OVERSIGHT OF THE SEC'S DIVISION OF ENFORCEMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, SECURITIES, AND INVESTMENT

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Wednesday, May 16, 2018

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
SECURITIES, AND INVESTMENT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:04 a.m., in room 2128, Rayburn House Office Building, Hon. Bill Huizenga [chairman of the subcommittee] presiding.

Present: Representatives Huizenga, Hultgren, Stivers, Wagner, Poliquin, Hill, Emmer, Mooney, MacArthur, Davidson, Maloney, Sherman, Lynch, Scott, Foster, Sinema, and Vargas.

Also present: Representative Hensarling.

Chairman HUIZENGA. Committee will come to order. Without objection the Chair is authorized to declare a recess of the committee at any time. This hearing is entitled, "Oversight of the SEC's Division of Enforcement." I now recognize myself for 4 minutes to give an opening statement.

As we all know, the Securities and Exchange Commission (SEC) has a three-part mission: To protect investors; maintain fair, orderly and efficient markets; and to facilitate capital formation. Today's hearing will focus on the policies and procedures of the SEC's Division of Enforcement.

The Enforcement Division investigates potential violations of the Federal securities laws and prosecutes these cases in the Federal courts or in administrative proceedings before the SEC's own administrative law judges.

The SEC is a civil enforcement agency—it cannot bring criminal charges itself, although it can refer cases for criminal prosecution to the Justice Department—that pursues civil money penalties, discouragement of illicit profits, and injunctions to prohibit future violations. However, the division has broad authority to subpoena documents and testimony from individuals and entities that are violating the Federal securities laws or who may have information relevant to a fraud investigation.

In November of 2017, the SEC's Enforcement Division released their annual report highlighting their enforcement priorities, which are guided by five core principles: First, focus on the Main Street investor; two, focus on individual accountability; three, keep pace with technological change; four, impose sanctions that most effectively further enforcement goals; and five, consistently assess the allocation of SEC resources.

In the Fiscal Year of 2017, the SEC brought 754 enforcement actions and obtained almost $3.7 billion in disgorgement and civil penalties resulting from those actions. Additionally, $1.07 billion was distributed to harmed investors, which was a dramatic increase from the previous year's $140 million.

While this increase is significant, the SEC noted that much of the effort that resulted in the Fiscal Year 2017 numbers occurred in years prior. However, focusing on the number of enforcement actions and total amount of penalties to measure, quote/unquote, "success," can be misleading, in my opinion.

I believe in this instance that these statistics only provide a very limited picture of the quality, nature, and effectiveness of a successful enforcement program. For example, violations that are prevented or deterred cannot accurately be measured by that particular statistic.

I am pleased to see the Enforcement Division under Chairman Clayton's leadership has redirected its focus away from the broken windows enforcement philosophy—i.e., targeting a high number of minor infractions in order to discourage larger securities violations—which was championed by former Chair Mary Jo White.

In a 2013 speech, then-Chair White characterized this approach as, quote, "The theory is that when a window is broken and someone fixes it, it's a signal that disorder will not be tolerated. But when a broken window is not fixed, it is signal that no one cares, and so breaking more windows costs nothing. The same theory can be applied to our securities markets. Minor violations that are overlooked or ignored can feed bigger ones and perhaps, more importantly, can foster a culture where laws are increasingly treated as toothless guidelines," close quote.

In a speech last week, the SEC Commissioner Hester Peirce stated that by, quote, "following the broken windows approach, perhaps the SEC should have changed its name to the Sanctions and Exchange Commission, because it acted like a branch of the U.S. Attorney's Office for the Southern District of New York," close quote.

I couldn't agree more with Commissioner Peirce. In my mind, I believe that this misguided approach to enforcement appears to have only been successful at boosting statistics, versus meaningfully improving investor protections.

I am pleased to see that the division is shifting away from minor violations of securities laws, instead taking a more selective approach to enforcement. After all, we should not evaluate the true effectiveness of a regulatory agency or its enforcement program solely based on how many headlines it can generate.

I look forward to hearing from our Co-directors of enforcement and on how well the rules are working and if there are regulatory gaps that need to be filled to allow you to do your jobs more closely and more carefully.

With that, the Chair now recognizes the Ranking Member of the subcommittee, the gentlelady from New York, Mrs. Maloney, for 3 minutes for an opening statement.

Mrs. MALONEY. OK. I thank the Chairman for yielding and two of my minutes are going to Mr. Sherman.

I thank you for holding this hearing. The Division of Enforcement's job is to investigate and punish people who violate the securities law, and it is the largest division in the SEC because its job is so very important.

The Enforcement Division makes all of the other divisions at the SEC matter. After all, if you don't enforce your regulations and rules, then you might as well not have them. But if it's a job that the Enforcement Division can't do alone—the division's budget actually decreased slightly in Fiscal Year 2018, and it is still badly outspent by the financial industry and the white-collar defense bar.

The SEC is responsible for overseeing over 8,000 public companies and more than 26,000 registered market participants, such as investment advisers and brokers, and there are tens of thousands of retail investors who rely on vigorous enforcement of the securities laws to get a fair shake.

To cover all of this, the enforcement division has a staff of around 1,200. Less than 4 percent of the number of companies the SEC oversees, and easily less than 0.1 percent of the employees of those companies. Given this huge disparity, there is simply no way that the enforcement division can catch and punish every single violation of the securities laws.

That's why Congress gave investors the right to sue companies that they invest in for violations. This private right of action allows investors who have been harmed to recover their losses without relying on the SEC Enforcement Division to do all the work.

This is one of the reasons why investors have so much confidence in U.S. markets. They know they can hold companies they invest in accountable when they violate the law, even if the SEC's Enforcement Division doesn't have the time or the resources.

So, if you care about enforcing the securities law and punishing bad actors who take advantage of retail investors, which I know our panelists do, then you should support private enforcement of the securities law through investor lawsuits.

I also want to mention that the SEC has been very active recently in cracking down on fraud in virtual currencies and so-called initial coin offerings, or ICOs.

This is important because retail investors are getting killed in virtual currencies, which are being treated like speculative investments rather than currencies. This is a problem that we need to address, and the SEC's Enforcement Division has been at the forefront of this effort.

So I want to thank both of our panelists. I look forward to hearing from you. I yield back my time.

Chairman HUIZENGA. Gentlelady yields back.

I have one more minute remaining on my side, where I will recognize the Vice Chairman of the committee for 1 minute for an opening statement. Then we will be going to Mr. Sherman for his 2 minutes.

Mr. HULTGREN. Thank you for convening this hearing, Chairman Huizenga. Thank you to our witnesses. Enforcement of our securities laws is a critical part of achieving orderly and efficient markets.

The SEC's Division of Enforcement is critical to providing investors the confidence to participate in our markets. This is especially true for retail investors who may not have a strong understanding of sophisticated financial products and services.

Additionally, the market participants should be reasonably informed about the expectations of the Commission for following our securities laws. Transparency in this respect is of the utmost importance.

Enforcement practices should be about ensuring the law is followed. Enforcement proceedings should not result from miscommunication or misunderstanding of the law.

Finally, I am pleased to see that the Commission's enforcement approach has prioritized protecting retail investors. I want to ensure they maintain the confidence to invest, especially given the historic opportunities for investment and ongoing growth of our economy.

With that, Mr. Chairman, I yield back.

Chairman HUIZENGA. The gentleman yields back.

The Chair recognizes the gentleman from California, Mr. Sherman, for 2 minutes for an opening statement.

Mr. SHERMAN. In discussing the purpose of the SEC, often the focus is on the fairness to the market participants, but the real focus has to be funding American business. You deal with the people who participate in the markets, but it is those entrepreneurs and companies that get funded that really affect the economy.

As the Ranking Member pointed out, you are beginning to do something on initial coin offerings. I would have hoped you would have done more. I hope you shut it all down.

It will be interesting to find out what barriers you face in doing that, because if someone is trying to fund an operating business that might employ thousands of people, and they try to comply with the securities laws, and they screw up Footnote 27, you might be on them like a ton of bricks.

But, if somebody just builds on the image of the securities laws as an unregistered offering of, quote, "coins," calls it an initial coin offering to be similar to an initial public offering and is selling an investment with no investor protection, something, like in every Ponzi scheme, is valuable only because another sucker might be found, and, furthermore, isn't funding operating businesses. Now, it's true, somebody selling an initial coin offering might give a small donation to the Red Cross; every scoundrel does something good in their life.

But, when somebody's trying to fund creation of jobs, they have to do it very carefully, or you are on them for a misstatement in Footnote 27. When somebody is selling cryptocurrencies to investors, it's taking you a while to shut them down.

You are still wondering—there is still delay. I hope that you will be as tougher on them than those who try to comply with the securities laws.

Chairman HUIZENGA. The gentleman's time has expired.

Today, we welcome the testimony of Ms. Stephanie Avakian and Mr. Steven Peiken, who are the Co-directors of the SEC's Division of Enforcement.

I am going to recognize you collectively for a generous 5 minutes. That will save us a few minutes, actually, rather than each of you being recognized. Without objection, your written statements will be made part of the record.

So with that, Ms. Avakian, you are recognized first.

STATEMENT OF STEPHANIE AVAKIAN

Ms. AVAKIAN. Thank you. Thank you. Good morning, Chairman Huizenga, Ranking Member Maloney, and members of the subcommittee. My name is Stephanie Avakian, and, along with my colleague, Steven Peiken, who will address you next, I serve as Co-director of the United States Securities and Exchange Commission's Division of Enforcement. Thank you for inviting us here to testify today on behalf of the Commission about the Enforcement Division.

The Enforcement Division plays an essential role in carrying out the SEC's mission to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. Our vigorous enforcement of the Federal securities laws in order to detect, deter, and punish wrongdoing and compensate harmed investors enables the Commission to promote confidence in our markets, which is critical to encouraging capital formation.

Our efforts are aided by our regular coordination with the Commission's other divisions and offices and our partners at the Department of Justice and other Federal, State, and foreign regulators.

Since our appointment almost a year ago in June 2017, the Enforcement Division has remained focused on its core mission of strong and effective enforcement of the Federal securities laws. The cases we have investigated and recommended to the Commission over the past year are a product of the hard work, professionalism, and expertise of our career staff in Washington and our 11 regional offices.

In November of last year, we issued a report in which we outlined five key principles that guide our decisionmaking. These are: Focus on the interests of Main Street investors, focus on individual accountability, keep pace with technological change, impose sanctions that most effectively further enforcement goals, and constantly assess the allocation of our resources. Today, we would like to briefly explain how we are applying several of these principles.

Protecting retail investors has always been at the heart of the Enforcement Division's mission. We have enhanced these efforts by forming a Retail Strategy Task Force, which is focused on identifying, punishing, and deterring misconduct that affects everyday investors.

This increased retail focus does not mean that we are allocating fewer resources to financial fraud investigations or to policing Wall Street. Since we were appointed Co-directors, the Commission has continued to pursue cases against large corporations, financial institutions, Wall Street firms, and other market participants who violate the Federal securities laws.

Focusing on individual accountability has also long been a priority, and the Enforcement Division's recent efforts show that our commitment to holding individuals accountable for misconduct in the securities markets has not diminished.

Since we assumed our roles, more than 80 percent of enforcement actions have included charges against one or more individuals at all levels of the corporate hierarchy, including CEOs, CFOs, and other high-ranking executives. Going forward, we will continue to hold individuals accountable, where warranted.

Thank you very much for the opportunity to testify today before the subcommittee. I would be happy to answer any questions you may have. My Co-director, Steven Peiken, will address you next.

[The statement of Ms. Avakian can be found on page 30 of the appendix.]

STATEMENT OF STEVEN PEIKIN

Mr. PEIKEN. Good morning, Mr. Chairman, Ranking Member Maloney, and members of the subcommittee. My name is Steven Peiken and, along with my colleague, Stephanie, I serve as Co-director of the Division of Enforcement. I want to touch on two additional points: Our efforts to address technological change, and the issue of remedies and relief.

In an effort to keep pace with technological change, we are focusing the Enforcement Division's efforts and resources on emerging cyber-related threats and issues, including issues relating to hacking, data breaches, virtual currencies, and initial coin offerings.

We think these are among the greatest risks facing investors in the financial markets today, and we recently formed a cyber unit to focus on these sorts of issues.

Cyber-related matters are an area where we have sought to utilize the full range of tools and remedies that are available in an effort to balance protecting investors and allowing for real innovation. In some cases, we recommend enforcement actions against wrongdoers. In others, we have acted on an emergency basis to recommend the Commission suspend trading in stocks.

The commission and the Enforcement Division have also issued a number of public statements and alerts to focus investors and others on the risks relating to ICOs, including, for example, the risks associated with celebrity endorsements of these products.

The sanctions the Enforcement Division seeks in its actions are critical to influencing the behavior of market participants, and we have a wide array of tools available to us; discouragement, penalties, industry suspensions and bars, and other relief. In every case, we consider the facts and circumstances, and we seek the package of available remedies that is most appropriate.

The Enforcement Division is also focused on compensating harmed investors for losses stemming from violations of Federal securities laws. We place great importance on putting money back into the pockets of harmed investors. In the last Fiscal Year, the Commission returned a record $1.07 billion to harmed investors.

Now, despite our successes in recovering funds, a recent development threatens our ability to do so for long-running frauds. In a case called Kokesh v. SEC, the Supreme Court held that claims for discouragement are subject to a 5-year statute of limitations. As you would expect, many fraudsters try to conceal their schemes. Some are successful and defraud investors for years before they are discovered.

We appreciate the need for clear statutes of limitations, and we are redoubling our efforts to uncover, investigate, and bring cases as quickly as possible. But, no matter how quickly we work, it's likely that the Kokesh decision will impact our ability to obtain recovery for harmed investors in long-running frauds.

So thank you for inviting us here today to discuss the Division of Enforcement, and Stephanie and I are happy to answer any questions you have.

[The statement of Mr. Peikin can be found on page 30 of the appendix.]

Chairman HUIZENGA. Thank you very much. We appreciate that. I am going to recognize myself for 5 minutes at this time for questioning.

As I mentioned in my opening statement, I believe that lawmakers should never necessarily evaluate the efficacy of a regulatory agency or a rule or enforcement program solely based on number of headlines or press releases that it can generate.

But there have been some recent news articles criticizing the drop of enforcement actions by the SEC under the new Administration from 868 in 2016, to 754 in 2017.

Joint question to you both and, Ms. Avakian, you had talked about a focus on protecting the retail investors, which I think is great and needs to be done—but does the statistic—this drop in actual cases—beg the question of whether the SEC Division of Enforcement has gotten soft on Wall Street, as some are accusing? Are you really trying to protect that retail investor?

Ms. AVAKIAN. Thank you for the question. When we think about whether we are protecting and to what degree we are protecting the retail investor, and when we think about our effectiveness, we really think it's most important to look at the nature and the quality of our actions, the actions we are taking and what it is we are doing.

