Duff & Phelps

Protect, Restore and Maximize Value

Quarterly U.S. Regulatory Roundup

Second Quarter 2019

INSIDE

Duff & Phelps In The News

Duff & Phelps has partnered with ComplySci, the industry leader in providing technology solutions to compliance professionals, to create a unique and powerful compliance administration software tool, RegHub, which allows compliance departments to monitor their employees core regulatory obligations and create firmwide certifications and attestations. It also enables firms' compliance departments to schedule their annual regulatory obligations and carry out monitoring checks.

Ken Joseph, Managing Director and Head of Disputes Consulting, was featured in Corporate Counsel commenting on Duff & Phelps' annual Global Regulatory Outlook 2019 survey.

Peter Wilson, Managing Director in Duff & Phelps' Compliance and Regulatory Consulting practice, was featured in an article, "How CCOs Can Use a Sample OCIE Information Request Letter", by Hedge Fund Law Report, discussing OCIE information request letters.

Kevin Braine, Managing Director in the Compliance Risk and Diligence practice, joined a podcast hosted by Compliance and Ethics to talk about economic sanctions compliance. The discussion follows the U.S. Department of the Treasury's Office of Foreign Assets Controls (OFAC) release of a new Framework for OFAC Compliance Commitment.

John Arvanitis, Managing Director in the Compliance Risk and Diligence practice, was quoted in Compliance Week in the article, "Poll Shows Room for Improvement on Training Third Parties".

Daniel Hartnett, Associate Managing Director in the Compliance Risk and Diligence practice, was featured in the June 2019 issue of National Defense Magazine, in his article "Reduce Risks in Overseas Third-Party Relationships".

SEC

Investment Adviser and Broker-Dealer Compliance Issues Related to Regulation S-P - Privacy Notices and Safeguard Policies

April 16, 2019

The Securities and Exchange Commission (SEC) Office of Compliance Inspections and Examinations (OCIE) released a list of the most frequently seen deficiencies or weaknesses identified in connection to Regulation S-P. The list includes references to Privacy and Opt-Out Notices, lack of policies and procedures or policies not implemented or not reasonably designed to safeguard customer records and information, including the following areas:

- Personal devices
- Electronic communications
- Training and monitoring
- Unsecure networks
- Outside vendors
- PII inventory
- Incident response plans
- Unsecure physical locations
- Login credentials
- Departed employees

Registrants should review their written policies and procedures, including implementation of those policies and procedures, to ensure they are compliant with relevant regulatory requirements.

Read the full article here.

SEC

Safeguarding Customer Records and Information in Network Storage – Use of Third Party Security Features

May 23, 2019

The SEC announced a risk alert concerning electronic storage of customer information by broker-dealers and investment advisers across a multitude of network storage platforms, distinctly noting those leveraging cloud-based storage. The OCIE identified three areas of concern: misconfigured network storage solutions and the lack of proper security configuration; inadequate oversight of vendors providing network storage solutions; and lack of policies and procedures to identify and risk rank the types of data stored electronically and the appropriate controls applicable to each category.

Read the full article here.

SEC Adopts Regulation Best Interest: The Broker-Dealer Standard of Conduct

June 5, 2019

The Securities and Exchange Commission is adopting a new rule under the Securities Exchange Act of 1934 (Exchange Act), establishing a standard of conduct for broker-dealers and natural persons who are associated persons of a broker-dealer (unless otherwise indicated, together referred to as 'broker-dealer) when they make a recommendation to a retail customer of any securities transaction or investment strategy involving securities (Regulation Best Interest).

Regulation Best Interest enhances the broker-dealer standard of conduct beyond existing suitability obligations, and aligns the standard of conduct with retail customers' reasonable expectations by requiring broker-dealers, among other things, to: (1) act in the best interest of the retail customer at the time the recommendation is made, without placing any financial or other interest of the broker-dealer ahead of the retail customer's interests; and (2) address conflicts of interest by establishing, maintaining and enforcing policies and procedures reasonably designed to identify and fully and fairly disclose material facts about conflicts of interest, and in instances where we have determined that disclosure is insufficient to reasonably address the conflict, to mitigate or, in certain instances, eliminate the conflict.

