



Whistleblowing in the Corporate World Series: Part IV

An Insider's Guide to the SEC Enforcement Process

Presenter

www.SECwhistlebloweradvocate.com



[Jordan A. Thomas](#) is a partner at Labaton Sucharow LLP and chairs its Whistleblower Representation Practice. Labaton Sucharow is one of the country's premier private securities litigation firms and the first law firm in the country to establish a practice exclusively focused on protecting and advocating for SEC whistleblowers. Prior to entering private practice, Jordan spent more than 15 years in federal law enforcement, as both a Trial Attorney at the Department of Justice and an Assistant Director in the Enforcement Division of the Securities and Exchange Commission. While at the SEC, Jordan played a leadership role in the development of its Whistleblower Program. He is also the Editor of SECwhistlebloweradvocate.com, a website dedicated to helping responsible organizations establish a culture of integrity and courageous whistleblowers to report possible securities violations—without personal or professional regrets.

email: jthomas@labaton.com
t: 212-907-0836
f: 212-883-7536

**Labaton
Sucharow**

© 2012 Labaton Sucharow LLP. All rights reserved.

- The Securities and Exchange Commission (the “SEC” or the “Commission”) is an independent federal agency and the primary overseer and regulator of the U.S. securities markets
- SEC was by created by Congress in the wake of the Great Depression in the Securities and Exchange Act of 1934 (the “Exchange Act” or the “’34 Act”)
- As the primary federal agency responsible for the securities industry in the United States, the SEC has broad rulemaking powers and the authority to investigate and enforce violations of the federal securities laws

Mission of the SEC

www.SECwhistlebloweradvocate.com

- Protect Investors
- Maintain Fair, Orderly, and Efficient Markets
- Facilitate Capital Formation

In furtherance of its mission, the SEC has the responsibility and authority to:

- Interpret the federal securities laws
- Issue new rules and amend existing rules
- Oversee the inspection of securities firms, brokers, investment advisors, and ratings agencies
- Oversee private regulatory organizations in the securities, accounting, and auditing fields
- Coordinate U.S. securities regulation with federal, state, and foreign authorities

- Securities Act of 1933
- Securities and Exchange Act of 1934
- Trust Indenture Act of 1939
- Investment Company Act of 1940
- Investment Advisors Act of 1940
- Sarbanes-Oxley Act of 2002
- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Securities Act of 1933

www.SECwhistlebloweradvocate.com

- Regulates the Public Issuance of Securities
- Two main objectives:
 - Ensure that investors received adequate financial and other important information about securities being offered to the public
 - Ensure that the information is accurate and reliable
- Key provisions:
 - Requires the Registration of Securities to Issued
 - Securities Must be Sold Pursuant to a Prospectus
 - Creates Liability for False and Misleading Statements in a Registration Statement or Prospectus

Securities and Exchange Act of 1934

www.SECwhistlebloweradvocate.com

- Established the Securities and Exchange Commission
- Regulates the activities of public companies
 - Imposes requirement of periodic corporate reporting
 - Regulates proxy solicitation and tender offers
- Mandates registration of broker dealers
- Regulates the purchase and sale of securities in the secondary markets
- Prohibits false and deceptive conduct in connection with securities transactions

Trust Indenture Act of 1939

www.SECwhistlebloweradvocate.com

- Requires a Trust Indenture for the sale of bonds and other debt securities worth over \$5 million
- Requires the Appointment of a Trustee to all bond issuers

Investment Company Act of 1940

www.SECwhistlebloweradvocate.com

- Regulates investment companies
 - Entities that are engaged primarily in the business of investing, reinvesting or trading in securities, or are engaged in that business and more than 40% of their assets consist of investment securities
 - Example: Mutual Funds
- Requires every investment company to register with the SEC
- Registered investment companies must file annual reports with the Commission disclosing information about their financial condition and investment policies to investors
- Imposes certain restrictions on the trading activities of investment companies

Investment Advisors Act of 1940

www.SECwhistlebloweradvocate.com

- Requires firms or individuals who advise others about securities investments to register with the SEC
- Applies only to advisors that manage at least \$25 million in assets, or that advise a registered investment company
- Prohibits fraudulent or deceptive conduct by investment advisors in connection with their services

Sarbanes-Oxley Act of 2002

www.SECwhistlebloweradvocate.com

- Created the Public Company Accounting Oversight Board
- Requires that all audited financial statements be certified as accurate by a corporation's senior management
- Requires companies to establish internal control and reporting systems to uncover fraud in financial reporting

