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Introduction

The third quarter marked the end of the SEC's fiscal year; a year defined by novel enforcement actions and steady pronouncements foreshadowing more boundary-pushing investigations and enforcement cases. In this edition of Schulte Roth & Zabel's *Securities Enforcement Quarterly*, we discuss the SEC's expanded enforcement in the digital asset space, its apparent return to the "broken windows" approach to enforcement and the recent enforcement activity related to unapproved communications platforms. We conclude by summarizing this quarter's notable enforcement actions.

Specific Enforcement Priorities for the Year Ahead

More than a year into their respective roles, SEC Chair Gary Gensler and Director of the Division of Enforcement (the "Division") Gurbir Grewal continue to push an expansive enforcement agenda focused primarily on financial institutions and private funds. In the third quarter of 2022, Chair Gensler, Director Grewal and others at the SEC emphasized that the upcoming year would include a continued focus on digital assets, gatekeeper liability and accountability in an effort to restore the public trust in financial markets and regulation.

In July, Director Grewal testified before Congress in support of the SEC's FY 2023 budget request. At the outset, Director Grewal pointed to a perception that the public currently has historically low trust in America's financial markets and institutions. He testified that the SEC hopes to enhance trust through "robust enforcement, robust remedies, and robust compliance."[1] By using SEC enforcement actions, Grewal stated that the SEC believes it can restore faith in America's regulators and show that all market participants play by the same set of rules — regardless of size or influence.

In support of its budget requests, the presentation highlighted the SEC's recently expanded Crypto Assets and Cyber Unit, which added 20 new positions. Director Grewal explained that since 2017, the Crypto Assets and Cyber Unit (formerly named the "Cyber Unit") has brought more than 80 enforcement actions related to fraudulent and unregistered crypto asset offerings and platforms, resulting in monetary relief totaling more than $2 billion. The Crypto Assets and Cyber Unit has also brought actions against SEC registrants and public companies for failing to maintain adequate cybersecurity controls and appropriately disclose cyber-related risks and incidents. Moving forward, Director Grewal explained that the bolstered unit could bring a wider variety of investigations and potential enforcement actions that focus on crypto asset offerings and intermediaries, including decentralized finance ("DeFi") platforms, non-fungible tokens ("NFTs") and stablecoins.

Grewal also emphasized a continued focus on gatekeeper accountability. Grewal specifically referenced the SEC's recent $100 million settlement with Ernst & Young LLP involving allegations that the company withheld evidence that many of its audit professionals cheated on Certified Public Accountant licensing exams.[2] Commissioner Hester Peirce also recently wrote in support of a settled administrative proceeding against a chief compliance officer ("CCO") where she emphasized holding gatekeepers or other supervisors accountable for abusing or misusing their positions.[3] Commissioner Peirce explained that, in the case at issue, the CCO was charged with aiding, abetting and causing the investment adviser's violations of Rules 206(4) and 206(4)-7 of the Investment Advisers Act, the CCO had opportunities to improve the compliance program but did not do so despite frequent reminders that the program was not working effectively. Commissioner Peirce added that the resolution was appropriate because the CCO's liability was based on his personal missteps and not general failings of the firm or others. In short, the Division will continue to open investigations and pursue enforcement to ensure accountants, attorneys and compliance officers fulfill their professional responsibilities and continue to serve as the first lines of defense against potential misconduct.

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[1] *See generally*, Gurbir S. Grewal, *Testimony on "Oversight of the SEC's Division of Enforcement" Before the United States House of Representatives Committee on Financial Services Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets,* July 21, 2022, available here.

[2] *Ernst & Young, LLP*, Exchange Act Release No. 95167, June 28, 2022, available here.

[3] *See generally*, Hester M. Peirce*, Chief Compliance Officer Liability: Statement on In the Matter of Hamilton Investment Counsel LLC and Jeffrey Kirkpatrick*, July 1, 2022, available here.

Notably, Director Grewal suggested that while the Division will continue to recommend the customary no-admit-no-deny settlements in most cases, it will begin seeking actual admissions in cases "where heightened accountability and acceptance of responsibility are in the public interest."[4] Sanjay Wadhwa, Deputy Director of Enforcement, recently echoed this sentiment at the SEC Speaks conference in September while referencing the Commission's settled action with J.P. Morgan Securities ("JPMS"). JPMS formally admitted that it failed to maintain and preserve written communications, including text messages, which were subject to statutory and regulatory recordkeeping requirements. Deputy Director Wadhwa acknowledged that this type of enforcement action "delivers much-needed public accountability."[5]

Finally, Grewal discussed the need for all market participants to share responsibility for robust compliance that is relevant to rapid technological change. In particular, he implored public companies to consider "how their specific business models and products interact with both emerging risks and their obligations under the federal securities laws" and to tailor their compliance practices and policies accordingly.[6] He cautioned that the Division will continue to promote robust compliance through the vigorous enforcement of laws and rules concerning "required disclosures, misuse of nonpublic information, cybersecurity, and the violation of record-keep obligations."[7]

Addressing the Digital Elephant in the Room

In September, invoking the words of the SEC's first chairman, Joseph Kennedy, that "[n]o honest business need fear the SEC," Chair Gensler addressed concerns about the SEC's approach to digital assets.[8] He emphasized that the core principles of the SEC's regulatory framework "apply to all corners of the securities markets" — regardless of underlying technologies — and that "[n]othing about the crypto markets is incompatible with the securities laws."[9]

Concerning crypto tokens, Gensler expanded on some of his previous statements by asserting that "the vast majority are securities."[10] He supported this belief by appealing to U.S. Supreme Court jurisprudence: first, by quoting Justice Thurgood Marshall who said that the definition of a security was painted by Congress "with a broad brush" in *Reves*; [11] and, then, by referencing the decades old test for determining what is an investment contract— one of the categories of a "security"— memorialized in *Howey*.[12] Gensler opined that "most crypto tokens are investment contracts under the *Howey* Test" because, generally, the investing public is buying or selling them with an expectation of profits derived from the efforts of others.[13] In short, Chair Gensler emphasized that courts disregard form and labels in favor of economic reality when assessing potential securities — and that digital asset market participants should take the same expansive view. According to Gensler, the same facts-and-circumstances

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[4] *Supra* note 1.

[5] *See* Sanjay Wadhwa, *Remarks at SEC Speaks*, Sept. 9, 2022, available here.

[6] *Supra* note 1.

[7] *Id.*

[8] *See* Gary Gensler, *Kennedy and Crypto*, Sept. 8, 2022, available here.

[9] *Id.*

[10] *Id.*

[11] *Reves v. Ernst & Young*, 494 U.S. 56, 60, 110 S. Ct. 945, 949, 108 L. Ed. 2d 47 (1990).

[12] *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 297, 66 S. Ct. 1100, 1102, 90 L. Ed. 1244 (1946).

[13] *Supra* note 8.

analysis should apply to stablecoins, because "[d]epending on their attributes . . . they may be shares of a money market fund or another kind of security."[14]

Both Chair Gensler and Director Grewal disputed criticisms that the SEC is not providing enough digital asset guidance and is instead stifling innovation in the crypto space through regulation by enforcement. Gensler contended that the Commission has spoken with a "pretty clear voice" for the past five years, referencing the DAO Report, the Munchee Order and its many Enforcement actions. Without mincing words, the Chairman stated that "[n]ot liking the message isn't the same thing as not receiving it."[15] Taking his turn at addressing the "digital elephant in the room," Grewal contended that critics seem to be upset, not because the SEC is unfairly targeting cryptocurrency and related products to the exclusion of other products or markets, but because the Commission is "not giving crypto a pass from the application of well-established regulations and precedents."[16] Even if the SEC is starting from a position of "well-established regulations and precedents," the SEC is applying those "well-established regulations and precedents" to products, technologies, and practices likely beyond anything envisioned by the court in *Reves* and *Howey*.

[14] *Id.*

[15] *Id.*

[16] Gurbir S. Grewal*, Remarks at SEC Speaks 2022*, Sept. 9, 2022, available here.

Enforcement of Prophylactic Rules Could Signal Renewed Focus on "Broken Windows"

In September 2022, the SEC announced a flurry of settled proceedings for violations of highly technical and prophylactic rules in matters that involved non-fraudulent conduct without any alleged investor loss. Private fund managers should take note of the SEC's apparent enforcement focus on these "smaller" violations that could be part of an enforcement strategy of deterring "bigger" violations of the securities laws.

Experienced advisers and practitioners in the private fund space will recall the SEC's "broken windows" enforcement policy that former SEC Chair Mary Jo White announced in 2013.[17] Under that policy, the SEC's Enforcement Division pursued and punished even the smallest infractions of the securities laws in an effort to deter more serious violations of the securities laws — e.g., those involving fraud and/or substantial investor loss — and to prevent fostering an environment of indifference to securities regulations.[18] Indeed, under former Chair White, the Enforcement Division sought to "pursue all types of wrongdoing. Not just the biggest frauds, but also violations such as control failures, negligence-based offenses, and even violations of prophylactic rules with no intent requirement."[19] Under the Trump Administration, however, the SEC signaled that it would no longer pursue a "broken windows" enforcement strategy, focusing instead on "intentional wrongdoing that results in losses for investors."[20]

While current Chair Gensler has not publicly stated a policy of "broken windows" enforcement, the SEC's recent announcements of settled proceedings involving alleged violations of the highly technical and/or prophylactic Custody and Pay-to-Play Rules—the violations of which require no intent — suggest that a renewed pursuit of "broken-window" infractions is well underway.

