

***Morgan Lewis Presents 2018 – A Conversation with Stephanie Avakian and Steven Peikin***

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Panelists: Stephanie Avakian, Co-Director, SEC Enforcement Division; Steven Peikin, Co-Director, SEC Enforcement Division

Moderators: Ben Indek, Partner, Morgan, Lewis & Bockius, LLP; Susan Resley, Partner, Morgan, Lewis & Bockius, LLP

Tim Burke: Good afternoon, everybody. My name is Tim Burke, and on behalf of the Securities Enforcement and Litigation group of Morgan Lewis, I'd like to welcome you all to the, what is now the 10th annual SEC Historical Society Presents program and we are delighted to have the Co-directors of Division of Enforcement with us, Stephanie Avakian and Steve Peikin. But I did want to just mention for purposes for the audience here in New York, that we are webcasting this around the world right now and this program will be posted on the SEC Historical Society's website, as have each of the prior nine programs that have been part of this presentation. And in just a moment, I'm going to introduce you to Jane Cobb, the Executive Director of the SEC History Society. For those of you who are not familiar with the Society, it is a fabulous resource. It has a virtual museum which you can visit by going to [SECHistorical.org](http://SECHistorical.org). That is the definitive repository of the history of financial regulation. And it includes both original materials as well as oral histories and programs like this. So I thank you again for coming. We look forward to a great program. I know this will be timely, informative, and very interesting.

Tim Burke: And with that, let me turn it over to Jane Cobb.

Jane Cobb: Thank you, Tim. I appreciate your service on our Board of Trustees. I also want to thank Morgan, Lewis & Bockius for their long-term support of this particular program. This is the tenth year for the program, and we greatly appreciate the firm's support of this Society's mission to preserve the history of the securities markets. I have the pleasure of introducing the panel this afternoon. On my right is Ben Indek. Ben joined Morgan, Lewis & Bockius over 30 years ago, right after kindergarten, and is currently a partner in the firm's litigation practice.

Ben Indek: Technically high school, but kindergarten's good.

Jane Cobb: Ben represents broker dealers and their executives in SEC and FINRA investigations. Prior to joining Morgan Lewis, from 1984 to 1987, Ben served as compliance officer for EF Hutton Company.

Jane Cobb: To Ben's left is Susan Resley. Susan joined Morgan Lewis about 6-1/2 years ago and currently leads the firm's Securities Enforcement Practice. Her practice focuses on representing companies and individuals in SEC, Department of Justice, and PCAOB matters as well as internal investigations. From 1992 until 1995, Susan worked in the SEC's Division of Enforcement in its Los Angeles Regional Office.

Jane Cobb: To my left is Steve Peikin. Prior to joining the SEC as the Co-director of the Enforcement Division with Stephanie, Steve was managing partner of Sullivan and Cromwell's Criminal Defense and Investigations Group. Before that from 1996 to 2004, Steve served as an Assistant US attorney in the Southern District of New York where he was also Chief of the Office's Securities and Commodities Fraud taskforce.

Jane Cobb: And to Steve's left is Stephanie Avakian. Stephanie was named Co-director of the SEC's Division of Enforcement along with Steve in June 2017. Before that, Stephanie was acting director of the Division of Enforcement after serving as Deputy Director of the division since June 2014. Stephanie previously worked in private practice and also served as a Branch Chief for the SEC's New York Regional Office and counsel to former SEC Commissioner Paul Cary.

Jane Cobb: Again, I want to welcome everyone and thank you for coming. I will turn it over to Ben Indek to get the conversation going. Thank you.

Ben Indek: Thank you, Jane. Welcome Steve and Stephanie. There are a lot of hot topics that we could talk about, so let's just jump right in and start with cryptocurrency. There's a lot activity in the crypto space, and we could spend the whole hour on that topic, but let's not do that. A few highlights include the creation of a Cyber Unit last year. The Commission's brought a number of enforcement actions in this space, so reported to have commenced [inaudible 00:04:42] crypto investigations and the issuance of many subpoenas to market participants, and most recently you brought your first case in the regulated area against a hedge fund and a broker dealer. So here are a few questions to get us started in this area. Could you first bring us up to date on work of the Cyber Unit, talk about its size, its remit, its breadth around the country, and what are the areas it's currently focusing on?

Stephanie Avakian: Yes, happy to. Thank you, again, for having us and before I forget, let me, on both our behalf, give a standard disclaimer that the views expressed today are our own, and do not necessarily reflect the views of the Commission or the Commission's staff.