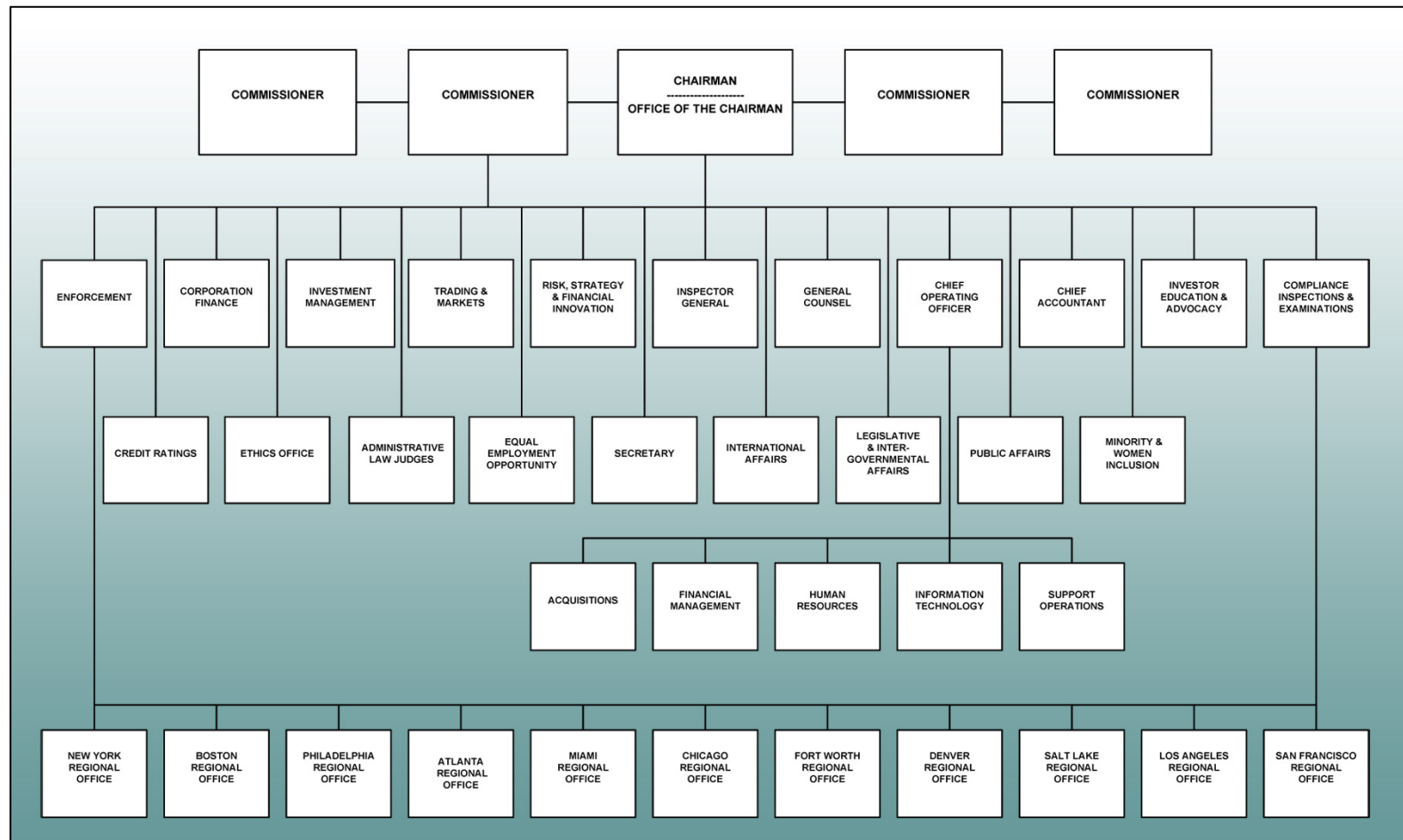
Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

www.SECwhistlebloweradvocate.com

- Created the Financial Stability Oversight Counsel
- Requires hedge funds managing over \$100 million in assets as investment advisers to register with the SEC
- Required the SEC to enact a whistleblower program to pay financial rewards to individuals who provide information about possible securities violations to the SEC

Organizational Chart Securities and Exchange Commission

www.SECwhistlebloweradvocate.com



Note: The Office of Investor Advocate, and the Office of Municipal Securities, required by P.L. 111-203, are in the process of being established.

Organization of the SEC

www.SECwhistlebloweradvocate.com

The SEC is organized into five major divisions:

- Division of Enforcement
- Division of Corporate Finance
- Division of Trading and Markets
- Division of Investment Management
- Division of Risk, Strategy, and Financial Innovation

Division of Enforcement

www.SECwhistlebloweradvocate.com

- Investigates and prosecutes violations of the federal securities laws in federal courts and administrative proceedings on behalf of the Commission.
- Often works in close coordination with other interested federal, state and self-regulatory organizations.
- Division also recommends Commission action, including:
 - Trading suspensions
 - Sanctions against entities and individuals
 - Injunctions and temporary restraining orders
 - Bars prohibiting participation in penny stock offerings or serving as an officer and director
- Largest SEC Division with more than 1100 staff members