SEC Charges Advisory Firms for Custody Rule and Form ADV Violations

On Sept. 9, 2022, following a targeted sweep by its Divisions of Examinations and Enforcement, the SEC announced settled enforcement actions against nine private fund advisers.[21] The SEC settled allegations with (1) two firms for their alleged failure to timely disseminate audited financial statements to private fund investors, in violation of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder (the "Custody Rule");[22] (2) one firm for its alleged failure to timely update its Form ADV disclosures to reflect receipt of audited financial statements for private funds it advises, as required by Section 204(a) of the Advisers Act and Rule 204-1(a) thereunder;[23] and (3) six firms for

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[17] *See* Former Chair Mary Jo White, *Remarks at the Securities Enforcement Forum*, Oct. 9, 2013, available here.

[18] *Id.* ("[M]inor violations that are overlooked or ignored can feed bigger ones, and, perhaps more importantly, foster a culture where laws are increasingly treated as toothless guidelines.").

[19] *See id.*

[20] *See* Dave Michaels, *SEC Signals Pullback from Prosecutorial Approach to Enforcement* (The Wall Street Journal, Oct. 26, 2017 6:00 PM ET), available here.

[21] *SEC Charges Two Advisory Firms for Custody Rule Violations, One Firm for Form ADV violations, and Six Firms for Both*, SEC Press Release No. 2022-156, Sept. 9, 2022, available here.

[22] 17 C.F.R. § 275.206(4)-2; *see Janus Henderson Investors US LLC*, Advisers Act Release No. 6114, Sept. 9, 2022, available here; *Polaris Equity Management, Inc.*, Advisers Act Release No. 6115, Sept. 9, 2022, available here.

[23] *See* 17 C.F.R. § 275.204-1(a); *see also QVR, LLC*, Advisers Act Release No. 6116, Sept. 9, 2022, available here.

their alleged violations of both the Custody Rule and Rule 204-1(a).[24] The settlements included combined civil penalties of more than $1 million.[25]

Alleged Custody Rule Violations

Among other things, the Custody Rule requires all advisers with custody of client assets to: (1) ensure that a qualified custodian maintains clients' assets; (2) notify clients in writing of accounts opened on their behalf by the adviser at a qualified custodian; (3) have a reasonable basis for believing that the qualified custodian sends account statements at least quarterly to clients (or in the case of private funds, a fund's limited partners); and (4) ensure that client funds and securities are verified by a surprise examination conducted annually by an independent public accountant.[26] However, the Custody Rule provides private fund advisers with an exception from complying with the Rule's notification, statement delivery and surprise examination requirements so long as private fund advisers: (1) ensure annual audited financial statements for any private fund client are prepared in accordance with U.S. Generally Accepted Accounting Principles by an independent public accountant that is registered with, and subject to inspection by, the Public Company Accounting Oversight Board; and (2) distribute audited financial statements to each fund's investors within 120 days of the fund's fiscal year end (180 days for funds of funds) (the "Audit Exception").[27]

Six of the nine firms that settled charges with the SEC failed to timely deliver annual audited financial statements to investors in their private fund clients in accordance with the Audit Exception.[28] Accordingly, they could not rely on the Audit Exception. The firms therefore were obligated to comply with the Custody Rule's notification, delivery and surprise examination requirements, which they had failed to do.

Alleged Rule 204-1(a) / Form ADV Violations

Section 204(a) of the Advisers Act and Rule 204-1(a) thereunder require advisers to amend their Form ADVs at least annually, and more frequently as required by the Form ADV instructions.[29] Form ADV, Part 1A, Schedule D, Section 7.B.23.(h) requires an adviser to report whether all of the audit reports prepared by the auditing firm for the relevant private fund since the adviser's last annual amendment contain unqualified opinions, with the option to check "Yes," "No," or "Report Not Yet Received." When an adviser files its annual Form ADV amendment and has checked "Report Not Yet Received," the instructions for that item state that the adviser must promptly file an amendment to Form ADV to update their response once the auditor's report is available.

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[24] *See BiscayneAmericas Advisers L.L.C.*, Advisers Act Release No. 6119, Sept. 9, 2022, available here; *Garrison Investment Group LP*, Advisers Act Release No. 6113, Sept. 9, 2022, available here; *Lend Academy Investments, LLC*, Advisers Act Release No. 6118, Sept. 9, 2022, available here; *Ridgeview Asset Management Partners, LLC*, Advisers Act Release No. 6117, Sept. 9, 2022, available here; *Steward Capital Management, Inc.*, Advisers Act Release No. 6111, Sept. 9, 2022, available here; *Titan Fund Management, LLC*, Advisers Act Release No. 6112, Sept. 9, 2022, available here.

[25] Penalties ranged from $50,000 for failure to timely deliver audited financial statements to certain fund investors or failure to timely amend Form ADV to $330,000 for failure to have independent audits performed, failure to timely deliver audited financial statements and failure on several occasions to timely amend Form ADV to reflect an adviser's receipt of audited financial statements.

[26] 17 C.F.R. § 275.206(4)-2(a)(1)-(5).

[27] 17 C.F.R. § 275.206(4)-2(b)(4).

[28] The SEC cited late delivery of audited financial statements to investors in eight of the nine settlement orders but did not indicate specific facts and circumstances with respect to late delivery in all cases. Note that existing Staff guidance provides some comfort where an adviser reasonably believed the audited financial statements would be delivered timely but were not due to unforeseeable circumstances. *See Staff Responses to Questions About the Custody Rule*, Question VI.9 (modified April 27, 2020), available here. Advisers faced with potential delays in delivering audited financial statements should promptly assess the circumstances and take appropriate action where necessary.

[29] 17 C.F.R. § 275.204-1(a).

Six of the firms that settled with the SEC had checked "Report Not Yet Received" on their annual Form ADV amendments and subsequently received audit opinions for their private fund clients. But they then allegedly failed to file amended Form ADVs for several months or, in certain instances, until they filed their next annual updating amendments in violation of Section 204(a) and Rule 204-1(a).[30]

In light of these settled enforcement proceedings, private fund managers relying on the Audit Exception should confirm that their policies and procedures are reasonably designed to ensure that audited financial statements are prepared and delivered in a timely manner and otherwise consistent with the Custody Rule's requirements. Policies and procedures should also effectively address managers' obligations to promptly and accurately amend their Form ADV filings when required, including with respect to Form ADV, Part 1A, Schedule D, Section 7.B.23.(h).[31]

SEC Charges Advisory Firms For Pay-To-Play Violations

One week after announcing the non-scienter-based Custody Rule and/or Form ADV violations by nine investment advisers, the SEC announced settled enforcement actions against four advisers for violating Section 206(4) of the Advisers Act and Rule 206(4)-5 thereunder (the "Pay-to-Play Rule").[32]

Among other things, the Pay-to-Play Rule prohibits advisers from providing investment advisory services for compensation to a government entity within two years after the adviser or one of its "covered associates"[33] makes a contribution to an "official"[34] of the government entity. Compliance with the Pay-to-Play Rule requires a high degree of care because the technical requirements of the rule are very specific and intent is irrelevant — i.e., it is a strict liability provision.

In all four of the settled cases, political contributions of $1,000 or less by covered associates of investment advisers mandated a two-year "time-out" from receiving fees from pension plans invested in funds managed by the advisers because the recipients of the contributions were "officials" of the pension plans. Notably, in each of the cases, the investment adviser had established an advisory relationship with the pension plan prior to their covered associates' contributions, which one would think limits any concern of a quid pro quo arrangement whereby a contribution is

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[30] A seventh adviser did not properly describe the status of its financial statement audits when filing its Form ADV and then failed to update its response in its Form ADV annual amendment for multiple years.

[31] *See also* Schulte Roth & Zabel LLP, *SEC Custody Rule Update: Takeaways from Recent Enforcement*, Sept. 19, 2022, available here.

[32] 17 C.F.R. § 275.206(4)-5; *see In re Canaan Management,* LLC, Advisers Act Release No. 6126, Sept. 15, 2022, available here; *In re Asset Management Group of Bank of Hawaii*, Advisers Act Release No. 6127, Sept. 15, 2022, available here; *In re Highland Capital Partners, LLC*, Advisers Act Release No. 6128, Sept. 15, 2022, available here; *In re StarVest Asset Management, Inc*., Advisers Act Release No. 6129, Sept. 15, 2022, available here.

[33] A "covered associate" is:

(i) Any general partner, managing member or executive officer, or other individual with a similar status or function; (ii) Any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee; and (iii) Any political action committee controlled by the investment adviser or by any person described in paragraphs (f)(2)(i) and (f)(2)(ii) of this section.

17 C.F.R. § 275.206-4(f)(2).

[34] An "official" is:

any person (including any election committee for the person) who was, at the time of the contribution, an incumbent, candidate or successful candidate for elective office of a government entity, if the office: (i) [i]s directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity; or (ii) [h]as authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity.