Stephanie Avakian: So, the Cyber Unit, thanks for asking about it. We do love talking about our work in this space. The Cyber Unit's now roughly 30 people, has a presence in five of our offices, so the home office, New York, Philadelphia, Chicago, San Francisco, but all of the offices also have a liaison to the Cyber Unit and what we've really tried to achieve, as with, I think it's fair to say all specialized units, we've really tried to achieve some level of centralized knowledge and expertise, consistency

in how we think about these cases. Probably in Cyber, because it's such a new area, and when I say Cyber, right now, I'm sort of talking more about ICO space, we really, because there have been so many ICOs and there are so many potential things to look at, I think we've really had to be thoughtful about what we open in terms of investigations and what we bring in terms of cases, right?

Stephanie Avakian: So we've been pretty judicious about focusing our resources and looking broadly across all the cases, all the investigations, everything we're tracking across the Division, and then coordinating centrally in terms of what makes sense to move forward on and that sort of thing and I think the cases we've brought so far, the actions we've taken so far, reflect that attempt. The cases roughly fall into two buckets. I would say those that are sort of where the technology [inaudible 00:07:02] for fraud. [inaudible 00:07:04] and we brought a bunch of cases, of course, and actions there including emergency actions, asset freezes, things like that.

Stephanie Avakian: And then the other bucket I would put in more the "not an obviously fraud and maybe not a fraud at all," more in the regulatory space. Failure to register, perhaps some other what someone might call a regulatory or technical violation. So I'd say that the cases kind of broadly fall in those two categories and some of what we've been doing to try to reach as far as we can both with messaging and with action is in the fraud space, obviously bring those cases and bring them quickly where we are able to maybe find the conduct. We've also done a lot of other things, like trading suspensions where there's just not enough information in the market place.

Stephanie Avakian: We've started doing, I shouldn't say started, it's not been probably nine months. But we've made some public statements, some Division of Enforcement public statements, which I think is not something the Division's traditionally done or at least hasn't done certainly in the recent past. And I think they've been to pretty good effect. One of the ones we point to-

Steve Peikin: So one of the ones we talk about a lot, there was a front page New York Times article on a Sunday about celebrity endorsements of ICOs and talked about a coin that was endorsed by the well-known investment advisor, Floyd Mayweather, and so we put out a statement I think with OCIE, maybe two days later saying, "Hey, if you're touting a security for compensation, you've got to comply with the anti-touting rules, and if you're a consumer and you're seeing your favorite celebrity tout, you've got to be asking questions." And really, I think we were pretty shocked to see that the conduct, all these celebrities had fell off a cliff, it stopped immediately. So the alternative, what we would say the regular way to do it would be okay, let's send out a subpoena to the Floyd Mayweather's of the world and then we'll take testimony and meanwhile this is going on for a year and then eventually we might or might not bring an enforcement action. But here we were able to really stop conduct forthwith.

Steve Peikin: And obviously we're not going to do that, our enforcement program is not going to be finger wagging at people. We're going to investigate and brings cases, but in appropriate cases-

Stephanie Avakian: And don't think that's to say we will or won't do investigations in addition to that, right? Or at the same time. But as Steve described it, we think there is some value in coming out and saying, in the right circumstances, in particularly Cyber where even though the law has been around for ages, the issues that it's applied to are new and different. And then finally, a jump to more the non-fraud type stuff and how we're approaching that. We've brought some cases in that space as you've noted including a recent one for active as an unregistered broker dealer in the TokenLot case. And in those, we're again, trying to be thoughtful and try to choose the cases that make sense in terms of sending the broadest message and thinking about what are the right remedies here, what do the resolutions look like? I think it's fair to say we kicked off most of this cyber activity with the [inaudible] report, not this past summer but the one before. And so a lot of cases have followed from that.

Ben Indek: Well I think that the getting the notice out with OCIE and you guys really did have an effect as Steve mentioned. I know my daughter told me that her Instagram feed all of a sudden, there were no more celebrities endorsing ICOs on it. So you definitely hit the mark there.

Steve Peikin: Sorry to disappoint.

Ben Indek: Maybe you could talk a little bit about, if you could, the sweep that you guys did, or reported sweep in the spring where you sent out a lot of subpoenas to various market participants. What do you see going forward in that or with those things going out?

Stephanie Avakian: Without adopting the sweep terminology, we've certainly sent out a lot of subpoenas in this space. We've been pretty open about the fact that we have dozens and dozens of open investigations in matters. Again, we're trying to be judicious about which ones it makes sense to pursue, which are the ones that by pursuing them first, we can send the broadest message and so that's really how we're thinking about it. I'm not sure I can give a lot more. You see the cases as they come out, I think you can see that we're trying to hit different areas. We had the Munchee case, which was registration. We had the TokenLot case which was the unregistered BD. We had the crypto-asset fund case more recently which was the unregistered investment company. And so I think we're trying to cover as broad a landscape as we can, but we've got a lot of open matters that we're pursuing.