The standard of conduct established by Regulation Best Interest cannot be satisfied through disclosure alone. The standard of conduct draws from key principles underlying fiduciary obligations, including those that apply to investment advisers under the Investment Advisers Act of 1940 (Advisers Act). Importantly, regardless of whether a retail investor chooses a broker-dealer or an investment adviser (or both), the retail investor will be entitled to a recommendation (from a broker-dealer) or advice (from an investment adviser) that is in the best interest of the retail investor and that does not place the interests of the firm or financial professional ahead of the retail investor's interests.

Read the full article here.

SEC

SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships with Financial Professionals

June 5, 2019

The SEC voted to adopt a package of rulemakings and interpretations designed to enhance the quality and transparency of retail investors' relationships with investment advisers and broker-dealers, bringing the legal requirements and mandated disclosures in line with reasonable investor expectations, while preserving access (in terms of choice and cost) to a variety of investment services and products. Specifically, these actions include new Regulation Best Interest, new Form CRS Relationship Summary, and two separate interpretations under the Investment Advisers Act of 1940.

Individually and collectively, these actions are designed to enhance and clarify the standards of conduct applicable to broker-dealers and investment advisers. In addition, these actions help retail investors better understand and compare the services offered and make an informed choice of the relationship best suited to their needs and circumstances; the actions also foster greater consistency in the level of protections provided by each regime, particularly at the point in time that a recommendation is made.

Read the full article here.

SEC

SEC Adopts Capital, Margin and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Amends the Capital and Segregation Requirements for Broker-Dealers

June 21, 2019

The SEC made strides toward addressing the regulatory regime for security-based swap dealers by endorsing a set of rules and rule amendments under Title VII of the Dodd-Frank Act. These rules intend to enhance the risk mitigation practices of firms that are heavily involved in the security-based swap market, thus protecting their counterparties and reducing risk to the broader market.

The rules addressed the following areas:

1. Minimum capital requirements for security-based swap dealers and major security-based swap participants for which there is not a prudential regulator. Increase in the minimum net capital requirements for broker-dealers that use internal models to compute net capital. Additionally, the new rules establish capital requirements tailored to security-based swaps and swaps for broker-dealers that are not registered as an SBSD or MSBSP to the extent they trade these instruments
2. Establish margin requirements for non-bank SBSDs and MSBSPs in terms of non-cleared security-based swaps
3. Establish segregation requirements for SBSDs and stand-alone broker-dealers for cleared and non-cleared security-based swaps
4. Amend the SEC's standing cross-border rule to provide a way to request substituted compliance with respect to capital and margin requirements for foreign SBSDs and MSBSPs, and administer guidance on how the SEC will evaluate requests for substituted compliance

SEC Chairperson, Jay Clayton, praised the SEC's Division of Trading and Markets and Division of Economic and Risk Analysis for their extensive work on the curation of these rules. Clayton noted that the effort would not have been possible without the inter-agency collaboration with the CFTC saying that the process "has been a wonderful opportunity to cooperate in a war that serves the American people."

Read the full article here.

SEC

Disclosing Conflicts of Interest Related to Revenue Sharing

April 20, 2019

The D.C. Court of Appeals upheld an SEC decision that the word "may" in a disclosure regarding conflicts of interest related to revenue sharing is not sufficient. A firm utilized Fidelity for execution, custody and clearing services, and from 2005 to 2013, received nearly $400,000 from Fidelity. In the initial 2011 version of its Form ADV Part 2A, the Firm stated that it "may" receive selling compensation and "may" receive additional compensation in the form of custodial support services from Fidelity based on revenue from the sale of funds through Fidelity. In 2015, the SEC alleged that these disclosures were inaccurate, but the case was dismissed by an administrative law judge. This was appealed in the D.C. Court, which ruled that the use of "may" was not sufficient when the firm "is" receiving compensation. Therefore, the Firm's conduct was found to be negligent, however, the D.C. Court ruled that the rule was not "willfully" violated as the SEC initially argued.

In recent years, using "may" to describe present conflicts of interest has become a common deficiency in SEC examination findings. Advisers are strongly encouraged to periodically review their regulatory disclosure and offering documents for instances where "may" is used to discuss a pre-existing arrangement and corresponding conflict.

Read the full article here.

FINRA

FINRA Provides Guidance to Firms Regarding Suspicious Activity Monitoring and Reporting Obligations

May 6, 2019

FINRA issued this Notice to provide guidance to member firms regarding suspicious activity monitoring and reporting obligations under FINRA Rule 3310 Anti-Money Laundering (AML) Compliance Program.

