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Introduction

During the first three quarters of 2021, SEC Chair Gensler set out an expansive regulatory agenda. The fourth quarter of 2021 was marked by the SEC's new Director of Enforcement, Gurbir Grewal, laying out his vision for the SEC's enforcement program and serving up notice that change is coming. In this edition of Schulte Roth & Zabel's Securities Enforcement Quarterly, we discuss Director Grewal's announced substantive and procedural changes to the SEC enforcement program and how those changes are reflected in recently announced enforcement proceedings. This edition also discusses the SEC's enforcement action against a consulting firm's investment adviser affiliate for failing to establish, maintain, and enforce policies and procedures to prevent the potential misuse of MNPI. We also discuss the headline-grabbing settlement with a broker-dealer subsidiary of a large financial institution for using unauthorized electronic communication platforms, which included the return of requiring respondents to admit to violations of the securities laws. We conclude by summarizing notable enforcement cases reflecting the priorities of various securities regulators, including "hacking" insider trading, anti-money laundering, market manipulation, and inadequate SPAC disclosures.

Statements by SEC Leadership Reveal Expansive Enforcement Agenda and Streamlined Process

The consensus has been that the U.S. Securities and Exchange Commission ("SEC") under Chair Gary Gensler and Director of Enforcement Gurbir Grewal would be more "aggressive" in its enforcement of the securities laws. Precisely what that would mean in practice has been less clear, though SEC Enforcement activity is gaining momentum. Recent public statements by senior SEC officials have begun to flesh out the SEC's enforcement priorities and approach, including efforts to streamline the enforcement process, delegate more authority to SEC staff, and provide additional guidance on how to obtain "credit" for cooperation. We highlight below a number of takeaways that may provide insight into what to expect in the coming months.

Both Chair Gensler and Director Grewal have articulated their vision of "proactive" enforcement and compliance. Chair Gensler envisions an SEC enforcement program that has "tremendous breadth, [is] nimble, and penalize[s] bad actors so we discourage misconduct before it happens."[1] The analogy Chair Gensler used, when discussing enforcement efforts regarding cryptocurrency, was the SEC not waiting "for a big spill on aisle three — the crypto aisle" before taking action.[2]

In his first public remarks since joining the SEC, Director Grewal echoed Chair Gensler's statements. Director Grewal emphasized the goal of addressing emerging risks before they cause harm to investors.[3] Under his leadership, the SEC will prioritize "first-of-their-kind" enforcement actions. For instance, the SEC charged a former corporate executive for "shadow trading," a form of insider trading where a person uses confidential information about one company to trade in the securities of another company that could be impacted by the same information, such as a competitor in the same industry.[4] Director Grewal cited additional examples of this approach in the cryptocurrency space, where the SEC recently brought the first action involving securities using decentralized finance or DeFi technology; commenced actions against trading platforms that illegally facilitate or tout trading in crypto securities; and charged promoters of an allegedly fraudulent digital asset securities offering.[5]

Chair Gensler uses novel, high-impact cases to bring attention to compliance issues and deter similar misconduct.[6] Yet he and Director Grewal dismiss complaints that the SEC's pursuit of such cases equates to "regulation by enforcement." They note that the SEC's actions are based on well-known and established legal requirements, even if they involve new technologies, products or business models.[7] For instance, public offerings involving Special Purpose Acquisition Corporations, or SPACs, have increased dramatically during the past two years. As Chair Gensler has noted, however, the underlying issues are no different than with traditional IPOs — ensuring complete and

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[1] Gary Gensler, *Prepared Remarks at the Securities Enforcement Forum*, Nov. 4, 2021, available here.

[2] Gary Gensler, *Remarks Before the Investor Advisory Committee*, Dec. 2, 2021, available here.

[3] Gurbir Grewal, *PLI Broker/Dealer Regulation and Enforcement 2021*, Oct. 6, 2021, available here.

[4] *See SEC v. Panuwat*, Case No. 4:21-cv-06322 (N.D. Cal. Aug. 17, 2021); *see also SEC Charges Biopharmaceutical Company Employee with Insider Trading*, SEC Press Release No. 2021-155, Aug. 17, 2021, available here. For further discussion, see *SRZ Securities Enforcement Quarterly*, Oct. 2021, available here.

[5] Gurbir Grewal, *Remarks at SEC Speaks 2021*, Oct. 13, 2021, available here; *see also In re Blockchain Credit Partners d/b/a DeFi Money Market, et al.*, Exchange Act Release No. 92588, Aug. 6, 2021, available here (first SEC case involving securities using DeFi technology); *In re Poloniex, LLC,* Exchange Act Release No. 92607, Aug. 9, 2021, available here (allegations of operating unregistered digital asset exchange); Complaint, *SEC v. BitConnect, et al.*, Case No. 1:21-cv-07349 (S.D.N.Y. Sept. 1, 2021), available here (charging promoters of allegedly fraudulent and unregistered offering involving digital assets lending platform). Each of these actions is discussed in SRZ's *Securities Enforcement Quarterly*, Oct. 2021, available here.

[6] Gensler, *supra* note 1.

[7] *See id*.

accurate investor disclosure, fair marketing practices, proper gatekeeper functions, and mitigating potential conflicts.[8]

Environmental, social and governance, or ESG, issues provide another example. As ESG has become more important to issuer disclosures and investors' investment decisions, "greenwashing" has become an investor protection concern. Director Grewal cautioned, however, that in this and other emerging areas, the SEC will apply long-standing principles of materiality and disclosure, and that there is nothing "new" about the SEC's approach.[9] According to Director Grewal, while the Enforcement Division's focus may change and evolve over time depending on the issues of importance to investors, companies and the economy as a whole, or in response to new and emerging technologies and investment products, the SEC will continue to apply "long-standing, well-known and understood regulations and standards."[10] Chair Gensler observed that, while some market participants may call this "regulation by enforcement," he simply calls it "enforcement."[11]

Another recurring theme that emerges from SEC officials' comments is accountability, with far-reaching potential implications. For one, the SEC will resurrect the practice of seeking admissions from wrongdoers in appropriate cases. According to Chair Gensler, admissions are appropriate in "cases where heightened accountability and acceptance of responsibility are in the public interest."[12] Director Grewal has described admissions as "a clarion call to other market participants to stamp out and self-report the misconduct to the extent it is occurring within their firm."[13] Deputy Director of Enforcement Sanjay Wadhwa elaborated that the SEC would seek admissions in cases involving "egregious misconduct" and where a large number of investors were harmed or where parties attempt to obstruct the SEC's investigations.[14]

In addition, the SEC will seek to deploy all the remedies available to it — industry and officer and director bars, conduct-based injunctions, penalties, undertakings, among others — in "carefully calibrated" and forward-looking ways.[15] Director Grewal has emphasized the need for "proportionality" in sanctions to maximize deterrence and avoid penalties that are seen as an acceptable cost of doing business.[16] Beyond calibrating sanctions to the egregiousness of the underlying conduct, Director Grewal says the SEC will consider whether prior penalties have provided sufficient deterrence or whether penalties or other remedies should be increased to deter future misconduct by others. So while sanctions imposed in prior cases involving similar conduct are a "relevant data point," they are merely the starting point for the conversation — even if a respondent is not a recidivist in areas where the SEC previously has charged others for similar violations.[17]

SEC officials have discussed several ways they intend to streamline the enforcement process. For instance, Director Grewal has stated there will be fewer Wells meetings with himself or Deputy Director Wadhwa and that defense

[8] Gary Gensler, *Remarks Before the Healthy Markets Association Conference*, Dec. 9, 2021, available here.

[9] Gurbir Grewal, *2021 SEC Regulation Outside the United States – Scott Friestad Memorial Keynote Address*, Nov. 8, 2021, available here.

[10] *Id.*

[11] Gensler, *supra* note 1.

[12] *Id.*

[13] Grewal, *SEC Speaks 2021*, *supra* note 5.

[14] Dave Michaels, *Wall Street, Companies May Have to Give Up More to Settle With SEC*, WALL ST. J., Updated Oct. 13, 2021, available here.

[15] Gensler, *supra* note 1.

[16] Grewal, *supra* note 3.

