Schulte Roth & Zabel

Securities Enforcement Quarterly

May 2022

Featured Topics

- **SEC's Proposed Rules and Amendments Put Hedge Fund and Private Equity Fund Advisers in the Crosshairs**
- **Enforcement's New Era: Reflecting on a Conversation with Gurbir Grewal**
- **SEC Settles First Enforcement Action Against Digital Asset Lending Platform**
- **Chair Gensler's Focus on Conflicts of Interest**
- **Recent Enforcement Actions**
    - **Investment Adviser Enforcement Actions**
    - **Broker-Dealer Enforcement Actions**
    - **Other Enforcement Actions**

Introduction

In 2021, the SEC set forth an ambitious agenda for enforcement and regulation and, as discussed in this edition of Schulte Roth & Zabel's Securities Enforcement Quarterly, during the first quarter of 2022, the SEC set forth sweeping rule proposals that are likely to impact most participants in the financial markets and lay a foundation for an increased focus on private fund advisers. This edition also describes the SEC's resolution of its first enforcement action against a digital asset lending platform and reflects on SRZ partner Craig Warkol's conversation with Gurbir Grewal, Director of the SEC's Division of Enforcement, at SRZ's 31st Annual Private Investment Funds Seminar in January 2022. The SEC's aggressive enforcement posture is reflected across this edition's discussion of novel enforcement actions targeting conflicts of interest and in the summary of key enforcement actions brought by the SEC and other financial regulators in the first quarter of 2022.

SEC's Proposed Rules and Amendments Put Hedge Fund and Private Equity Fund Advisers in the Crosshairs

SEC Enforcement continued to be active in the first quarter of 2022. In addition, the SEC proposed a variety of new rules that are likely to impact many participants in the financial markets. For example, new rule proposals include, among other things, prohibiting private funds advisers from engaging in certain activities and increasing disclosure obligations, shortening the standard securities settlement cycle to T+1,[1] shortening disclosure periods for beneficial ownership reporting,[2] focusing on cybersecurity risk and disclosures,[3] and targeting special purpose acquisition companies' ("SPACs") disclosures.[4] These rule proposals, as well as newly announced priorities from the SEC's Division of Examinations, portend a new era of increased SEC scrutiny for private fund advisers. The rule proposals have led to significant, and ongoing, debate between private fund advisers (and their advocates) and the SEC as to whether some of these proposals are necessary — or even achieve the stated goals.

Expansion of Form PF

In late January, the SEC issued proposed amendments that would expand Form PF's coverage and increase reporting requirements for hedge and private equity fund advisers in an effort to "help federal regulators to assess systemic risk" and "bolster the Commission's oversight of private fund advisers and the protection of investors in those funds."[5] The proposed amendments require hedge fund advisers to report certain events within one business day, including losses of 20 percent or more, significant margin and counterparty default events, material changes in the adviser's prime brokerage relationships, and events concerning withdrawals and redemptions.[6] Similarly, the proposed rules require private equity fund advisers to report, within one business day, events concerning adviser-led secondary transactions, implementation of clawbacks, removal of a fund's general partner, termination of a fund's investment period, and termination of a fund.[7] The proposed amendments also decrease the AUM threshold for large private equity advisers from $2 billion to $1.5 billion, and require additional reporting by large private equity advisers and large liquidity fund advisers.[8]

In particular, the proposed rules set one-day reporting standards that, if not managed correctly, could lead to incomplete or inaccurate reporting. Commentators — including Schulte Roth & Zabel LLP ("SRZ") — have urged the SEC to consider modifications to those amendments, including by extending the one-business-day reporting period to a more flexible "prompt" update requirement to avoid unnecessary over-reporting that could render the SEC's

---

[1] *See* SEC, *SEC Issues Proposal to Reduce Risks in Clearance and Settlement*, Feb. 9, 2022, available here.

[2] *See* SEC, *SEC Proposes Rule Amendments to Modernize Beneficial Ownership Reporting*, Feb. 10, 2022, available here.

[3] *See* SEC, *SEC Proposes Rules on Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure by Public Companies*, March 9, 2022, available here.

[4] *See* SEC, *SEC Proposes Rules to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections*, March 30, 2022, available here.

[5] Gary Gensler, *Statement on Form PF*, Jan. 26, 2022, available here.

[6] *See* SEC, *SEC Proposes Amendments to Enhance Private Fund Reporting*, Jan. 26, 2022, available here; SEC, *Proposed Rules: Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers*, Release No. IA-5950; File No. S7-01-22 ("Form PF Proposed Rules"), available here.

[7] *See* Form PF Proposed Rules.

[8] *See id.*

goals to assess systemic risk in real-time counterproductive, and to streamline the new reporting requirements to provide more useful information to regulators.[9]

Increased Regulation of Private Fund Advisers

In early February, the SEC proposed a series of new rules and amendments to existing rules under the Investment Advisers Act of 1940 (the "Advisers Act") that, if adopted, would significantly alter the existing and future relationships between private fund advisers and investors in the funds they advise.[10] Those proposed rules would require, among other things:

(i) Distribution of quarterly statements to investors including detailed fee disclosures, disclosures concerning fee calculation methodologies, and payments made by portfolio companies to the adviser;

(ii) Regardless of registration status, prohibitions on certain preferential treatment for particular investors and disclosure requirements concerning permitted preferential treatments;

(iii) Registered advisers to obtain private audits for each private fund they advise at least annually, notwithstanding any separate obligations under the Advisers Act Rule 206(4)-2 (the "Custody Rule");

(iv) Distribution of fairness opinions and other information prior to engaging in an adviser-led secondary transaction for a private fund client; and

(v) That all annual reviews under the Advisers Act Rule 206(4)-7 (the "Compliance Rule") be documented in writing.[11]

In addition, the proposals prohibit several activities for all private fund advisers — including those not registered with the SEC — regardless of whether the private fund's governing documents permit such activities and/or where investors have given either explicit or implicit consent to such activities. These changes are significant and may fundamentally impact advisers' assumptions regarding costs and pricing as well as protection from liability.[12] The proposed prohibitions would eliminate advisers' ability to:

(i) Seek reimbursement, indemnification, exculpation, or limitation of the adviser's liability for breach of fiduciary duty, willful misfeasance, bad faith, recklessness, or negligence in providing services to the fund;

(ii) Charging the private fund for fees or expenses associated with (i) an examination or investigation of the adviser or its related persons by any governmental or regulatory authority, or (ii) regulatory or compliance fees or expenses of the adviser or its related persons;

(iii) Reduce the amount of adviser clawbacks by taxes owed;

[9] *See* Schulte Roth & Zabel LLP, Comment Letter, *Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers (File No. S7-01-22)*, March 21, 2022, available here.

[10] Allison Herren Lee, *Statement on Proposed Rules for Private Fund Advisers*, Feb. 9, 2022, available here.

[11] *See* SEC, *SEC Proposes to Enhance Private Fund Investor Protection*, Feb. 9, 2022, available here; SEC, *Proposed Rule: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Release No. IA-5955; File No. S7-03-22 ("Private Fund Advisers Proposed Rule"), available here.

[12] *See* Private Fund Advisers Proposed Rule.

(iv) Charge or allocate fees or expenses for portfolio investments on a non-*pro rata* basis under certain circumstances;

(v) Charging a portfolio investment for monitoring, servicing, consulting or other fees in respect of any services that the investment adviser does not, or does not reasonably expect to, provide to the portfolio investment; and

(vi) Borrow money, securities, or other assets or otherwise receive a loan or credit from a private fund client.[13]

These proposals demonstrate, among other things, that the SEC wants to limit advisers' use of fund resources for certain expenses and is a reminder that fees and expenses will continue to be an exam priority,[14] with potential for enforcement action to follow.

SRZ submitted a comment letter identifying and addressing significant concerns with the proposals and recommending that they be withdrawn or modified to avoid stifling private fund opportunities.[15]

Cyber Risk Management

On Feb. 9, 2022, the SEC issued proposed cyber rules to, among other things, improve the cybersecurity preparedness of registered investment advisers ("RIAs") and others and to require more disclosure regarding cyber risks and incidents. [16] The proposed cyber rules seek to: (1) require RIAs to adopt and implement written policies and procedures that are reasonably designed to address cybersecurity risks; (2) require RIAs to report significant cybersecurity incidents to the Commission; (3) enhance RIA disclosures related to cybersecurity risks and incidents; and (4) require RIAs to maintain certain cybersecurity-related books and records.[17]

Among the many features of the proposed cyber rules, the SEC proposes the adoption and implementation of cybersecurity policies and procedures, which, at a minimum, must incorporate the following elements: periodic risk assessments; measures to detect, mitigate and remediate any cybersecurity threat and vulnerabilities; and controls designed to minimize user-related risks and prevent unauthorized access.[18] RIAs would be required to conduct an annual review that assesses the effectiveness of the cybersecurity policies and procedures, and prepare a written report that describes the review, assessment and any control tests performed, explains the results, documents any cybersecurity incident that occurred since the date of the last report and discusses any material changes to the policies and procedures since the date of the last report. Additionally, RIAs would be required to confidentially report significant cybersecurity incidents to the SEC within 48 hours after having a reasonable basis to conclude that

[13] *See id.*

[14] *See* Division of Examinations, *Examination Priorities*, 2022, ("Examination Priorities") available here.

[15] *See* Schulte Roth & Zabel LLP, Comment Letter, *Proposed Rules and Rule Amendments Regarding Private Fund Advisers (File No. S7-33-22)*, April 25, 2022, available here.

[16] Press Release, SEC, *SEC Proposes Cybersecurity Risk Management Rules and Amendments for Registered Investment Advisers and Funds* (Feb. 9, 2022), available here; SEC, *Proposed Rule: Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies*, Release No. IA-5956; File No. S7-04-22 ("Cybersecurity Proposed Rules"), available here; *see also* Schulte Roth & Zabel LLP, *SEC Proposes Cybersecurity Risk Management*, Feb. 10, 2022, available here.

[17] *See* Cybersecurity Proposed Rules. The SEC proposed similar rules for registered investment companies and business development companies.

[18] *See id.*

a significant cybersecurity incident has occurred or is occurring.[19] RIAs would also be required to publicly report cybersecurity risks and incidents on Form ADV.

The proposed cyber rules have raised concerns that they are so broad and prescriptive in some respects that they could compete with industry standards for cybersecurity. SRZ submitted a comment letter offering specific suggestions for revisions to the proposed rules with an eye towards flexibility and less prescriptive elements to better align with cybersecurity industry standards and to stand the test of time in the ever-evolving world of cybersecurity preparedness.[20]

The final adopted rules may vary from the proposal, however, the takeaway is clear. The SEC is focused on the risk of cybersecurity incidents, and oversight and enforcement of cybersecurity governance, transparency and risk management will be an area of heightened scrutiny.