17 C.F.R. § 275.206-4(f)(6).

made to influence the allocation of pension investments. In fact, in three of the cases, the investments by the pension plans were made *years before* the political contributions were made and the funds were closed-end funds with no redemption rights. And, in one case, the contributor was not a "covered associate" under the Rule at the time of contributing but became one within six months of the contribution and thus was subject to the "look-back" provision of Rule 206(4)-5(b)(2).[35]

Given this aggressive enforcement — and strict liability — it is critically important for investment advisers to maintain robust policies and procedures designed to prevent improper contributions by their "covered associates." Moreover, violations of the Pay-to-Play Rule are easily detected by the Staff due to the increasing public availability of information about many political contributions. While the Pay-to-Play Rule provides for an exception to the two-year "time out" for returned contributions, this exception is only available when the contribution has been discovered within four months of being made, is less than $350 and is returned within 60 calendar days from the date of discovery.

During election cycles, it is particularly important for investment advisers, including exempt reporting advisers, to focus on compliance with the Rule. Advisers also should keep in mind that contributions to candidates for federal office who otherwise would not be covered by the Pay-to-Play Rule may be covered if the candidate is currently a state officeholder at the time of the contribution. Additionally, contributions to PACs, political parties and other committees require heightened diligence with respect to the ultimate recipient of the funds.[36] Advisers should conduct periodic training and consider pre-clearance of all political contributions — irrespective of the recipient or the amount — each of which helps prevent contributions that might cause an adviser to run afoul of the Pay-to-Play Rule.[37]

None of the alleged violations of the Custody Rule, Rule 204-1(a), or the Pay-to-Play Rule involved allegations of fraud, theft, loss of client assets or any other potential wrongdoing by the advisory firms. The settlements serve as a strong reminder to private fund managers that the SEC views violations of these technical and prophylactic rules not as mere technical deficiencies but rather as broken, or at least cracked, windows that must be pursued and punished.

[35] *See* 17 C.F.R. § 275.206-4(b)(2) ("The prohibitions of . . . this section shall not apply to an investment adviser as a result of a contribution made by a natural person more than six months prior to becoming a covered associate of the investment adviser unless such person, after becoming a covered associate, solicits clients on behalf of the investment adviser.").

[36] A contribution to a PAC, political party or other committee does not necessarily trigger the two-year "time-out" under the Pay-to-Play Rule unless it is a means to do indirectly what the rule prohibits if done directly (e.g., the contribution is earmarked or known to be provided for the benefit of a particular political official). *See* Political Contributions by Certain Investment Advisers, Advisers Act Release No. 3043, 75 Fed. Reg. 41017, 41030 n. 154 (July 14, 2010); SEC Staff, "Staff Responses to Questions About the Pay to Play Rule," Question II.5, available here. Therefore steps must be taken to ensure that the allocation of such contribution is not for the benefit of an otherwise prohibited recipient. In addition, the Pay-to-Play Rule prohibits advisers and their "Covered Associates" from *coordinating or soliciting any person* (including a non-natural person) or PAC to make any payment to a political party of a state or locality where the investment adviser is providing or seeking to provide investment advisory services to a government entity. *See* Rule 206(4)-5(a)(2)(ii); SEC Staff, "Staff Responses to Questions About the Pay to Play Rule," Question V.3, available here.

[37] *See also* Schulte Roth & Zabel LLP, *SEC Pay-to-Play Rule Update: Recent SEC Enforcement Activity and What it Means for the November Midterms*, Sept. 21, 2022, available here.

Sixteen Wall Street Firms to Pay $1.1 Billion in Combined Penalties to Settle SEC Charges of Widespread Recordkeeping Violations

A new flurry of enforcement activity during the third quarter kept the spotlight on an industry-wide concern regarding the use of unapproved electronic communications platforms and subsequent recordkeeping violations. On Sept. 27, 2022, the SEC announced settled administrative enforcement proceedings against 15 broker-dealers and one registered investment adviser (together, the "Charged Firms") for widespread and longstanding violations of recordkeeping requirements under federal securities laws as well as violations of the firms' own policies.[38] Eight broker-dealers and five of their affiliates, including an investment adviser, each agreed to pay a penalty of $125 million, either alone or together with their affiliate(s). Two broker-dealers settled for a penalty of $50 million and another agreed to pay a $10 million penalty.

Background

These settlements follow on the heels of the Commission's December 2021 settlement order with JP Morgan Securities LLC and involve similar allegations of widespread recordkeeping violations by firm personnel for their use of unapproved electronic communication platforms.[39] According to the orders, from at least January 2018 through September 2021, employees of the Charged Firms regularly communicated about substantive business matters via personal text messages or other text messaging platforms, such as WhatsApp, on their personal devices.[40] The majority of these written "off-channel communications" were not maintained or preserved by the Charged Firms, as required by Section 17(a) of the Exchange Act and Section 204 of the Advisers Act.

According to the SEC's allegations, the use of unapproved off-channel communications was not limited to junior employees. The SEC alleged that supervisors, including Managing Directors, also sent and received off-channel communications using their personal devices. Many of these supervisors themselves were tasked with implementing and ensuring compliance with the firms' electronic communications policies.

The SEC maintained that the firms' recordkeeping failures likely hindered the Commission's ability to carry out its regulatory responsibilities and investigate potential violations of the securities laws.[41] The orders stated that SEC staff uncovered the firms' misconduct after commencing a risk-based initiative to investigate the use of off-channel and unpreserved electronic communications at Wall Street firms.

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[38] *SEC Charges 16 Wall Street Firms with Widespread Recordkeeping Failures*, SEC Press Release No. 2022-174, Sept. 27, 2022, available here.

[39] *See 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; *In the Matter of J.P. Morgan Securities LLC*, Exchange Act Release No. 93807, Dec. 17, 2021, at 2, available here.

[40] *Barclays Capital Inc.*, Exchange Act Release No. 95919, available here, at 2; *Citigroup Global Markets Inc.*, Exchange Act Release No. 95920, available here, at 2; *BofA Securities, Inc. and Merrill Lynch*, Exchange Act Release No. 95921, available here, at 2; *Goldman Sachs & Co. LLC*, Exchange Act Release No. 95922, available here, at 2; *Jefferies LLC*, Exchange Act Release No. 95923, available here, at 2; *Morgan Stanley & Co. LLC, et al.*, Exchange Act Release No. 95924, available here, at 2; *Nomura Securities International, Inc.*, Exchange Act Release No. 95925, available here, at 2; *Credit Suisse Securities (USA) LLC*, Exchange Act Release No. 95926, available here, at 2; *Cantor Fitzgerald & Co.*, Exchange Act Release No. 95927, available here, at 2; *Deutsche Bank Securities Inc., et al.*, Advisers Act Release No. 6153, available here, at 2; *UBS Financial Services, Inc., et al.*, Exchange Act Release No. 95929, available here, at 2.

[41] *See, e.g.*, *Barclays Capital Inc.*, at 2; *Cantor Fitzgerald & Co.*, at 6-9.

Violations

The 15 broker-dealers were charged with violating Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder, as well as Section 15(b)(4)(E) of the Exchange Act. The SEC reiterated that the rules adopted under Section 17(a)(1) of the Exchange Act, including Rule 17a-4(b)(4), require that broker-dealers preserve, in an easily accessible place, originals of all communications received and copies of all communications sent relating to the firm's business. The rules impose minimum recordkeeping requirements that are based on standards a prudent broker-dealer should follow in the normal course of business. As a result of the firms' employees' alleged off-channel communications on personal devices, the charged broker-dealers were found to have violated Rule 17a-4(b)(4).

Moreover, the Commission maintained that the firms' failure to implement their policies and procedures that prohibit such off-channel communications led to the failures to reasonably supervise their employees, with a view to preventing or detecting employees' aiding and abetting violations of Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder, within the meaning of Section 15(b)(4)(E) of the Exchange Act.

Deutsche Bank AG's indirect subsidiary, DIMA, was the only registered investment adviser charged in this round of proceedings. The SEC alleged that DIMA violated Rule 204-2(a)(7) adopted under Section 204 of the Advisers Act. Like Rule 17a-4(b)(4) adopted under the Exchange Act, Rule 204-2(a)(7) requires registered investment advisers to preserve, in an easily accessible place, originals of all written communications received and copies of all written communications sent relating to, among other things, any investment recommendation made or proposed to be made and any advice given or proposed to be given. DIMA also allegedly violated Section 203(e)(6) of the Advisers Act, due to its failure to reasonably to supervise its employees with a view to preventing or detecting certain of its employees' aiding and abetting violations of Section 204 of the Advisers Act and Rule 204-2(a)(7) thereunder.

Remedial Steps

In its orders, the SEC outlined the remedial steps that the Charged Firms undertook in response to the allegations. The Commission found that all Charged Firms "enhanced [their] policies and procedures, and increased training concerning the use of approved communications methods, including on personal devices, and began implementing significant changes to the technology available to employees."[42] In addition, the Charged Firms undertook to retain compliance consultants who will conduct a comprehensive review of (1) relevant policies and procedures, (2) trainings conducted, (3) surveillance program measures implemented, (4) technological solutions, (5) measures to prevent business communications over unauthorized channels, and (6) the framework adopted by the firms to address non-compliance. The consultants also are to reassess the Charged Firms' programs for the preservation of electronic communications in one year. And all of the Charged Firms undertook to notify the SEC regarding disciplinary measures imposed against employees found to have violated the firms' policies and procedures concerning the preservation of electronic communications.

Most notably, in the orders related to Morgan Stanley, Deutsche Bank and their affiliates — and only those two orders—the SEC credited past specific remedial and "disciplinary efforts" by the firms with respect to employees who violated policies prohibiting off-channel business communications.[43] The SEC was sure to acknowledge these "significant remedial steps to reduce the risk of the misconduct recurring."[44] In Deutsche Bank's case, these steps

[42] *See, e.g.*, *Barclays Capital Inc.*, at 6; *Cantor Fitzgerald & Co.*, at 6.