Ben Indek: Okay.

Susan Resley: On a related point as it pertains to cyber, separate and apart from that, are the breach cases, so maybe you can get us to speed as to what are the developments for both corporate issuers and registered entities.

Steve Peikin: Yes, so I mean, we've been saying I think for a long time that ... we've probably said this at conferences for a couple years saying, look, our goal here is not to bring actions because someone was a victim of a computer intrusion or data theft, etc. but that being said, could we imagine a scenario in which a firm, either an issuer or a registrant's controls, procedures, or disclosures were so deficient in the wake of that or in advance of such a cyber event that it would be appropriate for enforcement action, and I think we said, yes, we could imagine such as scenario.

Steve Peikin: Well, we don't have to imagine those scenarios because we brought two cases this year. I think the one that's garnered the most attention was the Yahoo case in which Yahoo delayed for over two years in disclosing what was then the world's largest cyber breach ever. So, Yahoo paid a penalty, or I should say the successor entity to Yahoo paid a penalty, and there, I think, the allegation suggested deficiencies in assessing the scope of the breach and making a judgment about whether there should be a disclosure that fell so far short of the mark that it was appropriate for enforcement action.

Steve Peikin: And then I think just last week in the Voya financial advisors case, we charged a dual registrant with violating the safeguards rule and the identity theft red flags rule. These are the first time those rule violations had been charged in an enforcement action. And these were the result of a cyber intrusion that, on reflection, we think that the firm's controls and procedures around this were sufficiently lacking that enforcement action was warranted.

Steve Peikin: Look, I think we need to be careful in this space because cyber intrusions, are, it's not just a securities law issue, it's probably the greatest threat, national security threat facing this country, economic threat facing this country. So being ham handed in the way we approach these issues is not in anybody's interest and so before we take action, we need to think about the consequences of an enforcement action and are we promoting the kind of behavior that we want or are we chilling the kind of behavior that we want to see, and we obviously want to fall on the former side rather than the latter side.

Stephanie Avakian: And I think when you look at the SP cases, it's been a small number, but I think when you look at the facts of SP cases and we've tried to put enough information in the orders both in Voya, if you look back at Morgan Stanley or RT Jones or those other cases, I think you can see ... I hope that it doesn't come across as second guessing as much as it across as, you know, there were real failures here.

Ben Indek: Well maybe that's a good segue into talking about, in terms of account intrusions, talk about retail investors, right? So from the Chairman Clayton on down, it's been clear that the SEC as a whole, and particularly you in the Division

of Enforcement, is really focused on protecting retail investors. Indeed, last year's annual report from the Division of Enforcement reminded me of the old Ford commercial, right? Quality, job one because you guys said in your report, principle one, focus on the Main Street investor. So let's talk about how you're doing that. So one thing to start with is in contrast to the Cyber Unit which is a standup unit that you guys added to the group, you set up a retail strategy taskforce. So it's a little bit different. Maybe you can talk about the difference between the taskforce and a standup unit and tell us what the taskforce is up to these days.

Stephanie Avakian: Yes, so the taskforce ... the Unit I think is different in the sense that we really want to centralize expertise and develop it. Really, everybody's job in the Division of Enforcement is to protect retail investors, right? That's what everybody does. I can make an argument that any case we bring affects retail investors, right? No matter what it is. And so we've always been focused on that. The idea with the retail strategy taskforce, and I should say our annual report does reflect it, everything the Chairman says reflects it. I think everyone in the Division is thinking about and embracing the idea of protecting retail investors probably in a more front of mind way than perhaps in the past.

Stephanie Avakian: But the Retail Strategy taskforce, the idea behind that is to have one centralized group of folks who are really responsible for thinking about the issues broadly. It doesn't mean they're focused on all the Ponzi schemes or all the offering frauds or all the unsuitable product sales and those kind of things, but they're really thinking broadly about, across the Division, about what can we do proactively to identify potential pockets of problems, broad pockets of problems and by that, I mean, let's look at some cases we brought, let's look at some areas where we did identify problems, where OCIE identified problems and think, okay, we had it here, say in Chicago, is there a way to test broadly for that. Is there a way to slice and dice data to see if we have this problem much more broadly. And I makes more sense to have a couple of folks responsible for thinking about that broadly as opposed to expecting people in LA or in San Francisco or somewhere else to look at what Chicago has done and say can we do more of that.

Stephanie Avakian: So that's part of it. I would say they've been involved in some cases. For the most part, the taskforce is not tasking with doing investigations and bringing cases, but I think we felt strongly and the leadership of the taskforce felt strongly that people are more engaged and they develop ideas in a more thoughtful and topical and relevant way when they're doing the cases and testing the stuff out themselves and everybody wants to do cases and I think we have a better shot of getting committed people to this if we had people who could also do investigations and so they have been involved in getting some stuff over the finish line.

