



SEC SUBPOENAS, INQUIRIES, FORMAL INVESTIGATIONS AND ENFORCEMENT ACTIONS:

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Presenters:

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Goals for Today

- Introduction to the SEC
 - Who they are
 - Where they are
 - What they do
 - Why
 - How
- Understanding of SEC Enforcement Activities
 - Conduct of inquiries, investigations and enforcement actions
 - Communications with the SEC
 - Subpoena Response
 - Defense of the Company and Individuals
 - Best Practices

Role of the SEC

- The Securities and Exchange Commission is the nation's primary regulator in connection with activities relating to the offer and sale of securities
 - The SEC has oversight responsibility for the initial offering of securities (IPOs) as well as the secondary trading of securities across all securities exchanges (NYSE, NASDAQ, etc.)
 - The SEC regulates public companies, broker-dealers, investment advisers, investment bankers, municipal advisors, mutual funds, hedge funds, investment pools, securities markets, and all primary and secondary market participants, including financial professionals affiliated with SEC regulated entities (as well as others not named)

Role of the SEC

- The SEC has three essential missions
 1. Protection of investors
 2. Fair, orderly and efficient operation of the securities markets
 3. Facilitation of capital formation (the lawful raising of capital by businesses, public and private)

Role of the SEC

- The SEC regulates and enforces the federal securities laws through the operation of five major divisions
 - Division of Corporation Finance
 - Division of Trading and Markets
 - Division of Investment Management
 - Division of Economic and Risk Analysis
 - Division of Enforcement

Role of the SEC

- The “Home Office” of the SEC is in Washington DC and the SEC also operates out of 11 regional offices, including New York, Boston and Philadelphia
 - [Philadelphia Regional Office](#)
1617 JFK Boulevard, Suite 520
Philadelphia, PA 19103
215-597-3100
- SEC has primary regulatory responsibility over 35,000 entities, including 9,500 public companies, 11,000 investment advisers, 9,700 mutual funds/ETFs, and 4,600 broker-dealers

SEC Enforcement Activities

- The SEC is also the chief enforcer of the nation's securities laws (primarily through the Division of Enforcement)
 - Each of the Regional offices of the SEC maintains an Enforcement Staff that often includes a Director of Enforcement (lead role), and various Branch Chiefs charged with leading inquiries and investigations into possible violations of the securities laws
 - Employees of the SEC include attorneys, accountants, economists, investigators, statisticians, mathematicians, and financial quantitative analysts (Quants), etc.

SEC Enforcement Activities

- Some of the nation's primary securities laws enforced by the SEC are
 - The Securities Act of 1933 (regulating the initial offering of securities)
 - The Securities Exchange Act of 1934 (regulating all aspects of the securities industry, including secondary trading of securities)
 - Investment Company Act of 1940 (regulating, among other things, mutual fund offerings)
 - Investment Advisers Act of 1940 (regulating the activities of investment advisers)
 - Sarbanes Oxley Act of 2002 (designed to combat corporate and accounting fraud)
 - Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (enhancing consumer protection and further regulating financial products, trading restrictions, and credit ratings, among other things)

SEC Enforcement Activities

- What type of conduct does the SEC investigate?
 - Examples:
 - Insider trading
 - Misrepresentation or omission of material information in a securities offering or filing
 - Broker-Dealer, investment adviser, hedge fund, mutual fund conduct
 - “Pay to play”
 - Unregistered securities offerings
 - Conduct disclosed by a Whistleblower
 - Conduct disclosed by another US agency (IRS)
 - Foreign Corrupt Practices (bribery)

SEC Enforcement Activities

- In order to enforce the nation's securities laws, the SEC Enforcement Staff conducts informal inquiries, directs formal investigations, and files enforcement actions administratively and in federal court
 - Informal Inquiry or "Matter Under Inquiry" – this is an initial investigation by the SEC into potential violations of the securities laws. The Staff does not have subpoena power but may request information from regulated and unregulated entities or individuals.