[43] *Deutsche Bank Securities Inc., et al.*, at 6; *Morgan Stanley & Co. LLC, et al.*, at 6.

[44] *Deutsche Bank Securities Inc., et al.*, at 6.

included, among others, widely providing specifically focused training; clear mandates from senior management; enhanced surveillance; swift employment action for off-channel communications, including compensation and promotion impacts, and termination; and significant investments in new technologies.[45] Morgan Stanley had conducted internal investigations regarding policy violations and, in some cases, "collected data from personal devices, before applying a disciplinary framework that led to penalties, including financial penalties, written warnings, and termination of employment."[46] Morgan Stanley also implemented additional trainings and technological improvements. The Commission considered such disciplinary efforts by those firms as additional cooperation afforded to the Staff.

Takeaways

If it was not clear enough already, registered investment advisers and broker-dealers should assess, or reassess, their policies and procedures with respect to off-channel business communications in light of these charges and the SEC's increased enforcement of recordkeeping rules. Compliance personnel need to implement an effective supervisory system that will ensure reasonable oversight of employees, and compliance with the SEC's recordkeeping requirements as well as the firms' own electronic communications policies and procedures. Investment advisers and broker-dealers should also keep in mind that a one-size-fits-all approach to the preservation of electronic records may not work; preservation notices and policies ought to be tailored to the pervasiveness of the off-channel business communications, and the platforms at issue.

[45] *Id.*

[46] *Morgan Stanley & Co. LLC, et al.*, at 6.

Recent Enforcement Actions[47]

Investment Adviser Enforcement Actions

A. Unsuitable Recommendations and Failure to Supervise: *In re Aegis Capital Corp.*[48]

Failure to develop reasonable policies and procedures and the failure to enforce existing policies leads to securities laws violations. On July 28, 2022, the SEC announced a settled administrative enforcement proceeding against Aegis Capital Corp. ("Aegis"), an investment adviser and a broker-dealer, concerning certain Aegis Registered Representatives ("Aegis RRs") making unsuitable recommendations of "highly-complex variable interest rate structured products" ("VRSPs") and failing to supervise Aegis RRs.

In its Order, the SEC finds that from January 2015 through May 2019, Aegis – through its Aegis RRs – recommended VRSPs to 48 customers for whom these securities were unsuitable in light of the customers' respective financial situation and needs. In July 2017, Aegis began requiring brokers to only recommend VRSPs to customers who did not have "High" or "Maximum" risk tolerances. Despite this new policy, none of the subsequent customers who purchased VRSPs aligned with this risk tolerance designation. Additionally, Aegis, failed to develop reasonable policies and procedures to prevent and detect Aegis RRs' conduct, and failed to make and keep current required broker-dealer records.

The SEC's Order finds that Aegis violated Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 (the "Securities Act"), and Section 17(a)(1) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rules 17a-3(a)(17)(i)(B)(1) and 17a-3(a)(17)(i)(B)(3) thereunder. Aegis was censured, ordered to cease and desist from committing any further securities laws violations and ordered to pay disgorgement of $165,828 plus prejudgment interest of $55,037, and a civil penalty of $2.3 million.

B. Inaccurate Disclosures: *In re Angel Oak Capital Advisors, LLC and Ashish Negandhi*

SEC charges investment adviser with inaccurate disclosures on novel fix-and-flip residential mortgage loans. On Aug. 10, 2022, the SEC announced a fully settled administrative enforcement proceeding against Angel Oak Capital Advisors, LLC ("Angel Oak") and Ashish Negandhi, a senior portfolio manager for Angel Oak, for the inaccurate disclosure of mortgage delinquency rates in connection with the securitization of residential mortgage loans.[49]

In its Order, the SEC finds that Angel Oak raised $90 million from investors in connection with the securitization of a pool of "fix and flip" residential mortgage loans. In light of increased delinquent mortgage payments, which threatened to breach an early amortization trigger in the securitization, Angel Oak diverted mortgage loan funds held in escrow accounts — LIP accounts — to make payments on borrowers' delinquent mortgages. LIP accounts were intended to reimburse borrowers for expenses related to renovating the mortgaged properties. The use of LIP

[47] The enforcement proceedings described below are based on allegations by the SEC, DOJ, FINRA or CFTC 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.

[48] *Aegis Capital Corp.*, Advisers Act Release No. 6076, July 28, 2022, available here.

[49] *Angel Oak Capital Advisors, LLC and Ashish Negandhi*, Advisers Act Release No. 6084, Aug. 10, 2022, available here.

account funds to reduce the appearance of delinquencies was inconsistent with Angel Oak's disclosures to investors. With respect to Ashish Negandhi, the Order finds that, in his role as portfolio manager, he was aware of Angel Oak's use of LIP account funds to cover delinquent payments, and failed to ensure that proper disclosures were made.

The SEC's Order finds that Angel Oak and Negandhi had violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 206(2) of the Investment Advisers Act of 1940 ("Advisers Act"). Angel Oak agreed to pay a penalty of $1.75 million, Negandhi agreed to pay a penalty of $75,000, and both defendants agreed to be censured.

C. Insufficient Policies and Procedures: *In re Arcadia Wealth Management, Inc.* and *In re Matthew W. Dreyer, CPA*

The SEC is policing investment advisory firms' compliance with the requirement that they obtain independent verification of client funds and securities through surprise examinations, and maintain policies and procedures to adequately supervise vendors. On Sept. 19, 2022, the SEC filed a settled administrative proceeding against Arcadia Wealth Management, Inc. ("Arcadia") for failure to comply with the Advisers Act requirement that it independently verify client funds and securities through surprise examinations, and for failure to adopt and implement policies and procedures designed to prevent Advisers Act violations relating to client accounts over which it had custody.[50]

In its Order, the SEC finds that Arcadia failed to obtain surprise examinations for certain accounts over which it had custody. Specifically, Arcadia was required to obtain a surprise examination for certain trusts and client credential accounts beginning as early as 2013, yet Arcadia only first asked an accountant in March 2018 to perform a surprise examination. However, Arcadia ultimately failed to obtain the surprise examination. For these failures, the SEC also finds that Arcadia failed to adopt and implement written policies and procedures that were reasonably designed to prevent violations of the independent examination requirement.

The Order finds that Arcadia violated Advisers Act Section 206(4) and Rules 206(4)-2 and 206(4)-7 thereunder. For these violations, Arcadia agreed to cease and desist from future violations of these provisions, pay a civil penalty of $90,000, and be censured.

On Sept. 19, 2022, the SEC initiated settled administrative proceedings against Matthew W. Dreyer ("Dreyer"), a New York licensed CPA, for his involvement in Arcadia's surprise examination violations. In its Order, the SEC finds that Dreyer was the accountant that Arcadia initially reached out to in 2018 to perform the surprise examination, to which he agreed without a written agreement. Dreyer, however, failed to conduct the examination and submitted to the SEC a false surprise examination report that contained various misrepresentations about an examination he never conducted. When asked by Arcadia about the report, Dreyer claimed that he completed the report in July 2018, which was false. The SEC finds that Dreyer violated Exchange Act Section 4C and Rule 102(e)(1)(ii) of the SEC's Rules of Practice. Dreyer agreed to a suspension from appearing or practicing as an accountant before the SEC for five years.[51]

[50] *Arcadia Wealth Management, Inc.*, Advisers Act Release No. 6137, Sept. 19, 2022, available here.

[51] *Matthew W. Dreyer, CPA*, Exchange Act Release No. 95833, Sept. 19, 2022, available here.

D. Misrepresentations About Fund Performance: *SEC v. Lindell*

Advisory firm managers will be held liable for fraudulent schemes to misrepresent and overvalue a mutual fund's and a hedge fund's performance where the manager fails to exercise reasonable care and undertake an appropriate investigation. On Sept. 30, 2022, the SEC filed a settled civil injunctive action (the "Complaint"), subject to court approval, charging Scott Lindell ("Lindell")—the former Chief Risk Officer ("CRO"), head of operations, Chief Compliance Officer ("CCO") and portfolio manager of Infinity Q Capital Management LLC ("Infinity Q")—with negligent conduct relating to a fraudulent scheme allegedly orchestrated by James Velissaris ("Velissaris") — founder and former Chief Investment Officer of Infinity.[52]

The SEC's Complaint alleges that between February 2017 and February 2021, Velissaris manipulated a third-party pricing service's valuation models and altered inputs for the model to conceal an Infinity fund client's actual performance. The scheme inflated the client's net asset values, which attracted additional investors and garnered Velissaris performance and management fees. The Complaint alleges that Lindell, in his various roles at Infinity Q, failed to exercise reasonable care or undertake an investigation of Velissaris' activity despite various red flags, negligently made misrepresentations to investors, and negligently helped Velissaris submit misleading documents.

The Complaint alleges that Lindell violated Advisers Act Sections 206(2), (4), 207, and Rule 206(4)-(8) thereunder; Securities Act Sections 17(a)(2) and (3); and Exchange Act Rule 13b2-2. The Complaint also alleges that Lindell aided and abetted Infinity Q's violations of Advisers Act Sections 204(a), 206(4), and Rules 204-2 and 206(4)-7 thereunder. Lindell agreed to a permanent injunction from violating the alleged provisions. Imposition of disgorgement with prejudgment interest, civil penalties and an officer and director ban will be determined by the Court at a later date.