Stephanie Avakian: And I think finally, education has been a huge part of what they do and they work together, I mean, obviously the Commission has an Office of Investor Education. They work closely with them. I don't think they're really overlapping. They're really taking the lessons we're learning in our investigations and figuring

out how to develop them in ways that can be messaged to investors as kind of the other side of it. Here's what you need to be looking out for. Here's what you need to be wary of. They're going out and meeting investors. We just made our first short video on the back of the stock option case that we brought at the end of last week, so we've got a two- or three-minute video that really targets investors. It's up on the website. So that's kind of ... we're thinking a little more holistically and both the investigative side but also the actual investor protection side.

Ben Indek: Let me pick up on something that you said there, Stephanie, about, you talked about big data. So that's also one of the priorities that you've been focused on. Let me put the two together so protecting retail investors and big data. In a recent case that you guys brought as part of the announcement that it was a cherry picking case, I think the Commission said in the press release that it identified the problematic activity by the big data that it had looked at and the data analytics. Without giving away the secret sauce or you can if you want, we're just amongst ourselves, you can.

Stephanie Avakian: I wouldn't understand it if I tried.

Ben Indek: Well, maybe Steve can tell us the secret sauce. Can you tell us how you guys are using big data to generate leads and then bring cases?

Steve Peikin: No. Not in this audience.

Ben Indek: I can get Mr. Mayweather here and we can talk about it.

Steve Peikin: One of the things I was most impressed by when I came to the Commission is the quality of the tools that have been developed in house, not off the shelf, but actually, we have programmers that have built tools that can intake an ingestion of large sets of data and analyze them to identify parallel trading and rings of insider traders or look at performance in an IA and identify a possible cherry picking scheme and the one that was brought, was built based solely on data analytics. It was identified that way.

Steve Peikin: So I think that everybody says big data, it's like the term [inaudible 00:21:11]. I'm not exactly sure what it means, but we have a lot of people in [inaudible] and elsewhere in the division that are quantitative and have tools, and I think we're going to continue to seek out ways to take advantage of it. One of the things the retail strategy taskforce is trying to do is use data to identify, say we've got a look at transactions that are in a zip code around a military base, do they indicate that, for example, there's some complex financial product that's being sold to people of military age, probably unsuitable and inappropriately, is that a case? Not to prejudge the outcome, but that's the kind of thinking that I think they're going to do.

Ben Indek: And so they're doing that background work and then feeding these ideas to people in your group?

Steve Peikin: Well, they're in our group, but it's kind of an idea generation group. And theoretically, you would find a problem and then you would identify a pattern and disseminate it out all over the country and ask people to look for it in their particular regions.

Ben Indek: Right. I think one of probably the major retail area issues that you guys have been working on, certainly in the RIA space is the mutual fund share class initiative. That's the second so-called self-reporting initiative that you guys have had over the last couple of years. There was one in the muni space prior to that. So two questions here. How do you identify areas that are worthy, potentially, of the self-reporting initiatives that you have put out? And secondly, can you just give us an update or status report on where you are with the share class initiative.

Steve Peikin: Just to take the first question, this is one that the idea for this initiative was developed in our Asset Management Unit because we had identified a problem that had cropped up and been the subject of enforcement activity over probably three or four years. And we brought probably 12 or so cases really on the identical fact pattern. An investment advisor recommending share classes that carried 12B1 fees that were paid to an affiliated broker dealer without disclosure of the potential conflict in that recommendation. And it became clear, I think, that the market wasn't ... because OCIE was continuing to detect this problem in exams, clearly the market wasn't getting the message. So we had a choice. What could we do? We can continue to do these, play this Whack-a-mole game, continue to get exam referrals, open up investigations, investigations are labor intensive and time consuming, and by the time we got around to addressing the problem, I'd be retired and so would most people in this room.

Steve Peikin: So the idea for the initiative is let's see if we can get people to self-report this problem, remediate it, and they need both a carrot and a stick, and the carrot is the recommendation of no penalty if people comply with all the terms of the initiative and the stick is the threat that if we find it after the initiative is closed and we're looking for it, that we will try to make people wish they had self-reported.

Stephanie Avakian: And I think a couple things, as Steve said, we have this problem, but to put a couple more details around it, this is part of what was driving us here is every case that we were resolving, and they did have penalties, the cases we brought and resolve, but in every case we were resolving, we were getting disgorgement and getting it back to investors. And that's part of how we were thinking about this. This is an opportunity to not only try to solve the problem broadly and much more quickly and in a much more compressed time frame, but also get money back into the pockets of investors as quickly as possible. These are all going to be, at least the intention is for these to be recommended as self-directed

distributions or respondent directed distributions which will have the effect of getting money back in the pockets of investors much more quickly.