Short Selling Data Collection

At the end of February, the SEC announced a proposed rule that would require institutional investment managers[21] to file confidential reports with the SEC within 14 calendar days after the end of each month that identify (among other things): (i) a gross short position in reporting equity securities with a U.S. dollar value of $10 million or more at the close of any settlement date during the calendar month; or (ii) a monthly average gross short position (determined by looking to the gross short position as of the close of each settlement date during the calendar month) equal to 2.5 percent or more of the shares outstanding; and (iii) for non-reporting equity securities, a gross short position with a U.S. dollar value of $500,000 or more at the close of any settlement date during the calendar month.[22] The SEC proposes to publish the aggregated data derived from the confidential reports on the basis that "[s]uch aggregated information would help inform market participants regarding the overall short sale activity by reporting managers."[23]

SRZ submitted a comment letter identifying several concerns with the proposed rule including: (i) the reporting requirement of $10 million or more may be a "low" bar for some managers and not actually reflective of "substantial gross short positions"; (ii) net short positions rather than gross short positions would reflect more accurate short position data; (iii) the need to protect confidential and proprietary business information by aggregating all published data and not utilizing the alternative proposal to publish data on an institutional investment manager basis; and (iv) the importance of a flexible approach to publication of data to address confidentiality concerns.[24]

---

[19] *See id.*

[20] Schulte Roth & Zabel LLP, Comment Letter, *Rules and Amendments to Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies (File No. S7-04-22)*, April 12, 2022, available here.

[21] *See* SEC, *Proposed Rule: Short Position and Short Activity Reporting by Institutional Investment Managers*, Release No. 34-94313; File No. S7-08-22 ("Short Position Proposed Rule"), available here.

[22] *Id.*

[23] *Id.*

[24] Schulte Roth & Zabel LLP, Comment Letter, *New Rule and Form For Short Position and Short Activity Reporting By Institutional Investment Managers (File No. S7-08-22)*, April 26, 2022, available here.

Expanded Definition of "Dealer"

In late March, the SEC proposed new rules that would expand the definition of "dealer" and "government securities dealer" and would include certain investment advisers and private funds. Subject to certain exceptions, proposed Exchange Act Rule 3a5-4 would require any person "engage[d] in a routine pattern of buying and selling securities for their own account that has the effect of providing liquidity" to register as a dealer.[25] This proposed expanded definition would include as a "dealer" any person that "routinely mak[es] roughly comparable purchases and sales of the same or substantially similar securities in a day." In the proposing release, the SEC explains that "routinely" does not need to be continuous and that "roughly comparable" purchases and sales can be determined through an analysis of the net imbalance of the dollar volume, number of shares, or risk profile of the same or similar securities on a given day.[26] Separately, proposed Exchange Act Rule 3a44-2 would require any person who, in four of the last six calendar months, bought or sold over $25 billion in government securities to register as a "government securities dealer." The Proposed Rules would not apply to an investment company registered under the Investment Company Act of 1940 or, subject to certain exceptions, persons who have or control total assets of less than $50 million. There is no exception, however, for investment advisers registered under the Investment Advisers Act of 1940 or other money managers or their managed accounts. Rather, the SEC's proposal expressly anticipates that certain advisers and private funds would have to register as dealers if the Proposed Rules are adopted.

Expanded Exam Staff Priorities

In late March, the SEC's Division of Examinations (the "Exam Staff") announced its 2022 Examination Priorities, which is usually a precursor to SEC enforcement actions, that align with the rule proposals highlighted above.[27] Private funds were listed as the Exam Staff's number one examination priority. In particular, the Exam Staff will continue to focus on fees and expenses, potential preferential treatment of certain investors, custody rule compliance, the adequacy of disclosures for cross-trades and principal transactions, and conflicts around liquidity. The Exam Staff will also be focused on emerging risk areas, namely ESG investing, digital assets, and the use of developing financial technologies (including alternative data research products).[28] The Examination Priorities indicate that the exam staff expects an increase in the number of referrals to the Enforcement Division and the amount of funds returned to investors as a result of the examination process. Additionally, in its January Risk Alert, the Exam Staff observed numerous deficiencies by advisers relating to performance and marketing disclosures, conducting sufficient investment diligence, and hedge clauses limiting liability. [29]

---

[25] SEC, *Proposed Rule: Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer*, Release No. 34-94524; File No. S7-17-22, available here. The term "dealer," as used herein, refers to both "dealers" and "government securities dealers" unless explicitly noted or the context indicates otherwise.

[26] Press Release, SEC, *SEC Proposes Rules to Include Certain Significant Market Participants as "Dealers" or "Government Securities Dealers"* (Mar. 28, 2022), available here.

[27] *See* Examination Priorities; *see also* Schulte Roth & Zabel, LLP, *SEC Examinations: What Private Fund Managers Can Expect in 2022* (April 19, 2022), available here.

[28] *See* Examination Priorities.

[29] *See* Division of Examinations, *Risk Alert: Observations from Examinations of Private Fund Advisers*, Jan. 27, 2022, available here; *see also* Schulte Roth & Zabel LLP, *SEC Identifies Private Fund Deficiencies, Signifying Increased Industry Scrutiny* (Jan. 31, 2022), available here.

Looking Ahead

In sum, while the SEC has proposed rules and amendments concerning a wide range of key topics in the securities industry, it has focused on rules and amendments specific to private fund advisers. That focus is consistent with the increase in enforcement actions brought against investment advisers and prior statements by the SEC's Director of Enforcement, Gurbir Grewal. Director Grewal has indicated that a top priority for the Division of Enforcement is countering what is viewed as a lack of trust in the financial system by holding bad actors accountable and demonstrating that there is one set of rules for all and that ultimately, restoring trust must be a shared mission, with private fund lawyers and compliance professionals actively involved.[30]

[30] *See generally* Gurbir Grewal, *Remarks at SEC Speaks 2021*, Oct. 13, 2021, available here; see also Gurbir Grewal, *PLI Broker/Dealer Regulation and Enforcement 2021*, Oct. 6, 2021, available here.

Enforcement's New Era: Reflecting on a Conversation with Gurbir Grewal

The combination of a capital market in high gear, a steady stream of new products and technologies, and changes in regulatory leadership presents considerable challenges for general counsel and chief compliance officers at private investment funds. To help provide clarity to our clients at such a dynamic time, we invited Gurbir Grewal, Director of the SEC's Division of Enforcement, to engage in a free-ranging conversation with SRZ partner Craig Warkol at SRZ's 31st annual Private Investment Funds Seminar in January 2022. While Director Grewal's remarks solely reflected his own views, they provided helpful direction regarding the regulatory environment for private investment funds. Our takeaways include:

The SEC is looking hard at private funds. Private investment funds are now a critical element of the capital markets space, with $18 trillion in assets — not just from high-net-worth individuals, but increasingly from pension plans, endowments and other institutional investors representing a broad sector of society. Further, fully one-third of Registered Investment Advisors are connected to private funds. The growth in SEC scrutiny tracks the greater role private funds play in financial services and the economy.

Restoring trust is the top — and shared — priority. The goal of the Enforcement Division — to protect investors, foster capital formation and promote fair and effective markets — does not change from administration to administration. What changes with new leadership are enforcement priorities and the philosophy behind them. For the Enforcement Division today, the top priority is countering what is viewed as a pervasive lack of trust in the financial system by holding bad actors accountable through robust penalties and demonstrating that there is one set of rules for all. Ultimately, restoring trust must be a shared mission, with private fund lawyers and compliance professionals actively involved.

Implementation is key. As recent SEC enforcement cases illustrate, private funds generally face regulatory action not because they lack compliance policies and procedures, but because those policies and procedures are not adequately enforced and maintained. There needs to be an internal culture of compliance, set at the top of the organization, that fosters surveillance, monitoring and training.

Common sense isn't novel. Many in the private funds space saw the *Panuwat* case as a novel application of insider trading laws. An alternative interpretation is that while the fact pattern was nuanced, the case represented yet another example of profiting from material non-public information in violation of a duty of confidentiality. In any event, the more dynamic enforcement environment means that guideposts are determined less by what was prosecuted in the past and more by deliberate and thoughtful adherence to underlying principles. Firms that don't test boundaries are unlikely to stray outside the lines — even if there is some ambiguity as to exactly where the lines are.

Technology and investment trends evolve, but the issues endure. Using underlying principles as a touchstone is particularly important when dealing with compliance issues involving new technologies or investment trends. Unregulated crypto exchanges are still unregulated exchanges, and while ESG has become increasingly important, the laws requiring private funds to be accurate in their disclosures and marketing materials remain constant. The obligation regarding maintaining adequate books and records is the same in the era of texting, Signal and WhatsApp.

Let the OIPs be your guide. Under Chair Gensler, the SEC has been remarkably transparent regarding its priorities. Beyond his speeches and testimony, however, fund GCs and CCOs should closely read the Commission's Orders Instituting Proceedings ("OIP") for insight into the SEC's thinking. For example, the OIP in the electronic communications case against JP Morgan serves as an actionable summary of what the SEC viewed as shortcomings, the questions GCs and CCOs should be asking, and a template for how a firm should handle remediation.

Clarity on cooperation is coming. To many observers, the criteria by which cooperation credit is given are opaque. GCs and CCOs can expect consent orders to give more direction on this matter going forward.

If you have a question, ask (until you get an answer). The SEC is well aware of the challenges that GCs and CCOs face — and has an open-door approach to communication. That the door is open, however, puts the responsibility on funds to get clarification in the face of ambiguity. GCs and CCOs should reach out though multiple channels to find out what they need to know — and be persistent in doing so. Sending a lone email and giving up when there's no response doesn't suffice. When in doubt, over-communicate, both to the SEC and to other relevant regulatory bodies.

SEC Settles First Enforcement Action Against Digital Asset Lending Platform

On Feb. 14, 2022, BlockFi Lending LLC ("BlockFi"), a wholly owned subsidiary of BlockFi Inc., and the SEC settled allegations that BlockFi's digital asset lending platform violated the Securities Act of 1933 and the Investment Company Act of 1940.[31] The allegations against BlockFi concern its BlockFi Interest Accounts ("BIAs"). The SEC instituted this administrative proceeding concurrently with the order, alleging that, beginning in March 2019, BlockFi's investors could, through the BIAs, lend their crypto assets to BlockFi, and in exchange, BlockFi promised a variable monthly interest payment generated by BlockFi's income, derived from other lending products.[32] By March 31, 2021, "BlockFi and its affiliates held approximately $14.7 billion in BIA investors assets"; and by Dec. 8, 2021, "BlockFi and its affiliates held approximately $10.4 billion in BIA investor assets and had approximately 572,160 BIA investors . . .."[33] As explained further below, the settlement order determined that BlockFi's BIAs violated sections 5(a), 5(c), 17(a)(2) and (a)(3) of the Securities Act and section 7(a) of the Investment Company Act.