Previously, on Feb. 17, 2022, the Department of Justice charged Velissaris with securities fraud and obstruction of justice,[53] and the SEC commenced a civil action against Velissaris for violating the anti-fraud provisions of various securities laws based on his above-described conduct.[54]

[52] Complaint, *SEC v. Lindell*, No. 1:22-cv-08368 (S.D.N.Y. Sept. 30, 2022), available here.

[53] *Founder and Former Chief Investment Officer of New York Based Investment Adviser Charged With Securities Fraud and Obstruction of Justice*, DOJ Press Release (Feb. 17, 2022), available here.

[54] Complaint, *SEC v. Velissaris*, 1:22-cv-01346 (S.D.N.Y. Feb. 17, 2022), available here.

Broker-Dealer Enforcement Actions

A. Failure To Adequately Implement AML Compliance Programs Is an Ongoing Concern

FINRA continues to bring actions against broker-dealers for failing to adequately implement AML compliance programs. FINRA brought several actions this quarter, each resulting in settlements through a Letter of Acceptance, Waiver and Consent ("AWC"). Three of these actions are briefly summarized below.

- *In re Glendale Securities, Inc.*[55] Respondent failed to develop and implement an AML compliance program reasonably designed to detect and report suspicious transactions. Specifically, the firm lacked reasonable written procedures for surveilling suspicious trading activity and unreasonably relied primarily on a manual review of a limited daily trade blotter. As a consequence of this conduct, Glendale allowed a customer to deposit millions of shares of low-priced securities into more than 50 foreign corporate accounts, immediately liquidate them, and then wire the proceeds to multiple foreign bank accounts. The AWC finds that Glendale violated FINRA Rules 3310(a) and 2010. It orders a censure, that Glendale retain an independent consultant to review its AML program, and a $50,000 fine.
- *In re MM Global Securities, Inc.*[56] Respondent failed to establish and implement an AML compliance program reasonably designed to detect and cause the reporting of suspicious activity and failed to establish and maintain written procedures that were reasonably designed to achieve compliance with federal securities laws between January 2019 to June 2020. Respondent also failed to implement its Customer Identification Program from October 2017 to April 2019 and failed to maintain instant messages and email communications of its registered representatives from November 2018 to August 2019. The AWC finds that MM Global violated FINRA Rules 3310(a) and (b), 3111, 4511 and 2010 and Exchange Act Section 17(a) and Rule 17a-4(b)(4) thereunder. It orders a censure, a $450,000 fine, and a prohibition on providing market access to customers for two years.
- *In re Vision Financial Markets LLC and Vision Brokerage Services, LLC.*[57] Respondents failed to establish and implement a reasonable AML program, to reasonably supervise for potentially manipulative trading, and to establish reasonable market access controls and procedures. Specifically, FINRA finds that Respondents' AML programs were not tailored to reasonably surveil suspicious trading and money movements through (i) exception reports, (ii) identification of relevant red flags for manipulative trading, or (iii) "watch lists" of high-risk clients. In addition to their insufficiently designed surveillances and procedures, respondents used a third-party vendor's automated system to generate suspicious trading alerts, but failed to reasonably review such alerts. The AWC finds that Respondents violated FINRA Rules 3310(a), (b) and 2010, and that Vision Financial further violated Exchange Act Section 15(c)(3) and Rule 15c3-5(b) and (c) thereunder. It orders a censure, a joint and several fine of $95,625, and an undertaking to retain an independent consultant with respect to their AML programs.

[55] *Glendale Securities, Inc.*, FINRA Letter of Acceptance, Waiver, and Consent No. 2019062351401, Sept. 9, 2022, available here.

[56] *MM Global Securities, Inc.*, FINRA Letter of Acceptance, Waiver, and Consent No. 2019062623001, Sept. 9, 2022, available here.

[57] *Vision Financial Markets LLC and Vision Brokerage Services, LLC*, FINRA Letter of Acceptance, Waiver, and Consent No. 2019061702701, Sept. 9, 2022, available here.

B. Record-Keeping Violations: *In re XP Investments US, LLC*

The improper installation of an introducing broker's audio recording system has led to a record-keeping enforcement action by the CFTC. On Sept. 23, 2022, the CFTC filed a settled administrative proceeding against XP Investments US, LLC ("XP") for failure to maintain audio records relating to executed commodities transactions.[58]

The CFTC finds that when XP moved its New York office in April 2019, its audio recording system was not installed properly, which caused inconsistent and incomplete audio call recordings during May and June 2019. As a registered introducing broker, XP was required to make and keep audio recordings concerning quotes, solicitations, bids, offers, instructions, trading and prices leading to the execution of commodity transactions for at least a year. XP's system only recorded some calls and none of the recording system's warnings were triggered to notify XP of the error. Upon discovering the issue, XP took steps to remedy the error.

In its Order the CFTC finds that XP violated Section 4g(a) of the Commodity Exchange Act and Commission Regulations 1.31(b)(2) and 1.35(a)(1)(iii). The CFTC is requiring XP to pay a $500,000 civil penalty and cease and desist from further violations of the charged provisions.

C. FINRA Charges Representative for Self-Interested Recommendations: *In re Donnie E. Ingram and Centaurus Financial, Inc., and In re Michael G. Seymour*

These FINRA filings demonstrate the strict stance FINRA takes on improper valuation of assets and/or conflicted investment recommendations against advisers, broker-dealers and those responsible for overseeing the adviser's activities. On Sept. 27, 2022, FINRA filed an administrative proceeding complaint (the "Complaint") against (1) Donnie E. Ingram ("Ingram")—a registered representative with Centaurus Financial Inc. and an investment adviser at his own SEC-registered investment advisory firm, Ingram Advisory Services, LLC ("IAS"), and (2) Centaurus Financial, Inc. ("Centaurus")—an independent broker-dealer. The conduct at issue in the Complaint stems from Ingram's alleged recommendations of Unit Investment Trusts ("UITs") and alternative investments to customers without a reasonable basis and Centaurus' alleged failure to reasonably supervise Ingram in doing so.[59]

In the Complaint, FINRA alleges that between September 2016 and September 2018 Ingram recommended and effected 595 customer purchases of standard version UITs across 83 customer brokerage accounts, causing customers to incur the full amount of transactional sales charges on all 595 purchases, instead of recommending fee-based UITs, which cost less. Similarly, FINRA alleges that during the relevant period Ingram recommended and purchased for nine customers real estate investment trusts ("REITs") and non-traded business development companies ("BDCs") from Bluerock Residential Growth REIT Inc. ("BRG") and MacKenzie Realty Capital, Inc. ("MAC"), respectively. BRG and MAC offered these alternative investments at a reduced cost if investors purchased them through investment advisers, yet Ingram elected not to enter into selling agreements with MAC and BRG through IAS to purchase the REITs and BDCs at the reduced rates. Instead, Ingram purchased the alternative investments

[58] *CFTC Charges New York Introducing Broker with Failing to Maintain Required Audio Recordings*, CFTC Press Release No. 8591-22, Sept. 23, 2022, available here.

[59] *Dep't of Enforcement v. Donnie E. Ingram CRD No. 1416971 and Centaurus Financial, Inc. CRD No. 30833*, FINRA Disciplinary Proceeding No. 2018057298701, Sept. 27, 2022, available here.

through Centaurus, which had a selling agreement that earned commission fees of up to seven percent, so that he could earn a commission.

The Complaint alleges that Ingram violated FINRA Rules 2111(a) and 2010, and that Centaurus failed to enforce its supervisory procedures by failing to conduct a reasonable supervisory review of Ingram's recommendations of UITs and alternative investments in violation of FINRA Rules 3110(a), (b), and 2010. For these violations, the Complaint requests that the Enforcement Panel order the imposition of sanctions (1) under FINRA Rule 8310(a), including disgorgement from Ingram and Centaurus, together with interest; and (2) under FINRA Rule 8330 for Ingram and Centaurus to bear the costs of the proceedings.

Additionally, on the same day it filed the Complaint, FINRA accepted an AWC from Michael G. Seymour ("Seymour")—the manager of Centaurus' Winter Haven, Florida branch office owned by Ingram and the Chief Operating Office and Chief Compliance Officer of IAS—for failing to reasonably supervise Ingram's recommendations and sales of UITs and alternative investments.[60] The AWC finds that Seymour violated FINRA Rules 3110(a), (b), and 2010. Seymour agreed to (1) a one-month suspension from associating with any FINRA member in any capacity; (2) a $10,000 fine; and (3) an undertaking within 90 days of the AWC to attend and satisfactorily complete 20 hours of continuing education concerning supervisory responsibilities.

D. FINRA Cracks Down on Failure-To-Deliver and Close Out Requirements: *In re Wedbush Securities, Inc.*

Failure to timely close out fail-to-deliver ("FTD") positions or place securities in the "penalty box" will trigger Regulation SHO violations. On Sept. 27, 2022, FINRA accepted an AWC from Wedbush Securities, Inc. ("Wedbush")—a FINRA member firm that trades securities on behalf of individuals and institutional clients—for failing to (1) timely close out fail-to-deliver positions, (2) place securities in the "penalty box," (3) comply with notice requirements of Regulation SHO Rule 204, and (4) establish and maintain a supervisory system reasonably designed to achieve compliance with Regulation SHO Rule 204.[61]

The AWC finds that during the periods of Jan. 1, 2016 through July 31, 2020 and Dec. 9, 2020 through April 7, 2021, Wedbush had FTDs, its automated system attempted to identify the FTDs and borrow/recall shares to close the trade out, but the automated system failed to acquire the shares. When this occurred, Wedbush staff was required to borrow, recall or buy-in shares and close out the FTD, but staff failed to do so in time to deliver them to the Continuous Net Settlement System ("CNS"). During the relevant periods this occurred about 2,056 times. Additionally, Wedbush failed on about 390 occasions to place into the penalty box a security in which it failed to obtain a close-out and to send the required notice that it had a position it had not closed out.