Stephanie Avakian: At the time we decided to do the initiative, I think we had probably 10 or 12 ongoing investigations in addition to the ones we already brought. On average, the ones we brought took 22 months to bring. And so that kind of gives you the broad picture of what we were facing.

Stephanie Avakian: In terms of how the initiative's played out, I think it's premature to put numbers around it, but I think we view it as a wild success at this point. We now, we've got almost all the information and everything and we've had a substantial number of self-reports and now we're working through it and in terms of getting it done and over the finish line, the way we're thinking about it is breaking it up into groups of cases and giving it to as few people across the division as we can so we have people across all the regions and in the home office taking chunks of this but in an effort to get it done consistently and as quickly as possible, we're also trying to have as few people as possibly do it. I mean, it's still a decent number of people. So that's the idea.

Ben Indek: I mean, picking up on what both of you were saying in terms of it being a wild success and you guys had several [inaudible 00:26:32], at least two, maybe three in the MCDC space, so is this a tool in your tool box that you guys are going to bring out more often going forward do you think?

Stephanie Avakian: I think if we can think about the right way to do it. Not everything can be a self-report.

Ben Indek: Understood.

Stephanie Avakian: For a bunch of reasons, but where it ticks the boxes in terms of solving a problem, doing it quickly, being good for investors either because it gets money back to them or because it stops some misconduct or something like that, I think we're certainly open to it. I don't know, Steve, if you have other ...

Steve Peikin: Yes, I mean, look. There's a policy cost in any kind of program like this because you're forgoing something that otherwise you would be getting. It's analogous to this is not an amnesty program because the self-reporters will be the subject of enforcement action, but if you think about it in comparison to the Department of Justice antitrust amnesty program which I think by any measure is a tremendous success, but there's a pretty big cost to that program in that one of the actors, and they can be really bad actors, gets complete immunity. So I think that's how we balance it here. We think the scale's tipped in favor of the time issue and getting the disgorgement returned to investors promptly.

Ben Indek: I think one thing that you did mention though is resources, right? Because it's a way for you guys to allocate resources and that's the last question I have on the retail space. So you guys have been focused on the retail space, but you've also

been careful in speeches and panels like this to make it clear that it's not to the exclusion of everything else and that you also do have an appetite for and have brought cases against financial institutions, Wall Street firms and those kind of entities. So how do you allocate the resources to those things and you've talked a little bit about the intersection between financial professionals-

Steve Peikin: I don't think it's an either or choice. A lot of the Wall Street cases that we've brought are cases that have significant impacts on retail investors, right?

Ben IndeK: There's a retail investor at the end.

Steve Peikin: Yes. So a Wall Street case doesn't have to be a fight between Morgan Stanley and Goldman Sachs. So it's not a binary choice, but we're looking, we have a complex financial instrument, specialized unit. Their work necessarily is focused primarily on intermediaries and large financial institutions. And so I think there is no loss of appetite in the Division of Enforcement to go against important registrants, significant financial intermediaries and the like. And I don't think, at the risk of repeating myself, it's not a binary them or them choice.

Ben IndeK: In the intermediary space, with the large institutional space, are there priorities or things that you guys are looking at, that the complex unit is looking at in particular that you can share with us?

Steve Peikin: Well, the one thing I think we've talked about and we can point out is the focus on the sale of sophisticated structure products and sophisticated products to retail investors is one area that I know is a focus, and we've brought some cases in that space and I think there will be more to come.

Stephanie Avakian: Yes, and I think other cases, the Cadaret, Grant case that we brought a week or two, maybe three weeks ago I think is a good example of some of the stuff in that space. These are products that in this case were unsuitable for the investors but part of the problem I think is where, and not specific to this case, but cases generally is where there are products that are being sold that aren't understood by folks who are selling them so there is a confluence of issues there. People are buying stuff that aren't necessarily suitable for them. Those selling the products don't fully understand them and so I would expect to see, we're certainly looking for those kind of things and have investigations involving those sorts of issues.

Steve Peikin: Yes, we've also continue to bring actions about order handling, dark pool related stuff and I think you'll see more of that coming down the pipe as well.

Susan Resley: So switching gears a little bit, there were some significant Supreme Court cases that certainly impacted-

Steve Peikin: I hadn't noticed. What are you talking about?

Susan Resley: That impacted enforcement and the first I wanted to cover and ask you a couple questions about was the Lucia case which in June, as you know, the Supreme Court determined that administrative law judges for the SEC were not simply federal employees, but were officers of the United States and therefore needed to be either appointed by the President, courts of law or heads of departments. And right after that opinion came down, the Commission did take several steps including lifting a prior stay on all administrative proceedings which were in a pause mode, and then also ratifying the ALJ appointments. So have these actions returned the AP process to business as usual?