Division of Corporate Finance

www.SECwhistlebloweradvocate.com

- Oversees the disclosure by public companies of information required to be filed with the Commission under the securities laws
- Disclosure documents reviewed include: registration statements for newly-offered securities, annual and quarterly reports, proxy materials, documents concerning tender offers, and filings related to mergers and acquisitions.
- Additional division responsibilities:
 - Providing administrative interpretations of the '33 Act, the '34 Act, and the Trust Indenture Act of 1939
 - Recommending regulations to implement these statutes
 - Providing guidance and counseling to registrants, prospective registrants, and the public to help them comply with these laws
 - Monitor the activities of the accounting profession, particularly the Financial Accounting Standards Board (FASB)

Division of Trading and Markets

www.SECwhistlebloweradvocate.com

- Responsible for maintaining fair, orderly, and efficient markets
- Provides day-to-day oversight of the major securities market participants, such as: securities exchanges, securities firms, self-regulatory organizations, transfer agents, credit rating agencies and the Securities Investor Protection Corporation
- Additional division responsibilities include:
 - Operating the Commission's financial integrity program for broker-dealers
 - Reviewing (and in some cases approving) proposed new rules, and proposed changes to existing rules, submitted by the SROs
 - Assisting the Commission in establishing rules and issuing interpretations on matters affecting the operation of the securities markets
 - Surveilling the markets for irregularities

Division of Investment Management

www.SECwhistlebloweradvocate.com

- Oversees and regulates America's \$26 trillion investment-management industry
- Regulated investment companies include mutual funds, closed-end funds, UITs, ETFs, interval funds, variable insurance products, and federally registered investment advisers.
- The Division's additional responsibilities include:
 - Assisting the Commission in interpreting laws and regulations for the public and SEC staff
 - Responding to no-action requests and requests for exemptions
 - Reviewing filings from investment companies and investment advisers
 - Assisting the Commission in enforcement matters involving investment companies and advisers

Division of Risk, Strategy, and Financial Innovation

www.SECwhistlebloweradvocate.com

- Established in September 2009 to help identify developing risks to and trends in the financial markets
- Among the functions being performed by the Division are:
 - Providing strategic and long-term analysis
 - Identifying new developments and systemic risk in financial markets
 - Providing guidance to the Commission regarding the effect of these new developments and risk on the its regulatory activities
 - Educating SEC staff on new developments and trends

Other Important Offices

www.SECwhistlebloweradvocate.com

Other SEC offices that provide vital support functions for the Commission:

- Office of the General Counsel
- Office of Compliance Inspections and Examinations
- Office of International Affairs
- Office of the Whistleblower

Enforcement Problems Before Dodd-Frank Act

www.SECwhistlebloweradvocate.com

- Lack of Actionable Information
 - Limited self-reporting by corporations
 - Low percentage of high-quality tips
 - Potential liability
 - Insufficient protections & incentives
- Regulators Limited to Being First Responders
- Circumstantial Case Development Challenges

A Changing Landscape

www.SECwhistlebloweradvocate.com

- Financial Crisis
- Madoff Scandal
- Congressional Investigations/Inquiries
- Government Enters Banking Business
- Public Outcry



Specialized Enforcement Units www.SECwhistlebloweradvocate.com

Created in January 2010 to address challenges facing the SEC in combating newer, more sophisticated, and more specialized types of securities fraud

- Office of Market Intelligence
 - Collects, analyzes, and monitors the hundreds of thousands of tips, complaints and referrals received by the SEC each year
- Specialized units within the Division of Enforcement
 - Asset Management
 - Market Abuse
 - Structured New Products
 - Foreign Corrupt Practices
 - Municipal Securities and Public Pensions
- Office of the Whistleblower
 - Administers the SEC Whistleblower Program

SEC Cooperation Program

www.SECwhistlebloweradvocate.com

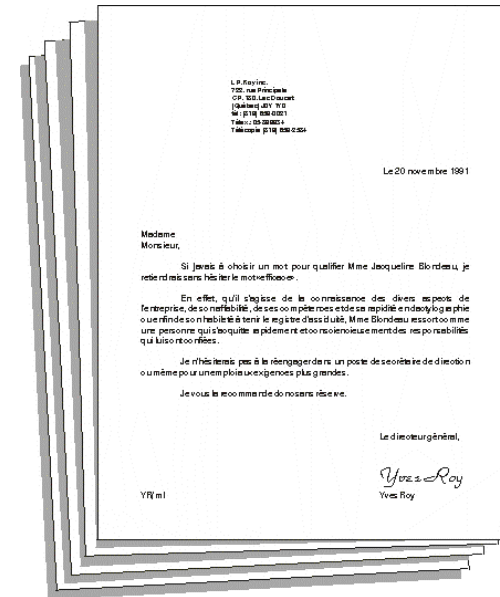
- Established January 2010
- Incentives for individuals & companies with potential civil and criminal liability to cooperate in enforcement matters:
 - Proffer agreements
 - Cooperation agreements
 - DPA
 - NPA
 - Immunity requests



