

The logo consists of a solid orange square on the left and the text 'K&L GATES' in white, sans-serif, uppercase letters on the right.

K&L GATES

2015 INVESTMENT MANAGEMENT CONFERENCE

Hot Topics in Enforcement

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New Developments at SEC

- Two new SEC Commissioners Nominated by President Obama
 - Lisa Fairfax (D)
 - Hester Peirce (R)
- Impact of Election Year 2016 on SEC Initiatives Affecting Enforcement



“Hot” Enforcement Themes for 2015

- Admissions Policy in SEC settlements
 - No widespread trend away from “Without Admitting or Denying” the violations, but more cases requiring admissions
- Waivers in SEC Settlements
 - The Controversy Shall Continue
- More SEC Enforcement Actions to Be Litigated through Administrative Proceedings rather than U.S. District Court
 - SEC’s proposed new rules providing for discovery and longer preparation time prior to administrative hearings
- Credit for Cooperation Still a Factor
- Impact of DOJ’s Yates Memo on companies
- Insider Trading – *Newman* standard of proof of “benefit”



The 2015 Highlights in SEC Enforcement

- 807 Enforcement Actions Tally \$4.19 billion in Sanctions
 - 507 Stand-Alone Cases (*i.e.* not “follow-on actions”)
 - 70% cases litigated in U.S. District Court vs. 30% Before Administrative Law Judges
 - 85% win rate in litigated administrative proceedings (2 of 13)
 - 6 federal trials in 2015 with no outright losses by SEC (4 favorable verdicts and 2 mixed verdicts)
 - **Compare** to 2014 – 17 trials resulting in 7 losses, 5 mixed verdicts and only 5 wins by SEC



Sources for SEC Enforcement Actions Affecting Investment Advisers and Funds

- SEC Asset Management Unit and Staff Initiatives
 - Aberrational Performance, Distribution-in-Guise, DERA
- Referrals from SEC OCIE Examinations
- Anonymous tips
- Whistleblowers and disgruntled former employees
 - Dodd-Frank Bounties – 10 to 30% of what SEC collects
- SRO Surveillance and consolidated data
- Media
- Competitors
- Short Sellers/Issuers
- Funnel from FBI Agents Embedded at SEC for Criminal Actions

SEC Enforcement's 2015 Buzzwords & Highlights

- **High Impact, First-of-their-Kind Cases**
 - **Distribution-in-Guise Initiative** – *First Eagle Investment Management & FEF Distributors*
 - **Data Driven Analytics** – Division of Economic & Risk Analysis (“DERA”)
 - **Aberrational Performance Initiative** to Root out Cherry-Picking and False Performance
 - Actions against Hack-attacks that Facilitate Insider Trading
 - High Frequency Trading manipulation – *Athena Capital*
 - Misallocation of “broken deal expenses” to private fund – *Kohlberg Kravis Robert & Co.*
 - Failure to Report Material Compliance Matter to Fund Board – *Blackrock Advisors LLC*



SEC Enforcement's 2015 Buzzwords & Highlights *(continued)*

- Pricing-Related Fraud in primary market for Municipal Securities – *Edward Jones*
- Municipalities Continuing Disclosure Cooperation (MCDC) Initiative Settlements
- First Action against Financial Institution for FCPA Violations. Arose from hiring interns – *BNY Mellon*
- First Action for Violations of Dodd-Frank Whistleblower Protection provisions (Securities Exchange Act Rule 21F-17) through Confidentiality Agreements – *KBR, Inc.*



