further, the entity makes its own clients and investors whole through prompt remediation, thereby shoring up the strength of those client relationships.

(5) *Realistic Goal-Setting*

Before self-reporting, entities should engage in some goal-setting with counsel by prioritizing potential outcomes—first, no action at all; second, outcomes that could be tolerated from a business perspective (modest penalties, no undertakings, no outside consultants); and third, identifying affirmatively undesired outcomes (loss of business status through disqualifications or loss of waivers). Among the considerations to be weighed here: impact to the organization of the disclosure of investigation, including reaction of clients or the public, economic cost of the investigation, and ability to absorb an enforcement outcome if the resolution remains contained to minor sanctions. Setting realistic goals requires understanding some of the tools used by the SEC to acknowledge and recognize self-reporting. Part of the goal-setting exercise focuses on considering which of

these choices the entity needs to obtain, and which may be desired outcomes, but not critical.

SEC Can Incentivize More Self-Reporting

To obtain increased numbers of self-reports, the SEC could consider both providing increased information about its cooperation program and the benefits of self-reporting and, similar to the DOJ's FCPA Pilot Program, create guidelines setting forth more specific and tangible rewards for self-reporting.

The SEC's non-public investigation practice means there is often incomplete and insufficient public information upon which to rely when making this difficult decision. Greater cooperation could be incentivized through data released by the SEC on an aggregated and anonymized basis. Such data might show the total number of self-reports to any division within the SEC and the overall outcomes, including closed investigations, dollar value for reduced or deferred penalties, and other relevant measures of credit given for cooperation.

The SEC should also consider establishing guidelines setting forth specific rewards for self-reporting violations. The SEC could look to its own Municipalities Continuing Disclosure Cooperation (MCDC) Initiative for guidance on this concept. In the MCDC Initiative, the Division of Enforcement agreed to recommend settlements on specified terms in exchange for self-reporting by municipal underwriters and issuers regarding specific violations of the securities laws.⁵⁰ Issuers (municipalities) were assured they would pay no civil penalties under the program. Municipal underwriters faced penalties, limited to specific guidelines based upon the number of offerings containing the false statements, size of offering, and the total revenue of the underwriter.⁵¹ The initiative succeeded for the SEC—as of August 2016, the SEC had filed a total of 143 actions against 144 respondents, including 72 municipal underwriting firms comprising 96 percent of the market share for municipal underwritings charged, and 72 municipal issuers and other obligated persons.⁵² Providing clear

guidance of the benefits of self-reporting worked. Even in the MCDC Initiative, there were self-reports that did not get charged.⁵³

Conclusion

If the SEC wishes to incentivize additional self-reporting and cooperation, it cannot be helpful that every settlement must be parsed to some significant degree in order to assess the value of such behavior. Changes to increase transparency and clarify expectations would be helpful. Until then, however, investment advisers, mutual funds and other investment companies, and private equity and hedge fund managers should consider carefully the risks and potential rewards associated with self-reporting in the context of the type of misconduct and specific facts presented in the situation.

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NOTES

- ¹ This article will focus on self-reporting by entities regulated by the SEC, such as investment advisers, investment companies, hedge funds, private equity funds, broker-dealers, and to some extent the holding companies for such entities.
- ² SEC, *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions* (Exchange Act Rel. No. 44969) (Oct. 23, 2001) (the Seaboard Report).
- ³ This article will focus on self-reporting by SEC-regulated entities and not individuals. To assess SEC cooperation credit for individuals determining to cooperate, see generally SEC, Press Release 2010-6, “SEC Announces Initiative to Encourage

Individuals and Companies to Cooperate and Assist in Investigations” available at <https://www.sec.gov/news/press/2010/2010-6.htm>; SEC, *SEC Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions*, 17 CFR Part 202 (Exchange Act Rel. No. 61340) (Jan. 19, 2010); SEC, “SEC Enforcement Manual,” (updated Oct. 2016) available at <https://www.sec.gov/divisions/enforce/enforcementmanual.pdf>; and SEC, Litigation Release 22298, *SEC Credits Former Axa Rosenberg Executive for Substantial Cooperation during Investigation* (Mar. 19, 2012) (release issued to “...provide guidance regarding the circumstances under which individuals may receive credit as part of the SEC’s Cooperation Initiative”).