SEC Whistleblower Program

www.SECwhistlebloweradvocate.com

- Established by the Dodd-Frank Wall Street Reform and Consumer Protection Act in July 2010
- Act required the SEC to establish a whistleblower program which offers:
 - Anonymous reporting
 - Robust employment protections
 - Significant monetary awards
- The implementing rules for the program became effective in August 2011



Whistleblower Defined

www.SECwhistlebloweradvocate.com

- Any individual who, alone or jointly with others, provides information to the SEC relating to a possible violation of the securities laws that has occurred, is ongoing, or is about to occur.
- Only individuals, not companies, are eligible for the whistleblower protections and incentives in Dodd-Frank.

Anonymous Reporting

www.SECwhistlebloweradvocate.com

- Confidential nature of SEC investigations
- Statutory representation requirement
- Practical reality

Section 922

PROHIBITION AGAINST RETALIATION—

(A) IN GENERAL—No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower...because of any lawful act done by the whistleblower—

- (i) In providing information to the Commission in accordance with this section...
- (ii) In making disclosures that are required or protected under Sarbanes-Oxley Act of 2002..., and any other law, rule, or regulation subject to the jurisdiction of the Commission.

Monetary Awards

www.SECwhistlebloweradvocate.com

Subject to the eligibility requirements, the Commission will pay an award or awards, 10-30% of the monetary sanctions collected, to one or more whistleblowers who:

- Voluntarily provide the SEC
- With original information
- That leads to the successful enforcement by the Commission in a federal court or administrative action
- In which the SEC obtains monetary sanctions totaling more than \$1 million

The SEC will also pay an award based upon amounts collected in certain related actions.

Enforcement Division in Perspective

www.SECwhistlebloweradvocate.com

- More than **30,000** tips, complaints and referrals annually
- Approximately **3,000** whistleblowers submissions were made in the first full year of reporting
- More than **2,000** active cases at any given time
- Approximately **1,100** division members
- **700-750** enforcement actions brought each year
- **20%** exceed **\$1 million** in monetary sanctions
- Approximately **\$3 billion** in monetary sanctions were secured annually by the SEC in 2010 and 2011

Sources of SEC Investigations www.SECwhistlebloweradvocate.com

- Information about potential violations comes from a variety of sources, including:
 - Market surveillance activities
 - Review of company filings made with the Commission
 - Inspections and examinations
 - Referrals from SROs and other authorities
 - Media Reports
 - Whistleblowers under Dodd-Frank

Selecting and Ranking Investigations

www.SECwhistlebloweradvocate.com

- The Enforcement Division handles a wide variety of investigations that vary in size complexity and programmatic importance. When evaluating cases, the staff considers whether the possible violation:
 - Presents an opportunity to send a strong and effective message that will deter future violations
 - Appears egregious or extensive
 - Involves potentially widespread or extensive harm to investors
 - Involves regulated individuals/entities, fiduciaries, or others with substantial authority or responsibility
 - Involves newly enacted legislation or regulatory rules
 - Occurs in connection with products, markets, transactions or practices that pose significant risks for investors or a systemically important sector of the market
 - Involves a substantial number of victims

Allocating Resources Among Investigations

www.SECwhistlebloweradvocate.com

- Since staff members are often assigned to more than one investigation at a time and investigative priorities can rapidly change, effectively allocating resources requires flexibility and creativity. Factors considered include:
 - Whether there is an urgent need to file an enforcement action
 - The volume of evidence that the staff must collect and review
 - The level of analysis required for complex data and evidence
 - The number, location and scheduled receipt of documentary and testimonial evidence
 - Travel requirements
 - Timelines for preparing internal memoranda and related review
 - Coordination with and timing considerations of other federal or state law enforcement and regulatory organizations

Types of Investigations

www.SECwhistlebloweradvocate.com

- SEC has the authority from Congress to conduct investigations “as it deems necessary to determine whether any person has violated, is violating, or about to violate” the federal securities laws
- The agency’s decision to initiate an investigation is not subject to judicial review
- Types of Investigations
 - Matters Under Inquiry
 - Informal Investigations
 - Formal Investigations

Matters Under Inquiry (MUI)

www.SECwhistlebloweradvocate.com

- A preliminary inquiry to determine whether information about a potential should be examined in more detail
- Very low threshold for opening a new MUI
- Purpose is to gather additional facts to help evaluate whether further investigation would be an appropriate use of resources
- An MUI automatically converts to a formal investigation when it has been opened for 60 days