Stephanie Avakian: I think the answer to that is a bit of a yes and a bit of a no in the sense that, I guess a couple things. We've continued, even while the case was pending before the Supreme Court, we continued to bring litigated administrative proceedings where appropriate. I think the degree to which we used the forum for litigated cases is probably reflective of how we will continue to use it and so we've certainly continued to use it and we'll continue to do so in cases where look, there are a lot of cases where we can only bring them as APs. There are some charges that can only be in the administrative forum. There are some relief we can only get in the administrative forum. We have to keep bringing them. Are we likely to bring an insider trading case or a financial fraud action in the administrative forum? I don't think we're likely to. We haven't in the last 12/18 months and I think we've been using it is how I'd expect to see us continue using it.

Stephanie Avakian: That said, it's also going to be a very overloaded forum going forward because Judge Murray, the Chief Judge just a week or two ago reassigned all of the cases consistent with the Supreme Court's decision and so there will be a lot of activity. Just based on the required time frames in APs, I expect us to see it through the next year and then kind of know where it's all going to land. But look, there is going to be a lot of activity. We're going to retry cases. We're going to put a lot of resources into retrying cases, in many cases with very old facts. Defense and respondents are going to have to put a lot of effort into this, so I think the next year brings a lot of challenge in that forum, and then hopefully after a year passes, we'll see it return to some level or normalcy, but I think normalcy is probably more what we've seen in the recent year or so as opposed to what we saw three, four, five years ago.

Susan Resley: So it sounds like impact on the enforcement program for the most part is, how would you describe it? It sounds like there's not really going to be much impact?

Steve Peikin: Well, I think we're much more judicious about the use of APs, and I think you'll see cases that I would describe as, for lack of a better word, regulatory cases that we ordinarily wouldn't be bringing in federal court. I think you'll see more of those brought in federal court. And there will continue to be constitutional and legal challenges made to the AP process. As we use the forum, there is some embedded legal risk in there for us and so I think we have to be mindful of trying to mitigate that to the greatest extent possible.

Susan Resley: A second case that we want to talk about is the Kokesh case which they weighed in on another important issue and there the Court determined that the five-year statute of limitations under section 2462 applied to disgorgement orders as it does to civil penalties and how has that impacted? Because disgorgement typically wasn't viewed as a penalty per se so how has that impacted your program?

Steve Peikin: Well, so first, I want to say one thing about Kokesh. So the Supreme Court's decision was 9-0, but the General Council of the SEC points out that every one of those votes was really close, so we didn't actually ... we didn't actually lose it by that much.

Ben Indek: That's a big data thing.

Steve Peikin: So it's had a seismic is too big, but something close to it. It's had a very significant impact, not just on our ability to obtain disgorgement, but also on the way we do business and I can touch on both.

Steve Peikin: So first of all, there is conduct, rather funds, that are outside our reach because of the impact of the ruling. I mean take Kokesh itself and I'm not sure, at least in the justice in that case is cause for celebration. Kokesh was found responsible for misappropriating I think \$35 million from clients. And as a result of the ruling, I think almost \$30 million of that was for conduct that occurred outside the statute, and he got to keep it. So it is what it is and obviously the impact of that decision spreads much more broadly. We've been keeping track in our litigated and settled cases how much disgorgement have we had to leave behind as a result of the ruling since the ruling, and I think the most recent stats I'm familiar with are I think from April or May, we tallied out about \$800 million, and I think the number has to be substantially higher now. So for long running frauds, particularly those that we don't discover until they've been going on for some period of time, there will be funds that should be, would otherwise be returned to investors that won't be.

Steve Peikin: So what does that mean for us? I think it means, one, we've got to work faster. We don't have the luxury of saying we'll be able to get that remedy no matter how long it takes. And secondly, I think we have to be thoughtful in our case selection process. If we're looking at conduct that is already three or four or more years old when we're starting the investigation, I think we have to ask ourselves the question of, it's great if we do a really good investigation, but at the end, we have no real relief to get, that's not really the best use of our resources. So I think in those two ways it's impacted us. I don't know if you have other stuff to add.

Stephanie Avakian: No, I think you've captured it.

Susan Resley: In those situations that you described of long running frauds that you make not discover until later in the scheme, do you foresee situations where the staff will seek tolling agreements more than they did in a pre-Kokesh world?