So, while statistics like how many actions the Commission has filed over a given period of time, or, the total amount of financial remedies ordered over a given period of time can be some measure of activity, we don't think that is the way to really look at the effectiveness of our program.

Instead, we take a step back and look more meaningfully at what are the actions we bring. Are we making a difference for investors? Is our program focused on the worst conduct, on the fraudulent conduct? Are we stopping ongoing frauds? Are we stopping inappropriate practices or sales of inappropriate products at financial institutions?

Are we focused on those cases that are most likely to get money back into the pockets of harmed investors? Are we getting bad actors out of the securities markets? Those kinds of things. Are we deterring wrongdoing? That is what we think.

Chairman HUIZENGA. With an enforcement program, can it be evaluated solely on those number of enforcements and penalties and those kinds of things? What we are really trying to get is, and what should be the evaluation of the effectiveness of your particular division? How should you be measured?

Ms. AVAKIAN. We should be measured on, are we creating deterrence against wrongdoing, are we getting bad actors out of the marketplace. Some of these things are measurable by statistics, but many are not. Are we stopping fraud on retail investors? Are we covering a broader range of retail investors or broader range of practices?

So not all of these things are amenable to using statistics to measure them. But, if you look at, for example, what we have done in the ICO space in a very short period of time? What our program has done in that time period is a good way to look at it.

In a very short period of time, the Commission has issued a report of investigation. We have brought a number of cases. The commission has issued a number of trading suspensions. We have made a number of statements to the marketplace. I think we have gotten response to that. So it's a more qualitative analysis.

Chairman HUIZENGA. OK. I have about a minute and a half here, and I want to move on to another issue. But I may follow up with a written—looking at number of complaints and those kinds of things, just to get a better handle on that.

In June 2017, the Supreme Court held in Kokesh v. The SEC that the 5-year statute of limitations applied to discouragement claims that the SEC seeks in enforcement actions by clarifying that the remedy of discouragement is a, quote, "penalty."

In your testimony, you noted that the Kokesh decision has already had significant impact across many parts of the division. Can you please explain the effects of it and what you have seen so far? Do you believe that investors ultimately will have to shoulder additional losses while fraudulent actors are able to keep ill-gotten gains due to this decision?

Mr. PEIKEN. It's a very significant decision that is having meaningful impact on our ability to recover funds and return it to investors, particularly in cases of long-running frauds, where they are not discovered until time has passed.

We can't reach back beyond 5 years and pull money out of the pockets of the wrongdoers and return them to investors. We have been keeping track of our litigated and settled cases of how much money we have had to forgo seeking recovery of, and the latest numbers are over $800 million, just in the last year or so alone, in our litigated—

Chairman HUIZENGA. That was out of the total enforcement—it was three-something—$4 billion?

Mr. PEIKEN. It was, last year. It's a very meaningful percentage. I think, we don't know what the ultimate impact will be, but this is going to have a significant impact on the recovery that we achieve for investors.

Chairman HUIZENGA. My time is expired and expiring, but what I want to know, and we will follow up in writing, is what we as Congress can do to ensure that bad actors aren't able to profit from their misbehavior and their fraudulent actions, and then get that remedy back to those investors.

So I think this is going to be a very significant thing and look forward to continuing that conversation. With that, I recognize the Ranking Member for a generous 5 minutes.

Mrs. MALONEY. Thank you and I look forward to working with you on the point that you made.

I would like to ask both of you about initial coin offerings and virtual currencies. There have been a strong debate about whether a token that is offered as an ICO can be a security when it is first issued to investors, and then later evolve into something that is not a security.

Some people think that, once it is a security, it is always a security, and others think that the token's status as a security can change over time. As far as I know, this is not a decision that has been decided by the SEC or the courts.

So I would like to ask both of you, do you believe it's possible for a token to start as a security, but then evolve to something that is not a security?

Ms. AVAKIAN. That's really a question that is primarily within the expertise of our Division of Corporation Finance, not us, as much. That said, I think it's always going to be a facts and circumstances test as to whether something meets the definition of a security. If the substance of something changes over time, that analysis is going to have to continue to happen.

But we really do look at the substance of the transaction, not the name of it, not what it's called, and look at does it fit the test for a security? Is it an investment in an enterprise in order to generate a profit based upon the efforts of others? That is really the test that is going to be applied.

Mrs. MALONEY. Have you seen any situations where this has actually happened?

Mr. PEIKEN. Yes, we have dozens of investigations that are ongoing, and one of the subjects of many of these investigations is evaluating whether or not a particular instrument is or isn't a security.

I don't think I can speak to the outcome of those, because some of that work is ongoing. A lot of what we have seen, though, in these ICOs obviously looks and meets the definition of securities.

Mrs. MALONEY. Building on that statement, Chairman Clayton has stated, and I quote, "I believe every ICO I have seen is a security." Do you agree with that statement?

Mr. PEIKEN. I can't speak to whether he has seen the broad gamut of instruments that our division is investigating. So I certainly don't dispute that what he has seen, he believes is a security.

The question, I guess, is whether some of the things that we are looking at do they actually meet that definition? I think that some more needs to be written on that.

Mrs. MALONEY. I know that you brought a number of enforcement actions on ICOs, and I am pleased to see that you are taking this issue seriously. A great number of retail investors are getting hurt with cryptocurrencies.

But there have been so many ICOs over the past few years, and none of them have been registered with the SEC as securities offerings. So, when your division is looking at all of these ICOs, how do you decide which cases to bring enforcement actions on?

Ms. AVAKIAN. We have, as you noted, there are a number of ICOs, and we have a number of investigations in the pipeline. I think, just speaking very broadly, in terms of how we prioritize, things that require emergency action are going to come to the front of the priority list.

So there are some cases we have brought in the last months, like the Centra ICO, which was a large ICO that involved celebrity promotion, the founders of that were arrested. Assets were seized. I think roughly $60 million in digital assets were frozen.

There are other cases, the AriseBank case, and there have been others where I think those ones that really do require an asset freeze or emergency action are going to come to the top.

But there are others, and like many other things, the investigations take time, so some of this is going to be, when the actions are ready, we will bring them.

Mrs. MALONEY. Do you believe that private lawsuits by investors can help supplement the Enforcement Division's work by deterring bad behavior that the SEC might not catch?

Mr. PEIKEN. So our main intersection with private securities litigation is that we often will use private securities litigation as a source to start an investigation of our own.

I think our assessment of whether or not to conduct an investigation on our own isn't impacted by whether or not there is a private civil litigation, because, if we think it's worth devoting our resources to, the remedies that we can get at the end of the day often are much broader than what a private litigant can achieve.

So, in addition to just getting money back for investors, we can also bar wrongdoers from the industry. But that is our principal intersection with the private securities bar.

Mrs. MALONEY. I think that sounds helpful to me. I believe it's important that the SEC not take the unprecedented step of allowing public companies to use forced arbitration clauses to prohibit their investors from ever suing them under the securities laws in court, even for securities fraud.

No matter how good a job the SEC Enforcement Division does, it will never be enough to catch all of the bad actors that are out there in our markets. I just want to say that, while the SEC's Enforcement Division is necessary, I don't think it will ever be sufficient by itself. It's so underfunded and understaffed compared to the challenge before you.

That is why it's important that investors keep their ability to sue public companies, including those class actions for securities fraud, in court. So my time is long past, and I yield back. Thank you.

Chairman HUIZENGA. The Chair was being generous, since I had been a little loose on my own time. So, with that, the Vice Chair of our committee, Mr. Hultgren from Illinois, is recognized.

Mr. HULTGREN. Thanks, Chairman. Thank you again, both, for being here.

In your written testimony regarding the Supreme Court's recent ruling on Kokesh v. the SEC, I wonder if you could explain—and I will let you decide who's best to respond—if you could explain this decision—how this rescission could restrict the Commission's ability to enforce our securities laws. What does this mean for retail investors?

Also we want to ensure our securities laws are enforced. We need to have enforceable rules in order to encourage effective markets for companies seeking access to capital, investors, and the brokers that facilitate these markets. So what steps do you believe Congress should take, if any, in light of the Supreme Court's recent decision?

Mr. PEIKEN. So, as I said, the Kokesh decision is significant, and it's going to have far-reaching impact on our ability to recover funds that have been stolen from victimized investors. I think that we don't come with a specific proposal for a legislative fix, if one's appropriate for Kokesh.

But we, I think, would be interested in working with this committee and with the members and their staff in fashioning a proposal, responding to anything that might come forward. Because this will have a significant impact on investors.

Mr. HULTGREN. Yes. Please let us know your thoughts as we move forward on that.

We had floated an amendment to CHOICE Act that would expand the reforms proposed for the SEC's enforcement division to the CFTC (U.S. Commodity Futures Trading Commission), and wonder if you could respond to—would you support a process within your office for closing investigations during this time—say, 180 days?

Could you make a determination to institute an administrative or judicial action, refer the matter to DOJ for potential criminal prosecution or inform the parties that investigations are closed?

Ms. AVAKIAN. I think we are not familiar with the details of the legislation, but, broadly speaking, the investigations typically take some amount of time.

What I will say is one of the things Steve and I have really messaged to the staff, and I think folks have taken quite seriously, is the importance of, first, moving quickly in our investigations, but also, really, once we make a determination that perhaps we shouldn't proceed, there is not a securities law violation to close the matter; if it's more appropriately referred to someone else, to do that quickly.

But we do take quite seriously prompt movement of our cases and decisionmaking.

Mr. HULTGREN. That's great. I think that the issue for us is, obviously, this is disruptive, and to get answers or information as quickly as possible when these investigations are going on or when they can be closed—that is what we want to see happen—obviously not shortchanging the process; making sure the process can work, but expediting where possible.

Let me move on a little bit to cyber-security expectations. In general, I wonder if you can speak to your expectations for public companies to protect themselves from cyber-security threats?

For example, after a breach, would you be able to reach a conclusion that a company was negligent in protecting itself and therefore, its investors from cyber-security threats? Would you look at something like NIST standards to inform this thinking?

Mr. PEIKEN. So we look at the question of cyber-security through the lens of disclosure. The Commission has issued guidance to public companies about what they should be thinking about, in terms of disclosing cyber risks, and how they should be thinking about the issue of disclosing a cyber event.

I think we are cautious in this area. We don't want to second-guess the good-faith disclosure decisions that companies that have been victimized by sophisticated actors, including even nation-states, have to face.

We have said before that, while we don't want to second guess those kinds of judgments, there could be circumstances that are so egregious—failures of disclosure—that we would bring enforcement action. We recommended, and the Commission brought enforcement action against the company formerly known as Yahoo, just a couple of weeks ago, for what we considered to be a case that had crossed over that line from good faith to an abdication of responsibility.

Mr. HULTGREN. Thanks. In my last seconds, just at the beginning of your testimony, you mentioned, in Fiscal Year 2017, the Commission brought 754 enforcement actions and obtained $3.8 billion in penalties and disgorgement, returned a record of $1.07 billion to harmed investors, and awarded nearly $50 million in payments to whistleblowers.

Critics of your office may point out that the Commission brought fewer cases since the change in leadership at the Commission. However, could you please explain how you were able to return a record amount to harmed investors? In general, what does this mean for how your office is approaching enforcement?

Ms. AVAKIAN. We have taken the issue of both collections and distributions quite seriously. They are both within our trial unit in the division. The collections, folks have been incredibly aggressive about going out and collecting money.

Our distributions area is an area where we have put additional resources and where we have put a serious focus on doing our best to quickly move to get money back into the pockets of harmed investors as quickly as possible.

Mr. HULTGREN. That's great. Thank you again. Thanks both for being here.

Yield back.

Chairman HUIZENGA. Gentleman yields back.

With that, the Chair recognizes the gentleman from Massachusetts, Mr. Lynch, for 5 minutes.

Mr. LYNCH. Thank you very much, Mr. Chairman, and thank you for having this hearing.

I want to go back to the Yahoo hack. Now it's called Altaba—I guess that is the new company. You are right, you just settled for $35 million with Altaba, formerly Yahoo. That hack effected several hundred million users.

Yahoo sold their digital and e-mail services for about $4.48 billion to Verizon. I did the math on this. So the $35 million represents about $0.08 per user that was hacked, and you are very correct when you say that case was, as you described it, an abdication of responsibility.

I think it was worse than that. They hid that disclosure of that hack for 2 years. The only reason they disclosed it was because they were for sale. So, I think that was the worst possible behavior to deceive investors.

They eventually had to discount the sale, because they had neglected to disclose that information to the buyer. But $0.08 per user hacked? Do you think that is fair?

I thought $35 million, for a company that sold for $4.48 billion, I thought $35 million was really selling short the damage that was done to users. I think it was a slap on the wrist, to be honest with you, because it really didn't affect anybody other than the users having their information compromised.

Mr. PEIKEN. I think it's a great question, and fashioning the appropriate recommended penalty in a case like this, where there had never been a case brought before against a company for failing to make a disclosure like this, obviously, is a difficult situation. You are trying to weigh the costs and benefits and burdens of any corporate penalty.

The penalty itself was never going to go back to compensate the people whose information was hacked.

Mr. LYNCH. How about fairness? I know they weren't going to be compensated. But you are also telling me now that we are not going to do dozens of cyber hacking cases in the future. We are going to shift gears.

So I just see a lot of this. We serve on another subcommittee that deals with cyber issues. I just think it was a case of first impression. I agree with that.

But I think you fell far short, or the SEC fell far short of holding anybody accountable here. I think, if there had been a meaningful penalty here, other companies would look at that and say, "Hey, we have to get our act together here."

Not only should we not allow this hacking to go forward and redouble our efforts to protect data, but, there is also the back end, the reputational damage to the company when that happens, and also the example to others in the future, because any company out there doing a sizable business in digital conduct is really going to blow this off, because $35 million is laughable, to be honest with you, for a company that is about $5 billion in value.

These people, as I said before, intentionally concealed this information from investors and its customers. So, it was especially egregious behavior.

I just think that example, coupled with your new policy, where you are not going to go after cyber hackers as you have in the past. So we are going from weak, to weaker. I don't know how much weaker you can get than $35 million for a company of that value. Now, you are going to do less. I just think you are going in the wrong direction, to be honest with you.

I think that some—this was a Russian hack—some of these entities are getting even more sophisticated, so your example, or the lesson that you are teaching is that the fines aren't that bad, compared to the cost of stiffening your system, strengthening your system, so why spend money on it? That is the message I am getting from you.

Mr. PEIKEN. I hope that the industry reads this case in a different way and that—

Mr. LYNCH. I don't know why they would, honestly. I am trying to be fair with you.

Mr. PEIKEN. Yes, and I would say that there certainly is no intent or plan on our part to abandon bringing cases against the perpetrators of these intrusions, which continues to be a significant priority for us.