Informal Investigations

www.SECwhistlebloweradvocate.com

- Investigations are informal unless a formal order of investigation is obtained from the Commission
- Informal investigations are a request for voluntary cooperation in providing information to the SEC staff
- The subject of the informal investigation is under no legal obligation to cooperate with the SEC, but must preserve documents
- The SEC staff will usually request the production of documents and may request interviews of relevant individuals
- The Commission can initiate enforcement actions based on informal investigations

Formal Investigations

www.SECwhistlebloweradvocate.com

- A formal investigation is initiated by the Commission's issuance of a formal order of investigation ("Formal Order")
- Enforcement staff seek Formal Orders by preparing a memorandum to the Commission
- The Commission gives deference to the staff seeking a Formal Order and rarely denies the request
- Formal Order summarizes the suspected statutory and regulatory violations
- Empowers named staff members to administer oaths and affirmations, subpoena witnesses, compel the attendance of witnesses, take evidence, and require the production of documents and other materials
- Formal Orders are issued without notice or an opportunity to be heard by the subject of the investigation

Length of Investigations

www.SECwhistlebloweradvocate.com

- In conducting investigations, the SEC must continually balance the need for complete, effective, and fair investigations with the need to file enforcement actions in as timely a manner as possible. Historically, investigations have taken two to four years to complete.
- Factors that tend to increase the length of an investigation include, but are not limited to:
 - Complexity of the possible violations
 - Scope of the alleged misconduct
 - Location of the relevant evidence
 - Coordination with other state and federal authorities
 - Delays caused by potential defendants and others with relevant information
- In fiscal year 2011, the SEC filed 61% of its first enforcement actions within two years of opening a MUI.

Subpoena Power

www.SECwhistlebloweradvocate.com

- The Enforcement staff have the authority to issue subpoenas once a Formal Order of investigation is issued
- May request any information that is reasonable and potentially relevant to the investigation including documentary evidence and witness testimony
- Subpoenas can be issued anywhere in the United States
- Witnesses may be compelled to appear at any designated place of hearing

Challenging a Subpoena

www.SECwhistlebloweradvocate.com

- A subpoenaed party may move a court to squash the subpoena but these motions are rarely successful
- SEC need only show:
 - Its investigation is being conducted pursuant to a legitimate purpose
 - The inquiry may be relevant to that purpose
 - The information sought is not already within the SEC's possession
 - All administrative steps required by law have been followed.
- Subpoenas are not self-enforcing and a party could refuse to comply
- SEC may bring subpoena-enforcement action to compel compliance, during which challenges to the subpoena may be raised

Producing Documentary Evidence

www.SECwhistlebloweradvocate.com

- The ability to obtain documents is critical to Enforcement investigations
- Enforcement staff often issue subpoenas requiring the production of certain categories of documents at a specified time and place
- Unwarranted delays or failure to produce relevant documents is viewed negatively
- Sanctions are possible for incomplete or delayed document production that harms “the integrity of the investigative process”

Testifying Before the SEC

www.SECwhistlebloweradvocate.com

- Enforcement staff will often seek sworn testimony from who are believed to have potentially relevant information about the possible securities violations
- Generally occurs after the production of documents
- Testimony is nonpublic—witness is allowed to have counsel present, but no one else
- Federal Rules of Civil Procedure and Rules of Evidence do not apply to the proceeding
- A potential defendant's testimony is likely to be an important factor in the staff's decision whether and to what extent to recommend an enforcement action

- Commission investigations and subpoena power are subject to evidentiary privileges. The most common are:
 - Attorney-Client Privilege
 - Work-Product Doctrine
- Privileges can be waived
- Whistleblowers should never produce privileged materials to the SEC without consulting with counsel or staff in the Office of the Whistleblower

Attorney-Client Privilege

www.SECwhistlebloweradvocate.com

- Protects from disclosure to the Commission any communications made in connection with obtaining legal advice
- Requirements for the attorney-client privilege:
 - The person or entity is, or has sought to become, a client
 - The person to whom the communication was made is a member of the bar or a subordinate of such person
 - The communication was for the purpose of obtaining a legal opinion or services in connection with a legal proceeding, and not for the purpose of committing a crime
 - The privilege has not been waived
- The voluntary disclosure of the communication by the client to a third party may result in a waiver of the privilege
- Communications to a corporation's attorney by an employee are generally protected under the attorney-client privilege

Work-Product Doctrine

www.SECwhistlebloweradvocate.com

- Protects from disclosure to the Commission all documents and other materials prepared by a party or his or her attorney in anticipation of litigation
- Broader than the attorney-client privilege
- Privilege is not absolute and can be overcome if:
 - There is a substantial need for the materials
 - A substantial equivalent of the materials cannot be obtained without undue hardship
- The voluntary disclosure of the protected material constitutes a waiver of the privilege

