

SEC Update

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SEC Sheds Light on Its Pursuit of "Streamlined" Investigations

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Securities market participants and their counsel have fretted recently over the Securities and Exchange Commission's (the Commission) **new aggressive enforcement initiatives**. In particular, in several recent speeches, Chairwoman Mary Jo White has warned that she intends for the Commission to be perceived as "being everywhere" by bringing enforcement actions against violators in "every market participant category and in every market strata." Accordingly, Ms. White has vowed to pursue "even the smallest infractions." Many have questioned the efficacy of this approach given that Commission officials have pledged simultaneously to continue bringing large cases, particularly time- and resource-intensive **accounting fraud cases**. Recently, Gerald Hodgkins, an Associate Director in the Commission's Division of Enforcement, shed light on how the Commission will seek to accomplish these conflicting goals – by conducting "streamlined" investigations into strict liability violations.

Mr. Hodgkins, speaking at a National Association of Criminal Defense Lawyers Conference in Washington, DC on October 24, explained that Commission officials have grappled with how to pursue small cases without impeding the agency's ability to devote adequate resources to its higher priority large cases. The Commission's resolution is to conduct "streamlined" investigations of small violations. Specifically, Mr. Hodgkins explained how the Enforcement Division utilized a streamlined investigation process in connection with the agency's recent charges against 23 securities firms for **violations of Rule 105 of Regulation M** (Rule 105 Actions).

Rule 105 is a strict liability rule that prohibits short selling an equity security during a restricted period (generally five business days before a public offering) and the purchase of that same security through the offering. In the Rule 105 Actions, Commission investigators notified over 100 securities firms via letter of potential Rule 105 violations committed by the firms. The Financial Industry Regulatory Authority (FINRA) referred many of these potential violations to the Commission. The letters advised the firms of the apparent violations and ordered them to identify, within a short time frame, any mitigating factors and remedial steps taken by the firms relevant to the violations. The Commission developed a "penalty framework" aimed at imposing sanctions equally across the pool of firms. This framework involved a per-violation calculation that assessed the improper profit earned by the firms while giving firms credit for mitigating factors and remedial efforts. The Commission used the penalty framework to formulate a "take it or leave it" settlement offer for each firm. The Commission refused to negotiate the settlement offers, as it does under its "traditional model," explained Mr. Hodgkins, because the agency "could not justify" devoting such resources to these small matters. This streamlined investigation of the Rule 105 Actions proved quite successful in the Commission's view given that only one of the 23 firms sued by the Commission refused to settle and opted to litigate. Indeed, Mr. Hodgkins acknowledged that the Rule 105 Actions likely would not have been pursued absent the streamlined investigation process.

Mr. Hodgkins warned that the Enforcement Division will continue to conduct streamlined investigations of strict liability violations – particularly "gateway" type violations that, if unaddressed, could embolden bad actors to commit more serious violations. Accordingly, we predict the Commission will pursue streamlined investigations into violations of Section 5 of the Securities Act of 1933 (prohibiting the sale of unregistered securities) and Section 13 of the Exchange Act of 1934 (requiring issuers to file accurate periodic reports with the Commission), as well as additional Rule 105 violations. We recommend that regulated entities thoroughly educate their employees about these rules as well as implement and enforce policies and procedures designed to achieve compliance with them. A company that finds itself swept up in a streamlined investigation should take the matter seriously and act quickly to formulate a defensive action plan.

*For more information regarding this alert, please contact **Michael J. Rivera** or **Hillary S. Profita**. Mr. Rivera is Chair of Venable's **Securities Enforcement and Compliance Practice Group**.*