[17] *Id.*

counsel should not "expect a meeting in each and every case."[18] Instead, senior Enforcement Division officials will limit their personal participation to matters involving novel legal or factual questions or raise significant programmatic issues.[19] This is part of a broader effort to delegate more authority and autonomy to Enforcement staff, including with regard to press releases and tolling agreements. SEC officials also promise greater transparency during the Wells process for certain matters, including reverse proffers, and permitting access to the investigative record, for instance.[20]

Chair Gensler and Director Grewal also emphasize that they have a "shared mission" with the securities bar, compliance personnel and market participants to maintain market integrity and enhance public confidence in the securities markets. Director Grewal has pressed the idea of "proactive compliance."[21] Citing Chair Gensler's earlier exhortation that market participants should consider "step[ping] back from the line,"[22] Director Grewal encouraged compliance personnel to model "excellence in compliance efforts" and not just adopt check-the-box policies and procedures.[23]

For instance, Director Grewal urged compliance staff to examine how specific business models and products offered by their firms interact with emerging risks and enforcement priorities, and to tailor their policies and procedures accordingly.[24] This is especially important, according to Director Grewal, in this era of rapid and profound technological change, which creates both "new avenues for misconduct, and new responsibilities for compliance."[25] Investment advisers' use of alternative data to inform trading decisions, for instance, creates compliance obligations to conduct diligence concerning data vendors to avoid exposure to material, nonpublic information that may be contained in data products.[26] Similarly, Director Grewal noted how the recordkeeping obligations of some market participants have become more complicated due to new technologies that allow for communications other than through historical channels.[27] While acknowledging that recordkeeping violations may not grab headlines, these and other underlying obligations are essential to market integrity and enforcement.[28] Rather than wait for the SEC to commence an action for compliance failures, firms should be proactive in response to new and emerging issues.[29]

When even proactive compliance efforts do not prevent violations, Director Grewal provided guidance on what actions by violators will result in cooperation "credit" after a violation. Responding in part to complaints that the SEC has been insufficiently clear regarding cooperation, Director Grewal explained that cooperation is not the "mere absence of obstruction" or firms simply living up to legal and regulatory obligations.[30] Receiving cooperation "credit"

[18] Grewal, *SEC Speaks 2021*, *supra* note 5.

[19] Grewal, *supra* note 3.

[20] Grewal, *SEC Speaks 2021*, *supra* note 5.

[21] Grewal, *supra* note 3.

[22] Gensler, *supra* note 1.

[23] Grewal, *supra* note 3.

[24] *Id.*

[25] *Id.*

[26] *See SEC Charges App Annie and its Founder with Securities Fraud*, SEC Press Release No. 2021-176, Sept. 14, 2021, available here. For a detailed discussion of the SEC's increased focus on alternative data, see *SRZ Securities Enforcement Quarterly*, Oct. 2021, available here.

[27] Gurbir Grewal, *supra* note 3; *see also SEC Charges Broker-Dealer with Failing to Preserve Required Electronic Records*, Administrate Proceeding File No. 3-20050, Sept. 23, 2020, available here.

[28] Grewal, *supra* note 3. As we discuss herein, however, at least one recordkeeping violation this quarter was headline-grabbing.

[29] *Id.*

[30] *Id.*

requires more than presenting witnesses for testimony, producing documents or self-reporting an issue only when it is about to become public.[31] According to Director Grewal, cooperation credit requires "significant, tangible steps" that enhance the quality of the SEC's investigation, allow it to conserve resources and bring charges more quickly, or help identify additional conduct or other violators."[32] Extensive resources — the *Seaboard Report*[33], SEC policy statements,[34] and the Enforcement Manual — provide insight regarding what is needed to obtain "credit" for cooperation.[35] Director Grewal also noted he would defer to the expertise and judgment of Enforcement staff when parties claim they have not received sufficient "credit" for their cooperation.[36]

In sum, public statements by Chair Gensler and Director Grewal confirm that, under their leadership, the SEC will be an aggressive enforcer of the securities laws. Their comments provide a roadmap to understanding the priorities of Chair Gensler and the likely future focus of the Enforcement Division under Director Grewal. The message is clear: The SEC will "follow the facts and the law, wherever they may lead ... [and will hold] individuals and companies accountable, without fear or favor."[37]

[31] *Id.*

[32] *Id.*

[33] *See 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 Release No. 44969, Oct. 23, 2001, available here.

[34] SEC, *Policy Statement Concerning Cooperation by Individuals in its Investigation and Related Enforcement Actions*, Exchange Act Release No. 61340, Jan. 13, 2010, available here.

[35] Grewal, *supra* note 3.

[36] *Id.*

[37] Gensler, *supra* note 1.

SEC Takes Action Against Consulting Firm's Investment Adviser Subsidiary for Deficient Insider Trading Policies

On Nov. 19, 2021, the SEC announced a settled enforcement proceeding against MIO Partners, Inc. ("MIO"), a registered investment adviser and subsidiary of consulting firm McKinsey & Company ("McKinsey").[38] MIO invests the assets of McKinsey's former and current partners, some of whom were members of MIO's Board of Directors and served on the Board's Investments Committee. According to the SEC, current McKinsey partners serving on MIO's Investments Committee possessed and had access to material non-public information ("MNPI") about issuers that were McKinsey's consulting clients. The partners who served on the Board's Investment Committee also were privy to MIO's own MNPI, including MIO's investment holdings, strategies, and allocations to third-party managers. The SEC alleged that MIO's written policies and procedures did not sufficiently account for the MNPI risks presented by MIO's organizational structure, in violation of Sections 204A and Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-7 thereunder.

At first blush, the SEC's case against MIO is unremarkable. Enforcement proceedings involving the risk or actual misuse of MNPI about a client obtained in the course of a professional engagement are brought regularly. The SEC's allegations against MIO, however, involved McKinsey partners' access to what the SEC viewed as two distinct types of MNPI. Partners serving on MIO's Board and Investments Committee allegedly possessed and had access to not only MNPI about McKinsey's clients ("Client MNPI") through the firm's consulting work, but also MNPI concerning MIO's own investments ("MIO MNPI") through their service on MIO's Board. The SEC alleged that MIO's policies and procedures were deficient in part because they "did not contemplate the ways that *MIO MNPI* could be misused by Investments Committee members in the course of their consulting work for McKinsey clients."[39] The SEC's view that access to MIO's *own* investment information presented an ongoing risk of the misuse of MNPI by active McKinsey partners is a relatively novel application of Sections 204A and 206(4) of the Investment Advisers Act and Rule 206(4)-7 thereunder. This enforcement action perhaps forecasts closer scrutiny of an area of MNPI compliance that historically has not garnered much attention from the SEC.

A. Background

According to the SEC's Order, MIO provides investment options to McKinsey's current and former partners and employees. MIO invests most of its client assets *indirectly* through third-party managers, either through separately managed accounts ("SMAs") in a special purpose fund owned and operated by MIO, or through accounts held in a third-party manager's own fund. MIO invests its remaining client assets *directly* through discretionary strategies of its own. The SEC alleged that MIO had full knowledge of all securities held directly in MIO's own accounts and indirectly in SMAs. For indirect investments in accounts held in a third-party manager's fund, however, MIO only had access to information regarding those investments through public filings and communications with the third-party managers.

[38] *McKinsey Affiliate to Pay $18 Million for Compliance Failures in Handling of Nonpublic Information*, SEC Press Release No. 2021-241, Nov. 19, 2021, available here; *see MIO Partners, Inc.*, Advisers Act Release No. 4912, Nov. 19, 2021, at 2, available here.

[39] *MIO Partners*, at 6 (emphasis added).

MIO's portfolio managers, led by a Chief Investment Officer ("CIO"), had day-to-day responsibility for MIO's investments and reported to MIO's Board, which, until September 2020, consisted primarily of active McKinsey partners. Together with the CIO, the Investments Committee of MIO's Board oversaw actual and anticipated direct investments and allocations to SMAs and other third-party managers in connection with MIO's indirect investments.

B. Access to MNPI

As described in the SEC's Order, members of MIO's Investments Committee included active McKinsey partners who had access to both Client MNPI and to MIO MNPI. The SEC's most noteworthy allegations concerned the risk of misuse of MIO's own MNPI, which the SEC described to include MIO's own "investment strategies, concentration limits, risk limits, and third-party manager allocations, and [ ] access to MIO's holdings (both direct holdings and holdings in SMAs)."[40] The Order alleged that McKinsey "provided consulting services to clients in which MIO funds were invested and about which MIO MNPI was potentially relevant[,]"[41] and that MIO's organizational structure created a risk that MIO MNPI could be used in a way that favored MIO's investments, presumably to the detriment of McKinsey's consulting clients. Significantly, however, the SEC's Order alleged neither actual harm to any consulting client nor actual misuse of MIO MNPI, but instead only that MIO's policies and procedures were not reasonably designed to account for the "real and significant" risk of such misuse.

As an example of an instance where MIO's MNPI was potentially relevant to McKinsey's consulting services, the SEC's Order described work that McKinsey's wholly-owned turnaround advisory and crisis management unit ("McKinsey RTS") did on behalf of a client in which MIO had invested indirectly. As part of the client's restructuring, McKinsey RTS helped develop a comprehensive reorganization plan that allegedly included establishing the value of securities to be exchanged for debt held indirectly by MIO through a third-party manager. To the SEC, this created "a risk that McKinsey RTS could influence the reorganization plan in a way that favored MIO's investments."[42]

As to Client MNPI, the SEC's Order alleged that MIO had substantial investments in securities about which MIO's Investment Committee members had Client MNPI, including information routinely gathered as part of McKinsey's consulting business, such as financial results, fundraising efforts, and mergers and acquisitions. Again, however, the Order did not allege the actual misuse of Client MNPI; rather, it recounted several scenarios that allegedly presented a risk of such misuse.