- A person or company can voluntarily waive the attorney-client and work-product privileges
- Limited versus general waiver
 - Majority view is a party cannot engage in a “limited” or “selective waiver” of either the attorney-client privilege or work-product doctrine
 - Some courts permit a limited waiver of the attorney-client privilege, and of work product that contains mental impressions or opinions of counsel
 - A few other courts have intimated that a limited waiver will be permissible if the Commission and the party being investigated take steps to preserve the confidentiality of the material

- Commission investigations are confidential and nonpublic
- The disclosure by the Commission to third parties of information obtained during an investigation is not generally permitted
- The implementing rules for SEC Whistleblower Program permit staff to disclose otherwise non-public information if the whistleblower signs a confidentiality agreement
- Section 24(c) and Rule 24c-1 of the Exchange Act
 - Permits the Commission to provide access to confidential and nonpublic information in Enforcement files
 - Access is generally limited to government agencies, law enforcement, self-regulatory agencies, and similar parties
 - Authorized recipients must provide assurances to the SEC that the information will remain confidential
 - Information that is privileged will rarely be disclosed

Freedom of Information Act (FOIA)

www.SECwhistlebloweradvocate.com

- A federal law that gives citizens the right to access information in the possession of the United States government
- The Commission could be required to disclose information pursuant to a FOIA request
- Nine exemptions from disclosure under FOIA—a few of the most relevant exemptions include information that:
 - Contains trade secrets or confidential business information
 - Constitutes inter/intra-agency communications
 - Was compiled for law enforcement purposes and their production would interfere with an ongoing enforcement proceeding.

Requesting Confidentiality Under FOIA

www.SECwhistlebloweradvocate.com

- A party may request confidential treatment of information provided to the Commission to prevent disclosure under FOIA
- Information may receive confidential treatment to protect personal privacy or sensitive business information
- If granted, the information is protected from disclosure while the investigation remains open
- The information must be:
 - Segregated from other information
 - Clearly marked as confidential
 - Accompanied by a written request for confidential treatment specifying the information to be kept confidential

Privacy Act of 1974

www.SECwhistlebloweradvocate.com

- Provides for notice and protection to persons from whom a federal agency requests information
- The Commission must give a notice to every individual asked to provide information stating:
 - The legal authority under which the information is being requested and whether compliance is voluntary or mandatory
 - The purposes for which the information will be used
 - The routine uses which may be made of the information
 - The potential consequences of not providing the information.
- Precludes the disclosure of information without permission unless disclosure is expressly permitted by the Act
- If disclosure is made, the Commission generally must keep a record of the disclosure, with limited exceptions
- The Privacy Act applies only to information sought from individuals and those who are United States citizens

- A letter from the Commission informing individuals or entities being investigated that the Commission intends to bring an enforcement action
- The Wells Notice should provide notice
 - That the Division of Enforcement is considering recommending or intends to recommend that the Commission file an enforcement action
 - The potential violations at the heart of the recommendation
 - The opportunity for the individual or entity to submit arguments or evidence to the Division of Enforcement and the Commission in opposition to an enforcement action
- No legal requirement to provide Wells Notice or to respond to such a notice

Wells Submission

www.SECwhistlebloweradvocate.com

- A voluntary written statement to the SEC setting forth a party's factual and legal positions as to why further enforcement action is unwarranted
- Made in response to the Wells Notice provide by SEC staff
- Potential benefits include persuading SEC staff:
 - Not to recommend an enforcement action
 - To recommend a more limited enforcement action
 - To offer more favorable settlement terms
- Potential dangers in making a Wells Submission include:
 - Discoverability in a private civil lawsuit
 - Disclosure to DOJ or another state or federal law enforcement or regulatory organization for use in a related proceeding.
 - Use as an admission of wrongdoing in a future SEC proceeding
 - Serving as a “roadmap” of a party's planned defense in future litigation

Closing Investigations

www.SECwhistlebloweradvocate.com

- Investigations cannot be closed until all enforcement actions in the case are complete
- This requires:
 - A final judgment in federal court or a Commission order
 - All monetary sanctions have been paid in full or excused by the Commission
 - All sanctions collected have either been distributed to investors or paid into the Treasury

Termination Letters

www.SECwhistlebloweradvocate.com

- Investigations are closed when no enforcement action is recommended
- Many different factors are considered
- SEC policy is to notify parties that investigation is closed by sending a Termination Letter
- Termination Letters are typically sent to anyone who:
 - Is identified in the caption of a Formal Order
 - Submitted or was solicited to submit a Wells Submission
 - Asks for a Notice of Termination
 - Reasonably believed that the staff was considering recommending an enforcement action against him
- Closing an investigation does not mean that the party has been exonerated or that no action may ultimately be taken in the future

Types of Securities Enforcement Actions

www.SECwhistlebloweradvocate.com

- Criminal enforcement actions by federal and state law enforcement authorities
- Civil enforcement actions by the SEC
- SEC administrative proceedings
- Civil actions by private investors