SEC Enforcement Activities

- Formal Investigation – this is an investigation where senior members of the Enforcement Division have determined that sufficient information exists concerning the potential violation of the federal securities laws. Upon the issuance of a “Formal Order of Investigation,” certain Enforcement staff are empowered to administer oaths and issue subpoenas compelling testimony or documents
- SEC Staff will typically not disclose the subject matter of any inquiry/investigation other than what is disclosed in the Formal Order of Investigation. Nevertheless, SEC defense counsel should attempt to learn as much as possible from discussions with the SEC Staff.

SEC Enforcement Activities

- Enforcement Actions – the SEC brings enforcement actions in two forms
 1. Administrative Proceeding – this is a filed enforcement action presided over by an administrative law judge where the SEC charges certain individuals or entities with a civil violation of the federal securities laws
 2. Federal court action – this is a lawsuit filed in federal court by the SEC charging individuals or entities with a civil violation of the federal securities laws
- While the SEC does not have criminal jurisdiction, it often refers matters for prosecution to the Justice Department and frequently cooperates with and coordinates investigations and prosecutions with the United States Attorney's offices

Communications with the SEC

- A company or individual's initial interaction with the SEC may be as simple as a phone call seeking information
 - While this initial communication may seem innocuous, it is often the first step in a protracted process that may include (i) informal requests for documents and ESI (electronically stored information), (ii) subpoenas issued ordering production of documents, ESI and testimony, and (iii) possibly a formal enforcement action (either administratively or in federal court).
- Importantly, any individual or company response to the SEC is governed by federal law concerning communications with federal officers. It is a crime to provide false information to a federal officer, so “off the cuff” responses are not recommended.

Interaction with the SEC

- **Best Practices**

- I tell all of my clients that any communication with the SEC is to be taken seriously and handled formally
- I recommend that it be company policy for any person contacted by the SEC to be courteous and accommodating to the investigating officer and to inform the investigating officer that it is company policy for staff to inform company counsel and compliance staff of any communication from the SEC to ensure that a prompt, comprehensive and cooperative responsive will commence
- Recommended initial response: *“Thank you for your call. I would be happy to speak with you but I am required under company policy to report any communication with a federal officer to our compliance function and company counsel. I will do that right away and the appropriate person will respond to you. Can you please provide the best number to reach you and your email address. I’m sure we will be back to you promptly.”*

Requests for Information

- With some exceptions (for regulated entities that may have frequent interactions with the SEC for compliance purposes or examinations), a Company receiving a formal (subpoena) or informal (letter/phone call) request for information from the SEC should engage competent SEC enforcement defense counsel to assist the Company's response and counsel the Company
 - This is true even if the Company views their role in the SEC investigation as “witness” only
 - WHY?

Requests for Information

- FORM 1662
 - Whenever the SEC requests information or testimony from an individual or representative of a Company, the SEC is required to provide a copy of SEC Form 1662, entitled
 - *Supplemental Information for Persons Requested to Supply Information Voluntarily or Directed to Supply Information Pursuant to a Commission Subpoena*
 - Form 1662 informs responding individuals and companies of the applicable federal laws concerning communications with the SEC
 - It also informs as to the “Routine Uses of Information” provided to the SEC

Requests for Information

- Summary of Form 1662
 - Section A informs that it is a federal crime (i) to provide false information to the SEC or conceal information from the SEC, (ii) to alter or destroy any document requested by the SEC
 - Section B informs that if an individual provides testimony to the SEC, then
 - Testimony will be recorded
 - You may receive a copy of the recorded transcript
 - Counsel may be present
 - ***Providing false testimony (perjury) is a federal crime***
 - Section D informs that information provided may be required to be disclosed pursuant to a Freedom of Information Act Request (FOIA request)

Requests for Information

- Section H informs about routine uses of information and testimony provided to the SEC, including that the SEC may provide it to:
 - Other federal or state agencies, entities or self-regulating organizations (SROs)
 - Federal, state or local law enforcement agencies
 - Trustees, receivers, special counsel or masters in connection with any bankruptcy or other court proceeding
 - IRS
 - Congress
- Overall, there are 22 routine uses of information provided