Steve Peikin: I think it depends on, I mean, I think we continue to practice that [inaudible 00:38:37] put in place that requires the Director or his or her designee to approve tolling agreements, so I don't think tolling agreements, what I don't want to see happen. I think neither of us want to see happen, we serve subpoenas with tolling agreements stabled to the back of them. There are going to be some cases, if we discover a Ponzi scheme and we're starting an investigation and we have someone who can toll, I don't think we're interested in letting the statute run and money that we might be able to recover, see that slip beyond our reach. I don't want, I don't think the remedy of this well we'll just toll.

Steve Peikin: Part of the problem is even as we try to prove our cases, two things. One, I think our cases have the most impact when they're brought closest in time to the relevant events. And then secondly, when we go to litigation, if we're litigating and we go to federal court and it takes us through discovery and summary judgment and it's three years before we're in front of a jury and we didn't bring that case until 5+ years after the events in question, so we're now eight years after the events in question and you call your first witness, where were you in 1998? I have no idea. So you can't prove those cases either. So I don't know if you ...

Stephanie Avakian: No, I think you captured it. And there's a lot of reason aside from Kokesh to bring cases faster and I think every director before us has been focused on that, so I think there are a lot of natural challenges with it, but we've also been very focused on thinking on things we can do in the division and trying to roll them out and do what we can to bring stuff faster.

Ben Indek: Thank you. Let me switch topics into the Commission's statement on staff views, and while we appreciate you here and giving your views to us today, last month-

Stephanie Avakian: They are not the law.

Ben Indek: Exactly, they are not the law. So Chair Clayton issued a statement stressing that although the SEC staff often provides guidance on various issues through various means such as letters, FAQs, speeches, Historical Society panels, etc., the Commission's longstanding position is that such statements are nonbinding and do not create enforceable legal rights or obligations and that he had recently instructed the Directors of Enforcement and also the staff at OC to further emphasize this. So can you give us some insight into the statement generally and the instruction to the Division?

Stephanie Avakian: Yes, I'm sure there's much more to it to share other than the reiteration of what we all know to be true, which is that staff guidance is not the law and we're not

going to charge violations of staff guidance. Certainly informs how we think about things and I think it's good to give guidance. It's certainly feels good for us to talk on panels and give speeches because we want people to know how we think about things, but ultimately, it's the law that dictates and it's the Commission that makes the decision about whether to bring cases and if so, what to charge or what not to charge. So it's not a programmatic change. I don't think there's anything more there than what he said. I don't think we're the only agency to have done that.

Ben Indek: Sure. The banking rates.

Stephanie Avakian: [crosstalk 00:41:44] before us. Yes, banking regulators.

Ben Indek: How about whistle blowers? Continue to give out a lot of money to whistle blowers who come forward timely with original information and that leads to a successful action. Last time we checked, the SEC had doled out awards of more than \$320 million to almost 60 individuals since the first one in 2012. What's new and interesting in this part of the program in the whistle blower space?

Stephanie Avakian: Well, we get a lot of whistle blower tip.

Ben Indek: How do you separate the wheat from the chaff?

Stephanie Avakian: That's a great question. I mean most of this comes in, most of it, not all of it. I think folks know there are some packaged up in a more sophisticated and advanced way when whistle blower counsel comes in and brings something. But oftentimes, they're just tips that come in, most of the time, they're tips that come in through the TCR process. The tips, complaints, and referrals process. I don't know what the number will be when the book closed on fiscal 2018 last week, but I can say the year before just about 17,000 TCRs of which I want to say a third to a quarter were whistle blower tips, maybe 4000 or so. And this year, we know we got more. I don't know what that number looks like yet, but we got substantially more TCRs, and so we've got our Office of Market Intelligence that does the first line triage. Every TCR that comes in including whistleblower tips should be reviewed in roughly three days, give or take, but should have eyes on it. And so we continue to do it that way. The ones that are actually state, we got a lot that don't even state a securities claim, maybe we send them to another agency, maybe it's any number of things. But we rely on the staff to separate the wheat from the chaff.

Stephanie Avakian: And there are more advanced tips that come in through counsel, whether it's whistle blower counsel or some other counsel that brings us stuff that's more developed in terms of investigation. But it's a great part of the program. I think, I want to say we're tracking roughly 700 cases of our open investigations that have some whistle blower component to it. So it's pretty big, and we just recently earlier this year, I don't remember how many months ago, have out the largest awards that we'd given out. I think two whistle blowers shared a \$50

million award and a third whistle blower received a \$33 million award. So there are some pretty substantial ones.

Ben IndeK: And a recent one to someone overseas so really opening up.

Stephanie Avakian: Yes. So it's a successful program. I think it's been incredibly successful. The downside of it is that you get more things that you have to go through in terms of complaints to review and things like that, but ultimately, it's all positive.