Furthermore, FINRA finds that during the relevant periods, Wedbush failed to establish and maintain a supervisory system, including written supervisory procedures ("WSPs"), reasonably designed to achieve compliance with Regulation SHO Rules 204(a) and (c). Specifically, Wedbush's WSPs did not provide sufficient instructions on how to manually close out FTDs when its automated system failed to borrow or recall shares, did not provide reasonable guidance on the required steps to execute buy-ins when the automated process failed, and did not effectively

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[60] *Michael G. Seymour*, FINRA Letter of Acceptance, Waiver, and Consent No. 2018057298702, Sept. 27, 2022, available here.

[61] *Wedbush Securities, Inc.*, FINRA Letter of Acceptance, Waiver, and Consent No. 2019061872201, Sept. 27, 2022, available here.

delegate responsibility for ensuring each FTD was closed out. FINRA finds that Wedbush was on notice of its system failures due to 2018 and 2019 exams from FINRA's Department of Member supervision.

The AWC finds that Wedbush violated Regulation SHO Rules 204(a), (b) and (c) and FINRA Rules 2010 and 3110. Wedbush agreed to a censure, $900,000 fine, half of which shall go to FINRA and the other half of which shall go to NYSE, NYSE American, NYSE Chicago and NYSE National, and an undertaking for Wedbush to submit, within 90 days of the AWC, a written certification by one or more of its principals and officers that its supervisory systems and written procedures are reasonably designed to achieve compliance with Regulation SHO Rules 204(a) and (c).

Other Enforcement Actions

A. Misleading Statements Results in Charges Against CEO: *In re Health Insurance Innovations, Inc., and Gavin D. Southwell*

The SEC continues to hold companies and their CEOs accountable for making misleading statements to investors. On July 20, 2022, the SEC announced a settled administrative enforcement proceeding against Health Insurance Innovations, Inc. ("HII") and CEO Gavin D. Southwell ("Southwell") for making false and misleading statements to investors by concealing consumer complaints about HII products. [62]

In its Order, the SEC alleged that, from March 2017 through March 2020, HII and Southwell falsely misrepresented to investors that HII held distributors to HII's high compliance standards in SEC reports, press releases, earning calls and other communications with investors. Despite these characterizations, HII's compliance department documented extensive failures to comply with HII's standards. According to the SEC, HII monitored calls from customers asking distributors to cancel products, but these calls did not comply with HII's compliance standards. After learning about these shortfalls, Southwell increased the compliance department's budget but ultimately failed to assess whether HII's compliance efforts were effective before falsely representing to investors that they were.

HII and Southwell also made misstatements regarding customer satisfaction. According to the SEC, more than 24,000 customers had filed complaints alleging insurance agents (1) made misrepresentations to customers to sell more products; (2) would not allow customers to cancel their plans; and (3) made customer charges that were not authorized. Despite having a clear record of the amount of complaints made against HII, Southwell continually represented to investors that the company's customer satisfaction was 99.99 percent.

The SEC finds that HII and Southwell violated Sections 17(a)(2) and (3) of the Securities Act and Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-11. HII was ordered to pay an $11 million civil penalty. Southwell was ordered to pay a civil penalty of $750,000 and to pay disgorgement of $320,000 and prejudgment interest of $41,511.

[62] *Health Insurance Innovations and Southwell*, SEC Release 11084, July 20, 2022, available here; *SEC Charges Tampa-Based Health Insurance Distributor and its Former CEO with Making False Statements to Investors*, SEC Press Release No. 2022-126, July 20, 2022, available here.

B. SEC Brings First Cryptocurrency Insider Trading Case: *SEC v. Wahi, et al*.

On July 21, 2022, the SEC announced the filing of a contested action in the U.S. District Court for Western District of Washington against a former Coinbase Global, Inc. ("Coinbase") manager, Ishan Wahi ("Ishan"), who allegedly tipped material and non-public information regarding Coinbase's listing announcement to his brother, Nikhil Wahi ("Nikhil") and close friend, Sameer Ramani ("Ramani"). Ishan's brother and friend profited by at least $1.1 million of off this trade information. [63]

In its Complaint, the SEC alleged that Ishan, as a manager in Coinbase's Assets and Investing Products Group, violated the duty, trust and confidence he owed to Coinbase by engaging in insider trading and providing Coinbase's confidential information, in violation of Coinbase's employee policy, to Nikhil and Ramani. For example, on or before June 6, 2021, Ishan learned about the June 8, 2021 listing announcement of AMP on the Coinbase platform. On June 7, 2021, Ramani purchased nearly 700,000 AMP tokens. Just hours before the AMP listing was announced, Ramani again purchased 1.165 million AMP tokens. After the listing of AMP went public on Coinbase, AMP's token price rose more than 11 percent. Just two days after the listing, Ramani sold nearly all of the AMP tokens he had purchased. According to the complaint, Nikhil and Ramani's trading involved eight other types of tokens during the relevant time period.

The SEC's Complaint alleges that each of the defendants violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The SEC seeks permanent injunctions, disgorgement and civil penalties. The U.S. Attorney's Office for the Southern District of New York also announced criminal charges against all three individuals. Nikhil Wahi pled guilty to one count of conspiracy to commit wire fraud, which carries a maximum sentence of 20 years in prison.[64]

C. Insider Trading

This quarter, the SEC brought a number of actions targeting insider trading; we have briefly summarized five of these matters below.

- *SEC v. Markin and Wong*.[65] In its Complaint, the SEC alleges that the Defendants, a former FBI agent and a friend, used MNPI misappropriated from the agent's romantic partner, who was a law firm associate, to purchase a public company's stock prior to an acquisition announcement. The SEC seeks permanent injunctions, disgorgement with prejudgment interest and civil penalties against the Defendants.
- *SEC v. Buyer and Buyer*.[66] In its Complaint, the SEC alleges that the Defendants, including a former U.S. Congress Representative from Indiana, traded based on MNPI acquired while employed as a consultant. The SEC seeks permanent injunctions, disgorgement with prejudgment interest and civil penalties.

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[63] Complaint, *SEC v. Wahi, et al.*, No. 1:22-cv-01009 (W.D. Wash. July 21, 2022), available here.

[64] *Tippee Pleads Guilty in First Ever Cryptocurrency Insider Trading Case*, DOJ Press Release (Sept. 12, 2022), available here.

[65] Complaint, *SEC v. Markin and Wong*, No. 1:22-cv-06276 (S.D.N.Y. July 25, 2022), available here; *SEC Charges Former FBI Trainee and His Friend with Insider Trading*, SEC Litigation Release No. 25451, July 26, 2022, available here.

[66] Complaint, *SEC v. Buyer and Buyer*, No. 1:22-cv-6279 (S.D.N.Y. July 25, 2022), available here; *SEC Charges Former Indiana Congressman with Insider Trading*, SEC Press Release No. 2022-128, July 25, 2022, available here.

- *SEC v. Dishinger, et al.*[67] In its Complaint, the SEC alleges that the Defendants were illegally tipping and trading in the securities of Equifax, Inc., in advance of the company's data breach announcement. The SEC seeks injunctive relief and civil penalties against each defendant. The SEC further seeks disgorgement of ill-gotten gains, prejudgment interest from certain defendants.
- *SEC v. Saini and Natividad.*[68] In its Complaint, the SEC alleges that the Defendants misappropriated MNPI from their employer, a news service company, and used such information to trade in advance of market-moving announcements issued by their employer. The SEC seeks to permanently enjoin Defendants from violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, disgorgement with prejudgment interest, and civil penalties.
- *SEC v. Moraes* and *SEC v. Holzer*.[69] In its Complaint, the SEC alleges that the Defendants engaged in insider trading of a NYSE-listed corporation by trading on MNPI acquired from an investment adviser pursuant to a non-disclosure agreement. The SEC seeks to permanently bar the defendants from acting as officers or directors of public issuer, disgorgement, prejudgment interest and a civil penalty.

D. Failure to Disclose: *In re Eagle Bancorp, Inc.; SEC v. Ronald D. Paul*

The SEC charges disclosure failures concerning related-party loans. On Aug. 16, 2022, the SEC announced a fully settled administrative enforcement proceeding against Eagle Bancorp, Inc. ("Eagle") for numerous disclosure failures concerning related party loans extended by its subsidiary, EagleBank, to family trusts affiliated with Ronald D. Paul ("Paul"), Eagle's former Chairman, CEO and President. At the same time, the SEC also announced the filing of a fully settled complaint (the "Complaint") against Paul for negligently making false and misleading statements about these loans.[70]

In its Complaint against Paul, the SEC alleges that Eagle failed to include undisclosed related-party loans to Paul's family trusts in the related party loan balances included in its annual reports and proxy statements filed with the Commission. The SEC also claims that in connection with failing to disclose these significant loans made to Paul's family trusts, Eagle and Paul falsely asserted that those loans were not related party loans and that Eagle was in compliance with all related party loan requirements. The misstatements were made in press releases denying any allegations of the loans, and through subsequent communications with investors failing to disclose the loans. The loans were also not disclosed in required filings with the Commission.