- ⁴ See *Seaboard Report*, *supra* n.2.
- ⁵ See *Seaboard Report*, *supra* n.2.
- ⁶ Placed on line for the first time in 2008, the SEC Enforcement Manual contains procedural rules, requirements, and policy statements from the Division of Enforcement leadership to the Staff attorneys and supervisors working on Enforcement investigations. SEC, *SEC Enforcement Manual*, (updated Oct. 2016) available at <https://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.
- ⁷ See *id.*
- ⁸ See *id.*
- ⁹ See *id.*
- ¹⁰ SEC, Press Release 2012-23, “SEC Charges Former Credit Suisse Investment Bankers in Subprime Bond Pricing Scheme During Credit Crisis” (Feb. 1, 2012) available at <https://www.sec.gov/news/press-release/2012-2012-23.htm>.
- ¹¹ See *id.*
- ¹² DOJ, “The Fraud Section’s Foreign Corrupt Practices Act Enforcement Plan and Guidance” (Apr. 5, 2016) available at <https://www.justice.gov/archives/opa/blog-entry/file/838386/download>.
- ¹³ DOJ, Statement by Assistant Attorney General Leslie R. Caldwell, “Criminal Division Launches New FCPA Pilot Program” (Apr. 5, 2016) available at <https://www.justice.gov/archives/opa/blog/criminal-division-launches-new-fcpa-pilot-program>.

- ¹⁴ DOJ lists the current declinations under the FCPA Pilot Program on its website. See <https://www.justice.gov/criminal-fraud/pilot-program/declinations>.
- ¹⁵ SEC, Press Release 2010-6, “SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations” (Jan. 13, 2010) available at <https://www.sec.gov/news/press/2010/2010-6.htm>.
- ¹⁶ Specifically, Scott Herckis, an accountant that served as the fund administrator for Hepplewhite Fund LP, a hedge fund with 25 investors and at least \$6 million in assets at the time of the agreement, entered into a DPA with the Commission. Mr. Herckis resigned from his position at the fund and voluntarily disclosed information to the government about the ongoing misappropriation of fund assets and overstatements of performance by the hedge fund’s principal Berton M. Hochfeld. See SEC, Press Release 2013-241, “SEC Announces First Deferred Prosecution Agreement With Individual” (Nov. 12, 2013) available at <https://www.sec.gov/news/press-release/2013-241> and Deferred Prosecution Agreement between US Securities & Exchange Commission and Scott Herckis (Nov. 8, 2013).
- ¹⁷ SEC, Press Release 2010-252, “SEC Charges Former Carter’s Executive With Fraud and Insider Trading” (Dec. 20, 2010) available at <https://www.sec.gov/news/press/2010/2010-252.htm> (first non-prosecution agreement entered by the SEC, acknowledging Carter’s for “... promptly self-reporting the misconduct); SEC, Press Release 2013-65, “SEC Announces Non-Prosecution Agreement with Ralph Lauren Corporation Involving FCPA Misconduct” (Apr. 22, 2013) available at <https://www.sec.gov/news/press-release/2013-2013-65.htm> (“The SEC has determined not to charge Ralph Lauren Corporation with violations of the [FCPA] due to the company’s prompt reporting of the violations on its own initiative...”); SEC, Press Release 2016-109, “SEC Announces Two Non-Prosecution Agreements in FCPA Cases” (June 7, 2016) available at <https://www.sec.gov/news/pressrelease/2016-109.html> (SEC announced two non-prosecution agreements with Akamai Technologies and Nortek, Inc. and noted that both companies self-reported the misconduct promptly).
- ¹⁸ SEC, Press Release 2011-112, “Tenaris to Pay \$5.4 Million in SEC’s First-Ever Deferred Prosecution Agreement” (May 17, 2011) available at <https://www.sec.gov/news/press/2011/2011-112.htm> (first deferred prosecution agreement by the SEC and acknowledging “[t]he company’s immediate self-reporting...”); SEC, Press Release 2015-13, “SEC Charges Former Executive at Tampa-Based Engineering Firm With FCPA Violations” (Jan. 22, 2015) available at <https://www.sec.gov/news/pressrelease/2015-13.html> (“PBSJ took quick steps to end the misconduct after self-reporting to the SEC...”).
- ¹⁹ SEC, Speech by Andrew Ceresney, “Speech at the ACI’s 32nd FCPA Conference Keynote Address,” (Nov. 17, 2015) available at <https://www.sec.gov/news/speech/ceresney-fcpa-keynote-11-17-15.html> (“... the Enforcement Division has determined that going forward, a company must self-report misconduct in order to be eligible for the Division to recommend a DPA or NPA to the Commission in an FCPA case.”).
- ²⁰ See e.g., DOJ, Press Release, “Och-Ziff Capital Management Admits to Role in Africa Bribery Conspiracies and Agrees to Pay \$213 Million Criminal Fine” (Sept. 29, 2016) available at <https://www.justice.gov/opa/pr/och-ziff-capital-management-admits-role-africa-bribery-conspiracies-and-agrees-pay-213>.
- ²¹ SEC, *In the Matter of Calvert Investment Distributors, Inc. and Calvert Investment Management, Inc.*, Advisers Act Rel. No. 4696 (May 2, 2017) (order instituting proceedings, making findings, and imposing cease-and-desist order) (self-report in distribution-in-guise matter leads to \$1 million penalty although SEC ordered disgorgement of nearly \$18 million); SEC, *In the Matter of Columbia Management Investment Services Corp.*, (Exchange Act Rel. No. 80016) (Feb. 10, 2017) (order instituting proceedings, making findings, and imposing remedial sanctions and order) (self-report of an employee that misappropriated \$1.2 million in shareholder funds with other cooperation and remediation resulted in a \$250,000 penalty).