We see intrusions for the purpose of stealing information for insider trading, and we have cases and investigations that were ongoing and that have been brought against the perpetrators of misconduct. I expect that will continue to be a high priority for the Enforcement Division.

Mr. LYNCH. Thank you.

I yield back, Mr. Chairman, thank you.

Mr. HULTGREN [presiding]. The gentleman yields back.

The gentlewoman from Missouri, Chairman Wagner is recognized for 5 minutes.

Mrs. WAGNER. I thank the Chairman, and I thank our witnesses for being here. I want to talk about a trend that occurred at the SEC in the last Administration that is very concerning to me and that I hope is being addressed with our new leadership.

Under the leadership of former Chairman Mary Jo White, the SEC increasingly turned to its own administrative law judges, ALJs, rather than the Federal courts to adjudicate enforcement actions.

In fact, a 2014 Wall Street Journal article found that, for 12 months straight, every case the SEC steered toward the agency's appointed ALJs was, quote, "successful for the SEC." In contrast, according the same article, the SEC fared far worse when they brought cases before the Federal court trials, winning approximately, I think, half of the time.

At the time, former Enforcement Director Andrew Ceresney, I think was his name, stated, quote, "We are using administrative proceedings more extensively because they offer a streamlined process with sophisticated fact-finders."

Let me start off by asking this. Are SEC administrative law judges the same as judges with lifetime tenure, appointed under Article 3 of the Constitution?

Ms. AVAKIAN. The judges are appointed in a different fashion. I am not sure of the exact mechanism, but they are different—

Mrs. WAGNER. So they are not appointed under Article 3 of the Constitution?

Ms. AVAKIAN. That's correct.

Mrs. WAGNER. Should SEC administrative law judges be interpreting and developing Federal securities laws, for example, insider trading laws, even though they aren't Article 3 judges?

Ms. AVAKIAN. There are, I think, some sorts of cases that make sense for administrative law judges to consider, given their securities background and the fact that the appellate rights are to the Commission of the—and to the Circuit Courts.

But I should step back and make it clear that, since we have been in this job, which has now been just about a year, the circumstances in which we have filed litigated actions as administrative proceedings have been fairly limited.

I would say, broadly, they have been limited to circumstances where either the charges that we are pursuing are only available in the administrative forums—so think failure to supervise of a broker-dealer, or something like that—or where the principal relief we are seeking is only available in the administrative forum—so barring someone from being in the securities business—or where the person involved is a registered person, like a registered broker-dealer or investment adviser.

So I think we have filed a far fewer number of litigated actions as administrative proceedings. Many of them are settlements.

Mrs. WAGNER. Maybe things have changed. I am going to reclaim my time, because I have several other questions. It's very clear the

SEC's lately been using these administrative judges for complicated cases, including several involving insider trading. How's their performance evaluated, quickly?

Ms. AVAKIAN. The administrative law judges?

Mrs. WAGNER. Yes.

Ms. AVAKIAN. I am not sure how their performance is evaluated.

Mrs. WAGNER. Doesn't this create a potential for conflicts of interest or undue bias in favor of the Commission in administrative proceedings?

Ms. AVAKIAN. Probably worth noting that, in the last year, we fared much better in litigation in District Court than we did in our administrative forum. I think our success rate was less than 60 percent in the—

Mrs. WAGNER. I am very concerned about the bias. So what steps are being taken to prevent bias, or at least the appearance of bias, in all ALJ proceedings?

Ms. AVAKIAN. Again, the administrative law judges are appointed unrelated to anything we do, in an independent fashion. But I will say that the appellate rights are initially to the Commission, but, after that, to the U.S. Circuit Court of Appeals, which is the same appellate path that a case takes if it goes through the District Courts.

So, I think, if there is concern, ultimately, there is a path for appeal that is very similar to that.

Mrs. WAGNER. Does the defendant have a choice about which path he can take?

Ms. AVAKIAN. No. As the plaintiffs, as the filers—

Mrs. WAGNER. Now, that is of concern to me. Does the SEC bring similar cases, for example, insider trading cases in both Federal District Court and administrative proceedings?

Ms. AVAKIAN. We have not filed an insider trading case as an administrative proceeding.

Mrs. WAGNER. Does this create the potential for different legal interpretations of the same or similar laws and potentially inconsistent enforcement actions?

Ms. AVAKIAN. I don't think any differently than you get by being in front of any number of District Court judges who decide the same set of facts in a different fashion. I understand the question, but I am not—

Mrs. WAGNER. Yes, these are complicated issues, and I have great concerns of this overreach of authority, especially given the fact that these are not Article 3 judges.

I look forward to working with you and the agency as we go forward to get the most proper outcome concerning these issues. So I thank you. I have run out of time. I yield back, Chairman.

Mr. HULTGREN [presiding]. Gentlewoman yields back.

Gentleman from Georgia, I think, Congressman Scott, is recognized for 5 minutes.

Mr. SCOTT. Thank you very much, Mr. Chairman.

Mr. Peiken and Ms. Avakian, let me ask you this: You listed in your testimony the recent Supreme Court decision of, I think it was Kokesh v. the SEC.

You said that that, along with President Trump's Administration's hiring freeze, put headwinds before you and could very well severely affect the effectiveness of your enforcement duties. Would you share with us why you have come to that conclusion? How serious would these impediments be?

Mr. PEIKEN. So, Mr. Scott, appreciate the question. I think, really, a couple points in response; the first is the Kokesh decision, if not changed, it's going to limit our ability to recover funds that have been stolen from investors as part of long-running frauds.

Some cases, like Ponzi schemes, for example, are self-covering, and so they often go on for many years before they are discovered, and then we can't reach back and get money that has been stolen from investors.

The question of hiring is one that we think about a lot. We have been operating under a hiring freeze. We think we are adequately resourced to do our jobs. We have asked, in the current budget request, for an additional 17 slots for enforcement, which we will use for our cyber efforts and our trial unit and other key areas.

But we are working, we are trying to use the resources we have to make decisions about how to allocate scarce resources. Like every other law enforcement agency, we have a broad area to cover.

We are doing things like using data analytics and trying to leverage our investigations to work smarter to try to make the biggest impact with the resources that we have.

Mr. SCOTT. Yes. There was a case, I believe, in Dallas, with this company who's running a scam operation. You may remember that. My information is that they were trying to develop a false federally insured bank. Could you tell us about that, so we could see the ingenuity of folks doing that? It was AVS Bank, I believe. I know it starts with an A.

Mr. PEIKEN. I think that you are talking about a case called AriseBank, where an initial coin offering was supposed to fund a banking operation. This is one of the cases that Ms. Avakian referred to, where we acted to obtain emergency relief. It turned out that it was a total scam, as we allege. The individuals were ultimately arrested, and we seized digital assets.

So I think it's a great illustration of how these initial coin offerings can present real risks to investors and how we have been trying to work quickly to stop this fraud from going on.

Mr. SCOTT. All right. Now, in my last minute and a half here, we are now in the grips of dealing with Russia and China and their use of their very sophisticated technology of really breaking into our security systems.

What I would like to get from you is, how serious is this nation-states' threats? Who would be the leaders that we have to worry about the most? How so?

Mr. PEIKEN. So I am not sure that I am in a position to really answer that question fully, but I will tell you that our cyber unit, which is focused in large part on addressing securities law violations that are perpetrated by cyber criminals, including nation-states, seize, actors in the Russian Federation and other places that you have mentioned trying to steal nonpublic information to trade, forcing trading by breaking into people's brokerage accounts and the like.

The Yahoo case, which I mentioned before, is one in which actors, which, I think, we allege were associated with the Russian Federation were involved in stealing the information from Yahoo.

Mr. SCOTT. So you have actually seized Russian operatives who are acting physically, correct?

Mr. PEIKEN. I believe, in the Yahoo case, the allegation is that the people who were identified, broke in to Yahoo and stole user information were associated with the Russian Federation, so yes.

Mr. SCOTT. In your enforcement capacities, what has been the disposition of these Russian operatives?

Mr. PEIKEN. As you can imagine, for a civil investigative agency that polices the securities markets, we are often looking at people who trade on that information or benefit from the theft of that information. So, whether we can actually bring action against the perpetrators depends on the case.

Mr. SCOTT. Thank you very much.

Chairman HUIZENGA. Gentleman's time has expired.

With that, the gentleman from Minnesota, Mr. Emmer, is recognized for 5 minutes.

Mr. EMMER. I want to thank the Chair, again, for convening this hearing, and the Co-directors, for joining us today and for the job that you are doing.

As I have listened today, clearly, I must have a different point of view when it comes to some of my colleagues on cryptocurrencies. I will say that you just testified that these initial coin offerings present real risks to investors.

But let's not forget they also present real opportunities, and we are talking about a technology, blockchain technology, that has an amazing potential.

I would like to go back to some of the questions earlier and ask them a little bit differently. I want to thank you before I start, because I think it was Representative Maloney that started the hearing this morning by suggesting that Secretary Clayton had said every initial coin offering is a security.

That's not what I heard you say. You are reviewing these, and you are developing what your view is of the different types of cryptocurrency. Problem is a lot of people up here with white hair, without hair, or people that have been around for awhile don't even understand what they are talking about. We worry that too much government could kill this thing before it can grow into something that is very good for our economy.

So I would like to know, since you have been getting involved in some of these enforcement actions and investigations, what has been your level of engagement with cryptocurrency exchanges—with the actual exchanges about their decision process around listings? Are you actually communicating with them and having a back-and-forth?

Ms. AVAKIAN. We, as an agency, broadly speaking, are engaging with the marketplace, to some degree, the exchanges, although we are not necessarily in the best position to answer that particular question.

The reason is, as an agency, we have really worked together across divisions and across offices. So we have a distributed ledger technology working group. That's an interagency group. We have a fintech working group. That's an interagency group. Those groups, particularly the fintech group, have been working closely with the marketplace, with folks who are coming to us, with folks we are doing outreach to.

I would say the Division of Corporation Finance is probably on the frontline of a lot of it. The Division of Trading and Markets is going to be on the frontline of the exchange issue. But we are working with industry, and we encourage market participants to come to us, whether it's through the fintech e-mail box, which we have set up, fintech@sec.gov, or whether it's to reach out directly to a particular division or office.

Mr. EMMER. I would go the next step, then. How does the SEC distinguish between an ICO and the sale of a token for use on a blockchain platform?

Ms. AVAKIAN. That's always going to be a real facts-and-circumstances question. We are going to take a step back and look at exactly what the substance of that particular transaction or token is, not the name of it.

Is it something that someone's investing something of value in? Is it an enterprise someone's investing something of value in order to generate a profit? I think it's based upon the efforts of others. That's the basic definition of what is a security.

Mr. EMMER. Is that evolving? Are you—because it could be a security. It could be a commodity. It could be a currency. There have to be some delineated lines so that people understand where they are at and who has jurisdiction over them, because we want to make sure that they are continuing to explore the opportunity and not just going out of business.

Ms. AVAKIAN. Yes, I think that is right. We have spoken a lot publicly about it. Certainly, the Chairman has spoken a lot publicly about it, to the extent something is a pure currency, a pure medium of exchange, that is not a security.

I think we are relying on the experts in the marketplace; the gatekeepers, the lawyers, others like that to really take a step back and take a true look at what is the underlying substance of a transaction. That is really going to be, I think, what guides someone.

But we are open in terms of having folks come to us and help work through that analysis with them.

Mr. EMMER. Let me ask you this last one. When looking at potential enforcement actions, what specific factors are used by the division to determine which token presales will be targeted?

Ms. AVAKIAN. When we think about enforcement action and what we are going to look at, we are working together with our Division of Corporation Finance, to a large degree, to analyze what it is we know about the substance of an underlying product. Is it a security? Is it potentially a security? That will guide how we think about it.

Mr. EMMER. OK. I look forward to working with you as this evolves. I want to thank you again for the work that you are doing and your light-touch policies so far.

Thank you. I yield back.

Chairman HUIZENGA. Gentleman yields back.

At this time, we are going to stay on the Republican side, and the Chair will recognize Mr. Davidson from Ohio for 5 minutes.

Mr. DAVIDSON. Thank you, Chairman. I thank you both for your testimony and for the work you are doing to protect our markets and to make sure that America remains the world's best place to raise capital and see it grow.

I will spend a fair bit of time on ICOs and cryptocurrencies, but I want to pick up where Mrs. Wagner left off on due process with administrative law judges.

I couldn't have used 5 minutes better. For that reason, I introduced H.R. 2128, the Due Process Restoration Act, which seeks to give defendants the option of Federal court, versus a no-option path to an administrative law judge proceeding.

I have some of the concerns about a near 100 percent batting average for the ALJs and, I think, over time, about a 670 batting average for the courts, which says that the SEC's good about picking their cases, but it does raise concerns about the path of ALJs.

Director Peiken? I guess, are you concerned that the SEC administrative proceedings have fewer due-process rights than in the courts?

Mr. PEIKEN. So let me just make a couple of reactions to that. So, one, I think, as Stephanie said earlier we have been much more restrained in the use of administrative proceedings in the last year, and really using them in only the limited categories for litigated cases that she outlined.

When you look broadly at the success rate of our litigated cases over a broad period of time in the administrative forum, versus Federal court, they actually are pretty close. Now, don't get me wrong, when we bring a case, we are looking to win them all. We don't. We win about 75 percent of our cases in Federal court and about 85 percent in administrative forum. They are roughly equivalent success rates.

There are protections. There are obviously different processes in administrative proceedings from in Federal court. But the rules around administrative proceedings have been modernized in recent years to, for example, allow for depositions from each side.

There are some protections in the administrative forum that aren't even available in Federal court. So we have to turn over our entire file immediately in an administrative forum. We don't have to do that in Federal court. We have to turn over Brady or Giglio information which is exculpatory or helpful to the other side. We don't have to do that in Federal court. There is a balance. There are obviously different rights and procedures in both forums.

Mr. DAVIDSON. There is a case pending before the Supreme Court. So we look forward to that outcome and we look forward to vote on the Due Process Restoration Act here.

But we also look forward to regulatory certainty around initial coin offerings, in particular. The CFTC also has claimed some jurisdiction. You have a working group, as you referenced earlier.

Is it clear where the CFTC's jurisdiction is? Because we do have court proceedings, and we have CFTC, who's staked out claims on cryptocurrencies since 2015. What do you make of these folks that are clearly a cryptocurrency today, yet, if they had raised capital, might be seen as a security at the time? How do you resolve that?

Mr. PEIKEN. Yes. I think some of this, we are obviously encountering a new area with new products and changing technology. Some of these issues are being worked out in the courts, as we speak.

Our financial system has operated for a long time with regulators with different jurisdictions, the CFTC regulating derivatives and commodities and SEC focused on securities.