To resolve the SEC's charges, BlockFi agreed to pay a $50 million penalty, cease its unregistered offers and sales of BIAs, and take steps to comply with the provisions of the Investment Company Act within 60 days of the entry of the order. BlockFi's parent company also announced that it intends to register under the Securities Act of 1933 the offering and sale of a new lending product, BlockFi Yield.[34] Separately, BlockFi also agreed to pay an additional $50 million in fines to 32 states to settle similar charges.

The Order

The SEC's Order settling this matter highlights several key issues with the BIAs and BlockFi's digital asset lending program.

First, the SEC finds that the BIAs were securities because: (a) they were "notes" under *Reves v. Ernst & Young*, 494 U.S. 56, 64-66 (1990); and (b) they were "investment contracts" under *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946).

In the SEC's view, the BIAs satisfy the definition of notes under *Reves'* four-part test because:

- They were sold to "obtain crypto assets for the general use of [BlockFi's] business", and "purchasers bought BIAs to receive interest ranging from 0.1% to 9.5% on loaned crypto assets"[35];
- "BIAs were offered and sold to a broad segment of the general public[;]"[36]

[31] *In the Matter of BlockFi Lending LLC*, Securities Act Release No. 11029 (Feb. 14, 2022), available at here.

[32] *Id.* at 2.

[33] *Id.*

[34] *BlockFi Enters Landmark Resolution with Federal and State Regulators Providing Clarity on Pathway for Crypto Interest Securities*, Feb. 14, 2022, available here.

[35] *In the Matter of BlockFi Lending LLC* at 8.

[36] *Id.*

- "BlockFi promoted BIAs as an investment, specifically as a way to earn a return on crypto assets;"[37] and
- "No alternative regulatory scheme or other risk reducing factor exist with respect to BIAs."[38]

Under *Howey*, the SEC found that the BIAs also constituted investment contracts under Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act, because:

- "BlockFi sold BIAs in exchange for the investment of money in the form of crypto assets"[39];
- "Each [BIA] investors' fortunes were also linked" because the returns earned "were a function of the pooling of the loaned crypto assets" and investors' profits were tied to BlockFi, the promoter, because it earned revenue "through its deployment of the loaned assets[;]"[40]
- "Through its public statements, BlockFi created a reasonable expectation that BIA investors would earn profits derived from BlockFi's effort to manage the loaned crypto assets;"[41] and
- BlockFi maintained "complete ownership and control over the borrowed crypto assets . . .[its] lending activities were at its own discretion, and BlockFi advertised that it managed the risk involved."[42]

As a result of this alleged conduct, the Commission concluded that BlockFi violated Sections 5(a) and 5(c) of the Securities Act[43] because "BlockFi offered and sold securities without a registration statement filed or in effect with the Commission and without qualifying for an exemption from registration[.]"[44] By establishing two alternative theories on which to base its claim that BIAs are securities, the SEC preserves flexibility and precedent for future claims against other digital asset lending services offering similar, but perhaps not identical, products.

Second, the SEC determined that, because BlockFi made loans constituting investment securities and because it held "over 40% of the value of its total assets in investment securities . . . , BlockFi met the definition of an investment

[37] *Id.*

[38] *Id.*

[39] *Id.*

[40] *Id.* at 8-9.

[41] *Id.* at 9.

[42] *Id.*

[43] Section 5(a) states: "Unless a registration statement is in effect as to a security, it shall be unlawful for any person . . . to make use of any means or instruments of transportation or communication in interstate commerce . . . through the use or medium of any prospectus or others; or to carry . . . by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale." 15 U.S.C. § 77e(a)(1)-(2). Section 5(c) states: "It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or . . . any public proceeding or examination under section 77h of this title." 15 U.S.C. § 77e(c).

[44] *Id.*

company" from at least Dec. 31, 2019 through Sept. 30, 2021.[45] Accordingly, the SEC found that BlockFi, was operating as an unregistered investment company in violation of Section 7(a) of the Investment Company Act.[46]

Third, the SEC took specific issue with several posts that BlockFi made on its website regarding the level of risk in its various loan portfolios, including a misrepresentation that certain institutional loans were "typically" over-collateralized. Accordingly, the Order settling this matter also finds that BlockFi violated Sections 17(a)(2) and 17(a)(3) of the Securities Act[47] when it "made a materially false and misleading statement on its website . . . concerning its collateral practices, and therefore, the risks associated with its lending activity."[48]

Conclusion

Chair Gensler hailed BlockFi's settlement as making "clear that crypto markets must comply with time-tested securities laws" and signaled that the Commission is willing "to work with crypto platforms to determine how they can come into compliance with those laws." [49] While the SEC's Order is novel to the extent it is the first of its kind involving a digital asset lending platform, the core legal principles underpinning the resolution are not—rather the Order signals a desire to fit cryptocurrency products into the "time-tested securities laws" framework.

[45] *Id.* at 7; Section 7(a) states: "No investment company organized or otherwise created under the laws of the United States or of a State and having a board of directors, unless registered under section 80a-8 of this title, shall directly or indirectly—offer for sale, sell, or deliver after sale, by the use of the mails . . . any security or any interest in a security, . . . or offer for sale, sell, or deliver after sale any such security or interest, having reason to believe that such security or interest will be made the subject of a public offering by use of the mails or any means or instrumentality of interstate commerce[.]" 15 U.S.C. § 80a-7(a)(1).

[46] *In the Matter of BlockFi Lending LLC* at 3.

[47] Under Section 17(a)(2) and 17(a)(3) makes it "unlawful for any person in the offer or sale of any securities . . . or any security-based swap agreement . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made . . . not misleading; or to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." 15 U.S.C. §77q(a)(2)-(3).

[48] *In the Matter of BlockFi Lending LLC* at 2.

[49] *BlockFi Agrees to Pay $100 Million in Penalties and Pursue Registration of its Crypto Lending Product,* SEC Press Release No. 2022-26, available here.

Chair Gensler's Focus on Conflicts of Interest

Under the direction of Chair Gary Gensler, the SEC has signaled a broad return to an aggressive enforcement posture. Specifically, throughout 2021 and the first quarter of 2022, actions by the SEC's Division of Enforcement have demonstrated the Commission's willingness to reshape the regulatory landscape not just through the traditional rulemaking and guidance process but by bringing novel enforcement actions and signaling its intent to aggressively use its enforcement powers to curtail long standing industry practices.

Over the last year, SEC Chair Gensler has consistently emphasized advisers' obligations in connection with conflicts of interest. In a November 2021 speech at the Institutional Limited Partners Association Summit, Chair Gensler emphasized that, irrespective of attempts to reduce or modify an adviser's fiduciary duties under state law, the "federal fiduciary duty may not be waived."[50] Echoing a Commission-issued interpretation of the federal fiduciary duty applicable to advisers,[51] Chair Gensler noted that, "regardless of the sophistication of [a] client," Advisers should "[m]ake no mistake: An investment adviser to a private fund has a federal fiduciary duty to the fund enforceable [and not waivable] under the Advisers Act."[52] Additionally, Chair Gensler has also intimated that existing rules do not go far enough in addressing advisers' conflicts, suggesting that new rules should be considered to both enhance conflicts of interest disclosures and mitigate advisers' conflicts of interest, including "considering the need for prohibitions on certain conflicts and practices."[53] While the particular details of any adopted conflicts of interest restrictions remain unclear, Chair Gensler has offered his view that regulation may also be appropriately effected by bringing enforcement actions in "the hard cases, the novel cases, and yes, the high-impact cases . . . ."[54] He noted that "[s]ome market participants may call this 'regulation by enforcement.' I just call it 'enforcement.'"[55]

The current Commission is particularly focused on the perceived failure of industry participants to adequately identify and mitigate conflicts of interest. Chair Gensler has suggested that existing SEC rules may not sufficiently address conflicts of interest, and on Feb. 9, 2022, the Commission proposed new rules to address these deficiencies.[56] A few weeks later, the SEC's Division of Enforcement brought a series of enforcement actions against investment advisers related to conflicts of interest, including the five highlighted below. The flurry of activity evinces the rapidly evolving enforcement and regulatory landscape, raising the specter that the Commission's rule proposals are a lagging indicator of the type of adviser conflict issues that the Division of Enforcement intends to aggressively target.

[50] Gary Gensler, *Prepared Remarks At the Institutional Limited Partners Association Summit* (Nov. 10, 2021), available at https://www.sec.gov/news/speech/gensler-ilpa-20211110.

[51] *See Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Advisers Act Release No. 5248 (June 5, 2019), available at https://www.sec.gov/rules/interp/2019/ia-5248.pdf.

[52] *Supra* note 46.

[53] *Id*; Gary Gensler, *Testimony Before the United States House of Representatives Committee on Financial Services* (Oct. 5, 2021), available at https://www.sec.gov/news/testimony/gensler-2021-10-05.

[54] Securities and Exchange Commission, Chair Gary Gensler, *Prepared Remarks At the Securities Enforcement Forum* (Nov. 4, 2021), available at https://www.sec.gov/news/speech/gensler-securities-enforcement-forum-20211104.

[55] *Id.*

[56] *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Investment Advisers Act Release No. IA-5955 (Feb. 9, 2022), available at https://www.sec.gov/rules/proposed/2022/ia-5955.pdf.

Conflicts Arising from Undisclosed Compensation: *Arthur S. Hoffman*[57]

On Feb. 24, 2022, the SEC filed charges against Arthur S. Hoffman for fraud. The charges arise from recommendations Hoffman made to clients while working as an investment adviser representative of Ameriprise Financial Services. The complaint alleges that, in violation of his fiduciary duties, Hoffman deceived clients about his financial conflicts of interest and perpetuated this deception by taking steps to conceal his misconduct from the SEC-registered investment adviser with whom he was associated.

The SEC alleges that, from May to Dec. of 2019, while working as an investment adviser representative of Ameriprise Financial Services, Hoffman recommended that eight of his investment adviser clients invest in securities issued by Zima Global Ventures LLC, which purported to use investor funds to trade cryptocurrencies and other digital assets for profit. Hoffman recommended Zima's securities to clients without disclosing conflicts of interest. Specifically, Hoffman failed to disclose that Zima had agreed to lend Hoffman up to $1.5 million at 2 percent interest per year for soliciting investors and that, in most cases, Hoffman already owed Zima tens of thousands of dollars under that agreement.