FINRA Rule 3310 (AML Compliance Program) requires each member firm to develop and implement a written AML program reasonably designed to achieve and monitor the firm's compliance with the requirements of the Bank Secrecy Act (BSA),1 and implementing regulations promulgated thereunder by the U.S. Department of the Treasury (Treasury).

FINRA Rule 3310(a) requires firms to "[e]stablish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under [the BSA] and the implementing regulation thereunder." The BSA authorizes the Treasury to require financial institutions to file suspicious activity reports (SARs).

Read the full article here.

FINRA Proposed Rule 4111 (Restricted Firm Obligations)

May 2, 2019

FINRA has proposed a regulation that would require firms to maintain funds in an escrow account that would be used to pay arbitration awards and for other purposes.

Brokerages that have a track record of violations or hire a high number of registered representatives with disciplinary actions in their past would draw tougher oversight under a FINRA rule proposal released in May 2019.

Firms targeted by FINRA as posing a heightened risk to investors, deemed "restricted firms," would also be required to shift money or qualified securities to an account controlled by FINRA at a bank or clearing firm.

The money in the segregated account, which could not be withdrawn without FINRA's written consent, could be used to fund arbitration awards or for other purposes. FINRA has been under pressure for years to reduce the number of unpaid arbitration awards.

Read the full article here.

NFA

Effective Date for Amendments to Incorporate Swaps Supervision Requirements and Make Technical Changes to Certain NFA Rules and Interpretive Notices

June 12, 2019

NFA recently amended several Compliance Rules and Interpretive Notices to expressly incorporate supervision requirements for members' swaps activities. As amended, NFA Compliance Rule 2-9(a) will specifically apply to the commodity interest activities of futures commission merchant (FCM), introducing broker (IB), commodity pool operator (CPO) and commodity trading advisor (CTA) members, thereby covering the swaps activities of those member categories. In addition, NFA adopted Compliance Rule 2-9(d), requiring swap dealer (SD) members to diligently supervise swaps activities of their employees and agents. NFA also amended several related Interpretive Notices primarily to identify the supervisory obligations that apply to specific member categories and made several non-substantive technical amendments.

NFA also adopted a new Interpretive Notice titled NFA Compliance Rule 2-9(d): Supervision Requirements for Swap Dealer and Major Swap Participant Members. This Interpretive Notice clarifies that, like the CFTC, the NFA retains examination and enforcement authority over SD members relying on substituted compliance. In addition, under appropriate facts and circumstances, NFA may find that an SD member relying on substituted compliance has violated the supervision requirement set forth in NFA Compliance Rule 2-9.

Read the full article here.

NFA

Effective Date for Amendments to Incorporate Swaps into Certain Compliance Rules and Interpretive Notices

May 08, 2019

NFA recently amended several Compliance Rules and Interpretive Notices to expressly incorporate swaps, counterparties and related concepts. The amendments also clarify that certain rules apply to all commodity interests and specify that other rules only apply to specific membership categories. The amendments became effective on July 1, 2019.

The NFA Compliance Rules listed below will be amended as follows:

- Rule 1-1 (Definitions) to add definitions for the term's commodity interest, major swap participant, swap dealer and swap;
- Rule 2-2 (Fraud and Related Matters) to include references to swaps, counterparties and related concepts;
- Rule 2-3 (Sharing in Profits) to expand it to cover all commodity interests;
- Rule 2-6 (Expelled or Suspended Member or Associate) to expand the rule to apply to all commodity interests, incorporate language from an existing Interpretive Notice and specify that this rule only applies to FCM, IB, CPO, and CTA Members, FDMs and Associates;
- Rule 2-10 (Recordkeeping) to list all Member categories to make clear that the requirements relating to English records and fluency apply to SD and MSP Members;
- Rule 2-38 (Business Continuity and Disaster Recovery Plan) to clarify the Member categories subject to various aspects of this rule; and
- Rule 3-15 (Member or Associate Responsibility Actions) to incorporate references to commodity interest and counterparties.

Read the full article here.

CFTC

CFTC Staff Provides Further Brexit-Related Market Certainty

April 5, 2019

The Commodity Futures Trading Commission's (CFTC) Divisions of Swap Dealer and Intermediary Oversight (DSIO), Market Oversight (DMO) and Clearing and Risk (DCR), today announced they will grant no-action relief to provide greater certainty to the global marketplace in connection with the anticipated withdrawal of the United Kingdom of Great Britain and Northern Ireland (UK) from the European Union (EU), with or without a ratified withdrawal agreement (Brexit).