I think the way things have fallen out recently, where we have been focused on the tokens and crypto-assets that fit the definition of a security, and the CFTC has then focused its jurisdiction on currencies and mediums of exchange. I am not sure I am the expert to say where that exact line is drawn. I think some of this is going to be worked out over time.

Mr. DAVIDSON. Yes, OK. So our office is working on an initial coin offering bill that would provide certainty about how a security is—it's fundamentally—is the Howey Test still relevant? What is the role of SAFS? Is a whitepaper going to cut it, or are you going to use SEC forms that already exist? How do you advise proceeding forward with your office?

Mr. PEIKEN. So, obviously, we would be interested in providing technical assistance and working with you and your staff on any proposal. Our Division of Corporation Finance is probably a critical participant in that, because some of this is beyond the expertise of the Enforcement Division.

Mr. DAVIDSON. All right. Thank you, my time is expired. I yield.

Chairman HUIZENGA. Seeing no further questioners on the Democrat side, we will move to Mr. Poliquin from Maine for 5 minutes.

Mr. POLIQUIN. Thank you very much, Mr. Chairman. I appreciate it. Thank you both for being here today. I represent the great State of Maine. I know you folks are new at your job. You have been there for a year. You probably have a very stressful situation at the SEC.

So I want to remind everybody that Maine is vacationland. If you haven't booked your vacation in Maine, you should do it. We don't have any air conditioning. We get a lot of moose, a lot of critters everywhere, a lot of blueberry pie and lobsters.

So, with that, let's get right into it.

I am concerned about small investors, because rural Maine is, like, the most beautiful part of the world. We are the hardest-working people. I don't worry as much about folks who have big, fat accounts. But I worry about small investors.

In particular, when you look at small investors who are starting out to build their nest egg, maybe for the first time, through a mutual fund, and they mark-to-market every day, and it's public, and it's one portfolio for the asset manager. I don't worry as much about that.

But what happens if one of our small investors builds up that nest egg to a point where they might want a separate account from an investment adviser? Or maybe they participate in a 401(k) plan or a defined benefit pension plan, and that account is managed by an asset manager in a separate account.

Now, I used to be in the asset management business. What you are providing for your investors, for your accounts, if you are in that business, is trust and security. The product you are selling, in great extent, is your rate of return, your performance record over time.

So what I worry about and what I want to ask you folks is how you deal with this. When you go look at an asset manager—it's time for their review—and you are trying to make sure that the rate of return that they are showing their prospective clients—how do you make sure there is accuracy in the performance data that they are submitting, because that is what people are buying, past performance; no guarantee of future performance. But that is what they are selling.

So, for example, if you walk into an asset manager's firm and they have a hundred different accounts, how do you know they are all fully discretionary? How do you know there are no restrictions on tobacco or alcohol or gambling?

How do you know about the size of the account? Are they diversified enough so that you are getting a true reflection of what the performance is, such that investors are able to make the decisions with confidence that the data is accurate? Tell us how you do that.

Ms. AVAKIAN. Sure. I think the first line of defense on the potential problems you are worried about really is our Office of Compliance Inspections and Examinations, OCIE.

They are the ones that go in and do the examinations. They do risk-based examinations. They do other sorts of examinations. This is one of the things they are looking at: Is what an investment adviser's representing to its clientele—is it accurate? Is it true? Is their performance what they say it is?

So that is one of the things that OCIE looks at. I would note that we have done some risk-based proactive work within the Division of Enforcement's Asset Management Unit. One thing we have looked at is performance reporting. Our economic folks in DERA, the Division of Economic Research and Analysis, have also spent time looking at this issue broadly.

It's a very, potentially, real concern that you raise, and it's a very good question. But it is one that, I think, our examination folks take seriously.

Mr. POLIQUIN. Mr. Peiken, have you found that these wonderful examination folks that work over at the SEC, that there is a problem?

Or is the oversight, the enforcement, the audits that you perform on behalf of the investors and savers in Maine and beyond is enough to keep folks in line? Or have you seen there have been problems here?

Mr. PEIKEN. So the issue of valuation is, it has been a problem in a number of instances, and we have brought a number of enforcement actions against wrongdoers for giving investors false information about the true value of any performance returns.

We have a very close relationship with our Office of Compliance Inspections and Examinations, and they refer to enforcement results from their examination. So, if they go in and they find something that is sufficiently serious that they don't just issue a corrective letter, they will refer it over to enforcement, and we open investigations. Some of our most significant cases have been brought based on these examinations.

Mr. POLIQUIN. What type of penalties are common with an asset manager who might be cooking the books?

Mr. PEIKEN. So it could be the whole gamut. That could be disgorgement and return of money to victims, penalties, barring them from participating in the investment advisory business altogether. Anything up to and including being kicked out of the business.

Mr. POLIQUIN. Please keep working at what you are doing. Make sure you vacation in Maine. But don't forget about the small investors, the small savers. We need to make sure they have confidence when they turn over their hard-earned savings to an investment manager.

Thank you very much. Thank you, Mr. Chairman.

Chairman HUIZENGA. The gentleman's time has expired. If it is fine with our Co-directors, we are going to do a quick second round of questioning, which, at this point, we think will be rather limited. We might not decide whether it's Laurel or Yanny, but let's at least continue the conversation.

I am going to turn to my friend, the gentleman from Georgia, for 5 minutes.

Mr. SCOTT. Sure. Let me get to what I think is really the gist of the matter here.

I have recently read a Wall Street Journal report, and it says this: It says that U.S. regulators have repeatedly put cryptocurrency companies and their advisers on notice, in recent months, about what officials say are widespread violations of security rules designed to protect investors.

Could you share what these widespread violations are?

Mr. PEIKEN. So I think when we look at these crypto-asset-related issues, they really fall into two buckets. So, on the one hand, we have the out-and-out frauds, like the one that you were talking about with the Dallas bank company.

These are people who are trying to just trade on whatever newsworthy event there is and make money. In the past, it's been in the marijuana industry or hurricane relief, and this just happens to be a newsworthy thing, this technology, so they are trying to take advantage of investors by trading on that.

So we see those out-and-out frauds. Then we also see, in another bucket, the failure to register broad offerings of what we think meets the definition of a security.

If you are going to make a general solicitation of a security offering broadly to investors, if you are not subject to an exemption from registration, that has to be registered with Securities and Exchange, and you have to comply with the various rules and requirements.

If you don't meet an exception, then investors are presented with an investment opportunity without the information that the Commission has decided they are entitled to have.

So those are the two real buckets that we see these issues falling into.

Mr. SCOTT. Yes, but this whole move in our technology, the cryptocurrencies, all of this seems to be moving at warp speed, and with some worriation that what we are doing isn't enough.

Just to carry this point further, in this same article, your Chairman, Jay Clayton, said this: He said, Many promoters of ICOs and cryptocurrencies are not complying with our current security laws.

Then he also said that he has urged his staff, meaning you the enforcers, to be on high alert for approaches to ICOs that may be contrary to the spirit of these laws.

However, with all these warnings from you and from your Chairman—it goes on, this article. Very good, I hope more people will read this Wall Street Journal article.

It says, such warnings have failed to chill the booming market for digital tokens. Coin offerings have already raised about $1.66 billion this year and are on pace to even top last year's $6.5 billion tally, according to research and data from Token Report.

Then he went on to say, we are just dealing with the tip of the iceberg. When you are just dealing with the tip of the iceberg, you have problems with the ship below.

All we have to do is look at the great sinking of the Titanic. If we have just reached the tip, the real serious part of this iceberg is down below, as it was with the Titanic. If that happens, our nation's going to be in serious trouble.

Is this article accurate? Are they sounding the necessary alarms? Do you agree with it?

Mr. PEIKEN. So you raise a great point. If you look at the work that the staff has done, there have been enforcement actions that we have brought.

There are many investigations that are ongoing, and those will take time, but many of them will likely lead to enforcement actions. I don't know how many, but many of them will. We have also communicated with people, and they have stopped a token offering because—

Mr. SCOTT. Good.

Mr. PEIKEN. They have been told that they were about to violate the Federal securities laws, so no violation occurred.

Mr. SCOTT. But let me ask you—I have 10 seconds here.

Mr. PEIKEN. Yes.

Mr. SCOTT. Is there anything that we in this committee, we in Congress can do to help you with your forward progress in this great challenge?

Mr. PEIKEN. I think we have adequate statutory tools, but, obviously, we would be willing and interested in working with your staff and the staff of any members here on any proposed legislation.

Mr. SCOTT. All right, thank you.

Chairman HUIZENGA. All right. Gentleman's time has expired.

We are going to go back, for the PSA for pure Maine, with Mr. Poliquin from Maine for 5 minutes.

Mr. POLIQUIN. Thank you very much, Mr. Chairman. I appreciate it.

Folks, if one of you could take a stab at this? Ms. Avakian, am I pronouncing that right?

Ms. AVAKIAN. Avakian.

Mr. POLIQUIN. Great. In February, you folks made an announcement about your share class selection disclosure initiative. I believe it deals with investment advisers and reporting and self-reporting and so forth, so on. Could you explain that program to us and how it might help investors?

Ms. AVAKIAN. Absolutely. Happy to explain it. We do except it to directly impact and help retail investors in particular. So one of the problems we have seen over the years, both our Office of Examinations and in enforcement, are problems where investment advisers are recommending higher-fee mutual fund share classes for which they are being compensated, when there are lower or no-fee share classes of the exact same product available.

Mr. POLIQUIN. Now, does this only apply to, if I may, to fund companies

It doesn't deal with managers who manage separate accounts. You are just talking about mutual fund companies, is that correct?

Ms. AVAKIAN. The share classes in mutual fund companies—the self-reporting initiative is targeted to investment advisers.

Mr. POLIQUIN. Got it.

Ms. AVAKIAN. OCIE has identified this problem in a number of exams over the years. We have brought in the Enforcement Division, in a number of cases, for failure of investment advisers to identify this conflict of interest for their clients. The fact that there is this higher-fee share class for which they are being compensated, while there is a—

Mr. POLIQUIN. Now, does this apply to no-loads, as well as load funds, where you are just talking about the H2Bs that are—not the H2Bs. The fees that are charged by the—

Ms. AVAKIAN. Typically the 12B–1 fees, yes.

Mr. POLIQUIN. Yes, thank you very much.

Ms. AVAKIAN. The self report—and we have brought a number of cases against financial institutions, in each of which the Commission assessed penalties in connection with the resolution of those cases.

The self-reporting initiative provides a defined period of time—4 months—for investment advisers who have this problem, who have identified this problem to come forward and self-report, and, in exchange for that, we will recommend to the Commission standard settlement terms.

Those standard settlement terms require these investment advisers to disgorge the moneys and to repay them back to investors. In exchange for that, we will have standard settlement terms that will not include a financial penalty.

Ultimately, what we are trying to do here is take a problem we identified on a broad scale, investigations that take a substantial amount of time to complete, and, instead, say, all of you who have this problem come forward, identify it to us, and hopefully attract and get a much larger universe with way fewer staff resources invested in it and money back into the pocket of investors.

Mr. POLIQUIN. In doing your work, do you find there is a common thread among the asset manager community that participates in these practices that—there are not?

Mr. PEIKEN. No.

Mr. POLIQUIN. There's no common—

Mr. PEIKEN. We have seen it from the smallest advisers, to the biggest financial services firms on Wall Street.

Mr. POLIQUIN. OK, good. Thank you.

Mr. Chairman, I yield back my time. Thank you.

Chairman HUIZENGA. Gentleman yields back.

We will give the Ranking Member an opportunity, as well.

Mrs. MALONEY. OK. I apologize. I have another hearing taking place. There are just many, many hearings today, with a lot of work to cover.

I want to go back to the Kokesh decision. I want to understand how you got a 9–0 ruling. That's very rare in the Supreme Court. Yet there seem to be a concern on both the Republican and Democratic side, and from you, that this would limit very much the Securities Exchange Commission in your mission to protect investors. Can you give me some insights on the Kokesh case and ruling?

Then, what do we do about it? You identified it as a problem as did many of my colleagues on both sides of the aisle. Would it take legislation to correct it? But what were the circumstances of this case that so overwhelmingly came out in a 9–0 ruling?

I don't know of any other 9–0 ruling. It's court seizing. So, if you could give me some more understanding of the Kokesh case—and I am responding, really, to both of your testimony that this is a big challenge for the SEC.

Mr. PEIKEN. Yes. So the Kokesh decision—a couple things.

So, first of all, the case itself involved a pretty egregious fraud in which Kokesh stole, I think, like $35 million from investors. That took place over a 10-year period. By the time he was prosecuted, enough time had lapsed that, in the end, as a result of the Supreme Court's decision, he was allowed to keep all but, I think, about $5 million of that $35 million that was misappropriated from investors.

The Supreme Court's decision was unanimous, and we obviously accept it and it's the law of the land. The issue is not with the decision, but, rather, with the effect of it, which is that, going forward—

Mrs. MALONEY. But, if it was a huge crime where they abused investors, you would think that the court would be sympathetic to investors being reimbursed. In other words, they cut off their ability to be reimbursed. There has to be a reason why.

Mr. PEIKEN. I think they were addressing a technical, legal question of how did the statute of limitations apply to the remedy of disgorgement. So, I think, absent an extension of the statute of limitations that is, we are going to live with this, and we will have to act faster.

But there will be cases where there is some ongoing fraud for years, we don't discover it until some of that money is out of our reach. I just would note that we respect the fact that statute of limitations are important. They put limits on the government in appropriate cases.

But there are many statute of limitations that apply to financial fraud cases that are much longer than 5 years. For example, the Justice Department has the ability to use the Financial Institutions Recovery and Reform Act, which has a 10-year statute of limitations. So it's not without precedent for there to be a longer statute of limitations available.

Mrs. MALONEY. But the way Congress could react is by legislating, correct?

Mr. PEIKEN. Absolutely.

Mrs. MALONEY. We constantly legislate after Supreme Court decisions that we disagree with. Most notably, the one I was involved in was the Lilly Ledbetter Act that allowed people to sue when they have been discriminated against. But, in any event, I just want to thank you for your testimony today. It's a very difficult job, and we want to help you in any way we can.

I yield back.

Chairman HUIZENGA. Gentlelady yields back.

I am going to take a couple of moments here, as well, for a quick question on—explore, maybe, a little bit of the differences between corporate and individual penalties and how that might affect things.

Former SEC Chair Mary Jo White emphasized the need to seek more admissions of wrongdoing from defendants as a condition of really settling the enforcement cases.

Mr. Peiken, you have noted that, for people that resolve cases with the Commission without admitting wrongdoing, but still agreeing to all points of relief, most people don't particularly view that as, hey, I got away with one here.

But can you explain how other tools, such as obtaining disgorgement, monetary penalties, mandatory business reforms, compare with the admission of guilt in settling? Is there something more significant that comes with that admission?

Does settling help obtain relief more promptly, rather than going on and risking a trial and the time and effort and costs of that?