According to the SEC's allegations, MIO's written policies and procedures did not address sufficiently that active McKinsey partners serving on MIO's Investments Committee brought Client MNPI to their roles on MIO's Board, and conversely brought MIO MNPI to their roles as consultants. Specifically, prior to September 2020, MIO's written policies or procedures did not "(i) effectively [seek] to identify whether Investment Committee members may have [Client or MIO] MNPI that was relevant to their involvement in MIO's investment decisions, or (ii) set forth a recusal procedure reasonably designed to guard against the misuse of McKinsey Client and MIO MNPI."[43] Moreover, MIO's existing policy governing information sharing between McKinsey and MIO personnel, contained a carve-out that permitted — improperly in the SEC's view — MIO's Board and Investments Committee members to access information about MIO portfolio investments. That same policy likewise allegedly failed to "contemplate the ways

[40] *Id.* at 4.

[41] *Id.* at 5.

[42] *Id.*

[43] *Id.* at 6.

that MIO MNPI could be misused by Investments Committee members in the course of their consulting."[44] As a result, the SEC alleged that "MIO's policies and procedures were not reasonably designed, taking into consideration the nature of its business, to prevent the misuse of McKinsey Client MNPI or MIO MNPI."[45]

C. Implications

The SEC's focus on the risk of misuse of MNPI is noteworthy. In that regard, the SEC's Order is as significant for what it said as what it did not: The SEC did not allege that McKinsey's partners actually used or relied upon Client or MIO MNPI improperly; rather, the SEC limited its allegations to the risk that MNPI could be misused given MIO's business organization, and that MIO's policies and procedures did not sufficiently address such risk. Likewise, there was no allegation that Investments Committee members acted in breach of fiduciary duties they owed to MIO's clients or made any decisions that benefitted MIO's investments to the detriment of McKinsey's clients. This focus on the risk of potential abuse — rather than actual harm — merits the attention of legal and compliance professionals who should be assessing compliance policies accordingly.

[44] *Id.*

[45] *Id.*

SEC and CFTC Impose Combined Penalty of $200 Million for Use of Unapproved Communication Methods and Related Recordkeeping Failures

On Dec. 17, 2021, the SEC settled charges against J.P. Morgan Securities LLC ("JPMS"), a broker-dealer subsidiary of JPMorgan Chase & Co., for widespread and longstanding failures by the firm and its employees to maintain and preserve written communications.[46] On the same day, the U.S. Commodity Futures Trading Commission ("CFTC") also issued an Order simultaneously filing and settling charges against JPMorgan Chase Bank, N.A., JPMS, and J.P. Morgan Securities plc (collectively "JPMorgan") for the same conduct.[47] The firm admitted the facts set forth in both Orders and acknowledged that its conduct violated both the Securities Exchange Act of 1934 ("Exchange Act") and the Commodity Exchange Act ("CEA"). Per the SEC Order, JPMS agreed to cease and desist from further violations, a censure, and a civil penalty of $125 million, as well as undertaking to retain a compliance consultant to help implement robust improvements to JPMS's policies and procedures, and voluntarily report to the SEC for two years any discipline JPMS imposes in connection with any employee's violation of policies and procedures concerning the preservation of electronic communications. The CFTC Order imposed similar requirements and a civil penalty of $75 million.

According to the SEC Order, from at least January 2018 through at least November 2020, JPMS employees, including those at senior levels, regularly communicated — both internally and externally — about securities business matters by text message, mobile messaging applications, and personal email accounts on their personal mobile devices.[48] JPMS, however, failed to maintain or preserve these communications as required by federal securities laws. JPMS also admitted that its failure was firm-wide and encompassed employees of all levels of authority, including senior personnel responsible for supervising more junior employees to prevent such unapproved use. Senior personnel themselves routinely communicated about securities business matters using their personal devices, in violation of the firm's policies and procedures. This widespread failure to implement firm policies and procedures that undertook to forbid such communications in turn caused JPMS's violation of its duty to reasonably supervise its employees.[49] As a result, JPMS consented to the entry of an Order pursuant to which it acknowledged violating Section 17(a) of the Exchange Act and Rules 17a-4(b)(4) and 17a-4(j). The SEC's Order also found that JPMS violated Section 15(b)(4)(E) of the Exchange Act, because of the widespread failure to implement its policies and procedures that forbid its misconduct and the resulting failure to reasonably supervise its employees.

Under the CFTC Order, the relevant time period was significantly broader, encompassing communications from July 2015 to December 2021, but the findings were largely the same.[50] Like the SEC, the CFTC found that none of the written communications made through unapproved methods were maintained or preserved by JPMorgan. Likewise, the firm failed to promptly furnish the communications to a CFTC representative upon request during an investigation. As a result of its recordkeeping failures, the CFTC found that JPMorgan violated Sections 4g, 4s(f)(1)(C)

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[46] *JPMorgan Admits to Widespread Recordkeeping Failures and Agrees to Pay $125 Million Penalty to Resolve SEC Charges*, SEC Press Release No. 2021-262, Dec. 17, 2021, available here ("SEC Release").

[47] *CFTC Orders JPMorgan to Pay $75 Million for Widespread Use by Employees of Unapproved Communication Methods and Related Recordkeeping and Supervision Failures*, CFTC Press Release No. 8470-21, Dec. 17, 2021, available here ("CFTC Release").

[48] *J.P. Morgan Securities LLC*, Exchange Act Release No. 93807, Dec. 17, 2021, at 2, available here.

[49] JPMS's shortcomings came to light as a result of other entities in the SEC's and CFTC's investigations producing text messages and WhatsApp messages with JPMS employees that JPMS had failed to promptly produce in the same investigations. *Id.* at 5; CFTC Release.

[50] *JPMorgan Chase Bank, N.A. et al.*, CFTC Docket No. 22-07, Dec. 17, 2021, at 1-2, available here.

and 4s(g)(1) and (3) of the CEA and Regulations 1.31, 1.35, 23.201, and 23.202(a)(1) and (b)(1). In addition, the CFTC found that JPMorgan did not maintain adequate internal controls regarding business communications through unapproved communication methods. This was exemplified by the involvement of even the supervisory personnel in the misconduct at issue. Because of this failure to implement a diligent supervisory system to ensure compliance with the CFTC's recordkeeping requirements and the firm's own policies and procedures, JPMorgan failed to diligently supervise matters related to its business as a CFTC registrant, in violation of Section 4s(h)(1)(B) of the CEA and Regulations 166.3 and 23.602.

In the aftermath of JPMorgan's settlements, both SEC and CFTC officials emphasized how critical recordkeeping and related supervision requirements are to market integrity and investor protection. Gurbir S. Grewal, Director of the SEC's Division of Enforcement, commented, "[r]ecordkeeping requirements are core to the Commission's enforcement and examination programs and when firms fail to comply with them, as JPMorgan did, they directly undermine our ability to protect investors and preserve market integrity."[51] Similarly, the CFTC's Acting Director of Enforcement Vince McGonagle stated, "[f]irm compliance with recordkeeping and associated supervision requirements is essential to the CFTC's efforts to promote the integrity, resilience, and vibrancy of the U.S. derivatives markets."[52] Sanjay Wadhwa, the SEC's Deputy Director of Enforcement, also noted that JPMorgan's recordkeeping and supervisory failures hindered several investigations historically and "required the staff to take additional steps that should not have been necessary."[53] Both agencies stressed their commitment to aggressively investigating and prosecuting violations of recordkeeping and associated supervision requirements.

Notwithstanding that this matter specifically involved JPMorgan's broker-dealer subsidiary, investment advisers and other financial services firms would be wise to reassess their policies and procedures with respect to internal and external business communications through unapproved communication channels in light of this matter. Indeed, as a result of the findings in this investigation, the SEC has commenced additional investigations relating to recordkeeping practices at financial services firms, and has established a mechanism for firms to self-report potential violations.[54] Compliance personnel need to implement an effective supervisory system that will ensure reasonable oversight of employees, and compliance with federal agencies' recordkeeping and other requirements as well as the firms' own policies and procedures.

[51] SEC Release.

[52] CFTC Release.

[53] SEC Release.

[54] SEC Release.