The SEC further alleges that at least one client asked Hoffman about his compensation from Zima, and Hoffman represented that his association with Ameriprise limited him to a 1 percent commission. However, Hoffman was prohibited by Ameriprise from recommending the investments to clients, and his true compensation totaled more than $170,000 in low-interest loans from Zima, which was more than 25 percent of the total amount invested by his clients. Hoffman allegedly also took steps to conceal his conduct from Ameriprise, including by using a non-Ameriprise email address to communicate with clients about Zima's securities, which allegedly violated Ameriprise's policies and procedures, and by persuading two clients not to tell Ameriprise that Hoffman recommended Zima's securities to them when Ameriprise contacted the clients about their investments.

In total, eight of Hoffman's clients invested a total of more than $640,000 in Zima's securities based on his recommendations. The complaint alleges that Zima collapsed in January 2020 when its principals were arrested and charged by the federal criminal authorities with conspiracy to commit wire fraud and money laundering, leaving six of Hoffman's clients with total losses of more than $610,000.

The SEC's complaint charges Hoffman with violating the antifraud provisions of Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Investment Advisers Act. Without admitting or denying the allegations of the SEC's complaint, Hoffman consented to the entry of a judgment imposing a permanent injunction, which is subject to court approval. The complaint also seeks the return of ill-gotten gains plus prejudgment interest and civil penalties to be determined by the court upon a motion filed by the SEC.

Conflicts Arising from Mutual Fund and Account Recommendations: *Cambridge Investment Research Advisors, Inc., et al.*[58]

On March 1, 2022, the SEC filed contested charges against Cambridge Investment Research Advisors, Inc. ("CIRA") in the U.S. District Court for the Southern District of Iowa for failing to disclose material conflicts of interest and breaching its duty of care related to its selection of mutual funds and wrap accounts for clients.

[57] *See* Complaint, *SEC v. Hoffman*, No. 22-cv-296 (D. Ariz. Feb. 24, 2022), available here.

[58] *See* Complaint, *SEC v. Cambridge Invest. Research Advisors, Inc., et al.*, No. 22-cv-071 (S.D. Iowa Mar. 1, 2022), available here.

The SEC alleged that, since at least 2014, CIRA repeatedly breached its fiduciary duty to advisory clients by failing to disclose material conflicts of interest. For example, the SEC alleges that CIRA invested client assets in certain funds that generated millions of dollars in revenue sharing payments to an affiliated broker-dealer instead of lower-cost share classes and investment options that would have yielded less revenue sharing. According to the SEC, these undisclosed investment practices allowed CIRA to avoid paying millions in transaction fees. In addition, the SEC alleges that CIRA converted hundreds of accounts to its more expensive wrap account program without adequate disclosure or analysis about whether doing so was in its clients' best interests. The SEC also alleged that CIRA failed to disclose that its investor adviser representatives received compensation in the form of forgivable loans in exchange for meeting certain criteria such as maintaining certain asset levels and tenure with CIRA.

The SEC alleges that CIRA violated Sections 206(2) and (4) of the Investment Advisors Act and Rule 206(4)-7 thereunder. The SEC is seeking a permanent injunction, disgorgement, and civil penalties against CIRA.

Conflicts Arising from Discretionary Investing in Proprietary Mutual Funds: *City National Rochdale, LLC*[59]

On March 3, 2022, the SEC announced a fully settled administrative enforcement proceeding against City National Rochdale, LLC ("CNR") for its failure to adequately disclose conflicts of interest associated with its investment selection practices.

The SEC alleged that, from at least 2016 through 2019, CNR failed to inform its clients of its practice of investing their assets in proprietary mutual funds that generate fees for CNR and its affiliates, rather than in competitor funds whose fees may be lower. Additionally, CNR failed to inform some prospective clients that they could invest in CNR's proprietary funds at a lower cost. For example, CNR failed to disclose that its proprietary mutual funds had two share classes, one of which was subject to Rule 12b-1 of the Investment Company Act of 1940, that were more expensive than other transaction fees in connection with purchasing shares in the same funds available to CNR's clients. The SEC alleged that CNR did not adequately disclose this conflict of interest and breached its duty to provide its clients with the information they needed to give informed consent to, or reject, CNR's conflict of interest when investing their assets in proprietary funds. According to the SEC, CNR also did not disclose to the prospective clients who were introduced to CNR by their third-party financial advisors that they could invest in proprietary funds at lower cost. Finally, the SEC alleged that CNR failed to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder in connection with its use of proprietary funds and its disclosures of related conflicts of interest.

CNR settled the SEC's charges that it violated the provisions of Sections 206(2) and (4) of the Investment Advisers Act of 1940 and Rule 206(4)-7 promulgated thereunder. CNR was censured, ordered to cease and desist from further violations, and ordered to pay disgorgement of $22,013,613, prejudgment interest of $2,848,191, and a civil money penalty of $5,500,000.

Conflicts Arising from Fee Calculations and Investment Selection: *Educators Financial Services, Inc.*[60]

On March 4, 2022, the SEC announced a fully settled administrative enforcement proceeding against Educators Financial Service, Inc. ("Educators") for inaccurately aggregating the value of accounts held by family members living

[59] *City National Rochdale, LLC*, Exchange Act Release No. 94352; Advisers Act Release No. 5973, Mar. 3, 2022, available here.

[60] *Educators Financial Services, Inc*., Advisers Act Release No. 5976, Mar. 4, 2022, available here.

in the same household when determining fee rates and for its failure to adequately disclose conflicts of interest associated with its investment selection practices.

The SEC alleged that Educators failed to consistently aggregate the value of all accounts held by family members living in the same household when determining the fee rate, causing certain clients to pay a higher advisory fee than they should have, and failed to refund pre-paid advisory fees after clients terminated the advisory relationship. The SEC alleged that Educators purchased, recommended, or held advisory clients mutual fund share classes that charged 12b-1 fees, instead of lower-cost share classes of the same funds that were available, and failed to adequately disclose all material facts regarding this conflict of interest breaching its duty to seek best execution. The SEC also alleged that Educators failed to adopt and implement written compliance policies and procedures reasonably designed to prevent violations in connection with its billing practices and mutual fund share class selection.

Educators settled the SEC's charges that Educators violated Sections 206(2) and (4) of the Investment Advisers Act of 1940 and Rule 206(4)-7 promulgated thereunder. Educators was censured, ordered to cease and desist from further violations, and ordered to pay disgorgement of $727,843.61, prejudgment interest of $129,646.94, and a civil money penalty of $250,000.

Conflicts Arising from Undisclosed Management Fees and Inter-fund Transactions: *Alumni Ventures Group, LLC and Michael Collins*[61]

On March 4, 2022, the SEC announced a fully settled administrative enforcement proceeding Alumni Ventures Group, LLC ("AVG") for making misleading statements about its management fees and engaging in inter-fund transactions in breach of fund operating agreements. The SEC also charged AVG's CEO, Michael Collins ("Collins"), with causing AVG's violations.

The SEC alleged that, from June 2016 through Feb. 2020, AVG included misleading statements regarding its collection of management fees and effected inter-fund loans and cash transfers and loans from AVG to funds it advised. For example, AVG included misleading statements at various times in marketing documents for the funds it advised, emails to prospective fund investors, and on its website. Specifically, AVG represented that its management fee was the "industry standard '2 and 20'" whereas, in reality, AVG's typical practice was to assess management fees totaling 20 percent of an investor's initial fund investment. The SEC also alleged that AVG made inter-fund loans and cash transfers between its funds that violated the funds' respective operating agreements regarding commingling of investor assets and breached AVG's fiduciary duties to the funds. According to the SEC, AVG also failed to disclose these transactions to fund investors, creating an undisclosed conflict of interest for AVG as between various funds that it managed. The SEC alleged that Collins knew and approved of these practices.

AVG and Collins settled the SEC's charges that AVG violated Sections 206(2) and (4) of the Investment Advisers Act of 1940 and Rule 206(4)-8 promulgated thereunder, and that Collins caused AVG's violations. AVG repaid $4,791,401 to affected funds. In addition, AVG was censured, ordered to cease and desist from further violations, and ordered to pay a $700,000 civil monetary penalty. Collins was ordered to pay a $100,000 civil monetary penalty.

Renewed Self-Assessment

As we move further into 2022, we expect that the Commission's enforcement agenda will further accelerate, and that investment advisers will be subject to renewed scrutiny of conflicts of interest, including a fresh review of long-

[61] *Alumni Ventures Group, LLC, et al.*, Advisers Act Release No. 5975, Mar. 4, 2022, available here.

standing practices that may present conflicts between an adviser and its clients or among an adviser's clients. While the Commission's enforcement agenda under Chair Gensler is only just starting to take shape, advisers can look to activity during the first quarter of 2022 to gain helpful insight into how the Commission's approach to investigating and enforcing against potential conflicts of interest may unfold over the next few years. Advisers should take this opportunity to review their practices and associated disclosures with a fresh set of eyes, and assess whether they can satisfy the increasingly high bar being set by Chair Gensler for avoiding or mitigating conflicts of interest.

Recent Enforcement Actions[62]

Investment Adviser Enforcement Actions

A. False and Misleading Statements: *SEC v. Safeguard Metals LLC and Santulan*

An investment adviser and its principal were charged with defrauding investors in a multi-front enforcement action filed on Feb. 1, 2022. The SEC simultaneously with the CFTC and 27 NASAA state securities regulatory agencies filed a contested injunctive action against Safeguard Metals LLC ("Safeguard") and its principal, Jeffrey Santulan, for a fraudulent scheme involving retirement aged individuals. [63]

The SEC alleged that, from Dec. 2017 through at least July 2021, Safeguard and Santulan acted as investment advisers and made false and misleading statements to persuade investors to sell their existing securities, transfer the proceeds into self-directed IRAs, and invest the proceeds into gold and silver coins. Throughout the scheme, the SEC claims that Safeguard and Santulan obtained approximately $67 million from the sale of coins to more than 450 mostly elderly investors by charging average markups of approximately 64 percent on its sales of silver coins rather than the 4 percent to 33 percent markups that were disclosed to investors. The SEC alleges that Safeguard and Santulan made additional false and misleading statements about the safety and liquidity of the investors' securities investments, Safeguard's business, and Safeguard's compensation. For example, Safeguard and Santulan targeted investors through Safeguard's website which, under Santulan's authority, falsely stated that Safeguard had $11 billion in assets under management and an office in London. According to the SEC, Safeguard's social media sites, also under Santulan's control, were connected to fake profiles of prominent individuals in the securities industry showing that they were associated with Safeguard.