Mr. PEIKEN. Thank you, Mr. Chairman.

We continue to consider whether seeking admissions is an appropriate part of the resolution of any case. Obviously, though, we have to balance, as you note, that against the possibility that, by demanding admissions, rather than getting all the other remedies that we might seek, like disgorgement and the ability to return money to investors today—

Chairman HUIZENGA. So the SEC still can go for these admissions of guilt, right?

Mr. PEIKEN. Yep, and we do.

Chairman HUIZENGA. You do, OK.

Mr. PEIKEN. But, if there is a case where a respondent says, I am willing to give you everything expect those admissions, we have to make a cost-benefit analysis about whether it's worth going through what could be years of litigation.

In some cases, that might well be worth it. In others, maybe not. We evaluate the full package of potential remedies and relief as part of every resolution.

Chairman HUIZENGA. Do you mind addressing, briefly, maybe, individual versus corporate penalties and how that may affect people's actions?

Mr. PEIKEN. Chairman Clayton has said, individual liability, in his view, and I agree this drives behavior more, even, so than organizational liability. So we put a high premium on bringing—

Chairman HUIZENGA. I think, at one point, he said, well, look, it is shareholders that, then, are paying for that penalty, correct?

Mr. PEIKEN. Yes. I think that the way we look at it is, in every case that we recommend to the Commission, we are seeking, where appropriate, to recommend action against an individual.

In some cases, that is not possible. But, over the last year, it's been possible, in about 80 percent of all the cases that we bring, there are charges against an individual, as well as, potentially against an institution.

So we are looking at both. There is a place for corporate liability and corporate penalties, and there are places for individual responsibility and individual penalties, and—including getting bad actors out of the markets.

So some of the individuals that we come across in our investigations are recidivists or have engaged in serious wrongdoing, and they have no place being in our markets. We will recommend, as part of our proposal that we seek to suspend them or bar them entirely from participating in the industry.

Chairman HUIZENGA. Previously, we had Bill Hinman here from Corporate Finance Division and talked a lot about ICOs and those kinds of things. It's been pretty clear that most of these seem to be birthed as a security, and then some migrate into a futures.

How I have been describing it is, is it fish or is it fowl? It turns out these are platypuses. Somehow or another, they don't quite fit into categories.

So I appreciate the opportunity to explore that a bit more. We certainly are working on that issue and needing some clarification—again, how that works for you all to, then, enforce what is being laid out.

So, with that, I just want to say thank you. I appreciate the time. Thank both of you for your efforts on behalf of the SEC and that retail investor, as well. Without objection, I would like to submit the following statements for the record. I think we can.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

So, again, Mr. Peiken, Ms. Avakian, thank you for your time today here, and our hearing is adjourned.

Ms. AVAKIAN. Thank you.

[Whereupon, at 11:30 a.m., the subcommittee was adjourned.]

A P P E N D I X

May 16, 2018

Testimony on "Oversight of the SEC's Division of Enforcement"
by
Stephanie Avakian and Steven Peikin
Co-Directors, Division of Enforcement
United States Securities and Exchange Commission

Before the
United States House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets, Securities, and Investment

May 16, 2018

Chairman Huizenga, Ranking Member Maloney, and Members of the Subcommittee:

Thank you for inviting us to testify today on behalf of the Division of Enforcement ("Enforcement" or the "Division") of the U.S. Securities and Exchange Commission ("SEC" or the "Commission").

The Division of Enforcement plays an essential role in carrying out the SEC's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The Division primarily supports the SEC's mission by investigating and bringing actions against those who violate the federal securities laws. By vigorously enforcing these laws, the Division furthers the Commission's efforts to deter, detect, and punish wrongdoing in the financial markets, compensate harmed investors, and—critically—maintain investor confidence in the integrity and fairness of our markets.

Since our appointment as Co-Directors in June 2017, the Division has remained focused on its core mission and will continue its efforts to protect investors and markets through strong and effective enforcement. Chairman Clayton charged us to root out fraud, market manipulation, and other violations of the federal securities laws with conviction and energy. The Division has taken that charge to heart, and our successes are due to the professionalism and expertise of the staff, not only in Washington but also in our eleven regional offices. The staff in our home and regional offices—under the leadership of former prosecutors and other dedicated public servants—works each day to protect our capital markets and to punish wrongdoers.

Each year, the Commission brings hundreds of civil enforcement actions against individuals and entities for fraud and other misconduct and obtains important, meaningful remedies—including disgorgement of ill-gotten gains and monetary penalties, which are frequently returned to harmed investors—as well as industry bars, injunctions, and orders prohibiting unlawful conduct. Last year, the Division remained focused on our core mission of protecting investors and markets through the robust enforcement of the federal securities laws. To that end, the Division investigated and recommended a diverse mix of cases targeting fraud and other wrongdoing. In Fiscal Year ("FY") 2017, the Commission brought 754 enforcement actions and obtained $3.8 billion in penalties and disgorgement, while returning a record $1.07

billion to harmed investors, and awarding nearly $50 million in payments to whistleblowers.[1] The Commission's enforcement actions covered a broad range of subject areas, including investment management, securities offerings, issuer reporting and accounting, market manipulation, insider trading, broker-dealer activities, cyber-related conduct, and the Foreign Corrupt Practices Act ("FCPA"), among many others.

While the Division's responsibilities necessarily require that we police a broad landscape and have numerous areas of focus, at a high level, our decision making is guided by five core principles: (1) focus on the interests of Main Street investors; (2) focus on individual accountability; (3) keep pace with technological change; (4) impose sanctions that most effectively further enforcement goals; and (5) constantly assess the allocation of our resources. We appreciate the opportunity to provide you with an overview of our enforcement efforts and to share the principles, priorities, and initiatives that will guide Enforcement's work going forward.

ENFORCEMENT PRIORITIES

Protecting the Interests of Main Street Investors

Protecting retail investors has always been at the heart of the Enforcement Division's mission and is a first principle for us. Retail investors depend on fair, orderly, and efficient markets to build savings to buy homes, pay for college, or plan for retirement, among other things. They are not only often the most prevalent participants in our markets, but, in many cases, also the most vulnerable and least able to weather financial loss.

The Division continued its commitment to protecting the interests of retail investors in FY 2017, both by building on successes of the past and through new initiatives, including the formation of a new Retail Strategy Task Force.[2] The Task Force combines the Division's significant experience with the knowledge and expertise of other key Commission divisions and offices, such as the Office of Compliance Inspections and Examinations ("OCIE"), the Division of Economic and Risk Analysis ("DERA"), and the Office of Investor Education and Advocacy.[3] Its mission is straightforward: to develop effective strategies and techniques to identify, punish, and deter misconduct that most affects everyday investors.[4] The Division will continue to focus its enforcement efforts on the kinds of misconduct that traditionally have affected retail

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1 U.S. Sec. & Exch. Comm'n, Div. of Enforcement, *Annual Report: A Look Back at Fiscal Year 2017* at 6-11 (Nov. 15, 2017), available at https://www.sec.gov/files/enforcement-annual-report-2017.pdf ("Enforcement Div. 2017 Annual Report"); U.S. Sec. & Exch. Comm'n, *Whistleblower Program 2017 Annual Report to Congress* at 1 (Nov. 15, 2017), available at https://www.sec.gov/files/sec-2017-annual-report-whistleblower-program.pdf.

2 Press Release 2017-176, *SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors* (Sept. 25, 2017), available at https://www.sec.gov/news/press-release/2017-176 ("Cyber Unit/Retail Strategy Task Force Press Release").

3 Stephanie Avakian, Co-Dir., Div. of Enforcement, U.S. Sec. & Exch. Comm'n, *The SEC Enforcement Division's Initiatives Regarding Retail Investor Protection and Cybersecurity* (Oct. 26, 2017), available at https://www.sec.gov/news/speech/speech-avakian-2017-10-26.

4 *Id.*

investors, such as accounting fraud, charging inappropriate or excessive fees, "pump-and-dump" frauds, and Ponzi schemes, to name just a few.[5] For example, we recently announced an initiative to encourage self-reporting and remediation by investment advisers who have received compensation for recommending or selecting more-expensive mutual fund share classes for their clients when identical and less-expensive share classes were available, without disclosing this conflict of interest.[6] This initiative reflects our commitment to leverage our resources to identify and expose widespread undisclosed practices that have the potential to harm investors. In short, vigorous enforcement efforts across our markets that are aimed at protecting Main Street investors have been—and will remain—a priority for the Enforcement Division.

And, to emphasize a key point, even as we enhance our focus on protecting retail investors, we will continue to actively pursue cases against large corporations, financial institutions, and other market participants who violate our federal securities laws. We do not face a binary choice between protecting Main Street and policing Wall Street. The Commission has recently brought a number of cases against Wall Street firms and large corporations for a wide variety of misconduct, and we expect that the Commission will continue to be vigilant in our oversight of these and other key market participants.

Holding Individuals Accountable

Another core pillar of a strong and effective enforcement program is individual accountability. To have a strong deterrent effect on market participants, it is critical to hold individuals responsible in appropriate cases and to pursue wrongdoing at the highest corporate levels supported by the evidence.

Individual accountability has long been a priority of the Enforcement program, and recent efforts show that our commitment to this key concept has not flagged. Since May 2017, a significant number of the Commission's enforcement actions have also involved charges against one or more individuals. These actions have involved charges against the senior-most executives of large companies and firms, including CEOs, CFOs, presidents, and senior partners.[7] The Commission also has charged individuals in several cyber-related matters.[8]

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5 *Id.*

6 Press Release 2018-15, *SEC Launches Share Class Selection Disclosure Initiative to Encourage Self-Reporting and the Prompt Return of Funds to Investors* (Feb. 12, 2018), available at https://www.sec.gov/news/press-release/2018-15.

7 *See, e.g.*, Press Release 2018-6, *Six Accountants Charged with Using Leaked Confidential PCAOB Data in Quest to Improve Inspection Results for KPMG* (Jan. 22, 2018), available at https://www.sec.gov/news/press-release/2018-6; Press Release 2018-41, *Theranos, CEO Holmes, and Former President Balwani Charged with Massive Fraud; Holmes Stripped of Control of Company for Defrauding Investors* (Mar. 14, 2018), available at https://www.sec.gov/news/press-release/2018-41; Press Release 2017-196, *Rio Tinto, Former Top Executives Charged with Fraud* (Oct. 17, 2017), available at https://www.sec.gov/news/press-release/2017-196.

8 *See, e.g.*, Press Release 2018-70, *SEC Charges Additional Defendants in Fraudulent ICO Scheme* (Apr. 20, 2018), available at https://www.sec.gov/news/press-release/2018-70 ("Centra Am. Compl. Release); Press Release 2018-61, *SEC Obtains Emergency Freeze of $27 Million in Stock Sales of Purported Cryptocurrency Company Longfin* (Apr. 6, 2018), available at https://www.sec.gov/news/press-release/2018-61 ("Longfin Release"); Press Release 2018-52, *SEC Charges Fintech Company Founder With Scheme to Defraud Investors*

To be sure, our focus on individual accountability consumes more of our limited resources; with much to lose, individuals may be more likely to litigate with the Commission. But that price is worth paying. We will continue to hold individuals accountable where warranted by the facts and the law.

Keeping Pace with Technological Change: Combatting Emerging Cyber-Related Threats

One important area where we are focusing the Division's enforcement efforts and resources is combatting emerging cyber-related threats to investors and the financial markets. These threats are among the greatest risks facing investors and our securities markets today, and the Division has been working to further develop its already substantial expertise and proficiency in the tools and investigative techniques needed to address these issues. We remain committed to ensuring that the Division continues to keep pace with the technological changes that continually transform our markets.

We formalized our work in this area in FY 2017 by forming a Cyber Unit.[9] The creation of the Cyber Unit, which is the first new unit that the Division has created since specialized units were first formed in 2010, demonstrates the priority that we place on combatting cyber-related threats to investors and our markets.[10] The Cyber Unit focuses its efforts on the following key areas:

- Market manipulation schemes involving false information spread through electronic and social media;
- Hacking to obtain material, nonpublic information and trading on that information;
- Violations involving distributed ledger technology and initial coin offerings ("ICOs");
- Misconduct perpetrated using the dark web;
- Intrusions into online retail brokerage accounts; and
- Cyber-related threats to trading platforms and other critical market infrastructure.[11]

Enforcement has been focused on many of these issues for some time, and the Cyber Unit centralizes, leverages, and builds upon the considerable expertise that the Commission has developed in this rapidly developing area.

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and Misappropriate Funds (Apr. 2, 2018), available at https://www.sec.gov/news/press-release/2018-52; Press Release 2018-53, *SEC Halts Fraudulent Scheme Involving Unregistered ICO* (Apr. 2, 2018), available at https://www.sec.gov/news/press-release/2018-53 ("Centra Release").

9 Cyber Unit/Retail Strategy Task Force Press Release, *supra* note 2.

10 *Id.*

11 *Id.*

Cyber-related matters are an area where we have sought to utilize the full range of tools and remedies available to the Commission. Our work in this field reflects a careful balancing of the need to protect investors from risks inherent in new technologies against the need to allow innovation to take place. For instance, the Commission has provided clarity for market participants in new or developing areas, starting with a Section 21(a) report (the "Report") regarding ICOs issued last July.[12] The Report concerns the application of the federal securities laws to the offer and sale of virtual tokens that were created and distributed on a blockchain by an entity called "The DAO." In the Report, the Commission applied longstanding securities law principles to conclude that this virtual token constituted an investment contract and therefore was a security, and to reiterate the fundamental principal that the federal securities laws apply—including to those relating to offers, sales, and trading—regardless of whether the security is certificated or issued on a blockchain.

The Division has continued to take other actions to address ICOs and cryptocurrencies following publication of the Report. For example, in November 2017, the Division, along with OCIE, issued a joint statement regarding the potentially unlawful promotion of ICOs by celebrities and others.[13] In January 2018, we issued a joint statement with the Director of the Commodity Futures Trading Commission's ("CFTC") Division of Enforcement regarding virtual currency actions.[14] We advised market participants that when they engage in fraud under the guise of offering digital instruments—whether characterized as virtual currencies, coins, tokens, or the like—the SEC and the CFTC will look beyond form, examine the substance of the activity, and prosecute violations of the federal securities and commodities laws.[15] In March, the Division of Enforcement and the Division of Trading and Markets issued a joint statement alerting investors that if they use online trading platforms for trading digital assets they may not have the protections provided by the federal securities laws and SEC oversight.[16] And, we continue to encourage parties to contact Commission staff who specialize in these issues for assistance.

And, since the issuance of the Report, the Commission has brought a number of enforcement actions for alleged ICO-related violations of the registration requirements of the

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[12] *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO* (July 25, 2017), available at https://www.sec.gov/litigation/investreport/34-81207.pdf.