2015 Topics for SEC Enforcement Actions Against Investment Advisers, Registered and/or Private Funds

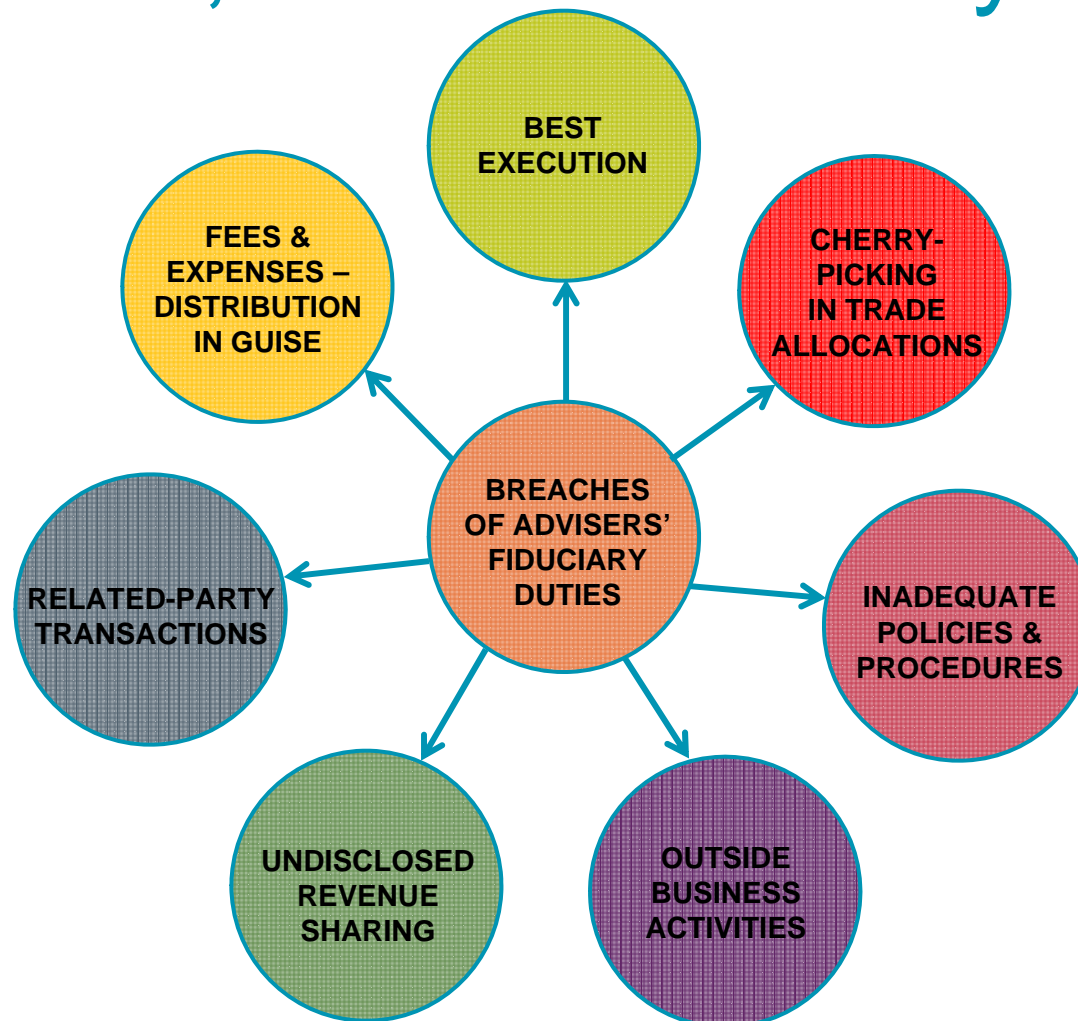
- Conflicts of Interest
- Valuation
- False Performance Advertising
- Misallocated or Undisclosed Fees and Expenses
- “Cherry Picking” by Improper Trade Allocations



2015 Topics for SEC Enforcement Actions Against Investment Advisers, Registered and/or Private Funds *(continued)*

- Fund Trustees' Review of Investment Adviser Contracts (Violations of Investment Company Act §15(c))
- Violation of Client Investment Restrictions
- Failure to Adopt Cybersecurity Policies & Procedures
- Inadequate Compliance Policies & Procedures

“Conflicts, Conflicts Everywhere...”





Distribution-In-Guise Initiative

In the Matter of First Eagle Investment Management & FEF Distributors

- Violations of Investment Company Act §12(b) by fund investment adviser and distributor for causing funds to pay nearly \$25 MM for distribution-related services outside of Rule 12b-1 plan
- Expenses “disguised” as Transfer Agency Services (sub-TA)
- Treated as a failure to disclose in breach of adviser’s fiduciary duties
- \$40 MM in sanctions ordered by SEC



DERA and Cherry-Picking

In the Matter of Wellhouse & Associates, Inc.

- Adviser failed to allocate trades on a pro rata basis contrary to disclosures to clients
- Case developed by SEC staff through its data-driven initiative reviewing trading patterns and trading records
- Case brought as a litigated action; stayed pending settlement



Unlawful Valuation of Illiquid Fund Assets

In the Matter of Lynn Tilton & Patriach Partners

- Adviser to Zohar Funds allegedly failed to properly value distressed loans in funds' portfolio (CLO's) in accordance with disclosed valuation policies
- Improper valuation resulted in over \$200 MM in management fees to adviser
- Breach of adviser's fiduciary duties
- Litigated action pending against adviser and related entities and firm's CEO



Action Against Adviser and Certain Board of Trustees for Section 15(C) Violations

In the Matter of Commonwealth Capital Management LLC

- Mutual fund adviser, principal, and 3 mutual fund board members from one fund family were charged with failing to satisfy their statutory obligations in connection with the evaluation and approval of mutual fund advisory contracts
- Adviser alleged to have omitted or provided inaccurate information requested by independent directors of mutual funds in connection with board meetings to approve the firm's advisory contract relating to fund profitability, expenses and breakpoints
- Cease and desist order against adviser, shareholder services affiliate and 3 trustees



Action Against Adviser for Failure to Report Outside Business Activities & Related Party Transactions

In the Matter of Blackrock Advisors LLC

- Private fund adviser failed to disclose that energy fund portfolio manager owned oil & gas company in which fund had a significant investment
- Violations of SEC Rule 38a-1 for failure to report matter to fund board even though conflict was known by compliance
- \$12 MM in sanctions

In the Matter of Guggenheim Partners Investment Management LLC

- Adviser's failure to disclose \$50 MM loan from client to senior executive of adviser
- Compliance procedures did not detect loan even though management was aware of the transaction
- \$20 MM in sanctions