- ²² For example, the SEC entered a settlement with Essex Financial Services alleging that it and its former president and CEO breached their fiduciary duty by failing to disclose a conflict of interest to a client. Despite the vulnerability of the victim, an elderly widow with accounts valued over \$100 million, the SEC did not impose any civil penalty. Essex self-reported the conduct to the SEC, began an internal investigation into the conduct, and removed the violator, the president and CEO of the entity, and reported the misconduct to the SEC Staff, *In the Matter of Essex Financial Services, Inc.* (Exchange Act Rel. No. 79757)(Jan. 9, 2017)(order instituting proceedings, making findings, and imposing remedial sanctions and order).
- ²³ See e.g., *In the Matter of Deutsche Bank Securities Inc.*, Sec. Act Rel. No. 10272 (Dec. 16, 2016) (imposed \$18.5 million penalty and acknowledged remedial acts).
- ²⁴ In a deferred prosecution agreement with Regions Financial Corporation (Regions Bank), the SEC acknowledged Regions Bank’s “extensive cooperation” throughout the investigation and listed specific examples of such cooperation, without citing any self-reporting. SEC, “Deferred Prosecution Agreement between US Securities & Exchange Commission and Regions Financial Corporation” (June 10, 2014). Similarly, the SEC’s press release credited Regions Bank with “substantial cooperation” and then-Director of Enforcement Andrew Ceresney, stated, “The bank helped us bring a case against culpable individuals while remediating the misconduct by restructuring its processes and putting new management in place, among other things.” SEC, Press Release 2014-125, “SEC Announces Fraud Charges Against Three Former Regions Bank Executives in Accounting Scheme” (June 25, 2014) available at <https://www.sec.gov/news/press-release/2014-125>. Yet the SEC assessed a \$26 million penalty against Regions Bank, deemed satisfied if Regions Bank paid an even greater penalty to the Federal Reserve. See *id.*
- ²⁵ SEC, Press Release 2015-235, “Blackstone Charged with Disclosure Failure” (Oct. 7, 2015) available at <https://www.sec.gov/news/pressrelease/2015-235.html>.
- ²⁶ *In the Matter of Blackstone Management Partners L.L.C., Blackstone Management Partners III L.L.C., and Blackstone Management Partners IV L.L.C.*, Advisers Act Release No. 4219 (Oct. 7, 2015) (order instituting cease-and-desist proceedings, making findings, and imposing a cease-and-desist order).
- ²⁷ See n.25 *supra*.
- ²⁸ SEC Speech by Andrew Ceresney, “The SEC’s Cooperation Program: Reflections on Five Years of Experience,” (May 13, 2015) available at <https://www.sec.gov/news/speech/sec-cooperation-program.html>.
- ²⁹ *Kokesh v. Securities and Exchange Commission*, 137 S. Ct. 1635 (2017)(holding that SEC disgorgement constitutes a penalty and is thus subject to the five-year statute of limitations applicable to civil penalties).
- ³⁰ *SEC v. Texas Gulf Sulphur Co.*, 312 F. Supp. 77, 91 (SDNY 1970), *aff’d in part and rev’d in part*, 446 F.2d 1301 (2d Cir 1971).
- ³¹ *Kokesh v. Securities and Exchange Commission*, 137 S. Ct. 1635 (2017)(*quoting* Restatement (Third) of Restitution and Unjust Enrichment §51, Comment a, p. 204 (2010)(Restatement (Third))).
- ³² See *Kokesh*.
- ³³ See n.28 *supra*.
- ³⁴ See e.g., Non-Prosecution Agreement between the US Securities and Exchange Commission and Akamai Technologies, Inc. (June 7, 2016) available at <https://www.sec.gov/news/press/2016/2016-109-npa-akamai.pdf> (Akamai ordered to pay \$652,452 in disgorgement and \$19,433 in prejudgment interest); Non-Prosecution Agreement between the US Securities and Exchange Commission and Nortek, Inc. (June 7, 2016) available at <https://www.sec.gov/news/press/2016/2016-109-npa-nortek.pdf> (Nortek ordered to pay \$291,403 in disgorgement and \$30,655 in interest); Non-Prosecution Agreement between the US Securities and Exchange Commission and Ralph Lauren Corporation, (Apr. 22, 2013) available at <https://www.sec.gov/news/press-release/2013-2013-65htm> (Ralph Lauren required to pay more than \$700,000 in disgorgement, and required to pay penalty to Department of Justice).