DSIO, DMO and DCR are providing regulatory certainty by issuing two joint staff letters. The first letter ensures existing regulatory relief provided by DSIO, DMO and DCR, pursuant to certain staff letters affecting EU entities, continues to be available for UK entities following Brexit. In the second letter, DSIO and DMO provide time-limited no-action relief to ensure the continued availability, following Brexit, of substituted compliance and regulatory relief under certain existing CFTC comparability determinations and exemption orders originally issued by the CFTC for EU entities. Simultaneously, CFTC staff undertakes an analysis of UK law in order to make appropriate recommendations of comparability or exemption to the CFTC.

Read the full article here.

CFTC

CTFC Approves a Final Rule to Provide Exception to Annual Privacy Notice Requirement

April 19, 2019

The CFTC revised CFTC Regulation 160.5, removing a requirement to provide annual privacy notices when conditions are satisfied in accordance with the FAST Act's statutory amendment to the Gramm-Leach-Bliley Act, which grants such relief. The rule pertained to futures commission merchants, retail foreign exchange dealers, commodity trading advisors, commodity pool operators, introducing brokers, major swap participants and swap dealers. The final rule went into effect on May 28, 2019 and is significantly similar to SEC requirements for registered investment advisers.

Read the full article here.

CFTC Proposes to Amend Derivatives Clearing Organization Regulations

April 29, 2018

The Commodity Futures Trading Commission (CFTC) approved a proposed rule to amend certain regulations that apply to derivatives clearing organizations (DCOs) under Part 39 of the CFTC's regulations. Part 39 implements the statutory core principles for DCOs.

Since the Part 39 regulations were adopted, CFTC staff has worked with DCOs to address questions regarding interpretation and implementation of various requirements in Part 39. Considering this, the CFTC believes it would be helpful to amend or clarify certain provisions of Part 39 as well as codify staff relief and guidance granted in the interim.

Additionally, the proposed amendments would, among other things, streamline the registration and reporting process, address certain risk management and reporting obligations, and add new requirements regarding default procedures and event-specific reporting in response to recent events.

This proposal is in keeping with the CFTC's Project KISS, an agency-wide initiative to adopt appropriate changes and simplify agency rules, regulations and practices to make them less burdensome, less costly and more transparent to all market participants.

Read the full article here.

MARKET MANIPULATION

Major Brokerage Fined by DOJ, CFTC for "Spoofing" in Precious Metals Futures

June 25, 2019

A major global commodities trading business agreed to pay $25 million and enter into a non-prosecution agreement with the U.S. Department of Justice (DOJ) on Tuesday to settle charges regarding a multi-year scheme by its precious metals traders to mislead the market for precious metals futures contracts traded on the Commodity Exchange Inc. The firm admitted to the allegations that beginning by at least 2008 and continuing through 2014, its precious metals traders schemed to deceive other market participants by injecting materially false and misleading information into the precious metals futures market by placing fraudulent "spoof" orders for precious metals futures contracts that, at the time the traders placed thousands of fraudulent orders, they intended to cancel before execution. The intention was to manipulate the market by creating the false impression of increased supply or demand and, in turn, to fraudulently induce other market participants to buy and sell futures contracts at quantities, prices and times that they otherwise likely would not have done. The firm also agreed to cooperate with the government's ongoing investigation of individuals and report to the government, evidence or allegations of criminal violations. The DOJ also obtained an indictment against two former precious metals traders in July 2018, related to this investigation. Those charges are pending. The Commodity Futures Trading Commission (CFTC) also settled charges with the firm on related, parallel proceedings where the firm agreed to pay a civil monetary penalty of $11.5 million.

Read the full article here.

SEC Freezes Assets in International Manipulative Trading Scheme

June 20, 2019

The Securities and Exchange Commission (SEC) announced charges against five foreign traders for executing illegal matched trades in the stock of Medico International, Inc. (MDDT). The SEC also obtained an emergency court order freezing assets held in brokerage accounts of the defendants, including approximately $144,000, which otherwise could have been wired offshore, and hundreds of thousands of shares of MDDT stock.