Investment Adviser Enforcement Actions[55]

A. Fraud by Recidivist: *SEC v. Rege, et al.*

The SEC will not hesitate to seek immediate relief in proceedings against recidivist securities laws violators. On Oct. 26, 2021, the SEC filed a contested action in the U.S. District Court for the District of New Jersey against Swapnil J. Rege ("Rege") and his company SwapStar Capital, LLC ("SwapStar," and collectively with Rege, the "Defendants") for fraudulently soliciting over $10 million from advisory clients *even after* the SEC barred Rege from associating with or acting as an investment adviser in 2019, and ordered Rege to cease and desist from further violations of certain antifraud provisions of the Advisers Act ("2019 SEC Order").[56]

The SEC's complaint alleged that Rege (via SwapStar) violated the 2019 SEC Order by continuing to act as an investment adviser despite being barred from doing so and engaged in further violations of the antifraud provisions of the Advisers Act by failing to disclose the 2019 SEC Order to the clients from whom he subsequently raised money. Rege allegedly misappropriated the money he raised (principally from social acquaintances and neighbors) to pay the legal bills associated with the 2019 SEC Order, among other personal expenses, and also to pay his clients the annual returns he guaranteed of 40–60% or to repay their principal investments.

The SEC's complaint charged Rege with fraud in violation of Sections 206(1), (2) and (4) of the Advisers Act and Rule 206(4)-8 thereunder, and for acting as an investment adviser while subject to the SEC's Order barring him from doing so in violation of Section 203(f) of the Advisers Act. The SEC's complaint seeks permanent injunctive relief, disgorgement of $600,000 of profits, plus $49,170.84 in interest, and a civil penalty of $100,000. The SEC also sought and obtained, on Nov. 8, 2021, a temporary restraining order and preliminary injunctive relief.[57] The court's order froze the Defendants' assets, prohibited the Defendants from accepting any additional investor funds, and restrained the Defendants from violating the aforementioned antifraud provisions of the Advisers Act. The CFTC initiated a parallel action against Rege on Oct. 26, 2021 in the U.S. District Court for the District of New Jersey.[58] The CFTC's complaint charged Rege with violating Section 6(c)(1) of the CEA and Regulation 180.1(a)(1)–(3) thereunder, in addition to violating a 2019 CFTC Order that charged Rege with violating these same provisions and barred Rege from trading for a period of at least three years.

B. Disclosure of Investment Policies: *In re Upright Financial Corp., et al.*

Investment advisers must manage their funds consistently with internal policies and public disclosures. On Nov. 24, 2021, the SEC announced settled charges against Upright Financial Corp. ("Upright"), a registered investment adviser, and David Yow Shang Chiueh ("Chiueh"), Upright's founder and president, for managing a mutual fund contrary to internal policies and public disclosures and for repeatedly miscalculating the fund's net asset value.[59]

[55] The enforcement proceedings described below are based on allegations by the SEC, CFTC, or FINRA that either are being contested in active litigation or are part of a settled action in which the respondents have agreed to "neither admit nor deny" the allegations.

[56] *See* Complaint, *SEC v. Rege, et al.*, No. 3:21-cv-19313 (D.N.J. Oct. 26, 2021), available here; *see also Swapnil Rege*, Advisers Act Release No. 5303, July 18, 2019, available here.

[57] *Court Orders Asset Freeze and Other Preliminary Relief Against Recidivist and Barred Investment Adviser and His Firm*, SEC Litigation Release No. 25259, Nov. 8, 2021, available here.

[58] *See CFTC Charges New Jersey Resident and His Company with Fraudulent Solicitation, Misappropriation, and Violating Consent Order*, CFTC Release No. 8454-21, Oct. 27, 2021, available here.

[59] *Upright Financial Corp. et al.,* Advisers Act Release No. 5914, Nov. 24, 2021, available here.

The Order alleged that, from 2017 to 2020, Upright and Chiueh made investments for a mutual fund ("Fund") that they controlled that were inconsistent with the Fund's classification as a diversified investment company and the Fund's fundamental policy concerning industry concentration as disclosed in its registration statement. The Fund classified itself as a management company and, as such, must maintain 75% of its total assets in cash, Government securities, securities of other investment companies, and securities of other issuers limited in respect to any one issuer to an amount no greater in value than 5% of the value of the total assets of the management company, and not more than 10% of the outstanding voting shares of the issuer. The registration statement also stated that these specifications were an essential corporate policy. However, in practice, Chiueh, as the Fund's portfolio manager, implemented a put option strategy that caused the Fund to deviate from the policy's diversification and concentration requirements. The Order further found that Upright and Chiueh inaccurately calculated the client fund's net asset value, in some instances overstating or understating the value by over 15%.

The SEC Order found that Upright and Chiueh willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, Sections 20(a) and 34(b) of the Investment Company Act and Rule 20a-1(a) thereunder, and Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. Additionally, the Order found that Upright willfully violated Advisers Act Section 206(4) and Rule 206(4)-7 thereunder, and that Chiueh caused those violations. The Order further found that Upright and Chiueh caused the Fund's violations of Sections 13(a)(1) and 13(a)(3) of the Investment Company Act and Rules 22c-1 and 38a-1 thereunder. Without admitting or denying the SEC's findings, Upright and Chiueh consented to a cease-and-desist order, a censure, and certain undertakings including the retention of an independent compliance consultant. Additionally, Upright agreed to pay disgorgement of $390,705 and prejudgment interest of $36,505. Upright and Chiueh agreed to pay, jointly and severally, a civil penalty of $90,000.

C. Disclosure of Prior Misappropriation: *In re Rita Mansour*

The SEC will pursue investment advisers who fail to disclose to current and future investors when their financial advisers have misappropriated its clients' investments. On Dec. 10, 2021, the SEC announced a settled proceeding against Rita Mansour for failing to disclose to investors the misappropriation of their funds by another individual.[60]

The SEC found that Mansour sold securities in connection with private securities offerings by two pooled investment vehicles ("PIVs") that Mansour's employer advised. The PIVs offered for sale securities to raise money for the construction of a resort in Montenegro, and the money raised was to be used to purchase debt in a Montenegro entity that was to construct the resort. However, in October 2016, Mansour and her employer became aware that their "point-person" at the Montenegrin entity had misappropriated $488,331 of investors' funds to pay for personal expenses. Though that individual agreed to repay approximately $335,000 of the misappropriated funds, Mansour and her employer did not disclose to existing investors in the PIVs that the money had been misappropriated and then raised additional funds in early 2017 to new and existing investors without disclosing the past misappropriation.

Mansour was charged with violating Sections 17(a)(2) and (3) of the Securities Act and Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. Mansour has agreed to cease and desist from future violations of the charged provisions and to pay a disgorgement of $22,968.75, prejudgment interest of $4,884.71, and a civil penalty of $40,000.

[60] *Rita Mansour*, SEC Release No. 11012, Dec. 10, 2021, available here.

D. Flawed Fee Calculations: *In re Global Infrastructure Management, LLC*

Investment advisers must fully apply required management fee offsets and disseminate offering and governing documents that are consistent in the management fee calculation methodology. On Dec. 20, 2021, the SEC announced a settled proceeding against Global Infrastructure Management, LLC ("Global"), a registered investment adviser, for overcharging management fees associated with the private equity funds it manages.[61]

The SEC found that Global failed to offset certain portfolio company fees against the management fees it charged to the limited partners of Global's private equity funds, which resulted in those limited partners overpaying millions in additional management fees. Further, the Order alleged that Global provided its investors with inconsistent statements about how the adviser calculates and charges management fees, which were caused by deficiencies in Global's compliance program.

Global was charged with violating Sections 206(2) and 206(4) of the Investment Advisers Act and Rules 206(4)-7 and 8 thereunder. Global, without admitting or denying the findings in the SEC's Order, agreed to pay a $4.5 million civil penalty and agreed to a cease-and-desist order.

E. Fees from Payments to Related Affiliates: *In re 1st Global Advisors, Inc. a/k/a Avantax Advisory Services, Inc.*

Investment advisers must disclose conflicts of interest that result in their receipt of fees through payments to affiliates. On Dec. 20, 2021, the SEC announced a settled proceeding against 1st Global Advisors, Inc. ("1st Global"), a Texas-based registered investment adviser, for breaches of fiduciary duties in connection with its affiliated broker's receipt of third-party compensation for advisory clients without fully and fairly disclosing the alleged conflicts of interest to its clients.[62]

The SEC found that, since at least January 2014, 1st Global invested its clients in (1) mutual fund share classes that paid fees to 1st Global's affiliated broker; (2) mutual funds that generated no-transaction-fee revenue for one of 1st Global's affiliated brokers; and (3) cash sweeps that generated fee revenue for one of 1st Global's affiliated brokers without disclosing to its clients that 1st Global's affiliated broker was receiving such commissions. 1st Global did not provide to its clients a full and fair disclosure of these conflicts of interests. Furthermore, 1st Global violated its duty to seek best execution when it caused its clients to invest in mutual fund share classes that were less favorable in value than other share classes in the same funds and failed to adopt and implement policies and procedures designed to prevent violations of the Advisers Act.

1st Global was charged with violating Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7. Without admitting or denying the findings in the SEC's Order, 1st Global agreed to cease and desist from future violations of the charged provisions and to pay disgorgement of $12,349,153.11, prejudgment interest of $2,524,000, and a civil penalty of $2 million.

[61] *Global Infrastructure Management, LLC*, Advisers Act Release No. 5930, Dec. 20, 2021, available here.

