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Regulators Train Crosshairs On Compliance Professionals — Perception Or Reality?

By Peter Boutin and Christopher Stecher

On August 10, 2015, former Securities and Exchange Commission (SEC) Commissioner Luis A. Aguilar[1] issued a Statement on the Importance of Clarity in Commission Orders. In his statement, Commissioner Aguilar argued, among other things, that public concerns about recent Commission actions involving Chief Compliance Officers (CCOs) may be attributed, at least in part, to "Commission Orders that could have been clearer and more fulsome.[2]" Assuming he was espousing "more copious" Commission Orders, Commissioner Aguilar recognized that at least one commentator argued that a Commission Order related to CCOs could have been clearer by including more facts to distinguish misconduct that warranted an enforcement action from conduct that is merely 'naïve and ineffective.'"[3] But what is the line between actionable conduct versus that which is merely naïve and ineffective? Or, perhaps more importantly to today's compliance professional, how is that dividing line perceived by both regulators and those being regulated. Indeed, while SEC Chair Mary Jo White sought in July[4] to quash increasing concerns regarding CCO liability, 59% of compliance practitioners expect that their risk of personal liability will increase.[5]

Perhaps the recent comments of Andrew Ceresney, Director of the SEC's Division of Enforcement, to a group of compliance professional did little to allay those concerns. In his November 4, 2015 keynote address at the 2015 National Society of Compliance Professionals, National Conference, Director Ceresney attempted to echo Chairperson White's message of support.[6] Director Ceresney stated that the SEC's disciplinary actions against compliance professionals "punish misconduct that falls outside the bounds of the work that nearly all of you [compliance professionals] do on a daily basis [and] do not involve the exercise of good faith judgments."[7] Director Ceresney discussed at length Rule 206(4)-7 promulgated under the Advisors Act and proclaimed that, in the 12-year period since Rule 206(4)-7 was adopted, the SEC brought only five enforcement actions against individuals with CCO-only titles that involved charges under Rule 206(4)-7 where there were not otherwise efforts to obstruct or mislead SEC staff.[8]

As is often the case, what Director Ceresney did not say is just as thought-provoking as what he said. For example, Director Ceresney did not mention that all five of the enforcement actions he cited occurred in the last five years — four of them in the last two years — while he cited zero illustrative enforcement proceedings from the first seven years that Rule

1. Commissioner Aguilar's term expired in June 2015, but he stayed on with the SEC through December 2015. *See* http://www.reuters.com/article/us-sec-aguilar-idUSKCN0T52IN20151116.
2. Commissioner Luis A. Aguilar, "Statement on the Importance of Clarity in Commission Orders" (Aug. 10, 2015). The often mistakenly-used word fulsome is defined principally as "disgusting or offensive, esp. because excessive or insincere" and only tertiarily as "copious or abundant." *See* http://www.yourdictionary.com/fulsome#websters.
3. *Id.*
4. Chairperson Mary Jo White, "Opening Remarks at the Compliance Outreach Program for Broker-Dealers" (July 15, 2015) found at http://www.sec.gov/news/speech/opening-remarks-compliance-outreach-program-for-broker-dealers.html ("We do not bring cases based on second guessing compliance officers' good faith judgments, but rather when their actions or inactions cross a clear line that deserve sanction.").
5. Stacey English and Susannah Hammond, Thomson Reuters, *Cost of Compliance 2015* (May 13, 2015). *See* https://risk.thomsonreuters.com/sites/default/files/GRC02332.pdf. That expectation appears to be shared by at least one former SEC Commissioner Daniel Gallagher, who stated that recent enforcement actions illustrate a "trend toward strict liability for CCOs" and that the SEC "seems to be cutting off the noses of CCOs to spite its face." *See* Commissioner Daniel M. Gallagher, "Statement on Recent SEC Settlements Charging Chief Compliance Officers With Violations of Investment Advisers Act Rule 206(4)-7" (June 18, 2015) found at http://www.sec.gov/news/statement/sec-cco-settlements-iaa-rule-206-4-7.html. Like Commissioner Aguilar, Commissioner Gallagher's term ended in 2015, and he left his position on October 2, 2015.
6. Director Andrew J. Ceresney, "2015 National Society of Compliance Professionals, National Conference: Keynote Address" (Nov. 4, 2015) found http://www.sec.gov/news/speech/keynote-address-2015-national-society-compliance-prof-cereseney.html#_ftn15.
7. *Id.*
8. *Id.* Rule 206(4)-7 was proposed and adopted by the SEC in 2003. *See* U.S. Secs. & Exch. Comm'n, *Compliance Programs of Investment Companies and Investment Advisers,* 68 Fed. Reg. 74714 (Dec. 24, 2003).