Remedies Available in SEC Enforcement Actions

www.SECwhistlebloweradvocate.com

- **Civil Injunction**
 - Order prohibiting the continuing and future violation of the federal securities laws
- **Disgorgement**
 - The repayment of money obtained, or losses avoided, as a result of the wrongful conduct
- **Monetary Sanction**
 - Monetary penalties above and beyond any disgorgement ordered
- **Bar**
 - An order prohibiting an individual from serving as an officer or director of a public company or participating in a penny stock offering

Parallel Proceedings

www.SECwhistlebloweradvocate.com

- In securities cases, it is permissible for criminal, civil, and self-regulatory proceedings to occur simultaneously
- SEC is authorized to refer cases to the Department of Justice for criminal prosecution, and assist prosecutors
 - Rule 2 of Commission Rules Relating to Investigations—permits SEC staff to discuss a nonpublic investigation with other government authorities
 - Enforcement staff may share its investigation files with the DOJ upon request (Section 24(c) and Rule 24c-1)
 - Enforcement staff may not take an SEC civil investigative action in order to benefit a criminal investigation or prosecution
- SEC may also refer cases to other organizations, including:
 - Self-Regulatory Organizations
 - Public Company Accounting Oversight Board
 - State Law Enforcement and Regulatory Agencies
 - Professional Licensing Boards

COMMON QUESTIONS

What constitutes a security?

- **Section 2(a)(1) of the Securities Act of 1933:**
“any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a ‘security’”
- Similar definitions can be found in other federal securities statutes, including Section 3(a)(10) of the Securities and Exchange Act of 1934

- *SEC v. W. J. Howey Co.* test:
 - An investment contract is a “security” if “the person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.” *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946)
- Elements of the test:
 - An investment in money
 - A common enterprise
 - Expectation of a profit
 - Solely from the effort of others

What is the international reach of the U.S. securities laws?

Reach of the SEC Whistleblower Program

www.SECwhistlebloweradvocate.com

- With few exclusions or qualifications, a whistleblower can be any individual or group of individuals – regardless of citizenship.
- Eligible securities violations may occur anywhere in the world
- Potential international violators can be individuals or organizations (public or private)
- Jurisdictional Nexus: investors, investments, operations, employees or clients in the United States
- International Information Sharing

Registration of Securities Offerings

www.SECwhistlebloweradvocate.com

- Public offerings to U.S. investors by foreign issuers are subject to the registration requirements of the Securities Act.
- Foreign purchasers of securities issued in the U.S. have the same rights as U.S. purchasers.
- U.S. issuers may issue classes of securities to foreign investors that are restricted from U.S. investors without registering under the Securities Act .

Morrison v. National Australia Bank

Holding:

As a general rule, the anti-fraud provisions of the Exchange Act apply only to transactions in securities listed on domestic exchanges and domestic transactions in other securities.

What are the most common types of securities law violations?

Common Securities Violations

www.SECwhistlebloweradvocate.com

- Market Manipulation
- Offering Fraud
- Financial Fraud
- Insider Trading
- Trading and Pricing
- Foreign Corrupt Practices Act
- Municipal Securities Fraud

Market manipulation is the interference with the free and fair operation of the market by engaging in transactions and other practices that create or maintain an artificial price for a security. Examples include:

- **Churning**
 - Placing of both buy and sell orders for the same security at about the same price in order to create the appearance of increased trading activity, thereby increasing its price
- **Pooling**
 - An agreement among a group of people delegating authority to a single manager to trade in a specific stock, for a specific period of time, and then to share in the resulting profits or losses
- **Pump and Dump**
 - Spreading false information to increase the price of a security, then selling shares at the increased price

Offering fraud involves making material misrepresentations and/or omissions to potential investors in connection with an offering of securities. Examples include:

- **Unregistered Offering**
 - The securities being sold are not registered with the SEC as required under the Securities Act
- **Ponzi Scheme**
 - Investors are paid returns from their own money or from the money invested by subsequent investors, rather than from any actual profit earned
- **Affinity Fraud**
 - Targets members of an identifiable group, such as religious or ethnic communities, in order to induce those members to invest in a fraudulent investment opportunity

Financial fraud occurs when a public company files materially false or misleading financial statements with the SEC. Examples include:

- Misleading disclosures
- Misclassifications
- Improper recording of transactions
- Overstatements
- Understatements

Insider trading is the buying or selling of a corporate security while in possession of material information about that corporation that is not known to the public.