[62] *1st Global Advisors, Inc.*, Advisers Act Release No. 5932, Dec. 20, 2021, available here.

F. Unsuitable Investment Recommendations: *In re PeachCap Tax & Advisory, LLC, et al.*

Investment advisers must ensure that their financial advisers understand their clients' risk tolerances and investment objectives, and obtain consent from clients for investments inconsistent with those tolerances and/or objectives. On Dec. 22, 2021, the SEC announced a settled proceeding against PeachCap Tax & Advisory, LLC ("PeachCap"), an Atlanta-based registered investment adviser, and its principal, David Miller, for violating federal securities laws.[63]

The SEC found, first, that from May 2016 through October 2016, Miller offered and sold over $4.6 million in securities to PeachCap advisory clients in a hedge fund that he formed and claimed to utilize a fundamental long/short equity approach to generate attractive risk-adjusted returns. In actuality, however, the hedge fund engaged in risky trading inconsistent with its stated objectives and strategies. The hedge fund lost more than 90 percent of its value between May 2016, when it began trading, and December 2017, when it closed.

Second, the SEC found that PeachCap engaged in 492 principal trades for six advisory clients without providing the requisite notice or consent or adopting and implementing policies and procedures designed to prevent the securities violations associated with those principal trades. Finally, the SEC Order alleged that PeachCap failed to adopt policies and procedures regarding volatility-linked exchange traded products. This allegedly resulted in PeachCap's investment adviser representatives buying and holding a complex leveraged exchange traded fund for retail clients for time periods that were inconsistent with the purpose of the product, subjecting those clients to unreasonable risk of loss.

PeachCap was charged with violating Sections 206(2), 206(3), and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. Miller was charged with violating Section 17(a)(3) of the Securities Act and Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, as well as causing certain of PeachCap's violations. Without admitting or denying the findings in the SEC's Order, PeachCap and Miller agreed to cease and desist from future violations of the charged provisions. PeachCap agreed to be censured and to pay disgorgement of $3,055, plus prejudgment interest of $759, and a civil penalty of $135,000. Miller agreed to pay a penalty of $65,000 and to industry, director / officer, and penny stock bars.

[63] *PeachCap Tax & Advisory, LLC*, SEC Release No. 11020, Dec. 22, 2021, available here.

Broker-Dealer Enforcement Actions

A. Ponzi Scheme: *SEC v. BNZ One Capital, LLC, et al.*

The SEC will charge entities and their principals for offering frauds that resemble Ponzi-like schemes and for failing to disclose industry bars. On Oct. 28, 2021, the SEC filed a contested action in the U.S. District Court for the Central District of California against BNZ One Capital, LLC ("BNZ"), and its co-managers and founders Brett Reed Barber ("Barber") and Louis Zimmerle ("Zimmerle").[64] The SEC's complaint alleged that the defendants made a series of misrepresentations in order to obtain investments in BNZ, including falsely inflating BNZ's profitability, falsely claiming BNZ maintained professional accounting records, and failing to disclose Barber was barred by FINRA from associating with a broker-dealer.

The SEC alleged that, since June 2019, the defendants sold BNZ investments through promissory notes called "Lender/Investor's Statement Agreements" ("LIAs") and urged investors to roll over their investments for additional fixed periods by offering them "bonus" payments. According to the SEC's complaint, by March 2020, the defendants were aware that BNZ's tiny profits were not sufficient to pay investors their returns or principals, but nevertheless continued to sell the notes in BNZ by misrepresenting a guaranteed return of around 10% annually. Instead of investing funds to generate returns, the defendants used investor funds to cover personal expenses and pay investor returns in a Ponzi-like scheme. In addition, the SEC alleged that the LIAs sold by BNZ falsely represented that BNZ maintained "accurate and professionally managed records" when in actuality BNZ failed to do so and merely had a spreadsheet containing some information about the investments. Lastly, the SEC alleged that the LIAs highlighted Barber's education and experience in finance, but failed to disclose that, in 2012, FINRA barred Barber from associating with any member firm.

The SEC's complaint charged all three defendants under the antifraud provisions of Section 17(a) of the Securities Act and 10(b) of the Exchange Act and Rule 10b-5 thereunder, and for the unregistered sale of securities under Sections 5(a) and 5(c) of the Securities Act. The complaint also seeks to find Barber and Zimmerle liable as control persons of BNZ pursuant to Section 20(a) of the Exchange Act and acting as unregistered broker-dealers in violation of Section 15(a) of the Exchange Act. The SEC seeks injunctions against the defendants, disgorgement of profits plus interest, and civil monetary penalties. The U.S. Attorney's Office for the Central District of California is pursuing parallel criminal charges against Barber and Zimmerle.

B. Unsuitable Trading and Deficient Procedures: *In re Aegis Capital Corp.*

FINRA will impose sanctions on registered firms and their representatives who engage in excessive and unsuitable trading in customers' accounts. On Nov. 8, 2021, FINRA announced the acceptance, waiver, and consent of claims ("AWC") brought against Aegis Capital Corp. ("Aegis"), a New York-based introducing broker-dealer with more than 300 registered representatives in twenty-three branch offices.[65] It has been registered with FINRA since July 1984.

The AWC letter found that, from July 2014 to December 2018, Aegis failed to establish, maintain, and enforce a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with the suitability requirements of FINRA Rule 211 as it pertains to excessive trading. The letter found that the deficiencies detailed therein resulted in Aegis failing to identify hundreds of customer accounts that were making excessive and unsuitable trades — meaning that accounts were trading in ways that were inconsistent with the customer's

[64] *See* Complaint, *SEC v. BNZ One Capital, LLC, et al.*, No. 8:21-cv-01788 (C.D. Cal. Oct. 28, 2021), available here.

[65] *Aegis Capital Corp.*, FINRA Letter of Acceptance, Waiver, and Consent No. 2016051704305, Nov. 8, 2021, available here.

investment needs and objectives. Additionally, the letter found that the deficiencies in Aegis's policies and procedures led to its failure to identify customers who purchased and held non-traditional ETFs for extended periods of time, or whose purchases were otherwise inconsistent with their recorded investment objective, risk tolerance, or finances.

The letter alleged Aegis violated NASD Rule 3010 and FINRA Rules 3110 and 2010. Without admitting or denying FINRA's findings, Aegis agreed to a censure and to pay a fine of $1,050,000 and $1,692,256.44 in restitution. Aegis also agreed to submit a letter of compliance with recommendations regarding relevant rules and regulations by an independent compliance consultant retained by the firm. In a related proceeding, FINRA also announced on Nov. 8, 2021, the acceptance, waiver, and consent of claims brought against Joseph Giordano and Roberto Birardi, who each had supervisory roles at Aegis during the relevant times.[66] Giordano agreed to pay a $10,000 fine and a six-month suspension from association with any FINRA member in a principal capacity; Birardi agreed to pay a $5,000 fine and a three-month suspension.

C. Money Laundering Red Flags: *In re Wedbush Securities, Inc.*

The SEC will pursue broker-dealers that fail to investigate certain money laundering "red flags" exhibited by their accounts and that fail to file the appropriate suspicious activity reports. On Dec. 15, 2021, the SEC announced a settled enforcement proceeding against California broker-dealer Wedbush Securities Inc. ("Wedbush") for offering for sale unregistered securities and for failing to file suspicious activity reports (SARs) for certain transactions it executed.[67]

The SEC found that Wedbush, from January 2017 through September 2018, facilitated the offering and sale of unregistered securities by Wintercap SA (f/k/a Silverton SA ("Silverton")) for which it held a brokerage account. Silverton used its brokerage account at Wedbush to conceal its ownership and control over public companies, and it routinely deposited low-priced securities in the account only to sell a large quantity of those securities shortly thereafter and then withdraw the proceeds. Normally, Wedbush, as a broker-dealer, would be exempt from the registration requirements under Section 5 of the Securities Act through Section 4(a), as it was only executing, and not soliciting, transactions upon orders from its customer, Silverton. However, the SEC Order alleged that Wedbush failed to make a "reasonable inquiry" prior to effecting the transactions "that the person for whose account the securities are sold is an underwriter with respect to the securities or that the transaction is a part of a distribution of securities of the issuer," as required by Section 4(a). Furthermore, the SEC Order alleged that Wedbush overlooked numerous "red flags" raising the likelihood that the Silverton transactions were suspicious, and failed to file SARs for those suspicious transactions it executed on behalf of Silverton.

Wedbush was charged with violating Sections 5(a) and 5(c) of the Securities Act and Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. Without admitting or denying the SEC's findings, Wedbush agreed to cease and desist from future violations of the charged provisions, to a censure, and to pay $207,000 in disgorgement and a $1 million civil penalty. In a related action in 2018, the SEC brought an enforcement action against Silverton and, among others, its principal, Roger Knox, who was also charged criminally by the U.S. Attorney's Office for the District of Massachusetts.[68]

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[66] *Joseph Michael Giordano, et al.*, FINRA Letter of Acceptance, Waiver, and Consent No. 2016051704306, Nov. 8, 2021, available here.