In its Order, the SEC finds that Eagle made misstatements and omission about the related party loans, including issuing press releases denying allegations concerning the related party loans and representing that the loans were in compliance with securities laws.

The Complaint alleges that Paul violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Section 14(a) of the Exchange Act and Rules 13a-14 and 14a-9 thereunder. Without admitting or denying liability, Paul has agreed,

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[67] Complaint, *SEC v. Dishinger et al.*, No. 122-cv-03258-TWT (N.D. Ga. Aug. 15, 2022), available here; *SEC Charges Three Chicago-Area Residents with Insider Trading Around Equifax Data Breach Announcement*, SEC Litigation Release No. 25470, Aug. 16, 2022, available here.

[68] Complaint, *SEC v. Saini et al.*, No. 2:22-cv-05788 (D.N.J. Sept. 20, 2022), available here.

[69] Complaint, *SEC v. Moraes*, No. 1:22-cv-08243 (S.D.N.Y. Sept. 30, 2022), available here; Complaint, *SEC v. Holzer*, No. 1:22-cv-08342 (S.D.N.Y. Sept. 30, 2022), available here.

[70] *Eagle Bancorp, Inc*, Exchange Act Release No. 95505, Aug. 16, 2022, available here; Complaint, *SEC v. Ronald D. Paul*, No. 1:22-cv-06985 (S.D.N.Y. Aug. 16, 2022) , available here.

subject to court approval, to a permanent injunction, a two-year officer and director bar, to pay disgorgement of $109,000, prejudgment interest of $22,216, and a penalty of $300,000.

The Order finds that Eagle violated Sections 13(a), 13(b)(2)(A), 13(b)(2)(B) and 14(a) of the Exchange Act and Rules 12b-20, 13a-1 and 14a-9 thereunder. Eagle consented to pay disgorgement of $2.6 million, prejudgment interest of $750,493 and a civil penalty in the amount of $10 million.

E. SEC Expands List of Cryptocurrencies Determined to Be Securities: *SEC v. Dragonchain, et al*.

The SEC turns to *Howey* and alleges that certain cryptocurrencies are securities. On Aug. 16, 2022, the SEC charged John Joseph Roets and three entities he controls, Dragonchain Inc. ("Dragonchain"), Dragonchain Foundation (the "Foundation") and The Dragon Company ("TDC") with raising $16.5 million in unregistered crypto asset securities offerings. [71]

In its Complaint, the SEC alleges that in 2017, Roets, Dragonchain and the Foundation conducted an unregistered offering of Dragon tokens ("DRGNs") through, first, a discounted presale and, second, an initial coin offering broadly marketed to investors. According to the SEC's complaint, in connection with the initial coin offering, the defendants, their personnel and agents publicly discussed DRGN's investment value and that it would rise "as the Dragonchain 'ecosystem' matured" and that DRGNs would be listed on trading platforms. Dragonchain also engaged social media personalities and crypto influencers to regularly post and discuss the investment value, price and market capitalization of DRGNs. Then, between 2019 and 2022, Defendants again allegedly offered and sold approximately $2.5 million worth of DRGNs to cover business expenditures.[72] The SEC alleges the defendants distributed its offering of DRGNs without proper registration with the SEC.

The Complaint alleges that the defendants violated Sections 5(a) and (c) of the Securities Act. The SEC seeks permanent injunctions, disgorgement with prejudgment interest, civil penalties and conduct-based injunctions against each defendant.

F. Investment Bank Fails to Safeguard Consumer PII: *In re Morgan Stanley Smith Barney LLC*

Failure to ensure consumers' personally identifiable information ("PII") were destroyed from decommissioned devices led to settled charges from the SEC against Morgan Stanley Smith Barney LLC ("MSSB"). On Sept. 20, 2022, the SEC initiated a settled administrative proceeding against MSSB for failures to protect the PII of approximately 15 million customers.[73]

In its Order, the SEC finds that, dating back to 2015, MSSB failed to properly dispose of devices that contained its customers' PII. MSSB hired a moving and storage company that had no expertise in data destruction to decommission thousands of hard drives and servers that held PII of millions of its customers, and failed to monitor the company properly. In turn, the moving company sold thousands of MSSB's devices that held PII, which were

[71] Complaint, *SEC v. Dragonchain, et al.*, No. 1:22-cv-01145 (W.D. Wash. Aug. 16, 2022), ECF No. 1, available here.

[72] In January 2021, Dragonchain entered into a consent order with the state of Washington's Department of Financial Institutions which had determined that DRGNs were securities. *See Id*. at ¶73.

[73] *Morgan Stanley Smith Barney LLC*, Exchange Act Release No. 95832, Sept. 20, 2022, available here.

resold in internet auctions without removing the customer PII. MSSB did not properly safeguard customer PII or properly dispose of consumer report information upon its decommission of some local office and branch servers, which resulted in 42 servers that contained unencrypted customer PII going missing. Notably, the devices that had been decommissioned were equipped with encryption capability, but MSSB failed to activate such capabilities.

The Order finds that MSSB violated Rule 30(a) and 30(b) of Regulation S-P. Without admitting or denying the findings, MSSB has consented to the SEC's findings and agreed to pay a penalty of $35 million.

G. Cheetah Mobile Executives Hit With Insider Trading Charges: *In re Sheng Fu and Ming Xu.*

As the SEC's settled charges demonstrate, establishment of a 10b5-1 trading plan will not shield otherwise allegedly unlawful conduct. On Sept. 21, 2022, the SEC initiated a settled administrative proceeding against Sheng Fu, the CEO of Cheetah Mobile Inc. ("Cheetah"), and Ming Xu, the former President of Cheetah, (collectively, the "Respondents") for insider trading based on their sale of 96,000 shares of Cheetah's American Depository Shares while in possession of MNPI.[74]

In its Order, the SEC finds that the Respondents were aware that Cheetah's largest advertising partner would be rolling out a new algorithm that could potentially halve Cheetah's advertising revenues from the partner if Cheetah did not improve its advertising placement quality. The Respondents, parties to a jointly established 10b5-1 trading plan, obtained the advertising revenue MNPI prior to creating the 10b5-1 trading plan. By selling the 96,000 shares, Sheng Fu avoided $203,290 in losses, while Ming Xu avoided $100,127 in losses. In addition to finding that Respondents engaged in insider trading of Cheetah's securities, the SEC further finds that Sheng Fu (1) made materially misleading public statements relating to Cheetah's revenue trends on Cheetah's March 2016 earnings call when Fu stated that the negative revenue trend was due to "seasonality" instead of disclosing the algorithm change by Cheetah's advertising partner, and (2) caused Cheetah's failure to disclose the same material negative trend in its annual report for the year, released in April 2016.

The SEC's Order finds that the Respondents both violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and that Sheng Fu also violated Sections 17(a)(2) and (3) of the Securities Act, and caused Cheetah to violate Section 13(a) of the Exchange Act and Rules 13a-1 and 12b-20 thereunder. In their settlement with the SEC, the Respondents agreed to cease-and-desist orders, various undertakings addressing their trading of securities in the future, and civil penalties (Fu will pay $556,580 and Xu will pay $200,254).

H. Misleading Statements and Concealing Facts: *In re Boeing Company* and *In re Dennis A. Muilenburg*

Misleading statements following fatal airline crashes lead to settled charges of securities laws violations. On Sept. 22, 2022, the SEC initiated settled administrative proceedings against the Boeing Company ("Boeing") and its former

[74] *Sheng Fu and Ming Xu*, Securities Act Release No. 11104, Sept. 21, 2022, available here.

CEO, Dennis A. Muilenburg ("Muilenburg") for making materially misleading statements to the public and investors after two fatal accidents involving the 737 MAX aircraft.[75]

In its Order, the SEC finds that after the two fatal crashes, Boeing made public statements in an attempt to reassure the public that the 737 MAX "is as safe as any airplane that has ever flown the skies," despite having knowledge that the new flight control feature in the 737 MAX aircraft—Maneuvering Characteristics Augmentation System ("MCAS")—posed a safety risk and that Boeing was already attempting to redesign it. In a press release edited and approved by Muilenburg, Boeing also selectively highlighted certain facts from an official report on the crash to suggest pilot and maintenance error were responsible for the crash, rather than any aircraft design issue.

The SEC further finds that after the second crash, Muilenburg stated to reporters, following a shareholders meeting, that "there was no surprise or gap or unknown . . . that somehow slipped through [the] certification process" for the 737 MAX, and that Boeing "confirmed … that we followed exactly the steps in our design and certification processes that consistently produce safe airplanes." This second set of misleading statements followed (1) Boeing's discovery (in response to a DOJ subpoena) that internal documents suggested that Boeing failed to disclose to the Federal Aviation Administration's Aircraft Evaluation Group material facts about the MCAS's operational scope; and (2) Boeing's internal review that identified gaps and inconsistencies in Boeing's documentation of the MCAS's certification process.

The Order finds that Boeing and Muilenburg failed to exercise reasonable care in making these misleading statements, which were negligent violations of the antifraud provisions of Sections 17(a)(2) and 17 (a)(3) of the Securities Act. In their settlements with the SEC, Boeing consented to a $200 million penalty and Muilenburg consented to a $1 million penalty, both of which will be contributed to a Fair Fund pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002.