The SEC's complaint charges Safeguard and Santulan with violating the antifraud provisions of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and Section 206(1) and (2) of the Advisers Act and Santulan with violating Section 20(a) of the Exchange Act. The SEC seeks permanent injunctions, disgorgement of allegedly ill-gotten gains, plus interest, and civil penalties.

In their continuing litigation against Safeguard and Santulan, the CFTC and state securities regulators allege violations of Section 6(c)(1) of the Commodity Exchange Act, 7 U.S.C. § 9(1). And CFTC Regulation 180.1(a)(1)-(3), 17 C.F.R. § 180.1(a)(1)-(3)(2021). The CFTC and state securities regulators seek the return of ill-gotten gains, civil monetary penalties, restitution, permanent registration and trading bans, and a permanent injunction against further violations of the Commodity Exchange Act, state regulatory laws, and CFTC regulations.

[62] The enforcement proceedings described below are based on allegations by the SEC, 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.

[63] *See* Complaint, *SEC v. Safeguard Metals LLC and Santulan*, No. 2:22-cv-00693 (C.D.Cal. Feb. 1, 2022), available here; *see also The CFTC and 27 State Securities Regulatory Agencies Charge Los Angeles Area Precious Metals Dealer in Ongoing $68 Million Fraud Targeting the Elderly*, CFTC Press Release No. 8489-22, Feb. 1, 2022, available here.

B. Allocation Cherry Picking: *SEC v. Toroian and Bell Rock Capital, LLC*

Investment advisors are prohibited from putting their interests, or the interests of their principals and affiliates, above the interests of their investors. On Feb. 25, 2022, the SEC filed charges against Bell Rock Capital, LLC ("Bell Rock") and its principal, M. Cassandra Toroian, for operating a long-running fraudulent trade allocation scheme – commonly referred to as "cherry picking" – that defrauded Bell Rock clients. [64]

The SEC's complaint alleges that from at least Jan. 1, 2011 through Dec. 31, 2015, Toroian traded securities for herself and her family alongside her clients and that Bell Rock and Toroian misrepresented to clients that all trades would be allocated fairly and that Bell Rock and Toroian would not put their interests before their clients' interests. Toroian allegedly delayed allocating the securities to specific client accounts until after she had observed the securities' performance over the course of the day. The complaint alleges that profitable trades would be allocated by Toroian to accounts that belonged to her and her family members. Less profitable and losing trades were then allocated to Bell Rock's client accounts. The SEC alleges that the securities that Toroian allocated to the accounts belonging to her and her family members increased in value by more than 2 percent, or a gain of over $1 million between purchase and allocation. However, the securities that Toroian allocated to Bell Rock's client accounts are alleged to have decreased in value by more than 1.3 percent, or a loss of over $1 million, between purchase and allocation. In addition, the complaint also alleges that Bell Rock failed to implement appropriate policies and procedures designed to detect and prevent Toroian's cherry-picking allocation strategy.

The SEC charged Bell Rock and Toroian with violating Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, Section 17(a) of the Securities Act, and Sections 206(1), 206(2) of the Investment Advisers Act. It also charges Bell Rock with failing to adopt and implement adequate compliance policies in violation of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder and charges Toroian with aiding and abetting those violations. The SEC seeks injunctive relief, disgorgement of Toroian's ill-gotten gains with prejudgment interest, and civil penalties.

C. Lack of Transparency and Full Disclosure: *In Re Ameritas Advisory Services, LLC*

An investment adviser's fiduciary duties are not limited to keeping an investor's best interests at heart, investment advisers also have a fiduciary duty to be transparent about certain benefits than an investment adviser might receive. On Feb. 25, 2022, the SEC announced settled charges against registered investment adviser Ameritas Advisory Services, LLC ("Ameritas Advisory") for breaching its fiduciary duty by failing to disclose third-party compensation received when the advisory business was part of a registered investment adviser/broker dealer firm, Ameritas Investment Company.[65]

The SEC order alleges that since at least Feb. 2014, Ameritas Advisory failed to disclose its practices regarding mutual fund and money market share class selection, fee markups, margin interest, and business development credits, and in relation to this conduct, that Ameritas Advisory failed to seek the best execution for its advisory clients. Specifically, the SEC claims that Ameritas Advisory did not disclose its conflict of interest with a clearing broker that would share in a mutual fund's recurring fees. In addition, the SEC claimed that Ameritas Advisory failed

[64] *See* Complaint, *SEC v. Toroian and Bell Rock Capital, LLC*, No. 22-cv-715 (E.D. Pa. Feb. 25, 2022), available here.

[65] *Ameritas Advisory Services, LLC*, Advisers Act Release No. 5970, Feb. 25, 2022, available here.

to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder.

Ameritas Advisory settled the SEC's charges that it violated Sections 206(2) and 206(4) of the Investment Advisers Act and Rule 206(4)-7 thereunder. Without admitting or denying the SEC's findings, Ameritas Advisory consented to cease and desist from further violations, a censure, disgorgement of $3,334,804 and prejudgment interest of $543,390, and pay a civil penalty of $750,000.

D. Misleading Statements About Historical Performance: *In re Mark Alan Bourgeois and In re Sivendran Vettivetpillai*

Investment advisers that are raising new funds will be held accountable for overstating the performance of prior funds, particularly when the prior funds' internal analyses demonstrate more modest performance. On March 2, 2022, the SEC announced fully settled administrative enforcement proceedings against Mark Alan Bourgeois ("Bourgeois") and Sivendran Vettivetpillai ("Vettivetpillai") for misleading investors and potential investors about a new investment fund by concealing the misappropriation of funds and the financial conditions of investment adviser Arbraaj Investment Management Limited ("AIML").[66]

The SEC alleged that, in 2017, Bourgeois began leading AIML's fundraising for a new $6 billion global emerging markets private pooled investment vehicle. In offering investments in the new AIML fund, AIML investment personnel responsible for valuations stated internally that certain write-downs were needed for a number of portfolio companies held by private equity funds managed by AIML, but AIML did not make these write-downs, thus leaving its performance inflated. Bourgeois was responsible for the recommendation that AIML not apply (or delay applying) the write-downs. During the same time frame, Vettivetpillai allegedly agreed to delay using cash from another Abraaj Investment Fund so AIML could use it for its own benefit. According to the SEC, Vettivetpillai was aware of and assisted AIML in this misconduct. The SEC also alleges that, in at least 2018, Vettivetpillai helped AIML mislead investors and prospective investors about AIML's performance track records during AIML's fundraising.

Bourgeois settled the SEC's charges that he violated Section 17(a)(2) of the Securities Act and willfully aided and abetted and caused AIML's violations of Sections 17(a)(1) and (3) of the Securities Act, and; willfully aided and abetted and caused AIML's violations of Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. Bourgeois was ordered to cease and desist from further violations, to disgorge $1,993,880 in ill-gotten gains and prejudgment interest of $106,682.

Vettivetpillai settled the SEC's charges that he violated Section 17(a)(1) and (3) of the Securities Act and violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. Vettivetpillai was ordered to cease and desist from further violations, and barred from association with and prohibited from serving as an investment adviser. On July 26, 2021, Vettivetpillai pleaded guilty in the related criminal proceeding, *United States v. Arif Naqvi, et al.*, Case No. 1:19-cr-00233-LAK in the U.S. District Court for the Southern District of New York, for violating the securities laws of the United States with respect to his conduct while at the Abraaj Group, including Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.[67]

[66] *Mark Alan Bourgeois*, Exchange Act Release No. 94341, March 2, 2022, available here; *Sivendran Vettivetpillai*, Securities Act Release No. 11037, March 2, 2022, available here.

[67] *See Second Abraaj Executive to Plead Guilty, Cooperate With U.S.*, WSJ, June 22, 2022, available here.

E. Crypto Fund Fraud: *In re Stefan Qin*

As digital asset investments draw greater interest from retail investors, any associated misconduct will likely lead to substantial penalties. On March 4, 2022, the SEC announced a fully settled administrative enforcement proceeding against Stefan Qin ("Qin") for securities fraud in providing false and misleading statements to investors about the status of investment funds he controlled.[68]

The SEC alleged that Qin engaged in a deceptive course of conduct, misused and misappropriated investor assets, and made materially false and misleading statements in connection with his management of the Virgil Sigma Fund he controlled. For example, Qin had consistently claimed since 2016 that his proprietary, market-neutral arbitrage trading strategy in crypto currencies achieved positive returns in every month except one. In relation to those claims, Qin reportedly prepared and provided to investors documents that claimed the fund held millions of dollars' worth of digital assets, but, in reality, the fund held no assets and the purported platform account balances were fabricated.

Qin settled the SEC's charges that he violated Section 17(a) of the Securities Act and section 10(b) and Rule 10b-5 of the Exchange Act. Qin was ordered to cease and desist from further violations and barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization. On Sept. 15, 2021, Qin was sentenced in connection with his guilty plea to criminal conduct for securities fraud in violation of 15 U.S.C. § 78j(b) and was sentenced to seven and a half years' imprisonment, three years' supervised release, and forfeiture of $54,793,532.14.[69]

F. Failure to Supervise: *In re Natixis Securities Americas LLC*

Although technological advances can increase accuracy and efficiency, when technological shortcomings lead to errors or omissions, regulatory challenges can follow. On March 22, 2022, FINRA announced a fully settled letter of acceptance, waiver, and consent with Natixis Securities America, LLC ("Natixis") for its failure to report short interest positions and to maintain a supervisory system to comply with short interest reporting requirements.[70]

FINRA alleged that in Feb. 2013, Natixis set up two trading accounts for its parent company, but the firm's legacy systems were not updated to capture the two accounts in its short interest reports. As a result, FINRA alleges that from Feb. 2013 through June 2019, Natixis did not report any short interest positons in the two accounts which totaled 82,311 short interest positions and approximately 9.9 billion shares over more than six years. According to FINRA, Natixis's supervisory systems were not reasonably designed to ensure compliance. For example, while the firm had procedures that listed steps that personnel were supposed to follow to transmit the short interest report every two weeks, Natixis did not require supervisory review to determine the accuracy of the reports. On its own initiative, Natixis hired an outside consultant who discovered the reporting issue. FINRA notes that in July 2019, Natixis implemented a technology solution to include the accounts in its short interest reporting and was recognized for its extraordinary cooperation in reporting and correcting this issue.