- ³⁵ *In the Matter of First Eagle Investment Management, LLC and FEF Distributors, LLC*, Advisers Act Release No. 4199 (order instituting proceedings, making findings, imposing sanctions, and cease-and-desist order) (Sept. 21, 2015); *In the Matter of William Blair & Company LLC*, Advisers Act Release No. 4695 (order instituting proceedings, making findings, and imposing cease-and-desist order) (May 1, 2017); *In the Matter of Calvert Investment Distributors, Inc. and Calvert Investment Management, Inc.*, Advisers Act Release No. 4696 (order instituting proceedings, making findings, and imposing cease-and-desist order) (May 2, 2017).
- ³⁶ OCIE National Examination Program, “Examination Priorities for 2013” (Feb. 21, 2013) available at <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2013.pdf>; OCIE National Examination Program, “Examination Priorities for 2014” (Jan. 9, 2014) available at <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf>.
- ³⁷ *In the Matter of Calvert Investment Distributors, Inc. and Calvert Investment Management, Inc.*, Advisers Act Release No. 4696 (order instituting proceedings, making findings, and imposing cease-and-desist order) (May 2, 2017).
- ³⁸ *In the Matter of William Blair & Company LLC*, Advisers Act Release No. 4695 (order instituting proceedings, making findings, and imposing cease-and-desist order) (May 1, 2017) (order describes harm repaid by the adviser in the \$1.5 million range, penalty ordered was \$4.5 million).
- ³⁹ *In the Matter of First Eagle Investment Management, LLC and FEF Distributors, LLC*, Advisers Act Release No. 4199 (order instituting proceedings, making findings, imposing sanctions, and cease-and-desist order) (Sept. 21, 2015).
- ⁴⁰ When a conflict of interest or other material event occurs, advisers have a fiduciary duty to either eliminate the conflict of interest, or mitigate the conflicts and disclose its existence fully and fairly. *See e.g.*, SEC v. Capital Gains Research Bureau, Inc., 375 US 180 (1963); *see also* SEC, IM Guidance Update “Mutual Fund Distribution and Sub-Accounting Fees” (Jan. 2016) (citing *Mutual Fund Distribution Fees; Confirmations*, Investment Company Act Release No. 29367 (July 21, 2010) n.157 [75 FR 47064] (summarizing the case law regarding the fiduciary obligations of fund directors)).
- ⁴¹ *See e.g.*, Section 10A of the Securities Exchange Act of 1934, 15 USC 78j-1. Audit requirements (if a registered public accounting firm detects or otherwise becomes aware of information indicating that an illegal act occurred, the firm may have to report the conduct to the management of the issuer, or the board of directors of the issuer).
- ⁴² FINRA Rule 4530(b) requires broker-dealers to “...promptly report to FINRA... after the firm has concluded or reasonably should have concluded that an associated person of the firm or the firm itself has violated any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body or self-regulatory organization (SRO).” *See also*, Section 15(c)(3) of the Securities Exchange Act of 1934, 15 USC § 78o, and Rule 15c3-3, 17 C.F.R. §15c3-3, known as the “Customer Protection Rule.” Rule 15c3-3(i) specifically requires broker-dealers to self-report failures to comply, material weaknesses in controls that hinder a broker-dealer’s efforts at compliance, and actual failure to maintain the minimum required amount in a customer reserve account.
- ⁴³ *See e.g.*, SEC, *In the Matter of Columbia Management Investment Services Corp.*, Exchange Act Rel. 80016 (order instituting proceedings, making findings, and imposing remedial sanctions) (Feb. 10, 2017) (entity self-reported wrongdoing of individual, settled and paid \$250,000 penalty); “SEC Charges Former Credit Suisse Investment Bankers in Subprime Bond Pricing Scheme During Credit Crisis” (Press Release 2012-23) (Feb. 1, 2012) (no charges against Credit Suisse because of cooperation, only charges against individuals), available at <https://www.sec.gov/news/press-release/2012-2012-23.htm>.
- ⁴⁴ *See* n.12 and n.19 *supra*.