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206(4)-7 existed. Further, Director Ceresney discussed at length the two most recent of the five enforcement proceedings (*SFX Financial* and *BlackRock Advisors*[9]) in support of his argument that compliance professionals should not be concerned that, by engaging in good faith judgments, they will somehow be exposed to liability. However, Director Ceresney did not discuss the other three recent decisions, which create at least some reservations about accepting his benign conclusion.[10] In addition to the two recent actions discussed by Director Ceresney, this article analyzes the three enforcement proceedings Director Ceresney cited but did not discuss. In the end, the SEC's actions might be causing more uncertainty instead of less in the area of CCO liability.

Buckingham Research Group / Lloyd Karp

In *Buckingham Research Group*, the broker-dealer respondent instituted a review procedure to detect and prevent potential misuse by one of its wholly-owned subsidiaries of material research information, such as the initiation of research coverage or changes in price targets.[11] However, the SEC found that the written policy was not followed in practice.[12] The firm later changed its written policy to conform to its actual day-to-day practice.[13] The SEC specifically found that the CCO of both the broker-dealer and its wholly-owned subsidiary was aware of the compliance weaknesses and failures, and either failed to act or failed to correct the weaknesses. The SEC further determined that the CCO failed to take remedial steps that he had promised the SEC he would take, failed to initial and date compliance logs, and willfully aided and abetted and caused the firm's many compliance violations.[14] For his ***willful*** conduct, the CCO was censured and ordered to pay a civil penalty in the amount of $35,000.[15]

The *Buckingham Research Group* Order is noteworthy inasmuch as: (1) it is the earliest of the actions cited by Director Ceresney in his speech — 2010, over seven years after Rule 206(4)-7 was adopted; (2) it involved conduct that the SEC expressly determined to be "willful"; (3) it involved altered records[16] that were produced to the SEC; and (4) it featured a civil penalty that, as shown below, was commensurate with or less than the penalties imposed for CCO conduct that was ***not*** found to be "willful."

Ronald Rollins

Approximately two-and-a-half years after *Buckingham Research Group*, the SEC brought an enforcement action against Ronald Rollins, the CCO of an investment advisory firm where an employee, Timothy Roth, was found to have misappropriated over $16 million from clients in an elaborate scheme.[17] The CCO was the direct supervisor of Roth and was found to have willfully aided and abetted the firm's violation of certain rules and otherwise failed to reasonably supervise Roth. Notably, the SEC determined that, had the CCO supervised Roth properly and implemented other policies, he could have — not should have or would have — prevented or detected Roth's fraud. Notwithstanding the hypothetical nature of those findings, the SEC suspended the CCO for 12 months in any capacity and at least three years from acting in any supervisory capacity.[18] The finding of ***willful conduct*** appeared to be a key factor in determining the scope of the violation and the penalty. Within the next three months, however, the SEC would bring an action in which it made a finding of "willfulness" on starkly different facts.