According to the SEC's complaint filed in the U.S. District Court for the Southern District of New York on June 19, 2019, traders from China, Singapore and Malaysia attempted to manipulate the market for MDDT stock by entering matched orders to buy and sell MMDT at substantially the same times, sizes and prices. The SEC alleges that trades involving these five seemingly-unrelated individuals from three different countries accounted for 70% of the volume in MDDT over the period in which they traded. As described in the complaint, IP records show that at least three of the defendants' brokerage accounts were likely accessed by the same user or users while trading MDDT.

The SEC suspended trading in MDDT on June 20, 2019.

"We took swift action to protect the public from investing based on the artificial liquidity and volume created by this alleged scheme," said Marc P. Berger, Director of the SEC's New York Regional Office. "Notwithstanding that these overseas defendants attempted to mask their locations by using virtual private networks, we were able to halt the misconduct before substantial investor harm occurred."

The SEC's complaint charges the defendants with violating the antifraud provisions of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act of 1934, and Rule 10b-5 thereunder, and the market manipulation provision of Section 9(a)(1) of the Exchange Act.

Read the full article here.

FRAUD

Investment Advisor to Pay $5 Million to SEC for Compliance Failures

June 4, 2019

On June 4, 2019, the Securities and Exchange Commission (SEC) announced a private fund manager specializing in mortgage-backed securities was charged for deficiencies related to the internal valuation of fund assets. The Colorado-based investment adviser ultimately failed to ensure certain securities in its flagship fund were properly valued.

According to its investment strategy, the firm purchased heavily-discounted, high-yielding mortgage-backed securities for the fund, for which returns exceeded 20% each year from 2009 through 2014. During this period, the firm was ranked as one of the top performing and most consistent hedge funds in the country. The SEC order cited the firm as failing to have "policies and procedures in place to address the risk that its traders were undervaluing securities and selling for a profit when needed." The firm also failed to guard against its traders who provided inaccurate information to a pricing vendor and then used the prices it got back to value bonds. In fact, the traders were advised to do quite the opposite.

The CIO of the firm, agreed to pay a $250,000 penalty, as he oversaw the valuation of certain assets in the flagship fund and approved valuations that the traders had noted as undervalued with instruction to "mark [them] up gradually." Additionally, the CIO appointed relatives and other personnel, severely lacking adequate experience and qualifications, to the firm's valuation oversight committee.

Despite neither admitting to nor denying the SEC's findings, the firm and its CIO agreed to a censure, as well as a cease-and-desist from "committing or causing any violations and future violations of a provision of the Investment Advisers Act requiring reasonably designed policies and procedures." The firm will pay $5 million considering the findings.

Read the full article here.

FRAUD

SEC Charges Former Directors of Investment with Fraud

April 11, 2019

The Securities and Exchange Commission (SEC) charged two former directors of investments at an unregistered investment brokerage for their roles in its massive Ponzi scheme. The defendants were separately arrested and charged by criminal authorities, along with the firm's owner.

The SEC previously charged several of the highest-earning unregistered brokers. In January, a federal court in Florida ordered the firm and related companies, along with the owner, to pay $1 billion for operating this Ponzi scheme.

According to the SEC's complaint, although the two directors were not registered in any capacity with the SEC, they were responsible for fraudulently raising at least $1.2 billion from more than 8,400 retail investors, many of them seniors, and together receiving more than $3 million in transaction-based and other compensation.

According to the complaint, the defendants were responsible for hiring and training the sales force, approving fraudulent marketing materials and sales scripts, and helping create an appearance that brokerage was a legitimate operation, when in reality it was a Ponzi scheme that used money from new investors to pay existing investors.

The SEC's complaint charges the two directors with violating the securities registration, broker-dealer registration and anti-fraud provisions of the federal securities laws, and seeks disgorgement of allegedly ill-gotten gains, with interest and financial penalties.

Read the full article here.

FRAUD

Silicon Valley Company Settles Fraud Charge for Misstating Returns to Investors

April 19, 2019

The Securities and Exchange Commission (SEC) announced that a prominent Silicon Valley lending company will pay a $3 million penalty for miscalculating and materially overstating annualized net returns to retail and other investors.

