JACKO LAW GROUP, PC
SECURITIES & CORPORATE COUNSEL

Legal Risk Management Tip
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2012 SEC ENFORCEMENT CASES – A YEAR IN REVIEW

The Securities and Exchange Commission ("SEC") announced that it filed 734 enforcement actions in the fiscal year of 2012 – surpassing 2011's record results. Of these actions, 147 were against investment advisers, and another 134 were related to broker-dealers.[1] As mentioned in last month's Legal Risk Management Tip – "*Private Fund Adviser Updates: The New SEC Presence Examination*," passage of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") eliminated the private adviser exemption to the Investment Advisers Act of 1940 ("Advisers Act"), subjecting previously exempt advisers to registration and regulatory oversight by the SEC. Consequently, 2012 saw an increase in private fund adviser enforcement cases, as well as cases involving managers of separate accounts, involving areas such as adequacy of policies and procedures, due diligence, disclosures, conflicts of interest and insider trading. Below is a summary of some of the more notable cases.

Record-Keeping, Compliance Policies and Procedures and Disclosures

In the Matter of Alpine Woods Capital Investors LLC and Samuel A. Lieber, IA Rel. No. 3154 (Feb. 7, 2011). Alpine Woods Capital Investors, LLC, a registered investment adviser with over $11 billion in assets under management, allegedly gave preferential treatment to two of its smallest mutual funds in allocations it received of initial public offerings (IPOs). Alpine's Form ADV Part 2A falsely represented that it allocated IPO shares on a basis that was "fair and equitable." In addition, the adviser's actual allocation of the IPOs violated the firm's policy and procedure protocols. Further, Alpine failed to disclose in the two funds' prospectuses that IPO trading materially contributed to the performance of the funds and did not include any disclosures concerning the risks associated with short-term IPO trading. In accordance with a settlement agreement with the SEC, Alpine was ordered to pay a civil penalty of $650,000 and the firm's CEO and portfolio manager, Leiber, was individually ordered to pay a civil penalty of $65,000.

Compliance Program

In the Matter of OMNI Investment Advisors, Inc. & Gary r. Beynon, IA Re. No. 3323. The SEC charged OMNI Investment Advisers Inc. ("OMNI") and Gary R. Benyon, CEO and CCO, with failing to establish, maintain and enforce a written code of ethics, as required under Advisers Act Rule 204A-1, and also with failing to maintain and preserve certain books and records, as required by Advisers Act Rule 204-2(a)(10). Beynon was living outside the country at the time, and performed almost none of the compliance responsibilities his position required. The SEC found that the firm failed to adopt and implement a compliance program. Furthermore, the SEC found that Beynon "backdated his signature" on advisory contracts before responding to an SEC subpoena for the documents and "never performed numerous" CCO functions, such as reviewing employees' financial reports. As part of a settlement offer, Beynon was barred from compliance

[1] http://www.sec.gov/news/press/2012/2012-227.htm

and supervisory capacities and fined $50,000 for OMNI's complete noncompliance with Rules 204-2(a)(10) and 204A-1.

Social Media

Social media has been an area of increased emphasis by the SEC where the focus has shifted to retention and supervision requirements of firms. Earlier this year, the SEC released a National Examination Risk Alert addressing investment adviser use of social media, the need for advisers to have policies regarding the use of social media, and outlining specific factors that need to be addressed by these policies.

The enforcement action cited to by the SEC in their Risk Alert was In re Anthony Fields et. al, Inv. Adv. Act Rel. No. 3348 (Jan. 4, 2012). Here, the SEC alleged that Fields made fraudulent offers of fictitious securities through various forms of social media, reported false and materially misleading information to the Commission on AFA's Form ADV, failed to maintain required books and records and to implement adequate compliance policies and procedures, and published false and materially misleading information on the websites of both AFA and Platinum. While the court this month found Fields "not guilty" on the charges related to social media (although he was fined $150,000 and his IA registration revoked for other charges), this will clearly be an area of focus by the SEC in the new-year.

False and Misleading Statements Regarding Due Diligence

Calhoun Asset Management LLC et. al, Inv. Adv. Act Rel. No. 3345 (Dec. 29, 2011). The SEC brought action regarding materially false and misleading statements made by Calhoun, the investment adviser to two funds of funds, and Ward, its principal. Ward raised the assets managed by Calhoun by grossly exaggerating Calhoun's assets under management. Ward also made misleading statements about Calhoun's due diligence process, and filed numerous "false" Forms ADV with the Commission. In addition to making false and misleading statements, Ward failed to maintain records to support the performance that Calhoun claimed in its marketing materials. The results of a settlement agreement included both civil penalties totaling $50,000, as well as the barring of Ward from the brokerage and investment advisory business.

Improper Disclosure

SEC v. GEI Financial Services, Case No. 12-cv-7927 (Oct. 3, 2012). Recently the SEC brought suit against SEC registered investment adviser GEI Financial Services Inc. and its owners in federal district court in the Northern District of Illinois. The complaint details the myriad bad acts of the adviser and its husband and wife principals who were running a private fund focused on the health care industry. Among other things, the adviser entirely failed to disclose the management and performance fees charged to the fund and unilaterally changed the method in which the performance fee was calculated (removing aspects of the performance hurdle) without disclosure or the required investor consent. The case is in litigation and the SEC is seeking disgorgement of all profits, civil penalties, and various injunctive relief prohibiting the firm from engaging in future unlawful activities.

Conflicts of Interest

In the Matter of Focus Point Solutions, Inc., Adm.Proc. File No. 3-15011 (September 6, 2012). This recent SEC enforcement action against a registered investment adviser demonstrates the

need for registrants to disclose to its clients in writing any and all conflicts of interest. Here, the SEC alleged that the registered investment adviser failed to disclose to clients that the firm was receiving a percentage of revenues from a broker-dealer that managed mutual funds the adviser recommended for purchase by its clients. Additionally, the SEC charged the investment adviser for the failure to inform clients of its conflict of interest before it voted on behalf of clients to add itself as a sub-adviser to a certain mutual fund. In a settlement agreement, the adviser agreed to disgorge $900,000 in ill-gotten gains, pay a $100,000 penalty and hire an independent consultant to conduct comprehensive compliance reviews of the firm.

Insider Trading

SEC v. CR Intrinsic Investors, LLC et al., Civil Action No. 12 Civ. 8466 (Nov. 20, 2012). The SEC recently charged Stamford, Connecticut-based hedge fund advisory firm CR Intrinsic Investors LLC and its former portfolio manager along with a medical consultant for an expert network firm for their roles in a $276 million insider trading scheme involving a clinical trial for an Alzheimer's drug being jointly developed by two pharmaceutical companies. The illicit gains generated in this scheme make it the largest insider trading case ever charged by the SEC.

Conclusion

These cases highlight the current focus areas of the SEC. With this in mind, firms should take time at the end of this year to review the adequacy of its internal controls in these, and other areas, to help mitigate potential risks going into 2013. For more information, please contact Jacko Law Group, PC at (619) 298-2880 or email us at info@jackolg.com. Have a very happy holiday season.

Author: Robert Boeche, Associate; Editor: Michelle L. Jacko, Esq., Managing Partner, JLG. JLG works extensively with investment advisers, broker-dealers, investment companies, hedge funds and banks on legal and regulatory compliance matters.