Equitas Capital Advisors / Susan Christina

In *Equitas Capital Advisors*, the SEC instituted proceedings against an investment advisory firm, the firm's CEO and its CCO.[19] There, the firm was charged with (1) overcharging and undercharging certain clients over a period of three years; (2) failing to adequately disclose certain fees and conflicts of interest; and (3) disseminating misleading advertisements about its historical performance. The SEC ordered the CCO to cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.[20] The SEC found that the CCO "willfully aided and abetted and caused" the firm's violations notwithstanding the facts that: (1) the firm voluntarily refunded all of the overcharged fees, plus interest, once it discovered its error; (2) the firm had a policy and procedures manual, and the CCO reviewed the

9. Commissioner Gallagher voted against both settled actions, which he described as flying in the face of his admonition that the SEC should tread carefully when bringing enforcement actions against compliance personnel. *See* Commissioner Daniel M. Gallagher, "Statement on Recent SEC Settlements Charging Chief Compliance Officers With Violations of Investment Advisers Act Rule 206(4)-7" (June 18, 2015) found at http://www.sec.gov/news/statement/sec-cco-settlements-iaa-rule-206-4-7.html.
10. Director Ceresney also did not mention at all the *Fenway Partners* order, issued just one day before his speech. On November 3, 2015, the SEC announced that it had agreed to settle charges against an investment advisory firm for violations of Section 206(4) of the Advisors Act. *See In the Matter of Fenway Partners, LLC, et al.*, Advisers Act Release No. 4253 (Nov. 3, 2015). Among other penalties, the SEC fined the firm's CCO $75,000 and specifically noted that "violation of Section 206(4) and the rules thereunder does not require scienter." *Id.* at pp. 10, 12. The U.S. Supreme Court described scienter as "a mental state embracing intent to deceive, manipulate, or defraud." *See Ernst and Ernst v. Hochfelder*, 425 U.S. 185, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976).
11. *See In the Matter of The Buckingham Research Group, Inc., Buckingham Capital Management, Inc., and Lloyd R. Karp*, Advisers Act Release No. 3109 (Nov. 17, 2010).
12. *Id.* at p. 3.
13. *Id.* a p. 4.
14. *Id.* at p. 6.
15. *Id.* at pp. 10-11.
16. Since *Buckingham Research Group* involved altering of records produced to the SEC, the action arguably falls outside the scope of Director Ceresney's comments regarding cases where there were not "otherwise efforts to obstruct or mislead SEC staff."
17. *See In the Matter of Ronald S. Rollins*, Advisers Act Release No. 3635 (July 29, 2013).
18. *Id.* at pp. 10-11. No civil monetary penalty was imposed because the CCO submitted a sworn Statement of Financial Condition asserting his inability to pay a civil penalty.
19. *See In the Matter of Equitas Capital Advisors, LLC, Equitas Partners, LLC, David S. Thomas, Jr. and Susan Christina*, Advisers Act Release No. 3704 (Oct. 23, 2013).
20. *Id.* at p. 12.

manuals at times; (3) the CCO specifically raised concerns about marketing materials and advocated the inclusion of certain disclaimers; (4) the CCO recommended in writing to the firm's compliance committee and CEO that the firm adopt various improvements, including conducting a more robust annual compliance review, outlining the fee billing process, documenting the adviser due diligence process, and improving the process for advertising approvals.[21]

BlackRock Advisors

Two years after the *Ronald Rollins* and *Equitas Capital Advisors* actions, the SEC would dispense with the need to find any willfulness on the part of a CCO in simply "causing" a violation. In *BlackRock Advisors*, the investment management firm did not have written policies and procedures regarding outside business activities of its employees, even though the BlackRock CCO knew of and approved numerous outside activities engaged in by BlackRock employees.[22] The SEC determined that the CCO failed to develop and implement written policies and procedures to assess and monitor the outside activities of BlackRock employees and to disclose related conflicts of interest to the BlackRock funds' boards and to advisory clients. The SEC charged the CCO with a "wholesale compliance failure" — causing BlackRock's failure to adopt written policies regarding outside business activities. Even though there was no finding whatsoever that the CCO acted willfully, the CCO was ordered to pay a civil penalty in the amount of $60,000.[23]