I. Crypto Positions and Digital Asset Transfers: *In re bZeroX, LLC, et al.* and *CFTC v. Ooki DAO*

The CFTC, like the SEC, remains focused on ensuring cryptocurrency transaction participants comply with relevant regulations. On Sept. 22, 2022, the CFTC initiated a settled administrative proceeding against bZeroX, LLC ("bZeroX"), Tom Bean ("Bean") and Kyle Kistner ("Kistner" and, together with bZeroX and Bean, the "Respondents") for engaging in activities in which only a registered designated contract market ("DCM") or a registered futures commission merchant ("FCM") could engage.[76]

In its Order, the CFTC finds that from June 1, 2019 to Aug. 23, 2021, Respondents "designed, deployed, marketed, and made solicitations concerning" a decentralized Ethereum blockchain-based software protocol to accept and facilitate margined and leveraged transactions based on the price difference between digital assets. Respondents created a website on which to deploy the protocol, which enabled users to easily transfer digital assets and open positions on the protocol and touted that "there is no need for any verification, KYC or AML." During the relevant period, bZeroX did not in fact maintain a customer identification program, which FCMs must do. Bean and Kistner also made public statements to market the use of bZeroX's protocol.

[75] *The Boeing Company*, Securities Act Release No. 11105, Sept. 22, 2022, available here; *Dennis A. Muilenburg*, Securities Act Release No. 11106, Sept. 22, 2022, available here.

[76] *CFTC Imposes $250,000 Penalty Against bZeroX, LLC and Its Founders and Charges Successor Ooki DAO for Offering Illegal, Off-Exchange Digital-Asset Trading, Registration Violations, and Failing to Comply with Bank Secrecy Act*, CFTC Press Release No. 8590-22, Sept. 22, 2022, available here.

The CFTC finds that, as of Aug. 23, 2021, bZeroX transferred control over the protocol to Ooki DAO ("Ooki"), which is a decentralized autonomous organization ("DAO") that was formerly known as bZx DAO, to insulate the protocol from U.S. regulatory oversight and compliance accountability. Nonetheless, Ooki DAO operated the protocol essentially the same as it had previously and continues to engage in the same practices as before.

The CFTC's Order further finds that Respondents violated Commodity Exchange Act Sections 4(a) and 4d(a)(1) and Regulation 42.2. Without admitting or denying the CFTC's allegations, the Respondents consented to the imposition of an order requiring them to (1) cease and desist from the alleged violations; (2) jointly and severally pay a $250,000 civil penalty; and (3) comply with various undertakings listed in the settlement offer.

Additionally, the same day the CFTC filed a contested action (the "Complaint") in the U.S. District Court for the Northern District of California against Ooki for engaging in activities in which only either a DCM or an FCM could engage.[77] In the Complaint, the CFTC alleges that Ooki violated Commodity Exchange Act Sections 4(a) and 4d(a)(1) and Regulation 42.2. The Complaint seeks an order imposing on Ooki (1) a permanent injunction; (2) disgorgement of all benefits received, plus prejudgment and post-judgment interest; (3) rescission of all contracts and agreements and any customer or investor resulting from the violations; (4) restitution for every customer or investor; (5) civil penalties; and (5) costs and fees.

J. FCPA Bribery, Books and Records, and Accounting Violations: *In re Oracle Corp.*

Oracle settled allegations concerning a multi-country bribery scheme carried out through its subsidiaries in violation of the Foreign Corrupt Practices Act ("FCPA"). On Sept. 27, 2022, the SEC filed a settled administrative proceeding against Oracle Corporation ("Oracle") for violating the anti-bribery, books and records, and internal accounting controls provisions of the FCPA between 2014 and 2019.[78]

In its Order, the SEC finds that various subsidiaries of Oracle that are located in Turkey, the United Arab Emirates and India ("Oracle Subsidiaries") engaged in schemes that utilized Oracle's discount and marketing reimbursement policies to receive payments, which they subsequently used to create slush funds at distributers and resellers of the Oracle Subsidiaries. The slush funds were used to provide payment benefits to foreign officials. With respect to the discount schemes, the SEC finds that, despite Oracle's policy mandating that employees of the Oracle Subsidiaries obtain approval for discount requests and provide accurate information in doing so, Oracle did not require the employees to provide documentary support for discount requests. In turn, employees at the Oracle Subsidiaries engaged in a scheme to obtain larger discounts than necessary, which were used to create slush funds held by Oracle's distributers and resellers. As to the marketing reimbursement schemes, Oracle permitted sales employees to request purchase orders to reimburse distributers and resellers of the Oracle Subsidiaries for expenses incurred in marketing Oracle products. Under Oracle's policy, any reimbursement request under $5,000 could be approved without supporting documentation. As a result, employees at the Oracle Subsidiaries in Turkey and the United Arab Emirates made false requests for reimbursements, which were approved by complicit supervisors and used to fund slush funds.[79]

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[77] *See supra* note 75.

[78] *Oracle Corporation*, Exchange Act Release No. 95913, Sept. 27, 2022, available here.

[79] In its Order, the SEC further finds that dating back to 2012 Oracle recognized that its indirect sales model presented risk of abuse through improper slush funds, as reflected by Oracle's 2012 settlement with the SEC relating to Oracle India Private Limited's creation of unauthorized side funds at distributors from 2005 to 2007.

The SEC's Order finds that Oracle violated Sections 30A, 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act. The Order requires Oracle to (1) cease-and-desist from further violations of these sections of the Exchange Act; (2) pay disgorgement of $7,114,376 and prejudgment interest of $791,040, totaling $7,905,416; and (3) pay a civil penalty of $15 million.

K. Investment Bank Charged with Offering and Selling Unprecedented Amount of Unregistered Securities

After losing its well-known seasoned issuer ("WKSI") status, an investment bank's failure to implement controls to accurately track its offer and sale carry overs from its non-WKSI shelf offerings led to charges by the SEC. On Sept. 29, 2022, the SEC initiated a settled administrative proceeding against a large investment bank ("IB") for offering and selling "an unprecedented amount of securities" exceeding the amount IB registered with the SEC.[80]

In its Order, the SEC finds that IB lost its WKSI status in 2017, requiring it to file registration statements for non-WKSI shelf offerings that specify the maximum aggregate offering price of securities that it had available to be offered or sold. However, IB personnel miscalculated the amount of offers and sales to be carried over to IB's 2019 Shelf from its 2018 Shelf, which was exacerbated by IB's lack of internal controls to accurately record information relating to securities offered and sold from each Shelf. In turn, IB failed to accurately track the amount of securities offered and sold, causing it to exceed the amount of offers and sales stated on both its 2018 Shelf and its 2019 Shelf until about March 9, 2022 when it discovered the issue. Over this time period, IB offered and sold an estimated $17.7 billion in securities in excess of its registered amounts, which it self-reported to regulators upon discovery.

The SEC's Order finds that IB violated Sections 5(a) and (c) of the Securities Act and Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-15(a) thereunder. In reaching a settlement with the SEC, IB agreed to (1) cease-and-desist from violating these provisions; (2) comply with undertakings detailed in the Order meant to effect compliance; (3) pay a $200 million civil penalty; and (4) pay disgorgement of $149,731,011, with prejudgment interest of $11,463,229, which it satisfied through its offer of rescission.

L. CFTC Enforces Cybersecurity and Reporting Requirements: *In re CX Futures Exchange, L.P.*

The CFTC is also focusing on ensuring that cybersecurity safeguards and reporting requirements are met. On Sept. 29, 2022, the CFTC filed a settled administrative proceeding against CX Futures Exchange, L.P. ("CX") for violating system safeguard regulations, failing to report options transactions data to the CFTC or a swap data repository, and making a false statement to the CFTC.[81]

In its Order, the CFTC finds that between September 2017 and August 2021, CX did not sufficiently establish and maintain a risk analysis and oversight program to identify and minimize operational risk sources. Specifically, CX failed to (1) conduct adequate information security testing; (2) develop comprehensive enterprise technology risk assessments; (3) conduct sufficient internal and external penetration testing; (4) review enterprise technology risk

[80] *Barclays PLC and Barclays Bank PLC*, Securities Act Release No. 11110, Sept. 29, 2022, available here.

[81] *CFTC Orders Designated Contract Market to Pay $6.5 Million for System Safeguard, Reporting, and False Statement Violations*, CFTC Press Release No. 8603-22, Sept. 29, 2022, available here.

assessments and testing at the board level; or (5) promptly notify the CFTC about its plans to change its automated systems. The CFTC finds that the failures violated CFTC Regulations 38.1050 and 38.1051.

The CFTC's Order further finds that CX failed to report to the CFTC or to a swaps data repository certain data from more than 200,000 options transactions executed between November 2017 and June 2020. CX was required to do so as a designated contract market. The CFTC finds that the conduct violated Commodity Exchange Act Section 2(a)(13)(G) and Regulations 43.3(a)(1), 43.3(a)(2), and 45.3(a). Finally, the CFTC finds that, in relation to its failure to report data to a swaps data repository, CX told CFTC staff that it was and would continue to report data to the CFTC under Regulation 16.02 when it was not doing so. This violated Section 6(c)(2) of the Commodity Exchange Act.

Accordingly, CX is required to cease and desist from the violations described therein and pay a civil penalty of $6.5 million with post-judgment interest.

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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