[13] Div. of Enforcement & Off. of Compliance Inspections and Examinations, U.S. Sec. & Exch. Comm., *Statement on Potentially Unlawful Promotion of Initial Coin Offerings and Other Investments by Celebrities and Others* (Nov. 1, 2017), available at https://www.sec.gov/news/public-statement/statement-potentially-unlawful-promotion-icos.

[14] Stephanie Avakian & Steven Peikin, Co-Dirs., Div. of Enforcement, U.S. Sec. & Exch. Comm'n & James McDonald, Div. of Enforcement, Commodity Futures Trading Comm'n, *Joint Statement by SEC and CFTC Enforcement Directors Regarding Virtual Currency Enforcement Actions* (Jan. 19, 2018), available at https://www.sec.gov/news/public-statement/joint-statement-sec-and-cftc-enforcement-directors.

[15] *Id.*

[16] Div. of Enforcement & Div. of Trading and Markets, U.S. Sec. & Exch. Comm., *Statement on Potentially Unlawful Online Platforms for Trading Digital Assets* (Mar. 7, 2017), available at https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading.

federal securities laws. In one case, after being contacted by the Division, a company halted its ICO to raise capital for a blockchain-based food review service, and then settled proceedings in which we determined that the company's ICO was an unregistered offering and sale of securities in violation of the federal securities laws.[17] As a result of the SEC's intervention, the company refunded investor proceeds before any tokens were distributed.[18]

Finally, in cases where the technology is merely a veneer for an alleged fraud, we have recommended enforcement actions. To take one example, the Commission recently charged the co-founders of a purported financial services start-up with orchestrating a fraudulent ICO that raised more than $32 million from thousands of investors.[19] In another recent case, the Commission obtained a court order freezing more than $27 million in trading proceeds from allegedly illegal distributions and insider sales of restricted shares of a NASDAQ-listed company purporting to be in the cryptocurrency business.[20] Since the beginning of 2017, the Commission has also sought to protect investors by utilizing its authority to suspend trading in the stock of 13 publicly traded issuers because of questions concerning, among other things, the accuracy of assertions regarding their investments in ICOs and operation of cryptocurrency platforms.[21] As these cases show, the Division will not hesitate to take appropriate action where technology is used to defraud investors.

Beyond ICOs and cryptocurrencies, the Commission has prioritized the adequacy of companies' cyber-related disclosures. In February, the Commission issued a Statement and Guidance on Public Company Cybersecurity Disclosures to assist public companies in preparing their disclosures about cybersecurity. This guidance provides the Commission's views about the public companies' obligations under our laws and regulations with respect to matters involving

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17 Press Release 2017-227, *Company Halts ICO After SEC Raises Registration Concerns* (Dec. 11, 2017), available at https://www.sec.gov/news/press-release/2017-227.

18 *Id.*

19 Centra Am. Compl. Release, *supra* note 8; Centra Release, *supra* note 8.

20 Longfin Release, *supra* note 8.

21 *IBITX Software Inc.*, Exchange Act Release No. 83084 (Apr. 20, 2018), available at https://www.sec.gov/litigation/suspensions/2018/34-83084.pdf; *HD View 360 Inc.*, Exchange Act Release No. 82800 (Mar. 1, 2018), available at https://www.sec.gov/litigation/suspensions/2018/34-82800.pdf; Press Release 2018-20, *SEC Suspends Trading in Three Issuers Claiming Involvement in Cryptocurrency and Blockchain Technology* (Feb. 16, 2018), available at https://www.sec.gov/news/press-release/2018-20; *UBI Blockchain Internet, Ltd.*, Exchange Act Release No. 82452 (Jan. 5, 2018), available at https://www.sec.gov/litigation/suspensions/2018/34-82452.pdf; *The Crypto Co.*, Exchange Act Release No. 82347 (Dec. 18, 2017), available at https://www.sec.gov/litigation/suspensions/2017/34-82347.pdf; *Rocky Mountain Ayres, Inc.*, Exchange Act Release No. 81639 (Sept. 15, 2017), available at https://www.sec.gov/litigation/suspensions/2017/34-81639.pdf; *American Security Resources Corp.*, Exchange Act Release No. 81481 (Aug. 24, 2017), available at https://www.sec.gov/litigation/suspensions/2017/34-81481.pdf; *First Bitcoin Capital Corp.*, Exchange Act Release No. 81474 (Aug. 23, 2017), available at https://www.sec.gov/litigation/suspensions/2017/34-81474.pdf; *CIAO Group, Inc.*, Exchange Act Release No, 81367 (Aug. 9, 2017), available at https://www.sec.gov/litigation/suspensions/2017/34-81367.pdf; *Strategic Global Investments, Inc.*, Exchange Act Release No. 81314 (Aug. 3, 2017), available at https://www.sec.gov/litigation/suspensions/2017/34-81314.pdf; *Sunshine Capital, Inc.*, Exchange Act Release No. 80435 (Apr. 11, 2017), available at https://www.sec.gov/litigation/suspensions/2017/34-80435.pdf.

cybersecurity risk and incidents and describes the importance of comprehensive policies and procedures related to cybersecurity events, including appropriate disclosure controls, and the need to have policies and procedures in place to guard against corporate insiders trading on the basis of material nonpublic information about cybersecurity risk and incidents.[22] The Commission also recently announced settled charges against a major technology company for misleading investors by failing to disclose what was, at the time, the world's largest known data breach.[23] The case is the first that the Commission has brought against a company for failing to adequately disclose a cyber incident. We are aware of the challenges companies face when it comes to disclosing cyber attacks, and we will not seek to second-guess good-faith disclosure decisions. But, as this recent case reflects, there will be circumstances in which a company's procedures, controls, and response to a cyber incident warrant an enforcement action.

Imposing Effective Sanctions

The sanctions the Division seeks in its enforcement actions are critical to influencing the behavior of market participants, and we have a wide array of tools available to further our objectives. Possible remedies and sanctions include: obtaining monetary relief from wrongdoers in the form of disgorgement and penalties; barring wrongdoers from working in the securities industry or serving as directors and officers of public companies; and, when appropriate, more tailored relief and sanctions, such as specific undertakings, admissions of wrongdoing, and monitoring or other compliance requirements. The Division does not take a formulaic or statistics-oriented approach to determining what sanctions we will recommend in a particular matter. In every case, we consider the facts and circumstances. We often work with DERA to provide critical analysis in recommending appropriate sanctions. This allows the Commission to pursue the package of available remedies that is most appropriate in the matter at hand.

Compensating Harmed Investors

The Division is also focused on compensating harmed investors for losses stemming from violations of the federal securities laws. In many of our actions, funds paid by defendants or respondents are distributed to harmed investors. We place significant importance on putting money back in the pockets of victims when we are able to do so. In FY 2017, the Division's efforts enabled the Commission to return a substantial amount of money—a record $1.07 billion—to harmed investors.[24]

Despite our successes in returning funds to harmed investors, a recent development threatens our ability to continue doing so for long-running frauds. In the Supreme Court's

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22 U.S. Sec. & Exch. Comm'n, *Commission Statement and Guidance on Public Company Cybersecurity Disclosures*, Securities Act Release No. 10459 (Feb. 21, 2018), available at https://www.sec.gov/rules/interp/2018/33-10459.pdf.

23 Press Release 2018-71, *Altaba, Formerly Known as Yahoo!, Charged With Failing to Disclose Massive Cybersecurity Breach; Agrees To Pay $35 Million* (Apr. 24, 2018), available at https://www.sec.gov/news/press-release/2018-71.

24 Enforcement Div. 2017 Annual Report, *supra* note 1, at 11.

decision in *Kokesh v. SEC*,[25] the Court held that Commission claims for disgorgement are subject to a five-year statute of limitations. The *Kokesh* decision has already had a significant impact across many parts of the Division. Many securities frauds are complex and can take significant time to uncover and investigate. Some egregious fraud schemes—including, for example, the one perpetrated by Charles Kokesh himself—are well concealed and are not discovered until investors have been victimized over many years. In certain cases, *Kokesh* threatens to severely limit the recovery available to harmed investors. Wrongdoers should not benefit because they succeeded in concealing their misconduct. While we appreciate the need for clear statutes of limitations, we are concerned with an outcome where some investors must shoulder additional losses—and the fraudulent actor is able to keep those ill-gotten gains—because those investors were tricked early in a scheme rather than later.

The ultimate impact of *Kokesh* on SEC enforcement remains to be seen. However, some of the decision's effects are already clear. For example, because of the Court's ruling, Mr. Kokesh, who was found liable for defrauding his firm's advisory clients out of approximately $35 million in client funds over many years, kept more than 80 percent of the money he stole, and his victims will get no recovery of those funds.

We are redoubling our efforts to uncover, investigate, and bring cases as quickly as possible. Our enforcement actions have the highest impact, and our litigation efforts are most effective, when we bring our cases close in time to the alleged wrongful conduct. But no matter how quickly we work, it is likely that *Kokesh* will have a significant impact on our ability to enforce the federal securities laws and obtain recovery for harmed investors in long-running frauds.

FY 2019 BUDGET REQUEST

The achievements and initiatives we have outlined come against the backdrop of significant challenges that the Division faces. These challenges are described in more detail in the FY 2019 budget request that the SEC submitted to Congress earlier this year.[26] Some of these challenges are obvious, such as the broad spectrum of securities law violations that occur across the United States each year and emerging cyber-related threats to investors and markets. Others are less obvious, such as the challenges that increasingly fragmented and complex equity markets pose to our enforcement efforts, as well as the massive volume of data that we need to obtain, process, and analyze each year in order to satisfy our investigative responsibilities. There is also an ever-increasing volume of tips, complaints, and referrals to be reviewed and assessed by Enforcement staff; last year alone, the SEC received approximately 16,500 such tips.[27] These challenges require us to constantly assess and re-assess whether we are allocating the Division's

[25] 137 S. Ct. 1635, 1640 (2017).

[26] U.S. Sec. & Exch. Comm'n, *Fiscal Year 2019 Congressional Budget Justification and Annual Performance Plan and Fiscal Year 2017 Annual Performance Report* at 23-26 (Feb. 12, 2018), available at https://www.sec.gov/files/secfy19congbudgjust.pdf.

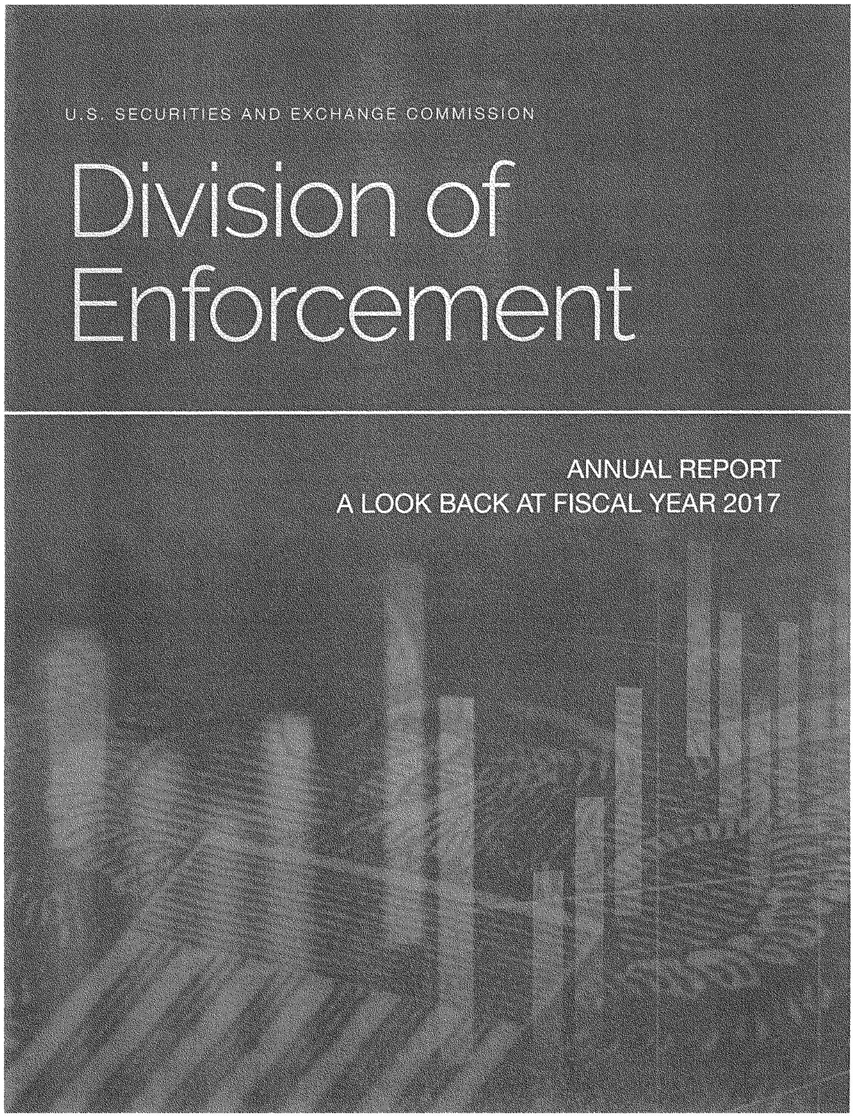
[27] *Id.* at 24.

limited resources in the most effective manner to address the most significant risks to investors and the markets.

To enable Enforcement to meet these challenges, and maintain an effective investigative capacity and deterrent presence, the SEC's FY 2019 budget seeks to restore several positions for Enforcement that were lost due to attrition and the SEC's inability to fill those positions with new staff as a result of the hiring freeze. Some of the requested positions will be used to support two key priorities of the Division: protecting retail investors and combatting cyber-related threats.

* * *

Thank you for inviting us here today to discuss the Division of Enforcement. We are happy to answer any questions you may have.


U.S. SECURITIES AND EXCHANGE COMMISSION

Division of Enforcement

ANNUAL REPORT

A LOOK BACK AT FISCAL YEAR 2017

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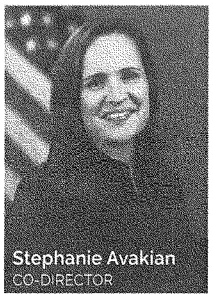
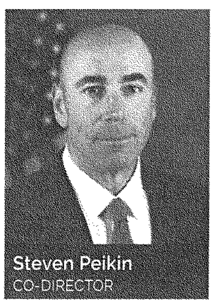
Report available on the Web at www.sec.gov/reports

MESSAGE FROM THE CO-DIRECTORS





Chairman Jay Clayton appointed us as Co-Directors of the U.S. Securities and Exchange Commission's Division of Enforcement in June 2017. We approach our roles guided by one overarching principle: Vigorous enforcement of the federal securities laws is critical to combat wrongdoing, compensate harmed investors, and maintain confidence in the integrity and fairness of our markets.