The San Francisco-based company is a marketplace lender that, through its website, offers and sells securities linked to the performance of its consumer credit loans. According to the SEC's order, from approximately July 2015 until May 2017, the lender excluded certain non-performing charged-off loans from its calculation of annualized net returns that it reported to investors. The order finds that, as a result, the firm reported overstated annualized net returns to more than 30,000 investors on individual account pages on its website and in emails soliciting additional investments from investors. Many investors decided to make additional investments based on the overstated annualized net returns. The order also finds that the firm failed to identify and correct the error despite knowledge that it no longer understood how annualized net returns were calculated and despite investor complaints about the calculation.

"For almost two years, the firm told tens of thousands of investors that their returns were higher than they actually were despite warning signs that that it was miscalculating those returns," said Daniel Michael, Chief of the SEC Enforcement Division's Complex Financial Instruments Unit. "As this case shows, we are committed to holding fintech companies to the same standards applicable to other participants in the securities markets."

Without admitting or denying the findings, the firm consented to the entry of an SEC order finding that it violated the antifraud provision contained in Section 17(a)(2) of the Securities Act of 1933. In addition to the penalty, the SEC's order requires it to cease and desist from future violations of Section 17(a) of the Securities Act.

Read the full article here.

FRAUD

CFTC Charges Forex Trading Firms and Principals in $75 Million Fraud

April 22, 2019

The Commodity Futures Trading Commission (CFTC) filed a civil enforcement action in federal court in Florida against several principals and related companies. The defendants are charged with operating a $75 million foreign currency (forex) trading scheme involving over 700 U.S. participants and over $47 million misappropriated in order to return funds to certain participants and for personal use, such as exotic vacations, sports tickets and college tuition.

Starting in 2011, according to the Complaint, the defendants fraudulently solicited and misappropriated money from over 700 U.S. residents for pooled investments in retail forex. From mid-April 2014 until now, the defendants received approximately $75 million from pool participants for investment in two commodity pools that would purportedly trade in forex. The defendants concealed their fraud by issuing false account statements to the pool participants. The Complaint also names nine relief defendants, who are alleged to have received pool participant funds.

Read the full article here.

INSIDER TRADING

SEC Charges Former Associate General Counsel with Insider Trading

April 9, 2019

The Securities and Exchange Commission (SEC) charged a former senior lawyer with insider trading based on nonpublic information that the company's revenue would be better than anticipated for the second quarter of 2018.

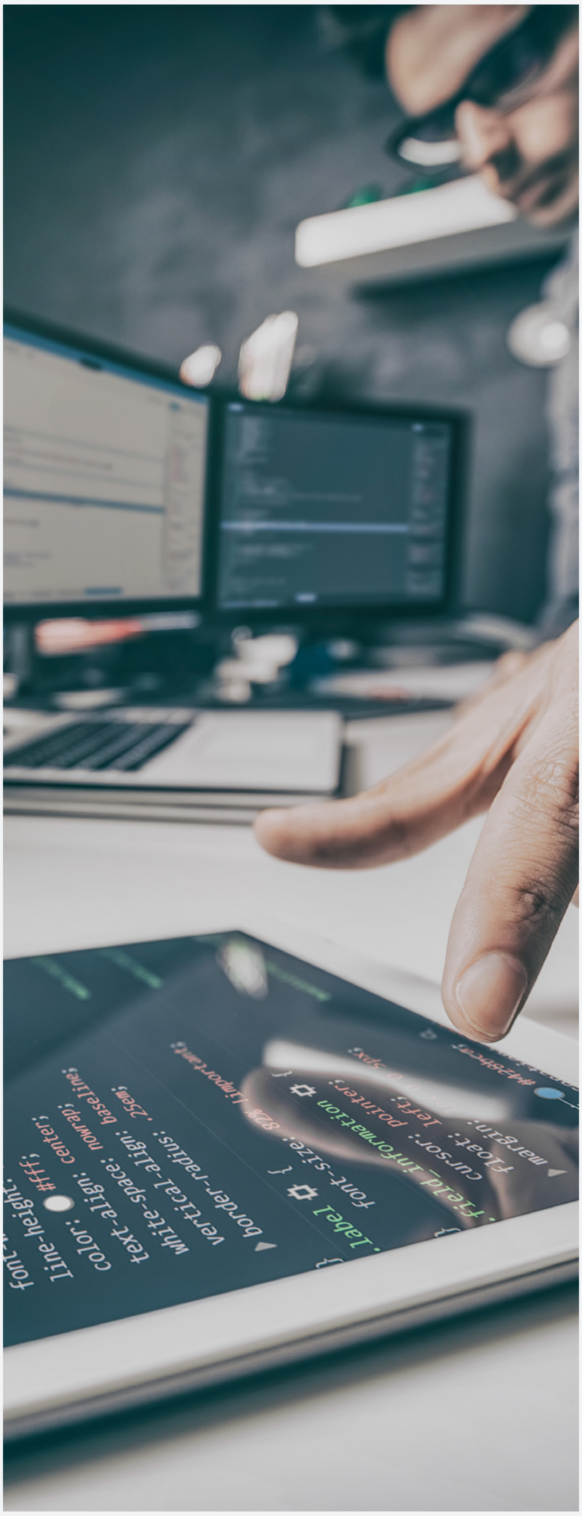
The SEC alleges that the attorney had early access to key revenue information as the company's associate general counsel and assistant secretary, and he purchased 18,000 shares of stock the day after he received a confidential draft of the 2018 second quarter earnings release that detailed a strong financial performance by the company after a lengthy period of decline. According to the SEC's complaint, he immediately sold his shares for approximately $65,000 in illicit profits after the company announced its positive earnings and the company's stock price increased by 17%.