Requests for Information

- **Best Practices**

- Competent SEC defense counsel can advise on the procedural aspects of an SEC investigation, the potential liabilities and risks, and the appropriate response process to ensure protection of companies and individuals responding to SEC requests for information or subpoenas
- Early engagement of counsel is critical. Too often counsel is engaged after significant interactions with the SEC Staff has occurred, expectations have been set, and information has been mishandled and misproduced
- Counsel will often be able to learn more about the subject matter of the investigation than can be gleaned or learned by company representatives
- Counsel often has a previous relationship with SEC Staff in the regional offices or home office and this can also be helpful

Responding to the SEC

- Initial SEC requests may be overbroad (and possibly mislabeled and awkward)
 - By having counsel who communicates with and has a relationship with SEC Staff, a Company may be able to limit the breadth of information to be provided to the SEC, or assist in having the response more targeted to specific information
- Information gathering may be difficult
 - The breadth of ESI can make the prospect of responding to an SEC subpoena or request very daunting for individuals and companies. Also, the responding individual or company must prevent deletion of ESI (and other information)

Responding to the SEC

- At a minimum, an “investigation hold” should be drafted and circulated to all custodians of potentially responsive information
 - The “investigative hold” will require work by Information Technology (IT) or other staff to ensure deletion does not occur
- We recommend that any documents or ESI produced to the SEC contain an identifying number (often referred to as a Bates stamp number) to provide evidence of production and easy identification of produced information
- Companies should request “confidential treatment” of any documents or ESI produced to the SEC; Company must follow specific procedures relating to the Freedom of Information Act (FOIA) to obtain possible protection from disclosure

Testimony Before the SEC

- To the extent the SEC requests testimony (by subpoena or otherwise) from an individual or a company representative, the person designated for testimony needs competent SEC defense counsel for representation at testimony
 - Initially, the Company (and the individual) need to determine whether the individual testifying can be represented by counsel who also represents the company (is there a conflict?)
 - Other considerations are whether any indemnification rights exist for the individual (such that the Company foots the bill for counsel for the individual)
 - The Company may have D&O liability insurance that provides coverage for defense costs, etc. in the event of an SEC investigation
 - If conflict counsel is engaged, it is often helpful for conflict counsel and company counsel to confer – preferably with a joint defense privilege applying to protect communications

Testimony Before the SEC

- Day of Testimony
 - Testimony is typically conducted in the SEC regional offices or home office in the presence of an SEC-approved court reporter who will manually transcribe and electronically record testimony
 - The Witness is sworn in by the court reporter and then often reminded by SEC staff of the criminal penalties for providing false information to a federal officer or the SEC
 - SEC staff normally employs a joint questioning technique that can be very effective at soliciting comprehensive testimony
 - Typically, one member of Staff will do the primary questioning, employing an outline prepared by Staff
 - More senior members of the investigating team (often two) will then ask follow-up or more detailed questions on the subject matter reviewed

Testimony Before the SEC

- Day of Testimony (cont'd)
 - While the Witness has the right to be represented by counsel, the SEC may seek to limit any statements by counsel while the SEC is questioning “on the record”
 - The SEC does not allow the Witness or counsel to retain a copy of any documents shown to the Witness as exhibits
 - While the SEC allows frequent breaks, they may restart testimony by asking whether the witness discussed prior testimony with anyone (even counsel) during the break
 - Counsel should object to any attempt to compel the witness to disclose exact communications with counsel, but the witness may be required to disclose whether any discussion of prior testimony occurred

SEC Enforcement Actions

- Wells Process
 - If the SEC enforcement staff determines that it intends to recommend to the Commission that an enforcement action be commenced, this triggers what is commonly referred to as the “Wells Process”
 - Initially, the SEC informs the individual or company of the intent to recommend to the Commission to commence an enforcement action (and generally why) by sending a “Wells Notice” to the individual or company
 - The Wells Notice is formal notice of the staff’s intended recommendation of an enforcement action
 - The Wells Notice is often preceded by a “Wells Call” from enforcement staff to counsel for the individual or company
 - After receiving a Wells Notice, it is typical for counsel for the individual or company to meet with SEC staff to discuss more fully the matters at issue