Two theories of insider trading:

- **Classical Theory**
 - Involves corporate insiders who have access to material, nonpublic information based on their positions inside a corporation
- **Misappropriation Theory**
 - Involves third parties who acquire material, nonpublic information about a corporation based on some relationship of trust with the source of the information

Trading and pricing violations involve any number of trading techniques that are illegal under the securities laws. Examples include:

- **Market Timing/Late Trading**
 - When a mutual fund permits select customers to purchase shares in the fund after trading has closed for the day
- **Wash Trades**
 - Involve the buying and selling the same security for the purpose of generating activity and increasing the price
- **Marking the Close**
 - Buying or selling a security near the close of the day's trading in order to affect the closing price
- **Front Running**
 - Buying or selling a security while knowing that another investor is about trade, or an analyst will make a recommendation, that will influence the price of the security

Foreign Corrupt Practices Act (FCPA)

www.SECwhistlebloweradvocate.com

- The FCPA prohibits the offer, payment, or promise to pay money or anything of value—i.e., a bribe—to any foreign official in an effort to win or retain business from that foreign official's government.
- Affirmative Defenses:
 - The payments are legal under the written laws of the country in which the payments are made; or
 - The payment is a reasonable expenditure directly related to the conducting of business with a foreign government.

Municipal Securities Fraud

www.SECwhistlebloweradvocate.com

- Municipal securities fraud occurs when materially false or misleading statements are made to investors in connection with the purchase or sale of debt securities issued by state and local governments in the United States.

What is the statute of limitations for bringing an SEC enforcement action?

28 U.S.C. § 2462:

- A “catch all” statute of limitations for actions brought by federal agencies in federal court
- SEC has five years to bring an enforcement action seeking civil penalties from the date that the claim first accrued

Tolling of the Statute

www.SECwhistlebloweradvocate.com

- **Discovery Rule**
 - Common law rule that applies only to fraud claims
 - Holds that the statute of limitations for a fraud claim does not accrue until the fraud is discovered, or could have been discovered with reasonable diligence
- **Fraudulent Concealment/Equitable Tolling**
 - Temporarily suspends the statute of limitations clock, even though a claim has already accrued, if the defendant took affirmative steps to conceal the wrongful conduct
 - Applies to non-fraud claims also
 - SEC or private plaintiff must plead facts establishing that the defendant took affirmative steps to conceal the wrongful conduct

Where can potential whistleblowers
and other interested parties
learn more about the securities laws
and the SEC enforcement process?

Additional Resources

www.SECwhistlebloweradvocate.com

SECWhistleblowerAdvocate

WHISTLEBLOWER PROGRAM

CORPORATE ETHICS

RESOURCES

ABOUT US



REQUEST CASE EVALUATION



In this era of corporate scandal, the world needs more truth tellers. History has consistently shown that law enforcement authorities cannot effectively and efficiently police the marketplace without the assistance of private individuals and entities. Labaton Sucharow is dedicated to helping responsible organizations establish a culture of integrity and courageous whistleblowers to report possible securities violations—without regrets.



SEC Insider's Guide



SEC Whistleblower Program Handbook



Securities Law Primer



SEC Whistleblower Eligibility Calculator



SEC Whistleblower Sanctions Database

Could You Blow the Whistle? Labaton Sucharow's SEC Whistleblower Eligibility Calculator

Jordan Thomas - Monday, July 30, 2012

Established under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the [SEC Whistleblower Program](#) is a powerful new tool that financial regulators and law enforcement authorities have to detect, investigate and prosecute corporate wrongdoing. With its significant [employment protections](#), [monetary awards](#) and [anonymous reporting](#), the SEC's innovative program is also an important vehicle for everyday citizens to take a stand and speak out against misconduct.

But do people know about the program? The answer is not enough.

In December 2011, as part of our [Ethics & Action](#) survey, we found that only 32% of Americans were aware of the SEC Whistleblower Program. In our recent survey of the financial services industry, [Wall Street, Fleet Street and Main Street: Corporate Integrity at a Crossroads](#), only 44% of respondents were aware of this critical investor protection initiative.

To increase public awareness of the SEC Whistleblower Program, we have launched an [SEC Whistleblower Eligibility Calculator](#). This first-of-its-kind web-based tool helps potential whistleblowers understand the in's and out's of the program. The easy-to-use calculator presents users with various questions, which then lead to a customized and detailed eligibility report. The assessment also provides numerous links to the rules, regulations and other helpful resources.

In the News

-  [Bloomberg Law—The SEC Whistleblower Program's Annual Report](#)
-  [Fox Business—Will Whistleblower Rules Help SEC Investigations?](#)
-  [Labaton Roundtable—Global Impact of U.S. Financial Reforms](#)

[VIEW ALL NEWS](#)

**For the People.
By the People:**
The SEC Whistleblower Program & Establishing a Culture of Integrity

**Labaton
Sucharow**

© 2012 Labaton Sucharow LLP. All rights reserved.

80



Whistleblowing in the Corporate World Series: Part IV

An Insider's Guide to the SEC Enforcement Process

Jordan A. Thomas
Labaton Sucharow LLP
140 Broadway
New York, NY 10005
(212) 907-0700
jthomas@labaton.com