We bring to this task our combined experiences in the U.S. Attorney's Office in Manhattan, the Commission's Enforcement Division, and private law firm practice. With that background, we asked ourselves at the outset: What goals should we pursue? The question almost answers itself: protect investors, deter misconduct, and punish wrongdoers. But how to achieve those objectives is the real question. While we necessarily police a broad landscape and have numerous areas of focus, at a high level, our decision making is guided by five core principles.

Principle 1: Focus on the Main Street Investor. Chairman Clayton has said that the Commission's analysis of whether it is accomplishing its mission "starts and ends with the long-term interests of the Main Street investor." We agree. Retail investors are often not only the most prevalent participants in our marketplace, but also the most vulnerable and least able to weather financial loss. We will continue to address the kinds of misconduct that traditionally have affected retail investors: accounting fraud, sales of unsuitable products and the pursuit of unsuitable trading strategies, pump and dump frauds, and Ponzi schemes, to name just a few.

We recently announced the formation of a Retail Strategy Task Force to develop effective strategies to address harm to retail investors. The task force will work closely with the Commission's examination staff, as well as the Office of Investor Education and Advocacy, and use data analytics to identify areas of risk to retail investors.

As we enhance our focus on retail investors, we will continue to vigorously pursue cases against financial institutions and intermediaries. We do not face a binary choice between protecting Main Street and policing Wall Street. The Commission has recently brought cases against Wall Street firms for a wide variety of misconduct, including: failing to ensure that retail clients understood the risks of complex financial products; overcharging millions in advisory fees; and putting investors in high-fee mutual fund share classes, when identical, lower-cost shares were available. Simply stated, our oversight of Wall Street is most effective, and protects those who need it most, when viewed through a lens focused on retail investors.

Principle 2: Focus On Individual Accountability.
The Commission has long pursued misconduct by both institutions and individuals. And it will continue to do so. But common sense and experience teach that individual accountability more effectively deters wrongdoing. The vigorous pursuit of individual wrongdoers must be the key feature of any effective enforcement program. That pursuit will send strong messages of both general and specific deterrence and strip wrongdoers of their ill-gotten gains. In many instances, we must also seek to protect investors by barring serious wrongdoers and recidivists from our markets.

In the six months since Chairman Clayton took office, pursuing individuals has continued to be the rule, not the exception. One or more individuals have been charged in more than 80 percent of the standalone enforcement actions the Commission has brought. To be sure, this focus on individuals consumes more of our limited resources; with more to lose, individuals are more likely to litigate with the Commission. But that price is worth paying.

Principle 3: Keep Pace With Technological Change.
Technology has dramatically transformed our markets. So too has it transformed the ability of wrongdoers to engage in cyber-enabled misconduct. Just a few years ago, it was difficult to imagine a market manipulation scheme accomplished by hacking into the electronic accounts of others and then forcing trades to pump up a stock price. Or the brokering of stolen inside information on the so-called "dark web," paid for in untraceable cryptocurrency. Yet these are the sort of schemes we now frequently encounter.

As nefarious actors take advantage of technological change and market evolution, the Commission's enforcement efforts must respond with purpose and vigor. To that end, we formed a specialized Cyber Unit to consolidate our substantial cyber-related expertise. The Cyber Unit includes experts in cyber intrusions, distributed ledger technology, and the dark web. Its members investigate and prosecute these increasing technologically-driven violations and coordinate with the Department of Justice and other criminal authorities.

Principle 4: Impose Sanctions That Most Effectively Further Enforcement Goals.
Sanctions are critical to driving behavior, and we have a wide array of tools available to further our objectives. Our remedies include: obtaining monetary relief in the form of disgorgement, penalties, and asset freezes; barring wrongdoers from working in the securities industry; and, when appropriate, obtaining more tailored relief, such as specific undertakings, admissions of wrongdoing, and monitoring or other compliance requirements. We do not believe in a formulaic or statistics-oriented approach. Instead, in every case we will consider the package of remedies that will be most appropriate in the matter at hand and more broadly.

Principle 5: Constantly Assess The Allocation Of Our Resources.
The volume of potential securities violations reflects the multi-trillion-dollar size of our markets. Last year alone, Commission personnel reviewed more than 16,000 tips, largely from the general public, and more than 20,000 reports of suspicious activity filed by broker-dealers and other entities.

The Enforcement Division is the Commission's largest division, but employs fewer than 1,200 professionals. As a result, we must constantly assess whether we are allocating our resources to address the most significant market risks and in the most effective manner, keeping front of mind the violators who pose the most serious threats to investors and market integrity.

Evaluating Our Efforts.
Judging the effectiveness of our resource allocation is a complex task. Traditionally, many have judged the Commission on quantitative metrics. Measured by those standards, Fiscal Year (FY) 2017 was successful. The Commission brought 754 actions and obtained judgments and orders totaling more than $3.7 billion in disgorgement and penalties. Significantly, it also returned a record $1.07 billion to harmed investors, suspended trading in the securities of 309 companies, and barred or suspended more than 625 individuals.

While such statistics provide some kind of measurement, they provide a limited picture of the quality, nature, and effectiveness of our efforts. For example, returning $100,000 to several dozen defrauded investors has little impact on our overall statistics, but can be life-changing for those investors. And, of course, violations that are prevented or deterred are never reflected in statistics. We also note that some cases take many years from initiation to resolution. Note that in 2017, $1.07 billion was distributed to harmed investors while $140 million was distributed in 2016, but much of the effort that resulted in the 2017 numbers occurred in prior years.

As a result, we believe the Commission's enforcement program should be judged both quantitatively and qualitatively and over various time periods. Have we focused on the most serious violations? Have we obtained meaningful punishments that deter unlawful conduct? Have we incapacitated wrongdoers? Are we recouping ill-gotten gains and returning money to investors? We believe the course we have set, and the principles we are following, answer all those questions in the affirmative.

This report is part of our effort to measure our effectiveness and our progress toward achieving these five objectives. In this report, we discuss the Enforcement Division's activity over the past fiscal year—activity that we believe should be assessed not just quantitatively, but also qualitatively.

Sincerely,

Stephanie Avakian and Steven Peikin
Co-Directors, Division of Enforcement
U.S. Securities and Exchange Commission
November 15, 2017

INTRODUCTION

The ongoing efforts made by the Division of Enforcement (Enforcement) to deter misconduct and punish securities law violators are critical to safeguarding millions of investors and instilling confidence in the integrity of the U.S. markets. Each year, Enforcement brings hundreds of civil enforcement actions against individuals and entities for fraud and other misconduct. The substantial remedies we obtain are important. They protect investors by deterring future wrongdoing, and when we obtain disgorgement of ill-gotten gains, harmed investors are often compensated. We also seek bars that prevent wrongdoers from working in the securities industry, as we believe holding individuals accountable for their improper actions is important and effective. It is a privilege to work in the securities industry and it is no place for bad actors.

INITIATIVES

Enforcement has a broad mandate with responsibility for covering broad ground across the securities markets. But, at the most basic level, the Division's area of greatest focus—protection of retail investors—has not changed over time. Today, this perspective is driving our resources to: risks posed by cyber-related misconduct; issues raised by the activities of investment advisers, broker-dealers, and other registrants; financial reporting and disclosure issues involving public companies; and insider trading and market abuse. These issues will be priorities for the Division, and we will continue to pursue cases and advance efforts to protect retail investors and market integrity.

In an effort to more closely align our allocation of resources with two of our key priorities—specifically, protecting retail investors and combatting cyber-related threats—at the end of FY 2017, the Division announced the creation of a Cyber Unit and a Retail Strategy Task Force.

The Cyber Unit

To combat cyber-related threats, which are among the greatest risks facing our securities markets, the Division formed a Cyber Unit. The Cyber Unit combines Enforcement's substantial, existing cyber-related expertise and its proficiency in digital ledger technology. The Unit initially will focus its efforts on the following key areas:

- Market manipulation schemes involving false information spread through electronic and social media;
- Hacking to obtain material nonpublic information and trading on that information;
- Violations involving distributed ledger technology and initial coin offerings (ICOs);
- Misconduct perpetrated using the dark web;
- Intrusions into retail brokerage accounts; and
- Cyber-related threats to trading platforms and other critical market infrastructure.

Although Enforcement has been focused on many of these issues for some time, the Cyber Unit formalizes the Division's efforts to develop and apply the Commission's considerable expertise in this rapidly-developing area.

While the end result of the Division's work is often a recommendation that the Commission take enforcement action, we also pursue alternatives where appropriate. The Division's recent activity in cyber-related actions provides two examples. First, in recognition of the growing use of distributed ledger technology and ICOs, in July 2017, the Commission released a Report of Investigation that concluded that the federal securities laws may apply to certain initial coin offerings or other distributed ledger or blockchain-enabled means for raising capital, depending on the facts and circumstance.[1] Second, in early November 2017, Enforcement and the Commission's Office of Compliance Inspections and Examinations (OCIE) issued a public statement concerning endorsements of stocks and other investments by celebrities and others on social media networks.[2]

The Retail Strategy Task Force

Effective enforcement of the federal securities laws is critical to safeguarding the long-term interests of retail investors. To focus the Division on the type of misconduct that often targets retail investors, the Division formed the Retail Strategy Task Force. The Task Force will be dedicated to developing effective strategies and methods to identify potential harm to retail investors. The Task Force builds on the Division's past efforts to protect retail investors and will draw from the Division's deep experience in the area. It is focused, in particular, on harnessing the Commission's ability to use technology and data analytics to identify large-scale wrongdoing. The Task Force also works closely with OCIE to identify areas of risk to retail investors, and with the Commission's Office of Investor Education and Advocacy to educate retail investors about those risks.

The Task Force will focus on wrongdoing implicating the microcap market, as well as Ponzi schemes and offering frauds, where victims typically are retail investors. But the Task Force also will focus on identifying misconduct in other areas, such as that which occurs at the intersection of investment professionals and retail investors, which can present significant opportunity for misconduct. Some examples of this type of misconduct include steering clients to higher-cost mutual fund share classes, abuses in wrap-fee accounts, investment adviser recommendations to buy and hold highly volatile products like inverse exchange-traded funds, suitability issues involving the sale of structured products to retail investors, and abusive sales practices such as churning and excessive trading.

1 www.sec.gov/litigation/investreport/34-81207.pdf.

2 www.sec.gov/news/public-statement/statement-potentially-unlawful-promotion-icos.

DISCUSSION AND ANALYSIS OF FISCAL YEAR 2017

Overall Results

Even in the midst of transition in leadership, FY 2017 was a successful and impactful year for the Enforcement Division. The Commission brought a diverse mix of 754 enforcement actions, of which:

- 446 were "standalone" actions brought in federal court or as administrative proceedings;
- 196 were "follow-on" proceedings seeking bars based on the outcome of Commission actions or actions by criminal authorities or other regulators; and
- 112 were proceedings to deregister public companies—typically microcap—that were delinquent in their Commission filings.

Detailed results from FY 2017 are set forth below. FY 2016 results are also reflected below for comparison.

The number of standalone enforcement actions decreased in FY 2017 when compared to FY 2016. The bulk of that difference is attributable to 84 actions brought in FY 2016 (roughly 15 percent of standalone actions that year) as part of the Commission's Municipalities Continuing Disclosure Cooperation (MCDC) Initiative, a voluntary self-reporting program that targeted material misstatements and omissions in municipal bond offering documents. The MCDC Initiative concluded in FY 2016.

Enforcement Actions Filed in Fiscal Year 2017 and 2016 (Including MCDC)

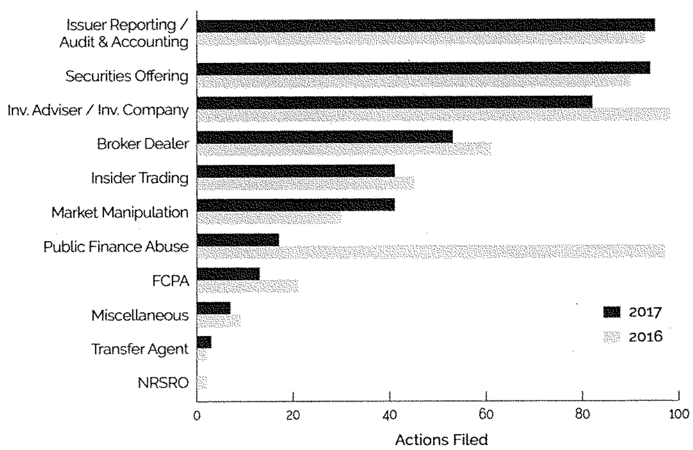
	FY 2017	FY 2016
Standalone Enforcement Actions	446	548
Follow-on Admin. Proceedings	196	195
Delinquent Filings	112	125
Total Actions	**754**	**868**

Enforcement Actions Filed in Fiscal Year 2017 and 2016 (Excluding MCDC)

	FY 2017	FY 2016
Standalone Enforcement Actions	446	464
Follow-on Admin. Proceedings	196	195
Delinquent Filings	112	125
Total Actions	**754**	**784**

Types of Cases

As the chart below illustrates, consistent with FY 2016, a significant number of the Commission's 446 standalone cases in FY 2017 concerned investment advisory issues, securities offerings, and issuer reporting/accounting and auditing, each comprising approximately 20 percent of the overall number of standalone actions. The Commission also continued to bring actions relating to market manipulation, insider trading, and broker-dealers, with each comprising approximately 10 percent of the overall number of standalone actions, as well as other areas.



A breakdown of the number and percentage of the types of actions brought in FY 2016 and 2017 is in the attached appendix.

Disgorgement and Penalties Ordered

In FY 2017, the Commission continued to obtain significant monetary judgments against parties in enforcement actions. All told, parties in the Commission's actions and proceedings were ordered to pay a total of $2.9 billion in disgorgement of ill-gotten gains, an increase over the prior year. Penalties imposed totaled $832 million, a decrease from the prior year. Total monetary relief ordered in FY 2017 declined approximately seven percent from the prior year.

Total Money Ordered (in millions)		
	FY 2017	FY 2016
Penalties	$832	$1,273
Disgorgement	$2,957	$2,809
Total	**$3,789**	**$4,083**

As the below tables demonstrate, the five percent of cases that involve the largest penalties and disgorgement account for the vast majority of all financial remedies the Commission obtains. Yet the remaining 95 percent of cases not only constitute the bulk of the Enforcement Division's overall activity, but also address the broadest array of conduct. This is one illustration of how statistical assessments present an incomplete picture.

Penalties Ordered (in Millions)

	2017		2016	
	Total	Pct	Total	Pct
Top 5% Largest Cases	$514	62%	$954	75%
Remaining 95% Cases	$318	38%	$320	25%
Total	**$832**	**100%**	**$1,274**	**100%**

Disgorgement Ordered (in Millions)

	2017		2016	
	Total	Pct	Total	Pct
Top 5% Largest Cases	$2,046	69%	$1,848	66%
Remaining 95% Cases	$911	31%	$961	34%
Total	**$2,957**	**100%**	**$2,809**	**100%**

Experience has shown that in most years, a significant percentage of the disgorgement and penalty totals are attributed to a small number of cases. As illustrated below, this was the case in FY 2016 and 2017.