[67] *Wedbush Securities Inc.*, SEC Release No. 11015, Dec. 15, 2021, available here.

[68] *See SEC Halts Microcap Fraud Scheme Orchestrated Through International Accounts*, SEC Litigation Release No. 24304, available here.

Other Enforcement Actions

A. SEC's Disgorgement Authority: *SEC v. Blackburn, et al.*

Although not a new enforcement proceeding, a federal appellate court opinion released in the fourth quarter is noteworthy for this audience as it was the first time a federal appellate court considered an aspect of the SEC's disgorgement authority as recently defined by the Supreme Court. On Oct. 12, 2021, the Fifth Circuit Court of Appeals upheld a disgorgement remedy entered by a Louisiana district court, applying the test for disgorgement established in the Supreme Court's 2020 decision, *Liu v. SEC*.[69] In *Liu*, the Supreme Court addressed whether the Exchange Act's grant of authority to the SEC to seek equitable relief supports the longstanding practice of ordering disgorgement in securities cases. The Supreme Court held that disgorgement is a permissible equitable remedy (as opposed to an impermissible punitive remedy) so long as the disgorgement does not exceed the defendants' "net profits" and provided the remedy is to "be awarded for victims."[70] The Fifth Circuit's decision was the first time a federal court of appeals determined whether the disgorgement remedy was "awarded for victims" since *Liu* was decided.

The SEC charged defendants in *Blackburn* in 2014, by asserting several claims against a penny-stock oil and gas company, Treaty Energy Corporation ("Treaty"), and three individuals involved with Treaty, Ronald L. Blackburn ("Blackburn"), Bruce A. Gwyn ("Gwyn"), and Michael A. Mulshine ("Mulshine"). The district court held that the individual defendants misrepresented the identity of Treaty's management in order to avoid disclosing that Blackburn — a convicted felon — was running Treaty behind the scenes, in addition to failing to register millions of Treaty shares, and misrepresenting critical facts about Treaty's business. The district court ordered disgorgement of profits from each individual defendant (approximately $1.5 million from Blackburn; $108,000 from Mulshine; and $772,000 from Gwyn). The individual defendants appealed, challenging the merits of the district court's decision, as well as the disgorgement remedy in light of the Supreme Court's recent decision in *Liu.*

The Fifth Circuit affirmed the district court's judgment against defendants, and held that the disgorgement remedy constituted permissible equitable relief under the Exchange Act, as interpreted by the Supreme Court in *Liu*. First, the Fifth Circuit held that the disgorgement remedy amounted to and did not exceed the "net profits" that the defendants received from their securities fraud. The court noted that the profits subject to disgorgement were assessed on an individual basis, relative to each individual defendant's particular gain, and the total disgorgement award was not subject to joint-and-several liability (i.e., the individual defendants were not independently liable for the sum of the award). Second, the Fifth Circuit held that the disgorgement remedy was "awarded for victims" because the defendants' fraud harmed individual investors — in comparison to crimes like insider trading that injure the market as a whole — and the SEC identified these investors and created a process for the return of the disgorged funds.

B. Scalping: *SEC v. Gallagher, a/k/a "Alexander Delarge 655321"*

The SEC continues to aggressively pursue those that engage in all types of market manipulation. On Oct. 26, 2021, the SEC filed an action in the U.S. District Court for the Southern District of New York against Steven M. Gallagher ("Gallagher") for using his Twitter platform to promote and encourage his followers to purchase microcap securities

[69] *See SEC v. Blackburn, et al.*, No. 20-30464 (5th Cir. Oct. 12, 2021), available here; *see also Liu v. SEC*, 140 S. Ct. 1936 (2020), available here.

[70] *Liu*, 140 S. Ct. at 1942.

while simultaneously concealing that he was taking advantage of the inflated price and liquidity his tweets helped create by selling his own shares in the same issuers.[71] This trading activity is known as "scalping."

The SEC alleged that, since September 2019, Gallagher, using the Twitter handle @AlexDelarge6553, engaged in scalping in connection with at least sixty different issuers and generated at least $3.39 million in profits from his fraudulent and manipulative scheme. For example, the SEC alleged that Gallagher bought twenty million shares in "All for One Media Corp." ("AFOM") and the next morning when the market opened, tweeted a flashing red graphic with the word "ALERT!!!!" and encouraged his followers to "load and hold" AFOM. According to the SEC, that same morning, after his ALERT tweet, Gallagher sold thirteen million shares of AFOM for an approximate profit of $42,000.

The SEC alleged that Gallagher violated the antifraud provisions of Section 17(a) of the Securities Act as well as Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 thereunder. On Nov. 5, 2021, the court entered a temporary restraining order ("TRO") prohibiting Gallagher from further violating securities laws and freezing $6.9 million of his assets. On Nov. 30, 2021, the court extended the TRO pursuant to a stipulated preliminary injunction agreement between the parties. The SEC also seeks permanent injunctive relief, disgorgement of profits plus interest, and civil monetary penalties.

C. Large-Scale Theft: *SEC v. Cammarata*

The SEC proved it is up to the task of investigating and uncovering innovative and unusual fraud schemes, particularly involving allegations of the theft of many millions of dollars. On Nov. 3, 2021, the SEC filed a contested action in the U.S. District Court for the Eastern District of Pennsylvania against Joseph Cammarata, Erik Cohen, David Punturieri, Alphaplus Portfolio Recovery Corp., and Alpha Plus Recovery LLC.[72] The named entities are New Jersey-based "claims aggregator" firms that administer the return of settlement funds to harmed investors. The named individuals are principals of the defendant-entities.

The SEC's complaint alleged that, from 2014 to 2021, the defendants orchestrated a scheme to steal money from distribution funds established for the benefit of securities fraud victims. The business model of a legitimate claims aggregator is to represent harmed individuals and entities by submitting their claims to distribution fund administrators in exchange for a fee. The crux of the alleged scheme was that defendants allegedly submitted false claims supported by falsified documents to the distribution fund administrators in the names of entities that never traded in the underlying securities. The defendants fabricated brokerage records, trading records, and other securities reports; created false personas to communicate with distribution fund administrators; lied to distribution fund administrators who questioned the claims and documentation; and masked their affiliation with the defendant entities. In total, defendants allegedly stole at least $40 million from approximately 400 distribution funds formed as a result of resolutions of securities class actions and SEC enforcement actions.

The complaint charged the defendants with violating Section 10(b) and Rule 10b-5 of the Exchange Act. The SEC obtained preliminary injunctive relief and seeks permanent injunctions against further violations of the aforementioned section, disgorgement of all ill-gotten gains, civil penalties, and an officer and director bar against Cammarata. In a parallel action, the U.S. Attorney's Office for the Eastern District of Pennsylvania criminally charged Cammarata, Cohen, and Punturieri.[73]

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[71] *See* Complaint, *SEC v. Gallagher, a/k/a "Alexander Delarge 655321"*, No. 1:21-cv-08739 (S.D.N.Y. Oct. 26, 2021), available here.

[72] *See* Complaint, *SEC v. Cammarata, et al.*, No. 2:21-cv-04845 (E.D. Pa. Nov. 3, 2021), available here.

[73] *See Two New Jersey, One New York Securities Claims Aggregators Arrested and Charged with $40M Fraud*, DOJ Release, Nov. 3, 2021, available here.

D. Section 3(a)(10) Penny Stock Scheme: *SEC v. CF3 Enterprises, LLC, et al.*

The increasing complexity of manipulative schemes involving penny stocks has not slowed down related enforcement activity. On Nov. 9, 2021, the SEC filed a contested action in the Southern District of Texas against CF3 Enterprises, Robert Gandy (a securities fraud recidivist), Silverback Promotions, LLC, Clarence Fitchett, Kathy Givens-Gandy, and Billy Chang.[74]

The complaint alleged that, between 2017 and 2018, defendants engaged in two separate schemes designed to avoid compliance with SEC registration requirements. Defendants allegedly falsified documents in order to make the securities of two penny-stock companies appear unrestricted. Utilizing Section 3(a)(10) of the Securities Act, under which a company may issue unrestricted stock in exchange for the satisfaction of a bona fide debt, defendants fraudulently backdated promissory notes so that the notes were purportedly owed by the penny-stock companies. Then, defendants filed actions in state court to collect on the fictitious notes. After the court approved the settlement of the debt, defendants were paid in unrestricted shares of the debtor company. The idea behind Section 3(a)(10) is that the owner of the note can satisfy the debt by selling the shares into the market. Pursuant to their scheme, defendants either sold the unrestricted shares into the market themselves, or sold the promissory notes to an unwitting third party who then sold the shares into the market themselves and paid defendants the purchase price of the note from the proceeds of the stock sale. In total, defendants were issued more than $7 million worth of unrestricted, free-trading shares.