Natixis settled FINRA's charges that it violated FINRA rules 2010, 3110, and 4560 and NASD Rule 3010. Natixis was censured and ordered to pay a $400,000 fine.

---

[68] *Stefan Qin*, Advisers Act Release No. 5974, March 4, 2022, available here.

[69] *See Founder Of $90 Million Cryptocurrency Hedge Fund Sentenced To More Than Seven Years In Prison*, DOJ Press Release 21-239, Sept. 15, 2021, available here.

[70] *Natixis Securities Americas LLC.*, FINRA Letter of Acceptance, Waiver, and Consent No. 2019063203501, March 22, 2022, available here.

Broker-Dealer Enforcement Actions

A. Failure to Make Timely Disclosures: *In Re tZero ATS, LLC*

The SEC will pursue broker-dealers that fail to make timely disclosures and adequate written standards. On Jan. 10, 2022, the SEC announced settled charges against tZERO ATS, LLC ("tZERO") (an indirect subsidiary of Overstock.com) for failing to comply with certain requirements of Regulation ATS.[71]

The SEC alleged that tZERO, a registered broker-dealer that operated an alternative trading system ("ATS"), failed to make timely disclosures on Form ATS before it shared information about the ATS's order book with two third-parties. Additionally, the SEC alleged that tZERO did not establish written standards for granting access to the ATS as required by the Fair Access Rule of Regulation ATS.

The SEC found that tZERO violated Rules 301(b)(2) and 301(b)(5) of the Regulation ATS under the Securities and Exchange Act of 1934. Without admitting or denying the SEC's findings, tZERO consented to a cease-and-desist order and a censure, and agreed to pay a civil penalty of $800,000.

B. Failure to Disclose Prior Fraud in Bond Offering and Associated Risks: *In re Fusion Analytics Securities, LLC*

FINRA responds to allegations of misrepresentations and omissions in bond offering with an enforcement action. On March 7, 2022, FINRA filed an enforcement action against Fusion Analytics Securities, LLC ("Fusion") for securities fraud and other violations of FINRA rules in connection with its sale of bonds in two private offerings.[72]

FINRA alleged that, starting January 2017, Fusion intentionally or recklessly made material misrepresentations and omissions to potential investors. Specifically, the misrepresentations and omissions concerned: a 2013 SEC Order and its findings that a promoter and company had misled investors and misdirected investment proceeds; the risks and anticipated revenue of the project being funded by the offerings; the progress of the offering; and that the issuer was in financial distress, late on interest payments, debt covenants, and needed to raise funds to pay interest to prior investors. FINRA alleged that Fusion knew about a series of red flags about the promoter and a prior bond offering but took no steps to investigate the veracity of that information and failed to follow its own procedures to supervise due diligence. FINRA also alleged that Fusion solicited potential investors, but did not inform them of the 2013 SEC Order's findings or disclosure regarding the past history of misleading investors. In addition, FINRA staff issued requests for information as part of their investigation seeking copies of relevant materials, but Fusion allegedly responded with incomplete and false information including disclosing some, but not all, bond sales.

FINRA charges that Fusion violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, FINRA Rules 2010, 2020, 2111, and 8210. FINRA is seeking disgorgement of Fusion's ill-gotten gains, an order that Fusion bear the costs of the proceedings, and findings that Fusion violated the provisions it was charged with.

---

[71] *tZERO ATS, LLC*, Exchange Act Release No. 93938, Jan. 10, 2022, available here.

[72] *Dep't of Enforcement v. Fusion Analytics Securities, LLC CRD No. 124245*, Disciplinary Proceeding No. 2018059545604, March 7, 2022, available here.

C. Inadequate Policies and Procedures: *In re Geneos Wealth Mgmt Inc.*

Failure to implement and maintain proper policies and procedures, and the failure to disclose information to investors results in a settlement with FINRA. On March 18, 2022, FINRA accepted a Letter of Acceptance, Waiver, and Consent from Geneos Wealth Management Inc. ("Geneos"), for its failure to adequately maintain policies and procedures to properly ensure that the firm and its representatives sufficiently understood the risks and features of the alternative mutual funds that it offered, and for its failure to disclose material information to investors regarding a product that they sold.[73]

Between Nov. 9, 2016 and Feb. 6, 2018, Geneos permitted the sale of the LJM Preservation & Growth Fund, ("LJM"), an alternative mutual fund that tried to capture profit from the "volatility premium" in the market. Despite offering sales of LJM, Geneos admitted it had no systems or procedures to determine whether a new mutual fund was a "complex product" or an alternative mutual fund that required heightened due diligence, that it did not have any written supervisory procedures advising firm principals how to supervise recommendations of alternative mutual funds, and that the firm's electronic trade review system did not account for risk factors associated with alternative mutual funds. As a result, Geneos did not properly evaluate the risk for LJM. In addition, Geneos failed to disclose material information to three investors in an investment in the GPB Automotive Portfolio, LP that the portfolio had not timely filed its audited financial statements with the SEC or the reasons for those delays.

Geneos settled that the allegations that it violated FINRA Rules 3110 and 2010. Geneos was censured, issued a $150,000 fine, ordered to provide restitution of $250,710.41 plus interest to certain customers who purchased LJM, and ordered to implement policies, procedures, and internal controls reasonably designed to address and remediate the issues pertaining to alternative mutual funds.

[73] *Geneos Wealth Mgmt Inc.*, FINRA Letter of Acceptance, Waiver, and Consent No. 2019061764701, March 18, 2022, available here.

Other Enforcement Actions

A. ICO Fraud: *SEC v. Crowd Machine, et al.*

The SEC has made clear that fraud concerning digital assets is a focus of enforcement, and on Jan. 6, 2022, the SEC announced charges against Craig Sproule and two companies he founded, Crowd Machine, Inc. and Metavine, Inc., for making materially false and misleading statements in connection with an unregistered offer and sale of digital asset securities.[74]

The SEC alleged that during the initial coin offering of Crowd Machine Compute Tokens ("CMCTs"), Sproule told investors that the ICO proceeds would be used to develop a new technology. The complaint charges that Sproule represented that ICO proceeds would be used to fund the development of a new technology, a "global decentralized" peer-to-peer network (or "Crowd Computer"), that he claimed would run their existing "no-code" application-development software from a network of the users' own devices instead of traditional centralized servers. According to the complaint, defendants never operationalized the Crowd Computer. Additionally, Sproule materially misrepresented how he intended to use the ICO proceeds. Starting during the ICO, Sproule and his companies diverted more than $5.8 million to gold mining companies in South Africa, purportedly in the form of loans or in exchange for equity interests in these mining operations.

For this conduct, the SEC alleges that Sproule and Crowd Machine, Inc. violated the antifraud and registration provisions of the federal securities laws, pursuant to Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, as well as Sections 5(a) and 5(c), 17(a) of the Securities Act. The SEC is seeking an order restraining the Defendants from further violations of the securities laws, disgorgement of ill-gotten gains, the imposition of civil penalties, and a director and officer bar for Sproule.

B. Scalping: *SEC v. Beck and Robinson*

The SEC continues to target scalpers, and other manipulators who use social media and deceptive practices to deceive investors for their own benefit. On Feb. 7, 2022, in the Central District of California, the SEC filed a complaint against Michael M. Beck for deceiving investors using a practice known as "scalping" in a fraudulent penny stock scheme. Beck's mother, Helen P. Robinson, who permitted Beck to trade in her brokerage accounts and was named as a relief defendant in the case.[75]

The SEC alleged that since at least Feb. 2017, Beck used Twitter to operate his scalping scheme. Beck reportedly used the Twitter handle, @BigMoneyMike6, where he had approximately three million followers. The SEC alleges that Beck encouraged his Twitter followers to join his email list – TeamBillionaire – and would then preview penny stock recommendations there before tweeting about them. As a result, this allowed TeamBillionaire recipients to purchase the stock prior to Beck's Twitter promotion. According to the SEC, these early purchases generally increased the stock's price, and made the stock look more favorable to potential investors on Twitter when Beck issued his public recommendation. In addition, Beck reportedly would pay third parties to post favorable messages about a stock on Investorshub.com to pump up the price. In conjunction with the increase in stock price, Beck allegedly sold his or his mother's holdings of the same stock. According to the SEC, at no point did Beck disclose his

---

[74] *See* Complaint, *SEC v. Crowd Machine et al.*, No. 5:22-cv-00076 (N.D. Cal. Jan. 6, 2022), available here.

[75] *See* Complaint, *SEC v. Beck and Robinson*, No. 2:22-cv-00812 (C.D. Cal. Feb. 7, 2022), available here.

plan to sell, or his ongoing selling, of shares he pushed on social media. As a result of this scalping, Beck obtained approximately $870,000 in proceeds.

The SEC charged Beck with violating the antifraud provisions of Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The complaint seeks finding of fact and conclusions of law that Beck committed the violations, a permanent injunction against further violations, civil penalties, a penny stock bar, and disgorgement of any ill-gotten gains with prejudgment interest.

C. Fraud: *SEC v. Booth, et al.*

High pressure sales tactics that target elderly and other vulnerable investors alerts both the SEC and prosecutors. On Feb. 9, 2022 in the Southern District of New York, the SEC filed a complaint that charged Robert Lenard Booth, a/k/a Trevor Nicholas, Daniel T. Wellcome Jr., Michael D'Urso, Antonella Chiaramonte, Alyssa D'Urso and Jay Garnock, (collectively the "Defendants") for their involvement in operating overseas "boiler rooms" that laundered more than $8,000,000 and defrauded more than 140 investors.[76]

From at least April 2019 to Dec. 2020, the SEC alleged that, several of these overseas boiler rooms defrauded elderly or retirement aged victims by selling fake investments. Specifically, the boiler rooms convinced investors to wire money that they believed would be used to purchase securities, but in reality, the Defendants split the money among themselves. Portions of that money were purportedly laundered back overseas to the boiler rooms. According to the SEC, the Defendants would create shell companies and open bank accounts to deceive other banks and the investors about the nature of the business. These shell companies had no legitimate operations and were purposefully named to sound like transfer agents in order to perpetuate the fraud. As an example, Booth purportedly operated a boiler room out of Thailand that brought in at least $700,000 from 10 investors.

Booth, Michael D'Urso, and Wellcome were charged with violating Section 17(a) of the Securities Act and Section 10(b) of the Securities Exchange Act, and Rule 10b-5 thereunder. Alyssa D'Urso, Chiaramonte, and Garnock were charged with violating and aiding and abetting those provisions. The SEC also charged Booth with violating the broker registration provisions of Section 15(a) of the Exchange Act and Michael D'Urso and Wellcome with aiding and abetting those violations. The SEC is seeking findings that the defendants violated these provisions, permanent injunctions from further violations and enjoining the Defendants from participating in securities offerings, disgorgement of any ill-gotten gains with prejudgment interest, and civil penalties.