"As alleged in our complaint, he blatantly exploited his access to non-public information by misusing confidential revenue data to enrich himself," said Kurt Gottschall, Director of the SEC's Denver Regional Office. "Investors should feel confident in the integrity of corporate officers, particularly attorneys. The SEC is committed to swiftly pursuing insiders who breach their duties to investors."

The SEC's complaint, filed in federal district court in Orlando, Florida, charges the attorney with fraud and has consented to a permanent injunction with the amounts of disgorgement and penalties, if any, to be decided by the court. The settlement is subject to court approval.

In a parallel action, the U.S. Department of Justice today announced criminal charges against the attorney arising out of the same conduct.

Read the full article here.



MISCELLANEOUS

SEC Awards $4.5 Million to Whistleblower Whose Internal Reporting Led to Successful SEC Case and Related Action

May 24, 2019

The Securities and Exchange Commission (SEC) awarded more than $4.5 million to a whistleblower whose tip triggered the company to review the allegations as part of an internal investigation and subsequently report the allegations to the SEC and another agency.

The whistleblower sent an anonymous tip to the company alleging significant wrongdoing and submitted the same information to the SEC within 120 days of reporting it to the company. This information prompted the company to review the whistleblower's allegations of misconduct and led the company to report the charges to the SEC and another agency. As a result of the self-report by the company, the SEC opened its own investigation into the alleged misconduct. Ultimately, when the company completed its internal investigation, the results were reported to the SEC and another agency. This is the first time a claimant is being awarded under this provision of the whistleblower rules, which were designed to incentivize internal reporting by whistleblowers who also report to the SEC within 120 days.

"In this case, the whistleblower was credited with the results of the company's internal investigation, which were reported to the SEC by the company and led to the SEC's resulting enforcement action and related action," said Jane Norberg, Chief of the SEC's Office of the Whistleblower. "The whistleblower gets credit for the company's internal investigation because the allegations were reported to the SEC within 120 days of the report to the company."

The SEC has now awarded approximately $381 million to 62 individuals since issuing its first award in 2012. All payments are made out of an investor protection fund established by Congress that is financed entirely through monetary sanctions paid to the SEC by securities law violators. No money has been taken or withheld from harmed investors to pay whistleblower awards. Whistleblowers may be eligible for an award when they voluntarily provide the SEC with original, timely and credible information that leads to a successful enforcement action. Whistleblower awards can range from 10% to 30% of the money collected when the monetary sanctions exceed $1 million.

Read the full article here.

MISCELLANEOUS

SEC Seeks Emergency Relief to Halt Ponzi Scheme Run from College Fraternity House

June 3, 2019

The Securities and Exchange Commission (SEC) announced an emergency action charging a recent college graduate with orchestrating a Ponzi scheme that targeted college students and young investors. The SEC is seeking an asset freeze and other emergency relief.

The SEC's complaint alleges that a 22-year-old college student conducted the fraud from a fraternity house. The student allegedly offered investments in a purported hedge fund, which he claimed had generated returns of as much as 56% in the prior year, and for which investor funds were guaranteed up to $15,000. In addition, the student allegedly sold "bond agreements," which promised investors their money along with a fixed rate of return. The SEC's complaint alleges that at least eight college students, recent graduates or their family members invested more than $269,000 in these schemes.