⁴⁵ SEC, Press Release, “Och-Ziff Hedge Fund Settles FCPA Charges” (Sept. 29, 2016) available at <https://www.sec.gov/news/pressrelease/2016-203.html>.

⁴⁶ *In the Matter of Och-Ziff Capital Management Group LLC, OZ Management LP, Daniel S. Och, and Joel M. Frank*, Exchange Act Rel. No. 78989 (order instituting proceedings, making findings, imposing remedial sanctions, and a cease-and-desist order and notice of hearing) (Sept. 29, 2016).

⁴⁷ DOJ, Press Release, “Och-Ziff Capital Management Admits to Role in Africa Bribery Conspiracies and Agrees to Pay \$213 Million Criminal Fine” (Sept. 29, 2016) available at <https://www.justice.gov/opa/pr/och-ziff-capital-management-admits-role-africa-bribery-conspiracies-and-agrees-pay-213>.

⁴⁸ *Id.*

⁴⁹ The “Bad Actor” disqualification provisions under Rule 262 of Regulation A and Rules 505 and 506 of Regulation D provide an example where failing to obtain the waiver could negatively impact underwriters, hedge funds, advisers, or other entities. To obtain a waiver of these provisions, one must demonstrate

to the Commission, delegated to the Division of Corporation Finance, “... good cause that the disqualification is not necessary under the circumstances.” Statement by SEC Division of Corporation Finance, “Waivers of Disqualification under Regulation A and Rules 505 and 506 of Regulation D” (modified Mar. 13, 2015) available at <https://www.sec.gov/divisions/corpfin/guidance/disqualification-waivers.shtml>. Such a showing is made far more likely after remediation and where recidivist entities engage in self-reporting.

⁵⁰ SEC Division of Enforcement Announcement, Municipalities Continuing Disclosure Cooperation Initiative (Mar. 10, 2014) available at <https://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml>.

⁵¹ *See id.*

⁵² Speech by Andrew Ceresney, “The Impact of SEC Enforcement on Public Finance,” (Oct. 13, 2016) available at <https://www.sec.gov/news/speech/speech-ceresney-10132016.html>.

⁵³ *See id.*

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