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Financial Reform Act Expands SEC's Enforcement Powers and Liability for Securities Violations

On July 21, 2010, the President signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act) into law. Overall, the Act is designed to promote stability in financial markets, eliminate or minimize excessive risk taking in the financial industry, and enhance investor and consumer protections. Consequently, the Act covers a number of sectors within the financial services industry. While the full effects of the Act, and whether it will have the desired sweeping results, will not be known for several years, some features of the law have an immediate impact on companies, broker-dealers, investment advisers, and other SEC-regulated persons and entities.

One important near-term focus of the Act is the strengthening of certain laws and practices relating to the SEC. While in certain respects the Act curtails or divides the SEC's oversight with other regulators, several provisions also enhance the SEC's arsenal of investigative and enforcement tools and likely impact the regulatory landscape and increase the potential liability for securities violations.

THE ACT'S ENHANCED SEC-RELATED SECURITIES PROVISIONS

Set forth below are some of the Act's major substantive and procedural provisions in this area and the changes they bring about:

- **Expanded Whistleblower Award Program** (Section 922): In a major expansion of prior law, the Act provides that the SEC is generally required, subject to discretion as to the amount, to pay cash rewards of between 10 percent and 30 percent of the monetary sanctions imposed against defendants (in cases where those sanctions exceed \$1 million) to persons who provide information that leads to successful enforcement action. It includes cases where the SEC, the Department of Justice and other regulatory agencies bring related enforcement actions. Previously, the SEC whistleblower bounty program's application was limited to insider trading violations and was rarely used. Two related developments announced earlier this year, the SEC's Cooperation Initiative and its increased investigative activity for possible large-scale FCPA bribery violations, support whistleblowers and may lead to more tips and complaints of wrongdoing, increased investigative action, and potentially enormous awards.

- **Increased Scope of Collateral Bar Orders** (Section 925): The Act expands the scope of securities-related employment bars, so-called "collateral bars," that can be imposed on securities professionals such as brokers and advisers who are found to have committed violations of the Securities Exchange Act and the Investment Advisers Act. Before the Act, an individual found to have committed a violation could only be barred more narrowly from serving in the same regulated employment capacity for a period of time. Now violators can be barred from serving in any securities industry-related position including as a broker-dealer, investment adviser, or municipal securities dealer. This provision restores a formidable remedy the SEC had used but that had been foreclosed as the result of an earlier court decision.
- **Expanded Nationwide Service of Process of Subpoenas** (Section 929E): The Act gives the SEC the authority in federal court enforcement actions to issue subpoenas to compel witness testimony or document production for a hearing or trial anywhere in the U.S. Under another provision of law, now made inapplicable to the SEC, the agency was previously limited to compelling testimony and documents within a relatively small geographic area.
- **Wider Confidentiality of Records Submitted to the SEC** (Section 929I): The Act provides that the SEC will not be forced to disclose, pursuant to a FOIA request, certain records and information obtained under the Securities Exchange Act, the Investment Company Act, and the Investment Advisers Act from regulated entities in its exams. The exact parameters of this provision are somewhat unclear. The SEC has taken the position that this provision is necessary and largely confirms its existing practices; however, on its face, the statute reads broadly and appears to expand the grounds on which the SEC may deny public access to these records. The provision has already generated controversy and a request for Congressional hearings.
- **Sharing of Privileged Information with Other Authorities** (Section 929K): In an effort to encourage the sharing of information and investigative resources, the Act amends the Securities Exchange Act to allow the SEC to share documents it collects in its investigations with the Public Company Accounting Oversight Board, foreign securities authorities, and other federal and state law enforcement agencies without losing or waiving applicable privilege protection. Conversely, the Act provides that the Public Company Accounting Oversight Board and other federal and state law enforcement agencies will not waive applicable privilege protection to any information transferred to the SEC for its use. Thus, the legal shield from disclosure will not fall from this sharing.
- **Expanded Aiding and Abetting Liability** (Sections 929M through 929O): The Act gives the SEC the power to bring secondary aiding and abetting charges under the Securities Act, the Investment Company Act, and the Investment Advisers Act against those who assist in a violation of those laws (as contrasted with those who are primary violators). It also states that the SEC can bring such charges against those who "knowingly" or "recklessly" assist a violation. In the past, the SEC could only bring aiding and abetting charges if it were an underlying violation of the Securities Exchange Act and the defendant had to have acted with knowledge of the wrongdoing. These provisions expand the possible universe of securities violations and lower the required state of mind (and likely the proof) required for a violation. Aiding and abetting charges by the SEC have become more popular in recent years, and with the new provisions, these types of charges are likely to be filed with greater frequency.
- **Broadened Ability to Impose Monetary Penalties** (Section 929P): The Act authorizes the SEC to impose civil monetary penalties in administrative cease-and-desist proceedings by the SEC and to do so against any person charged with violations of the securities laws. Previously, this type of action was only available against individuals who already fell under SEC oversight as regulated persons because they worked at a regulated brokerage firm or investment advisory firm or other SEC-registered entity. For all other persons (or if the SEC sought a money penalty in combination with administrative remedies), the SEC had to bring a federal court action. This provision eliminates the court versus administrative

proceeding distinction and gives the SEC a strong incentive to bring more cases as administrative actions, as opposed to federal court actions. Administrative actions are generally less favorable to targets because they are filed before an SEC administrative law judge, and there are several built-in and streamlined pro-SEC procedures that usually limit defensive options and lines of strategy for defense.

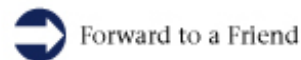
- **Deadlines for Completion of Exams, Reviews and Enforcement Actions** (Section 929U): The Act requires the SEC either to file an enforcement action or to notify the Director of the Division of Enforcement of its intent not to file an action within 180 days of providing a written Wells Notice informing targets that they will be charged with securities violations. This timely notification deadline can be extended for 180-day periods under certain circumstances if it is determined that the investigation is complex. This section addresses a common complaint that SEC actions and investigations take too long and that the subjects of its reviews are left without a definitive decision on their cases. It remains to be seen how often the SEC will invoke the complex case exception.

EFFECTIVE DATES

While many of the Act's other provisions have delayed effective dates, unless otherwise indicated in the law (such as with the whistleblower provisions that are not self-effectuating and require further SEC rulemaking), the provisions discussed above were largely effective upon enactment. To read the text of the above-listed sections, which are found in Title IX of the Act, please click [/A>](#).

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