SEC Enforcement Actions

- Wells Process (cont'd)
 - Upon receipt of a Wells Notice, the individual or company (through counsel) is invited to make a “Wells Submission” in which the individual or company disputes the allegations of the SEC
 - In preparing a Wells Submission, counsel for the individual or company may engage experts to provide helpful analysis or an affidavit
 - Depending on the subject matter of the case, the SEC may make available non-privileged files for review by defense counsel
 - Throughout the Wells Process, it is typical for the SEC and defense counsel to engage in settlement discussions

SEC Enforcement Actions

- Settlement or Enforcement Action?
 - Depending on the conduct at issue, the SEC may seek injunctive relief (asset freeze, etc.), disgorgement (forfeiture of alleged gains), other statutory relief (such as treble damages), civil money penalties, costs of investigation, fines, and/or a bar order (either permanent or temporary)
 - For instance, in an insider trading investigation, the SEC may seek disgorgement of trading profits (possibly trebled in addition), a civil money penalty (but not if disgorgement is trebled), and possibly an order barring the individual from association as a director or officer of a publicly traded company
 - The decision whether to settle with the SEC is difficult because resolving matters with the SEC does not necessarily resolve the question of any criminal prosecution of the individual or Company (but the settlement may provide that the SEC will not “refer the matter” for prosecution by the Justice Department)

Best Practices and Takeaways

- Companies can often demonstrate “good corporate citizenship” that may impact a future SEC investigation by
 - Reviewing and updating codes of conduct and compliance policies
 - Reviewing and updating accounting policies and procedures and determining whether they are being followed
 - Establishing a compliance culture (typically dictated by the conduct of senior executives)
 - Reviewing and updating document preservation/destruction policies as well as information technology policies

Best Practices and Takeaways

- It is recommended that companies anticipate regulatory involvement and investigation by having an established “playbook” for taking the appropriate steps upon learning of an SEC inquiry or investigation. Important steps are:
 - Initial response only by authorized personnel
 - Early engagement of counsel
 - Document and ESI collection and preservation procedures
 - Notification protocol
 - Senior executives and compliance personnel
 - Query – Should notification be provided to Audit Committee members, Board of Directors, auditors
 - Publicly traded companies may have disclosure obligations to investors
 - Regulated entities may have SRO disclosure obligations
 - Insurance carriers may need to be put on notice

Best Practices and Takeaways

- Upon learning of wrongful conduct, companies should consider proactive notification to the SEC (or, at a minimum, an internal investigation of conduct by qualified, disinterested professionals, such as an outside law firm that does not perform work for the company)
- Upon learning of an SEC inquiry or investigation, companies should weigh the benefits of proactive assistance to the SEC to help complete the investigation
 - Companies may receive “credit” in the form of reduced charges or sanctions for “self-policing, self-reporting, remediation and cooperation.”

Best Practices and Takeaways

- Companies should set an early positive tone in interactions with Commission staff (through counsel)
 - Immediate reach-out to investigating officers
 - Promise of cooperation
 - Discussing with Staff the gathering of information and ESI
 - Discussion of possible search protocols for ESI
- Companies should consider steps to preserve attorney-client privileged information and attorney work product protected information
- Companies should consider the possible impact of the SEC investigation and inquiry on civil litigation (existing or potential) and investigations by other governmental entities or SROs

Best Practices and Takeaways

- Remediation
 - Upon learning of potential or existing wrongful conduct, companies should consider prompt remedial steps, including financial steps, personnel changes, internal control changes, and enhancement of policies and procedures
- Insurance Coverage
 - Companies should be proactive in determining if adequate insurance coverage exists for the legal and expert fees that may accompany an SEC investigation/enforcement action

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