In a parallel action, the U.S. Attorney's Office for the Southern District of New York filed criminal charges against all six defendants. [77] On April 1, 2022, the SEC's civil action was stayed pending the outcome of the criminal charges. Wellcome also settled the civil charges against him on April 1, 2022 and was permanently enjoined from future securities violations.

D. FCPA Violations: *In Re KT Corp*.

A recent enforcement action highlights the risk of making improper payments to government officials and failure to implement appropriate internal accounting controls. On Feb. 17, 2022, the SEC announced settled charged against KT Corporation, the largest telecommunications operator in South Korea ("KT Corp."), for violations of the books and

[76] *See* Complaint, *SEC v. Booth, et al.*, No. 1:22-civ-01115 (S.D.N.Y. Feb. 9, 2022), available here.

[77] *See* Indictment, *United States of America v. Booth, et al.*, (S.D.N.Y. Feb. 9, 2022), available here.

records and internal accounting control provisions of the Foreign Corrupt Practices Act ("FCPA") related to improper payments to government officials in Korea and Vietnam.[78]

The SEC alleged that from at least 2009 through 2017 high level executives and other employees of KT Corp. maintained slush funds comprised of off-book accounts and physical stashes of cash that was used to provide gifts, entertainment, and illegal political contributions to government officials in Korea. In addition, between 2015 and 2016 KT Corp. reportedly made payments of over $1.6 million to three organizations at the request of high-level government officials without determining if these donations were legitimate. Likewise, KT Corp. hired two advertising executives with personal connections to Korea's presidential residence and office without conducting due diligence. Similarly, in Vietnam, the SEC alleged that between 2014 and 2018 KT Corp. employees discussed providing money to third parties connected the Vietnamese government in order to obtain contracts for two projects. According to the SEC, KT Corp. engaged intermediaries in connection with two projects that ultimately bribed government officials. In relation to this conduct, the SEC alleged that KT Corp. failed to implement sufficient internal accounting controls and lacked relevant anti-corruption policies and procedures.

KT Corp. settled the SEC's charges that it violated Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act. KT Corp. agreed to cease and desist from further violations, disgorge $2,263,821 in ill-gotten gains and $536,457 in prejudgment interest and pay a civil penalty of $3,500,000. Separately, KT Corp. and 14 executives were charged by South Korean authorities for criminal violations arising out of the same scheme.[79]

E. Fund Value Fraudulently Overstated: *SEC v. Velissaris*

On Feb. 17, 2022, in the Southern District of New York, the SEC charged James Velissaris, ("Velissaris"), the former CIO and founder of Infinity Q Capital Management ("Infinity Q"), in connection with a fraudulent scheme that overvalued Infinity Q assets by more than $1 billion and allowed Velissaris to collect more than $26 million in fees.[80]

The SEC alleged that, from at least Feb. 2017 through Feb. 2021, Velissaris manipulated the code of a third-party pricing service used to value certain Infinity Q funds' assets and cherry-picked inputs or entered inputs that he knew were incorrect in order to overvalue Infinity Q funds. The SEC also alleged that, during the market volatility at the onset of the COVID-19 pandemic, Velissaris forestalled redemptions by investors who likely would have requested a return of their money had they known the funds' actual performance. According to the SEC, at times during the pandemic, the funds' actual values were half of what was reported to investors. In addition, Velissaris reportedly tried to conceal his scheme from Infinity Q's independent auditor via forged transaction confirmation documents. Likewise, the SEC claims Velissaris tried to obstruct the SEC in its investigation of Infinity Q by altering and fabricating documents. In Feb. 2021, Infinity Q removed Velissaris from management after the SEC confronted the firm with information relating to the adjustments of the third-party pricing model.

The SEC charged Velissaris with violating Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act, and Rule 10b-5 thereunder, Sections 206(1), 206(2), 206(4) and 207 of the Investment Advisers Act, and Rule 206(4)-8 thereunder, and Sections 34(b) and 37 of the Investment Company Act, and in the alternative; that Velissaris violated Exchange Act Section 10(b) and Rule 10b-5 thereunder as a control person of Infinity Q under Exchange Act Section 20(a), and is therefore liable for violations by Infinity Q of Exchange Act Section 10(b) and Rule 10b-5(b) thereunder. The complaint also charges Velissaris with aiding and abetting Infinity Q's violations of Sections

[78] *KT Corporation*, Exchange Act Release No. 94279, Feb. 17, 2022, available here.

[79] *See KT CEO, company officials indicted on illegal political donation charges*, The Korea Herald, Nov. 4, 2021, available here.

[80] *See* Complaint, *SEC v. Velissaris*, No. 1:22-cv-01346 (S.D.N.Y. Feb. 17, 2022), available here.

17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5(a)-(c) thereunder, Sections 204(a), 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rules 204-2(a), 206(4)-7, and 206(4)-8 thereunder, and Section 34(b) of the Investment Company Act, and aiding and abetting the Infinity Q Diversified Alpha Fund's violations of Rule 22c-1 under the Investment Company Act. The SEC is seeking a permanent injunction enjoining future violations, disgorgement of all ill-gotten gains, civil penalties, and a bar on Velissaris from serving as a public company officer and director. The CFTC also initiated a parallel action against Velissaris on Feb. 17, 2022 in the Southern District of New York for violations of Sections 4o(1)(A)-(B), 4(b)(2)(A)-(C), 4b(e)(1)-(3), and 6(c)(1) of the Commodity Exchange Act, 7 U.S.C. §§ 6o(1)(A)-(B), 6b(a)(2)(A)-(C), 6b(e)(1)-(3), and 9(1), CFTC Regulation 180.1(a), and 17 C.F.R. § 180.1(a)(2021).[81]

F. Improper Exchange Rate: *In Re Baxter International Inc*.

An internal investigation reveals improper foreign exchange rate caused inaccurate financial statements. On Feb. 22, 2022, the SEC announced settled charges against Baxter International Inc. ("Baxter") for engaging in improper intra-company foreign exchange transactions that resulted in the misstatement of the company's net income. [82] The SEC also announced related settled charges against Scott Bohaboy, [83] Baxter's former treasurer, and Jeffrey Schaible, [84] Baxter's former assistant treasurer, for their misconduct in connection with the improper transactions.

The SEC alleged that, from at least 1995 through July 2019, Baxter used a foreign exchange rate convention not in accordance with GAAP to covert non-U.S. dollar denominated transactions and liabilities. For example, instead of using the exchange rate on the date of a transaction, Baxter would initially use an exchange rate from a specified date near the middle of the previous month. Furthermore, according to the SEC beginning in at least 2009 and through July 2019, Baxter used the convention to enter into intra-company foreign exchange transactions for the sole purpose of generating foreign exchange accounting gains or avoiding foreign exchange accounting losses. In March 2020, after an internal investigation concerning the transactions Baxter issued restated financial statements which reduced its previously reported net income from 2017 through June 30, 2019 and restated earnings as of Jan. 1, 2017 by $582 million. The vast majority of the changes in the report, $517 million, was related to foreign exchange gains and losses dating back to 2010, that were, in part, attributable to the exchange rate transactions at issue. In reaching the settlement, the SEC noted Baxter's substantial cooperation throughout the investigation and the multiple remedial measures that Baxter has taken in response to the misconduct.

Baxter settled the SEC's charges that it violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 13a-1, 13a-11, and 13a-13 thereunder. Baxter consented to cease and desist from future violations and pay a civil penalty of $18 million.

[81] *CFTC Charges Hedge Fund Manager with Fraudulent Scheme to Overvalue Investment Funds by $1 Billion*, CFTC Press Release No. 8495-22, Feb. 17, 2022, available here.

[82] *Baxter International Inc.*, Securities Act Release No. 11032, Feb. 22, 2022, available here.

[83] *Scott Bohaboy*, Securities Act Release No. 11034, Feb. 22, 2022, available here. Bohaboy settled the SEC's charges that he violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 13a-1, 13a-11, and 13a-13 thereunder. Bohaboy consented to cease and desist from future violations and agreed to pay a civil money penalty in the amount of $125,000.

[84] *Jeffrey Schaible*, Securities Act Release No. 11033, Feb. 22, 2022, available here. Schaible settled the SEC's charges that he violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 13a-1, 13a-11, and 13a-13 thereunder. Schaible consented to cease and desist from future violations and agreed to pay a civil money penalty of $100,000, a disgorgement penalty in the amount of $76,404, and prejudgment interest in the amount of $12,955.

G. Failure to Register: *In Re Richard Neal & Golden Signals LLC*

The CFTC takes consumer protection seriously and will aggressively pursue fraud. On Feb. 23, 2022, the CFTC announced settled charges against Golden Signals LLC ("Golden Signals") and its President, CEO, and sole employee, Richard Neal, ("Neal" and collectively, the "Respondents") for engaging in fraud while acting as a commodity trading advisor and commodity pool operator, failure to properly register with the CFTC, and for advertising without making CFTC required disclosures.[85]

The CFTC alleged that, from Oct. 2016 to at least Nov. 2021, Neal used two websites and social media channels to offer and sell real-time commodity binary options trading signals, trainings and strategy course offerings. In June 2017, Neal formed Golden Signals. The Respondents then began soliciting for their business and purportedly made false statements regarding profit percentage ratings, success of investments, and scarcity of services they offered. For example, the CFTC claims Respondents would falsely state that that Neal's strategies earned him "on average $500-$1000 a day." As a result of this conduct, the CFTC stated that approximately 1,600 customers lost at least $945,000 through the fraudulent solicitations for binary options signals, trainings, and strategy course offerings and 10 participants lost approximately $410,000 in an "Account Management" program that gave respondents funds to be pooled and traded in binary options.

Respondents settled the CFTC's charges that they violated Sections 4c(b), 4*o*(1)(A) and (B), and 4m(1) of the Commodity Exchange Act, 7 U.S.C. §§ 6c(b), 6*o*(1)(A), (B), 6m(1), and CFTC Regulations 32.4, and 4.41(a)(1)-(3), and 4.41(b), 17 C.F.R. §§ 32.4, 4.4(a)(1)-(3), 4.41(b) (2021). Respondents agreed to pay $409,965 in restitution plus any post-judgment interest, $896,673 in disgorgement plus any post-judgment interest, and a civil penalty of $1,306,638 plus any post-judgment interest.

