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## Regulators Put Chief Compliance Officers in Their Sights in 2 Financial Fraud Cases

By Sue Reisinger

In enforcement actions that point to the increased scrutiny on chief compliance officers, regulators have gone after two officers in very different cases involving investment fraud.

In one case, the compliance officer didn't do anything, including not implementing a compliance program; while in the second, the compliance officer was accused of actually taking part in the fraud.

The latest case came Wednesday when the U.S. Securities and Exchange Commission filed a **complaint** against Strong Investment Management in Anaheim, California, its majority owner and his brother, who served as the chief compliance officer that did nothing.

The SEC accuses the company and its owner of "cherry-picking" profitable trades by allocating them disproportionately to the owner's personal accounts. The company's number was no longer in service Wednesday.

The SEC complaint alleges that as the chief compliance officer, John Engebretson aided and abetted the company's violations by "carrying out his compliance responsibilities in an extremely reckless manner."

It says Engebretson never implemented any compliance program and "essentially did nothing to ensure that [the company's] trading policies and procedures were followed other than occasionally 'spot-checking' trade paperwork ... while repeatedly ignoring numerous 'red flags.'"

Attorney Brian Daly, a partner in the regulatory and compliance and investment management groups of Schulte Roth & Zabel in New York, called the SEC action "pretty extreme." Daly spent a decade as a general counsel and chief compliance officer at several investment firms before joining Schulte, including at Kepos Capital, Raptor Capital Management and The Carlyle Group.



**Brian Daly, partner with Schulte Roth & Zabel.**

"It's unusual," Daly told Corporate Counsel. "It's one thing to say he [compliance officer] could be sanctioned or censured, but they are accusing him of recklessly not carrying out his duties because of inaction, and of aiding and abetting bad actions."

In the second recent enforcement case, the U.S. Commodity Futures Trading Commission **held the chief compliance officer** of Phy Capital Investments accountable

for allegedly engaging in fraud upon customers and lying to the National Futures Association, a self-regulating agency. The company's phone number was no longer in service Wednesday.

The Sept. 12 consent order accused compliance officer Rafael Marconato of allowing the Miami company to profit from misappropriating client funds, of taking part in those profits and of making false statements and filing a false document.

Marconato, now living in Sao Paulo, could not be reached for comment. He was ordered to pay \$125,000 in restitution and a \$25,000 civil penalty. The order also prohibits him from commodities work, to cooperate with the agency's ongoing investigation into other parties, and to report to the National Futures Association as his monitor.

Philadelphia attorney Mary Hansen, co-chair of the white-collar defense and corporate investigations practice at **Drinker Biddle & Reath**, said while Marconato's misconduct warranted enforcement attention regardless, "his decision to try to cover by lying to the National Futures Association and providing them with false

documents undoubtedly made the situation much worse."

Hansen said making misrepresentations to examiners "is never worth it. It's better to deal with the violations than try to 'make it better.' With the National Futures Association, candor is of utmost importance."

She said it was an interesting case because the CFTC has a rule against lying to regulators, while the Securities and Exchange Commission does not.

She said the action served as a warning shot to chief compliance officers, showing they are in the sights of the regulatory agencies. "In the last couple years, we've seen more compliance officers charged," she added, "and that's not going away."

Hansen said the case was especially interesting because it showed the agency's willingness to reach across international borders into Brazil for Marconato.

Schulte's Daly agreed. He said following people to other countries shows the level of sophistication, funding and persistence that didn't exist at the CFTC in the past. "Ten years ago," he noted, "the level of enforcement activity at the CFTC was near zero."

Daly said another important lesson from the case is for companies to make sure any time there is a trade by a key compliance or legal person, that "someone outside that vertical needs to approve it. It's about who's watching the watchers."

He said for the most part the regulators have respect for, and give deference to, companies' lawyers and compliance officers. "They are seen as the independent sources of authority and integrity in a firm," he explained.

"I don't think regulators are out there looking for malfeasance by compliance officers directly," Daly said. "But I worry that too many of these kinds of cases [may result in] this respect and deference going away."

***Sue Reisinger** Senior reporter at ALM since 2004; based in Florida; covers general counsel and white collar crime; contact: [sreisinger@alm.com](mailto:sreisinger@alm.com)*

## Schulte Roth & Zabel

Schulte Roth & Zabel LLP  
919 Third Avenue, New York, NY 10022  
212.756.2000 tel | 212.593.5955 fax | [www.srz.com](http://www.srz.com)  
New York | Washington DC | London

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