Disgorgement Orders Over $100 Million in Fiscal Year 2017	
Party	Amount
Telia Company AB	$457 million
Braskem S.A.	$325 million
Teva Pharm. Industries Ltd.	$236 million
Steve Chen, et al.	$145 million
JPMorgan Chase & Co.	$131 million
Total Disgorgement Orders Over $100 M	**$1.294 billion**
Percentage of Total Disgorgement Ordered in FY 2017	**44%**

Disgorgement Orders Over $100 Million in Fiscal Year 2016	
Party	Amount
JPMorgan Chase Bank, N.A., et al.	$139 million
Trevor G. Cook, et al.	$264 million
Louis V. Schooler	$148 million
VimpelCom Ltd.	$375 million
The Bank of New York Mellon	$133 million
Och-Ziff Capital Mgmt Group LLC, et al.	$201 million
Total Disgorgement Orders Over $100 M	**$1.260 billion**
Percentage of Total Disgorgement Ordered in FY 2016	**45%**

Penalty Orders Over $50 Million in Fiscal Year 2017	
Party	Amount
Credit Suisse AG	$90 million
State Street Bank & Trust Co.	$75 million
Ming Xu	$57 million
Total Penalty Orders Over $50 Million	**$222 million**
Percentage of Total Penalties Ordered in FY 2017	**27%**

Penalty Orders Over $50 Million in Fiscal Year 2016	
Party	Amount
Merrill Lynch	$358 million
Weatherford Int'l	$140 million
JPMorgan Chase Bank, N.A., et al.	$128 million
Monsanto Company	$ 80 million
Total Penalty Orders Over $50 Million	**$706 million**
Percentage of Total Penalties Ordered in FY 2016	**55%**

More information about the actions that led to these disgorgement and penalty orders is available in the appendix.

Finally, a substantial amount of money was returned to harmed investors in FY 2017. In the past two years combined, the Commission distributed $1.21 billion to victims of wrongdoing. The majority of funds were distributed in FY 2017, when the Commission returned a record $1.07 billion to harmed investors.

Money Distributed to Harmed Investors (in millions)	
FY 2017	FY 2016
$1,073	$140

A significant portion of the total funds distributed in FY 2017 ($814 million) came from four Fair Funds—a $494 million disbursement from the CR Intrinsic Investors fund,[3] a $200 million disbursement from a JPMorgan Chase fund,[4] and a $120 million disbursement from two related Credit Suisse RMBS funds.[5] The balance of the funds distributed in FY 2017 ($259 million) came from 48 other distribution funds comprised of 28 Fair Funds ($242 million) and 20 Disgorgement Funds ($17 million).

Individual Accountability

Individual accountability is critical to an effective enforcement program. In FY 2017, 73 percent of the Commission's standalone actions involved charges against one or more individuals, the same percentage as in FY 2016 (excluding the 84 actions attributable to the MCDC Initiative).[6]

Relief Obtained

In every enforcement action, the Division seeks appropriately tailored sanctions that further enforcement goals. In addition to disgorgement and penalties, there are a wide array of potential remedies available. In each case, the Division seeks those remedies that will be the most meaningful. Some of these remedies are discussed in more detail below.

Trading Suspensions

Under the federal securities laws, the Commission can suspend trading in a stock for 10 days and generally prohibit a broker-dealer from soliciting investors to buy or sell the stock again until certain reporting requirements are met. Trading suspensions are a significant enforcement tool and greatly enhance our ability to protect investors from possible fraud. In FY 2017, the Commission suspended trading in the securities of 309 issuers, a 55 percent increase over FY 2016, in order to combat potential market manipulation and microcap fraud threats to investors.

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3 *SEC v. CR Intrinsic Investors, LLC, et al.*, No. 12-cv-8466 (S.D.N.Y.).

4 *JPMorgan Chase & Co.*, Administrative Proceeding File No. 3-15507.

5 *Credit Suisse Securities USA, LLC, et al.*, Administrative Proceeding File No. 3-15098

6 When MCDC-related actions are included in FY 2016's count, 61 percent of the Commission's standalone actions involved charges against one or more individuals.

Court-Ordered Asset Freezes

Court-ordered prejudgment relief in the form of asset freezes is important to the Commission's ability to protect investors. These freezes prevent alleged wrongdoers from dissipating assets that could be distributed to harmed investors. Wrongdoers often are adept at hiding and moving assets offshore, and the Commission's ability to obtain meaningful financial remedies, and to return money to harmed investors, therefore may depend on the ability to obtain an asset freeze at an early stage. These circumstances require seeking federal court action on an emergency basis. In FY 2017, the Commission sought 35 court-ordered asset freezes, a slight increase from FY 2016, when the Commission sought 33 asset freezes.

Bars and Suspensions Imposed

Bars and suspensions also are invaluable tools. One of the most important things that the Commission can do proactively to protect investors and the market is to remove bad actors from positions where they can engage in future wrongdoing. Bars and suspensions are the means by which the Commission prevents wrongdoers from serving as officers or directors of public companies, dealing in penny stocks, associating with registered entities such as broker-dealers and investment advisers, or appearing or practicing before the Commission as accountants or attorneys.

Enforcement actions resulted in over 625 bars and suspensions of wrongdoers in FY 2017 and over 650 bars and suspensions in FY 2016.

Noteworthy Enforcement Actions

While the Division's efforts resulted in many noteworthy enforcement actions in FY 2017, the matters described below give a sense of some of the actions the Commission brought in areas of the Division's greatest focus, as well as actions in other areas to demonstrate the breadth of the landscape the Division covers.

In FY 2017, the Commission brought charges against:

Direct Impact on Retail Investors and Conduct of Registrants

- Thirteen individuals allegedly involved in two Long Island-based cold calling scams that bilked more than 100 victims out of more than $10 million through high-pressure sales tactics and lies about penny stocks.[7]
- Twenty-seven individuals and entities behind various alleged stock promotion schemes that left investors with the impression they were reading independent, unbiased analyses on investing websites while writers actually were being secretly compensated for touting company stock.[8]
- Barclays Capital for charging improper advisory fees and mutual fund sales charges to clients, who were overcharged by nearly $50 million. The firm agreed to pay more than $97 million in disgorgement and penalties to settle the Commission's claims.[9]

7 www.sec.gov/news/press-release/2017-124.
8 www.sec.gov/news/press-release/2017-79.
9 www.sec.gov/news/press-release/2017-98.

- Morgan Stanley Smith Barney related to single inverse ETF investments it recommended to advisory clients. The firm agreed to pay an $8 million penalty and admit wrongdoing to settle these charges.[10]
- The investment services subsidiary of SunTrust Banks for collecting more than $1.1 million in avoidable fees from clients by improperly recommending more expensive share classes of various mutual funds when cheaper shares of the same funds were available. The firm agreed to pay a $1.1 million penalty to settle the charges, and separately began refunding the overcharged fees plus interest to affected clients after the Division's investigation began.[11]
- Investment management firm Pacific Investment Management Company for misleading investors about the performance of one its first actively managed exchange-traded funds and failing to accurately value certain fund securities. The firm agreed to retain an independent compliance consultant and pay nearly $20 million to settle the charges.[12]
- BNY Mellon for miscalculating its risk-based capital ratios and risk-weighted assets reported to investors. The firm agreed to pay a $6.6 million penalty.[13]
- Three New York-based brokers for allegedly making unsuitable recommendations that resulted in substantial losses to customers and hefty commissions for the brokers. One of the brokers agreed to pay more than $400,000 to settle the charges.[14]
- Two New York-based brokers with allegedly fraudulently using an in-and-out trading strategy that was unsuitable for customers in order to generate substantial commissions for themselves.[15]

Cyber-Related Misconduct

- Three Chinese traders for allegedly trading on hacked, nonpublic, market-moving information stolen from two prominent law firms, making almost $3 million in illegal profits.[16]
- A Virginia-based mechanical engineer for allegedly scheming to manipulate the price of Fitbit stock by making a phony regulatory filing.[17]

Insider Trading

- A partner at a Hong Kong-based private equity firm who allegedly amassed more than $29 million in illegal profits by insider trading in advance of the April 2016 acquisition of DreamWorks Animation SKG Inc. by Comcast Corp.[18]
- A former government employee turned political intelligence consultant and three others for engaging in an alleged insider trading scheme involving tips of nonpublic information about government plans to cut Medicare reimbursement rates, which affected the stock prices of certain publicly traded medical providers or suppliers.[19]

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10 www.sec.gov/news/pressrelease/2017-46.html.
11 www.sec.gov/news/press-release/2017-165.
12 www.sec.gov/news/pressrelease/2016-252.html.
13 www.sec.gov/news/pressrelease/2017-9.html.
14 www.sec.gov/news/press-release/2017-180.
15 www.sec.gov/news/pressrelease/2017-2.html.
16 www.sec.gov/news/pressrelease/2016-280.html.
17 www.sec.gov/news/press-release/2017-107.
18 www.sec.gov/news/pressrelease/2017-44.html.
19 www.sec.gov/news/press-release/2017-109.

Issuer Reporting and Disclosure Issues and Auditor Misconduct

- Ernst & Young LLP, which agreed to pay more than $11.8 million to settle claims related to failed audits of an oil services company that used deceptive income tax accounting to inflate earnings, as well as two of the firm's partners, who agreed to suspensions from practicing before the Commission.[20]
- KPMG LLP and an audit partner for failing to properly audit the financial statements of an oil and gas company, resulting in investors being misinformed about the energy company's value. The firm agreed to pay more than $6.2 million to settle the charges, and the audit partner agreed to a suspension from appearing and practicing before the Commission.[21]
- Canadian-based oil and gas company Penn West Petroleum Ltd. and three of its former top finance executives for their roles in an extensive, multi-year accounting fraud.[22]

Other Noteworthy Actions

- Petrochemical manufacturer Braskem S.A. for creating false books and records to conceal millions of dollars in illicit bribes paid to Brazilian government officials to win or retain business. The entity settled by paying $957 million to the Commission, the U.S. Department of Justice (DOJ), and authorities in Brazil and Switzerland.[23]
- Sweden-based telecommunications provider Telia Company AB related to violations of the Foreign Corrupt Practices Act (FCPA) to win business in Uzbekistan, which the entity settled by paying $956 million to the Commission, DOJ, and Dutch and Swedish law enforcement.[24]
- A former official of the nation's third-largest public pension fund and two brokers accused of orchestrating a pay-to-play scheme to steer billions of dollars to certain firms in exchange for luxury gifts, lavish vacations, and tens of thousands of dollars spent on illegal narcotics and prostitutes.[25]
- Citadel Securities LLC, which agreed to pay $22.6 million to settle claims that its business unit handling retail customer orders from other brokerage firms made misleading statements to them about the way it priced trades.[26]
- A businessman and two companies for defrauding investors in a pair of so-called ICOs purportedly backed by investments in real estate and diamonds.[27]
- A Ukraine-based trading firm, Avalon FA Ltd., accused of manipulating the U.S. markets hundreds of thousands of times and the New York-based brokerage firm of Lek Securities and its CEO who allegedly helped make it possible.[28]

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20 www.sec.gov/news/pressrelease/2016-219.html.
21 www.sec.gov/news/press-release/2017-142.
22 www.sec.gov/news/press-release/2017-120.
23 www.sec.gov/news/pressrelease/2016-271.html.
24 www.sec.gov/news/press-release/2017-171.
25 www.sec.gov/news/pressrelease/2016-272.html.
26 www.sec.gov/news/pressrelease/2017-11.html.
27 www.sec.gov/news/press-release/2017-185-0.
28 www.sec.gov/news/pressrelease/2017-63.html.

APPENDIX

Breakdown of Classification of Standalone Enforcement Actions	2017		2016	
	Actions	Pct	Actions	Pct
Issuer Reporting / Audit & Accounting	95	21%	93	17%
Securities Offering	94	21%	90	16%
Inv. Adviser / Inv. Company	82	18%	98	18%
Broker Dealer	53	12%	61	11%
Market Manipulation	41	9%	30	5%
Insider Trading	41	9%	45	8%
Public Finance Abuse	17	4%	97	18%
FCPA	13	3%	21	4%
Miscellaneous	7	2%	9	2%
Transfer Agent	3	1%	2	0%
NRSRO	0	0%	2	0%
Total	**446**	**100%**	**548**	**100%**

Disgorgement Orders over $100 Million Entered in Fiscal Year 2017

Party	Link to Release
Steve Chen, et al.	www.sec.gov/news/pressrelease/2015-227.html
JPMorgan Chase & Co.	www.sec.gov/news/pressrelease/2016-241.html
Braskem S.A.	www.sec.gov/news/pressrelease/2016-271.html
Teva Pharmaceutical Industries Ltd.	www.sec.gov/news/pressrelease/2016-277.html
Telia Company AB	www.sec.gov/news/press-release/2017-171

Penalty Orders over $50 Million Entered in Fiscal Year 2017

Party	Link to Release
Ming Xu	www.sec.gov/news/press-release/2014-60
Credit Suisse AG	www.sec.gov/news/pressrelease/2016-210.html
State Street Bank & Trust Co.	www.sec.gov/litigation/admin/2016/ic-32390-s.pdf

Disgorgement Orders over $100 Million Entered in Fiscal Year 2016	
Party	Link to Release
Trevor G. Cook, et al.	www.sec.gov/litigation/litreleases/2009/lr21313.htm
Louis V. Schooler	www.sec.gov/news/press-release/2012-2012-183htm
JPMorgan Chase Bank, N.A., et al.	www.sec.gov/news/pressrelease/2015-283.html
The Bank of New York Mellon	www.sec.gov/litigation/admin/2016/ic-32151-s.pdf
VimpelCom Ltd.	www.sec.gov/news/pressrelease/2016-34.html
Och-Ziff Capital Management Group LLC, et al.	www.sec.gov/news/pressrelease/2016-203.html

Penalty Orders over $50 Million Entered in Fiscal Year 2016	
Party	Link to Release
Merrill Lynch, Pierce, Fenner & Smith Inc., et al.	www.sec.gov/news/pressrelease/2016-128.html
Weatherford International PLC, et al.	www.sec.gov/news/pressrelease/2016-194.html
JPMorgan Chase Bank, N.A., et al.	www.sec.gov/news/pressrelease/2015-283.html
Monsanto Company	www.sec.gov/news/pressrelease/2016-25.html
VimpelCom Ltd.	www.sec.gov/news/pressrelease/2016-34.html
Och-Ziff Capital Management Group LLC, et al.	www.sec.gov/news/pressrelease/2016-203.html

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