According to the SEC's complaint, no hedge fund existed, and claimed performance returns that were fictitious, no investments were made to the funds as represented. Instead, as money was raised, substantial portions of investor funds were deposited in personal bank and brokerage accounts, which were used for personal benefit, which included trips to Las Vegas, shopping, travel and entertainment. The student also allegedly used portions of new investor money to pay earlier investors who had asked for their money back – the hallmark of a Ponzi scheme. Some new investors unwittingly sent their money to existing investors through payment applications such as Venmo, Zelle and Cash App, and were misleadingly told that existing investors were either a "partner" or "manager" in the fund.

Read the full article here.

MISCELLANEOUS

Accounting Firm to Pay a $50 Million Penalty for Illicit Use of PCAOB Data and Cheating on Training Exams

June 17, 2019

The Securities and Exchange Commission (SEC) charged a top-tier accounting firm with altering past audit work after receiving stolen information about inspections of the firm that would be conducted by the Public Company Accounting Oversight Board (PCAOB). The SEC's order also finds that numerous audit professionals cheated on internal training exams by improperly sharing answers and manipulating test results.

The firm agreed to settle the charges by paying a $50 million penalty and complying with a detailed set of undertakings, including retaining an independent consultant to review and assess the firm's ethics and integrity controls and its compliance with various undertakings.

Five former firm officials were charged last year in a case alleging they schemed to interfere with the PCAOB's ability to detect audit deficiencies. According to the SEC's order against the firm, senior personnel sought and obtained confidential PCAOB lists of inspection targets because the firm had experienced a high rate of audit deficiency findings in prior inspections and improvement had become a priority. Armed with the PCAOB data, the now-former personnel oversaw a program to review and revise certain audit work papers after the audit reports had been issued to reduce the likelihood of deficiencies being found during inspections.

The SEC's order also finds that audit professionals who had passed training exams sent their answers to colleagues to help them also attain passing scores. The exams related to continuing professional education and training mandated by a prior SEC order finding audit failures. They sent images of their answers by email or printed answers and gave them to colleagues. This included lead audit engagement partners who not only sent exam answers to other partners, but also solicited answers from and sent answers to their subordinates.

Furthermore, the SEC found that certain audit professionals manipulated an internal server hosting training exam to lower the score required for passing. By changing a number embedded in a hyperlink, they manually selected the minimum passing scores required for exams. At times, audit professionals achieved passing scores while answering less than 25% of the questions correctly.

In addition to paying a $50 million penalty, the firm was required to evaluate its quality controls relating to ethics and integrity, identify audit professionals that violated ethics and integrity requirements in connection with training examinations within the past three years, and comply with a cease-and-desist order. The SEC's order requires the firm to retain an independent consultant to review and assess the firm's ethics and integrity controls and its investigation.

Read the full article here.

MISCELLANEOUS

SEC Charges Major Retailer with FCPA Violations

June 20, 2019

The Securities and Exchange Commission (SEC) charged a major U.S. retailer with violating the Foreign Corrupt Practices Act (FCPA) by failing to operate a sufficient anti-corruption compliance program for more than a decade as the retailer experienced rapid international growth.

The company agreed to pay more than $144 million to settle the SEC's charges and approximately $138 million to resolve parallel criminal charges by the U.S. Department of Justice for a combined total of more than $282 million.

According to the SEC's order, the company failed to sufficiently investigate or mitigate certain anti-corruption risks and allowed subsidiaries in Brazil, China, India and Mexico to employ third-party intermediaries who made payments to foreign government officials without reasonable assurances that they complied with the FCPA. The SEC's order details several instances when the company planned to implement proper compliance and training only to put those plans on hold or otherwise allow deficient internal accounting controls to persist even in the face of red flags and corruption allegations.

The company "valued international growth and cost-cutting over compliance," said Charles Cain, Chief of the SEC Enforcement Division's FCPA Unit. "The company could have avoided many of these problems, but instead repeatedly failed to take red flags seriously and delayed the implementation of appropriate internal accounting controls."

The company consented to the SEC's order finding that it violated the books and records and internal accounting controls provisions of the Securities Exchange Act of 1934.

Read the full article here.

Protect, Restore and Maximize Value

About Duff & Phelps
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