



March 5, 2014

CLIENT ALERT

2014 SEC SPEAKS EVENT (Washington, D.C. February 21-22, 2014)

Chair Mary Jo White's "State of the Current SEC" opening address highlighted the expansion of and changes to the Commission's Enforcement, Examination and Rulemaking priorities, in order to keep pace with the expansion of the industry and its use of 21st century technology.

The following is our Executive Summary of the key "takeaways" from the conference:

1. Financial fraud, micro-cap fraud, and insider trading will continue to be priorities of the Enforcement Division, which will make greater use of multi-disciplinary Financial Fraud Task Forces and reliance on the latest technological developments to spot trends or aberrations in the marketplace¹. Focus on the "gatekeepers" (i.e. officers, directors, auditors) to the financial services industry will be an SEC priority, together with addressing 21st century risks².

¹ Financial Reporting and Audit Task Force Ms. White referred to includes coordination of efforts with global regulators and systemic risks to the markets where the new MIDAS system will collect market metrics.

² Commissioner Stein remarked that (i) there will be greater accountability for gatekeepers; (ii) executive compensation structures for public reporting companies should not encourage risky business enterprise; and (iii) lessons learned from the financial crisis are not exclusively addressed by the Dodd-Frank Act.

2. The SEC “Action Plan” will utilize expanded stress testing and increased oversight of the largest asset managers and RIA’s through more effective risk-based examination utilizing the Office of Compliance Inspections and Examinations’ newest data collection and “data-mining” analytical tools/methodologies³.
3. The 21st century SEC will utilize:
 - (a) Division of Economic Risk Analysis to analyze market structure and developments. Economic Analysis will provide substantive requirements for rulemaking involving four categories – Justification (why is rule necessary); Baseline (existing markets); Alternatives (what else could be done); and Consequences (impacts, trade-offs based on a cost/benefit analysis).
 - (b) Office of Quantitative Research developed a model which will extract basic information from a multiplicity of internal and external sources and pass it on to other divisions within the SEC. This office has created an analytical framework for marketplace risk management, which places Broker-Dealers in seven (7) peer group categories, so that predictive analysis can be used (“score card system”).
 - (c) Office of Litigation Economics composed of 15 internal staff economists, supports the Enforcement Division’s trial work and settlement negotiations. Primary emphasis will be the ability to refute defendant’s expert witness testimony and counter conclusions in expert reports.
4. State of the Enforcement Division is “strong” and it maintains a robust priorities list for the “post financial crisis marketplace”⁴.

From a legal and policy developments perspective, Enforcement will employ statutes and rules not previously utilized and will selectively choose forums to bring cases based on “appropriateness.” Forum Selection Factors include:

- greatest speed/efficiency involving procedural issues;
- nature of case considering regulatory expertise necessary to prevail; and
- litigation considerations, such as discovery and settlement issues.

5. The mission of the FRA Task Force is as follows:
 - (a) Understand financial reporting fraud and communicating earnings management through engagement with third-parties, academicians, and collaboration with regulators;

³ Commissioner Aguilar commented that since the 2009 Financial Crisis, the SEC has become a more aggressive regulator, having made 15,000+ enforcement recommendations and reorganizing the Enforcement Division into “specialized units.”

⁴ Enforcement actions increased 10%; 686 actions were brought recovering \$3.4 billion in disgorgement.

- (b) Identify financial auditing fraud⁵;
- (c) Best Practices collaboration with the agency for investigations and prosecutions; and
- (d) Increased coordination between law enforcement partners.

6. Investment Management themes included:

Disclosure trends, rulemaking initiatives and identifying risks. IM Guidance (through Interpretative Memos, No Action Letters and Guidance Notices) will continue to be a “resource” for the industry, while disclosure policy will emphasize managed volatility funds and the increased investment by mutual funds in commodity-linked instruments.

Rulemaking trends will include improvement in the quality of data being requested, modernization of forms and better use of data for fund compliance purposes.

The National Exam Program continues, but enhanced by Risk Identification and Monitoring which focuses on risk management at the macro level and on targeted matters for policymaking initiatives.

The Inspections and Examinations Office, through its Quantitative Analytics Unit, has “revolutionized” the BD and IA examination programs. Field examiners are armed with NEAT, a proprietary database and analytical tool providing on-site problem-solving of “big data” issues. BD exam focus will be: sales practices, trading, financial/operational issues. IA “presence” exams will have a new national initiative involving “Never Before Examined Registrants.” A focused review involves 6 topics:

- compliance programs;
- written supervisory procedures;
- firm’s disclosures; investment alternatives and relationships;
- marketing/advertising; false statements;
- portfolio management; trade allocation; asset safety and custodial issues; and
- conflicts of interest disclosure.

Dual registrants will also be selected for scrutiny during examinations.

Please contact the author, Paul A. Lieberman, any member of our firm’s Financial Services and Regulatory Practice Group, or your regular Warshaw Burstein attorney to discuss

⁵ “Operation Broken Gate” involves auditors who have not fulfilled their obligations, or who have violated “independence” requirements.

any questions you may have about SEC enforcement matters or broker-dealer and/or registered investment adviser examination issues.

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