H. Digital Asset Offering Fraud: *SEC v. John Barksdale, et al*.

Digital asset fraud does not go unnoticed by the SEC, and results in parallel SEC and DOJ actions. On March 8, 2022, the SEC filed charges against siblings John and JonAtina Barksdale (the "Barksdales") with defrauding thousands of retail investors out of over $124 million through two unregistered fraudulent offerings of securities involving a digital token.[86]

The SEC alleged that, from June 2017, the Barksdales offered and sold a digital token called the "Ormeus Coin" to investors on crypto trading platforms. To promote the offering, the Barksdales held roadshows around the world and created promotional materials that, the SEC claims, falsely stated that Ormeus Coin was supported by one of the largest crypto mining operations in the world even though the Barksdales abandoned their mining operations after only generating less than $3 million in total mining revenue. For example, the SEC alleges that the defendants falsely stated that Ormeus Coin had a $250 million crypto mining operation and was producing between $5.4 to $8 million in monthly revenues. To preserve this fiction the Barksdales arranged for a public website to display a wallet of an unrelated third party showing more than $190 million in assets as of November 2021 while, in reality, Ormeus wallets were worth less than $500,000. The SEC also alleged that the Barksdales manipulated Ormeus Coin's price and misused millions of investor funds for personal expenses.

[85] *CFTC Orders North Carolina Man and His Company to Pay $2.6 Million for Fraudulent Solicitation, Pool Fraud, and Failure to Register*, CFTC Press Release No. 8496-22, Feb. 23, 2022, available here.

[86] *SEC v. John Barksdale, et al.*, No. 1:22-cv-1993 (S.D.N.Y. Mar. 8, 2022), available here.

The SEC charges the Barksdales with violations of Sections 5(a), 5(c), 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The SEC is seeking disgorgement of ill-gotten gains, civil penalties, permanent enjoinment from future violations, permanent enjoinment from participating in the issuance, purchase, offer, or sale of any security in an unregistered offering, and findings that the Barksdales violated the provisions they were charged with. In a parallel action, John Barksdale is facing criminal charges brought by the U.S. Attorney's Office for the Southern District of New York.[87]

I. Bitcoin Ponzi Scheme: *CFTC v. Dwayne Golden, et al*.

Ponzi schemes are evolving in the digital age of cryptocurrencies, and the CFTC is pursuing actions to protect consumers. On March 8, 2022, the CFTC filed a federal civil action in the U.S. District Court for the Eastern District of New York charging Dwayne Golden of Florida, Jatin Patel of India, Marquis Egerton of North Carolina, and Gregory Aggesen of New York with fraud for operating Ponzi schemes involving bitcoin, for fraudulently soliciting more than $44 million of investments, and misappropriating millions of dollars.[88]

According to the CFTC, Golden, Patel, and Egerton operated the websites Empowercoin and Ecoinplus through which they fraudulently solicited individuals of more than $23 million worth of Bitcoin. Golden, Patel, Aggesen and an accomplice, reportedly operated the website JetCoin through which they fraudulently solicited individuals of more than $21 million Bitcoin. The CFTC alleges that the websites promised customers that professionals would trade their Bitcoin and guaranteed that the resulting profits would be paid daily, but in reality the customers' bitcoin were either misappropriated by the defendants and their accomplice or used to make supposed profit payments to other customers.

The CFTC alleges that defendants violated Section 6(c)(1) of the Commodity Exchange Act, as amended, 7 U.S.C. § 9(1), and Regulation 180.1(a), 17 C.F.R. § 180.1(a)(1) (2021). The CFTC is seeking to enjoin the defendants and affiliates from future violations and engaging in commodity interest trading, pay civil monetary penalties, disgorge ill-gotten gains, and to rescind all agreements with their customers. In a parallel action, Golden, Egerton, and Aggesen were indicted for criminal wire fraud, money laundering, and a separate individual was charged with obstruction of justice.[89]

J. Municipal Bond Offering Fraud: *In re Crosby Ind. School District, et al*.

An auditor who fails to supervise and exercise professional judgment and skepticism is among the targets of the SEC in connection with a municipal bond offering fraud. On March 16, 2022, the SEC announced a fully settled administrative enforcement proceeding against the Crosby Independent School District ("Crosby") and its former CFO, Carla Merka, ("Merka") with misleading investors in the sale of $20 million of municipal bonds. The SEC also charged Crosby's auditor, Shelby Lackey, ("Lackey") with improper professional conduct in connection with the audit of Crosby's financial statements.[90]

The SEC alleges that Crosby failed to report $11.7 million in payroll and construction liabilities and falsely reported having $5.4 million in general fund reserves in its audited 2017 financial statements. According to the SEC, Crosby and Merka were aware that the financial statements significantly underreported the payroll and construction

---

[87] *John Barksdale Charged with Cryptocurrency Securities Fraud in Connection With Sale of Ormeus Coin, DOJ Press Release*, Mar. 8, 2022, available here.

[88] *CFTC v. Dwayne Golden, et al.*, No. 1:22-cv-1252 (E.D.N.Y. Mar. 8, 2022), available here.

[89] *Owners and Operators of Online Cryptocurrency Companies Indicted for Defrauding Investors*, DOJ Press Release, Mar. 8, 2022, available here.

[90] *See SEC Charges Texas School District and its Former CFO with Fraud in $20 Million Bond Sale*, SEC Press Release 2022-43, Mar. 16, 2022, available here.

liabilities and they knowingly included false and misleading financial statements in the offering documents used to raise $20 million through the sale of municipal bonds in Jan. 2018. For example, Merka allegedly knew that earlier bond proceeds were already consumed and that the district would have to use its general fund to pay remaining construction commitments, but did not report the unpaid construction liability in the district's financial statements. Similarly, Merka allegedly underreported teacher payroll liabilities by misreporting it as all paid over the 10-month period corresponding with the start and end of the school year. This was inaccurate as teachers were actually paid evenly over the calendar year, which led to two months of payroll liabilities being unreported. In addition, the SEC alleged that Lackey failed to perform critical audit procedures in accordance with Generally Accepted Auditing Standards by failing to obtain appropriate audit evidence, failing to properly supervise the audit, and by failing to exercise professional judgment and maintain professional skepticism.

Crosby settled the SEC's charges that it violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act. In light of remedial acts, Crosby was ordered to cease and desist from further violations. Merka was charged with violating the antifraud provisions of the securities laws and agreed to pay a $30,000 penalty and not participate in any future municipal securities offering (subject to the approval of the U.S. District Court for the Southern District of Texas). The SEC charged Lackey with engaging in improper professional conduct pursuant to Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice. Lackey was barred from practicing before the SEC as an accountant with the right to apply for reinstatement after three years, and ordered not to serve as an engagement manager, partner, or quality control reviewer in connection with any audit expected to be posted in the MSRB's Electronic Municipal Market Access system unless reinstated by the SEC.

K. Insider Trading: *SEC v. Hari Prasad Sure, et al*.

The SEC targets misuse of inside information that the early pandemic closures would result in better than publicly announced earnings for cloud communication systems company. On March 28, 2022, the SEC filed charges against three software engineers employed at Twilio, Inc., and four of their family members and friends, (collectively the, "Defendants") in the United States District Court Northern District of California San Francisco Division for allegedly generating more than $1 million in collective profits by insider trading.[91]

The SEC alleged that the Defendants knowingly tipped off or used their brokerage accounts to trade Twilio options and stocks in advance of its May 6, 2020 earnings announcement while in possession of confidential information concerning customer use. Three of the defendants were software engineers at Twilio. Between late March and early 2020, the SEC claims that they accessed material non-public information regarding the company's revenue using Twilio's database and then tipped off close friends and family members. Subsequently, they traded Twilio options ahead of Twilio's first quarter earnings announcement. According to the SEC, the Defendants' insider trading scheme began in or about March 2020 when health measures taken in light of the Covid-19 pandemic unexpectedly increased Twilio's customer usage. Before those public health measures began, Twilio had publically announced guidance about the company's expected revenue, but prior to the close of the first quarter, customers substantially increased their reliance on cloud communication systems that Twilio provided and their earnings began to exceed those expectations by many multiples. According to the SEC, based on this information Defendants executed options on Twilio generating over $1 million in illicit gains.

[91] *SEC vs. Hari Prasad Sure, et al.*, No. 3:22-cv-01967 (N.D. Cal. Mar. 28, 2022), available here; *see also East Bay Resident Charged In Insider Trading Securities Fraud Scheme*, DOJ Press Release (March 28, 2022), available here.

The SEC charges that the Defendants violated the provisions of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. The SEC is seeking to enjoin Defendants from future violations, issue an order requiring civil monetary penalties, and to issue an order to disgorge illegal trading profits plus pre-judgment interest. In a related proceeding, the U.S. Attorney's office for the Northern District of California announced criminal charges against Dileep Kamujula, a friend of one of the defendant's Twilio software engineers.

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.

SRZ lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the SRZ lawyer with whom you usually work, the authors, or any of the following members of the Securities Enforcement practice group:

Charles J. Clark
Co-Chair, Securities Enforcement
+1 202.729.7480 | charles.clark@srz.com

Harry S. Davis
+1 212.756.2222 | harry.davis@srz.com

Taleah E. Jennings
+1 212.756.2454 | taleah.jennings@srz.com

Douglas I. Koff
+1 212.756.2773 | douglas.koff@srz.com

Martin L. Perschetz
+1 212.756.2247 | martin.perschetz@srz.com

Howard Schiffman
+1 212.756.2733 | howard.schiffman@srz.com

Michael E. Swartz
+1 212.756.2471| michael.swartz@srz.com

Craig S. Warkol
Co-Chair, Securities Enforcement
+1 212.756.2496 | craig.warkol@srz.com

Marc E. Elovitz
+1 212.756.2553 | marc.elovitz@srz.com

Gayle R. Klein
+1 212.756.2409 | gayle.klein@srz.com

Kelly Koscuiszka
+1 212.756.2465 | kelly.koscuiszka@srz.com

Betty Santangelo
+1 212.756.2587 | betty.santangelo@srz.com

Gary Stein
+1 212.756.2441 | gary.stein@srz.com

Peter H. White
+1 212.756.2413| pete.white@srz.com

The following SRZ lawyers assisted in preparing this client update: Shannon B. Wolf (Editor), Randall Adams, Philip J. Bezanson, Cara L. Chilton, Toni Deane, Angela Garcia, Derek N. Lacarrubba, Benjamin Lewson, Jason Mitchell, J. Eric Prather, Erika L. Simonson, Hamdi Soysal and Alex Wharton.

Schulte Roth & Zabel
New York | Washington DC | London
www.srz.com