The SEC's complaint charged the defendants with violating Section 10(b) of the Exchange Act and Rules 10b-5(a) and 10b(c) thereunder and Section 17(a)(1) and 17(a)(3) of the Securities Act. The SEC seeks permanent injunctive relief, an order barring Gandy and Fitchett from participating in the offer or sale of securities pursuant to, or claiming an exemption under, Section 3(a)(10) of the Securities Act, an order barring Fitchett from participating in any offering of a penny stock, disgorgement of ill-gotten gains plus prejudgment interest on a joint and several basis, and civil penalties. Gandy was previously charged with securities fraud by the SEC in 2013, and was already subject to a permanent injunction against any further violation of the securities laws.

E. Insider Trading: *SEC v. Dikshit; SEC v. Dobkin, et al.*

Two proceedings announced during the fourth quarter reiterate that, as always, insider trading remains a high priority in the SEC's enforcement agenda.

First, on Nov. 10, 2021, the SEC filed a contested action in the Southern District of New York against Puneet Dikshit, a former partner at McKinsey & Co., a global management consulting firm, alleging that he used his professional position to obtain and then trade on confidential information concerning the impending acquisition of GreenSky, Inc. by the Goldman Sachs Group, Inc.[75]

According to the SEC's complaint, Dikshit, a former McKinsey partner who led the consulting firm's unsecured lending practice in North America, traded on MNPI that he had acquired as part of his professional role as the lead advisor to Goldman Sachs in its attempt to purchase GreenSky. Dikshit allegedly purchased around 2,500 GreenSky call options two days before Goldman Sachs announced it would purchase the fintech lender. The trades allegedly

[74] *See* Complaint, *SEC v. CF3 Enterprises, LLC, et al.*, No. 4:21-cv-03672 (S.D. Tex. Nov. 9, 2021), available here.

[75] *See* Complaint, *SEC v. Dikshit*, No. 1:21-cv-09289 (S.D.N.Y. Nov. 10, 2021), available here.

netted Dikshit a return of 1,829% on his original investment of $23,647, totaling more than $450,000 in illegal profits.

The SEC complaint charged Dikshit with violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and seeks a permanent injunction and civil penalties. In a parallel criminal action brought by the U.S. Attorney's Office for the Southern District of New York, Dikshit pled guilty to one count of securities fraud on Dec. 15, 2021.[76]

Second, on Dec. 1, 2021, the SEC filed a contested complaint in the Northern District of California against Robert C. Dobkin, Cynthia Braun, Michael Fiorillo, and Jeffrey S. Gregersen for insider trading in the securities of Linear Technology Corporation ("Linear").[77]

The complaint alleged that Dobkin, the founder and former Chief Technical Officer of Linear, tipped his close friends, Braun and Fiorillo, and a third individual, Gregersen, ahead of an announcement of Linear's merger with Analog Devices, Inc. Braun, Fiorillo, and Gregersen then bought Linear securities, including stock and in-the-money call options, before Linear's public announcement of the merger on July 26, 2016. The defendants sold their options and stock on July 27, 2016, making a collective profit of more than $325,000.

The complaint charged the defendants with violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The relief sought includes a permanent injunction against violating the charged provisions, a civil penalty, and an officer and director bar against Dobkin.

F. Pump and Dump Platform: *SEC v. Lee, et al.*

Pump and dump schemes come in many forms, and the SEC is committed to pursuing individuals that assist in organizing these schemes. On Dec. 9, 2021, the SEC filed a complaint in the District of Massachusetts against Jay Scott Kirk Lee, Geoffrey Allen Wall, and Benjamin Thompson Kirk for a pump and dump scheme involving various public companies.[78]

The complaint alleged that, between at least 2011 and 2016, Lee, Wall, and Kirk, all Canadian citizens, used an illicit offshore platform called the "Sharp Platform," which was run by Frederick Sharp for the alleged purpose of enabling individuals to commit penny fraud stock.[79] The Sharp Platform supplied the defendants with alter ego offshore front companies, which they used to fraudulently conceal their virtual entire control of the public floats of various public companies from transfer agents and brokers. As a result, those transfer agents and brokers did not treat the defendants' stock as restricted stock that could only be purchased or sold in very limited circumstances. The defendants touted the companies through hired promoters, unloaded their shares on retail investors, and then disbursed the proceeds of those sales to various bank accounts around the world.

[76] *See Former Management Consulting Firm Partner Pleads Guilty to Insider Trading*, DOJ Press Release 21-356, Dec. 15, 2021, available here.

[77] *See* Complaint, *SEC v. Dobkin, et al.*, 5:21-cv-09285 (N.D. Cal. Dec. 1, 2021), available here.

[78] *See* Complaint, *SEC v. Lee, et al.*, 1:21-cv-11997 (D. Mass. Dec. 9, 2021), available here.

[79] The SEC previously filed an action against Sharp and his associates for violating the antifraud and registration provisions of the federal securities laws in connection with running the Sharp Platform; that proceeding is pending. *See SEC Charges International Microcap Fraud Scheme Participants*, SEC Press Release No. 2021-148, Aug. 9, 2021, available here; *see also* Complaint, *SEC v. Sharp, et al.*, 1:21-cv-11276 (Aug. 5, 2021), available here.

The complaint charged Lee, Wall, and Kirk with violating Sections 5(a), 5(c), and 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The relief sought includes permanent injunctions, disgorgement of allegedly ill-gotten gains plus interest, civil penalties, and penny stock bars.

G. Auditor Independence Rules: *In re Adam D. Bering, Esq.*; *In re Alan C. Greenwell, CPA*; *In re Philip S. Hurak, Esq.*; *In re Scott D. Clark, CPA*

The SEC continues to enforce auditor independence rules, reiterating its view that auditor independence is fundamental to sound financial reporting practices. On Dec. 10, 2021, the SEC announced settled administrative enforcement proceedings against four individuals associated with Ernst & Young LLP ("EY") for violating auditor independence rules.[80] The SEC charged Adam Bering ("Bering"), Alan Greenwell ("Greenwell"), Philip Hurak ("Hurak"), and Scott Clark ("Clark") for their respective roles in EY's alleged failure to provide independent audits for its client Cintas Corporation ("Cintas").[81]

The SEC Orders alleged that, between July 2009 and August 2018, EY audited the financial statements that Cintas filed with the SEC, which stated the audits had been conducted in accordance with the applicable standards that required auditors to be independent of their clients. The SEC challenged EY's independence, alleging that, during this same time period, EY also provided tax credit and incentive services for Cintas on a contingent fee basis. However, under Regulation S-X, an audit firm is not independent of its audit client if it provides any non-audit services for a contingency fee. Although EY represented to Cintas's audit committee and in its engagement letters that it would bill Cintas on a "time and material basis," the SEC alleged EY did not actually do so. Rather, according to the SEC's Orders, EY charged fees of approximately, and sometimes exactly, 10% of the benefit Cintas received for federal tax credits and 15% of the benefit Cintas received for state and local tax credits resulting from EY's services.

The SEC charged each individual with causing and/or willfully aiding and abetting Cintas's violations of Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-3 thereunder. The SEC also charged the three EY employees — i.e., Bering, Greenwell, and Hurak — with causing and/or willfully aiding and abetting EY's violations of Rule 2-02(b)(1) of Regulation S-X. Lastly, the SEC charged Greenwell with engaging in "improper professional conduct" within the meaning of Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's rules of practice. The SEC charged the other three individuals — i.e.*,* Bering, Hurak, and Clark, who was employed by Cintas — with willfully aiding and abetting Cintas's violations of the federal securities laws within the meaning of Section 4C(a)(3) of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

Without admitting or denying the findings in the SEC Orders, the four individuals agreed to pay civil money penalties relative to their roles in the matter. In particular, Bering, who was the EY engagement partner overseeing the tax credit and incentive services provided to Cintas, agreed to a $10,000 penalty; Greenwell, who was the EY tax partner serving as the tax account leader for tax services provided to Cintas, agreed to a $15,000 penalty; Hurak, who was the EY employee who reviewed and approved the contingency fee bills that EY sent to Cintas, agreed to a $20,000 penalty; and Clark, Cintas's VP of Corporate Taxation who approved the payment of the contingency fee invoices, agreed to a $30,000 penalty.

[80] *Adam D. Bering, Esq.*, Exchange Act Release No. 93749, Dec. 10, 2021, available here; *Alan C. Greenwell, CPA*, Exchange Act Release No. 93750, Dec. 10, 2021, available here; *Philip S. Hurak, Esq.*, Exchange Act Release No. 93751, Dec. 10, 2021, available here; *Scott D. Clark, CPA*, Exchange Act Release No. 93752, Dec. 10, 2021, available here.

[81] EY's independence as an auditor had been called into question by the SEC four months earlier in a different matter concerning EY's pursuit to serve as the auditor for a public company. *See SRZ Securities Enforcement Quarterly*, Oct. 2021, at 22, available here.