SFX Financial

Two months after *BlackRock Advisors*, the SEC instituted proceedings against another CCO who was never determined to have acted willfully. In *SFX Financial*, an employee of an investment advisory firm with full signatory power over client bank accounts misappropriated client assets for more than five years by withdrawing money directly from those accounts.[24] The CCO was involved in detecting, reporting and conducting an internal investigation of the misappropriation. Nevertheless, the CCO was charged with causing the firm's violation of Rule 206(4)-7 because the firm's policies and procedures were determined to be not reasonably designed or effectively implemented to prevent misappropriation of client funds and, therefore, the CCO was negligent in failing to conduct an annual review.[25] As a result, the CCO was censured and ordered to pay a civil penalty in the amount of $25,000 notwithstanding the fact that the CCO was found not to be involved in and was not charged with misappropriation.[26]

Caveat Obsequio Tribunus[27]

The orders and decisions addressed in this article do not reflect a comprehensive analysis of the SEC's policies and practices regarding enforcement actions. However, the cited authorities illustrate the delicate environment in which most compliance officers find themselves today.[28] Indeed, a review of the five principal cases cited by Director Ceresney in his November 4, 2015 speech hardly suggests that the SEC is seeking to "punish misconduct that falls outside the bounds of the work that nearly all [compliance professionals] do on a daily basis." Rather, along with the most recent *Fenway Partners*, recent SEC enforcement proceedings appear to reveal a trend toward dispensing with any willfulness finding before imposing CCO liability. Whether one takes caution from Commissioner Gallagher's opinion that the SEC has been "sending a troubling message" to CCOs or takes solace in the sentiments expressed by Commissioner Aguilar, Director Ceresney, and Chair White that the SEC is "in your corner," it is abundantly clear that compliance professionals face increasing scrutiny from a wide audience, including regulators, business executives and the investing public.

In today's environment, most compliance practitioners perceive that they face a heightened risk of potential supervisor liability.[29] Whether true or not, that perception should guide compliance officers as they consider their responsibilities to their various constituents. CCOs would be wise to consult early and often with in-house and/or outside legal counsel in dealing with complicated compliance issues. After all, at least the perception persists that the SEC will continue targeting compliance officers in 2016. That perception alone may be enough to establish the present truth.[30] ✦

21. *Id.* at pp. 6-7.
22. *See In the Matter of Blackrock Advisors, LLC and Bartholomew A. Battista*, Advisers Act Release No. 4065 (Apr. 20, 2015).
23. *Id.* at p. 12.
24. *See In the Matter of SFX Financial Advisory Management Enterprises, Inc. and Eugene S. Mason*, Advisers Act Release No. 4116 (June 15, 2015).
25. *Id.* at p. 3.
26. *Id.* at p. 5.
27. Loosely translated as "Let The Compliance Officer Beware."
28. The SEC enforcement actions also do not reflect, of course, the many other regulatory agencies under whose jurisdiction compliance officers fall. Less than three weeks after Director Ceresney's November 4, 2015 speech, NASDAQ disciplined a compliance professional at Quad Capital for taking a "mistaken position" and failing to supervise the firm's trading. The CCO was censured, suspended from serving as a supervisor for 18 months, was required to pass or re-take a Series 24 exam and was fined $30,000. *See* FINRA Matter No. 20100221850-02 (incl. 20110284443), Enforcement No. 2015-11 (Nov. 23, 2015), https://www.nasdaqtrader.com/Micro.aspx?id=PHLXDisciplinaryActions.
29. *See* English and Hammond, *supra*, Thomson Reuters, *Cost of Compliance 2015* (May 13, 2015).
30. "There is no truth. There is only perception." — Gustave Flaubert.