H. Hacking and Insider Trading: *SEC v. Kliushin, et al.*

International fraudsters who obtain information and then trade on it in violation of the federal securities laws will be pursued by the SEC. On Dec. 20, 2021, the SEC filed an action in the U.S. District Court of Massachusetts against five Russian nationals for engaging in a multi-year hacking scheme that involved stealing earnings announcements of companies traded on U.S. exchanges and then trading in advance of the public release of the earnings information.[82]

The SEC alleged that, from February 2018 until August 2020, one of the defendants, Ivan Yermakov ("Yermakov"), hacked into the computer systems of two firms that assist publicly traded companies with the preparation and filing of periodic and other reports with the SEC ("Servicers") via the SEC's online Electronic Data Gathering, Analysis and Retrieval ("EDGAR") system. The complaint alleged that Yermakov, who is the subject of two pending federal criminal indictments, used malware and compromised credentials of employees of the Servicers, such as usernames and passwords, in addition to other hacking techniques, in order to steal the filings before they were made public via EDGAR. According to the complaint, Yermakov then provided the stolen and non-public filings containing the earnings information of the companies to his co-defendants Vladislav Kliushin ("Kliushin"), Nikolai Rumiantcev ("Rumiantcev"), Mikhail Irzak ("Irzak"), and Igor Sladkov ("Sladkov") (collectively, the "Trader Defendants").

The Trader Defendants regularly traded securities through a variety of internationally-based brokerage firms that cleared their trades through U.S.-based brokerage firms. The SEC alleged that the defendants used MNPI hacked by Yermakov from the Servicers to trade in advance of 200 to 400 earnings announcements, racking up at least $82.5 million in profit. The Trader Defendants then shared the considerable profit with Yermakov, in part by funneling the money through a Russian information technology company founded by Kliushin and for which Yermakov and Rumiantcev serve as directors. The SEC's complaint alleged that its statistical analysis established that there was less than a one-in-one-trillion chance that the trades executed by the Trader Defendants occurred at random. The SEC also provided detailed factual allegations where, for instance, within hours of Yermakov hacking a certain company's earnings reports that beat analysts' expectations, the co-defendants bought significant amounts of shares in the same company before the earnings reports were made public.

The complaint charged all defendants with violating Section 17(a) of the Securities Act as well as Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The complaint charged the Trader Defendants only with aiding and abetting Yermakov's violations of the aforementioned provisions and with themselves violating Section 20(b) of the Exchange Act. The relief sought includes enjoining all defendants from committing future violations of the charged provisions, disgorgement, and civil money penalties. In a parallel action, the U.S. Attorney's Office for the District of Massachusetts brought criminal charges against the defendants.[83]

I. SPAC Disclosures: *In re Nikola Corporation*

In a proceeding related to several actions announced during the third quarter of 2021, the SEC continued to target entities connected to a transaction involving a special purpose acquisition company, or SPAC, for making misleading claims. On Dec. 21, 2021, the SEC announced a settled enforcement proceeding against Nikola Corporation

[82] *See* Complaint, *SEC v. Kliushin et al.*, No. 21-CV-12088 (D. Mass. Dec. 20, 2021), available here.

[83] *See Russian National Extradited for Role in Hacking and Illegal Trading Scheme*, Dep't of Justice, Dec. 20, 2021, available here.

("Nikola") for fraudulently inflating and maintaining its stock price prior to, and after, a merger deal with a SPAC which resulted in Nikola becoming a public company.[84]

The SEC alleged that, from March 2020 through September 2020, Nikola, a zero-emissions transportation system provider, deceived investors about the then-current reality of Nikola's technological advancements, in-house production capabilities, and financial outlook. The alleged deception occurred primarily through scores of misrepresentations by Nikola's CEO and later Executive Chairman, Trevor R. Milton ("Milton"), who the SEC charged in a separate action filed earlier this year in the U.S. District Court for the Southern District of New York.[85] For instance, Milton repeatedly tweeted from his personal Twitter account and made podcast appearances, claiming that Nikola had engineered and already completed a prototype of an electric pickup truck. However, the SEC's Order alleged that Nikola had not performed any engineering work or any design work other than CGI renderings of a Nikola employee's prior illustrations, and Nikola's third-party suppliers were only completing computer-aided design and beginning tooling. The SEC's Order also alleged that, apart from Milton's misrepresentations, Nikola separately misled investors through misrepresenting current and future costs and sources of electricity for the company's planned hydrogen production, and the economic risks and benefits associated with a contemplated partnership with General Motors. Milton's allegedly false and misleading statements were made at the time securities were being offered and sold pursuant to the registration statement that the SPAC filed with the SEC on March 13, 2020, and the registration statement Nikola filed with the SEC on June 15, 2020, after the merger combination that made Nikola public. Finally, the SEC Order alleged that Nikola failed to maintain controls and procedures to ensure the accuracy of its disclosures.

The SEC charged Nikola with violating Section 17(a) of the Securities Act as well as Section 10(b) of the Exchange Act and Rule 10b-5 and Rule 13a-15(a) thereunder. Without admitting or denying the SEC's findings, Nikola agreed to pay a civil penalty of $125 million, to cease and desist from future violations of the charged provisions, and to cooperate fully with the SEC's investigation and any related judicial or administrative proceeding.

J. Touting and Inflated Valuations: *SEC v. Medallion Financial Corp., et al.*

Companies and their officers who engage in fraud and other deceptive conduct when trying to increase the company's stock price are likely to face charges from the SEC. At the end of the quarter, on Dec. 29, 2021, the SEC filed a contested civil action against (1) Medallion Financial Corp. ("Medallion") and its President and CEO, Andrew Murstein ("Murstein"), for carrying out two schemes to fraudulently boost the stock price of Medallion; and (2) Ichabod's Cranium, Inc. ("Cranium"), and its owner, Lawrence Meyers ("Meyers"), for illegal touting related to one of the schemes perpetrated by Medallion and Murstein.[86]

The SEC's complaint described two allegedly fraudulent schemes, the first of which began when Murstein engaged Meyers and Cranium to anonymously promote Medallion online. Murstein approved all of the promotional publications by Meyers, which failed to disclose that they had been paid for by Medallion and Murstein. Under the second scheme, Murstein pressured an outside valuation firm to accept an inflated number of the fair value of an asset held by Medallion in order to increase Medallion's stock price. The valuation firm refused, and Murstein found an investment bank that would agree to use the inflated fair value number in the valuation in exchange for the

[84] *Nikola Corp.*, Securities Act Release No. 11018, Dec. 21, 2021, available here.

[85] *See* Complaint, *SEC v. Milton*, No. 1:21-cv-6445 (S.D.N.Y. Jul. 29, 2021), available here; *see also SRZ Securities Enforcement Quarterly*, Oct. 2021, at 20-21, available here.

[86] *See* Complaint, *SEC v. Medallion Financial Corp. et al.*, No. 1:21-cv-11125 (S.D.N.Y. Dec. 29, 2021), available here.

promise of lucrative investment banking work in the future. As a result, Medallion's financial statements filed with the SEC contained inaccuracies.

The complaint charged (i) Murstein with violating Rule 13b2-2 promulgated under the Exchange Act; (ii) Murstein and Medallion with violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 13(a) and 13(b)(2)(A) and (B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-3 thereunder, aiding and abetting Meyers's and Cranium's violations, and aiding and abetting uncharged violations of Section 17(b) of the Securities Act; and (iii) Meyers and Cranium with violating Section 17(b) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The relief sought includes permanent injunctions, disgorgement, civil penalties, and an officer and director bar against Murstein.

Closing Thoughts

The final quarter of 2021 saw the SEC's Director of Enforcement Gurbir Grewal articulate his vision for the SEC's enforcement agenda. The Director committed to changes in the enforcement program aimed at accelerating the process whereby enforcement proceedings are investigated and filed in an effort to implement quickly and decisively the Commission's enforcement priorities. Chair Gensler has spent 2021 highlighting his expansive regulatory agenda and the Enforcement Division is going to be on the leading edge of pressing that vision. Market participants will need to be proactive in their assessment and response to potential regulatory concerns in order to stay ahead of an energized enforcement program and out of the spotlight that accompanies an enforcement proceeding. As we head into 2022, we anticipate that the aggressive enforcement vision described by securities regulators since the start of the new Administration will begin to be fully realized.

About Schulte Roth & Zabel

SRZ's Securities Enforcement Group represents public and private companies, financial institutions, broker-dealers, private funds and their senior executives in securities-related enforcement proceedings and government investigations involving the full range of federal and state law enforcement and regulatory authorities. With numerous former federal prosecutors from U.S. Attorneys' offices, including chiefs of the Appeals and Major Crimes Units, and former SEC officials, our deep bench of lawyers offers guidance on matters ranging from informal inquiries and formal or grand jury investigations to administrative proceedings and cases brought in federal and state courts.

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