Ben IndeK: So at the risk of going back to Steve on the Supreme Court, another case 9-0, so I think it's 27-0 now if I'm doing the math right-

Steve Peikin: We got some votes in Lucia, though, didn't we?

Stephanie Avakian: We must have.

Steve Peikin: Yes, we must have, right.

Ben IndeK: So digital reality, right? Supreme Court case. An employee must tell the SEC and not their employer in order to get whistle blower status. Has that impacted the whistleblower program to date? What are you seeing in that area?

Steve Peikin: I think it's too soon to tell. I think logic would suggest that we'll get more whistle blower claims, but I think it's too soon to tell.

Stephanie Avakian: It's a real interesting issue, right? Because when the whistle blower rules came out, it really was industry, the market wanted to do things to encourage whistle blowers to report internally, and now we find ourselves in this circumstance that wasn't the original, I think, intent of those. Instead where people have to report to the SEC in order to be protected.

Ben IndeK: Susan, you want to talk about ...

Susan Resley: So we've just ended your fiscal year and the very last case that the SEC brought was probably one of its most noteworthy which was the Musk case. What would be the takeaway from that particular action, particularly for boards as well as executives, particularly the entrepreneurial-type executives that we see in where I'm from, San Francisco?

Steve Peikin: Look, I don't know that we're in a position to lay out all the lessons of the case. To some degree the allegation in the case suggests a kind of unusual fact pattern, right? That may or may not be repeated. On the other hand, I think if you take a slight step back, it's really a case about controls. At its heart, I think the core of the allegations against Tesla were a reflection of a failure to exercise appropriate controls and have adequate procedures over the communications of the CEO. And the thing to me that I think we think is most significant about the case and the settlement is the manner in which the relief we're seeking

which is still subject to court approval, but the relief that we've sought is very narrowly tailored to address the problem.

Steve Peikin: And I think we took a similar approach in the Theranos case earlier this year and just to back up the Theranos, there the relief required two things that are unusual. I think one, that the settling defendant Elizabeth Holmes had to convert her super majority shares into common shares, to basically give up control that she had obtained during the period of the fraud and secondly, that there be a preference to other shareholders that they receive the first \$750 million in values should there be a liquidation event.

Steve Peikin: Those were remedies that were designed to address a particular problem, which is the harm that could flow to investors from the control being vested in this particular person.

Steve Peikin: The Musk/Tesla case, similar, it has a series of corporate governance reforms and enhancement to controls and procedures that are designed to address the particular harm and problem that we allege in that case which was communication practices which were disruptive to the market and the lack of control over them. So I think what one of the principles that we laid out as guiding our decision making as Co-directors is to try to have relief that was thoughtful and tailored to address the particular problems. And I think if you look, these are relatively high profile examples of that. But if you look across a lot of the work that we're doing, we're not just saying well we're going to get that because we can or we're going to assess large penalties so we have a big pile of them at the end of the year. That's kind of how we're thinking about it.

Stephanie Avakian: No, that's exactly right. We really are thinking about what relief is most important in this case and why. What do we think addresses the problem? And that's exactly what Steve said.

Susan Resley: And as we've spoke today, you've provided some insight on some key cases and as you know, we will be seeing the annual report with the statistics. Can you give us any preview of what we may expect to see with respect to trends or anything along those lines?

Steve Peikin: Nobody's going to go see the movie if we do that, right?

Stephanie Avakian: Probably too soon to tell. I'm not sure. Look, we've been pretty outspoken about the fact that you shouldn't pick a specific time period and draw inferences from it. So I'm not even sure a year is a long enough time period to look at and say, well the trend is this or the trend is that. But it's fair to draw some conclusions about the work that we're doing. I think we just ... what we're going to stress in our annual report and will continue to stress as we speak publicly is really the impact of the actions, substance of the actions, the quality of the actions, and we do believe that for every case the Commission brings, people should be able to read that case and understand why the Commission brought a

case, what the Commission's message was, what the conduct was that was troubling to the Commission. That's what we're striving for.

Stephanie Avakian: I think probably no change in trends in terms of level of individual accountability continued to be a high priority. I'm not sure it will be this many more cases or that many fewer cases as opposed to prior years. Probably pretty close. A lot of stuff is probably fairly close in terms of looking at over a long period of time. But I think individual accountability was a big thing for us this year. I think we brought a number of cases, higher profile cases that said that including the Tesla case, including Theranos, including the litigated case we brought against Rio Tinto and its former chief executive, the case we brought recently against Walgreens and its former senior executives, the case we brought against Salix and its former senior executives so I think and there are a whole bunch of others, but I do think that will be, whether it's a trend that shows up when you look at all the cases, I hope that people look at the substance and say, we really took that very seriously.

Susan Resley: And we're three days into the current fiscal year, but can you give us a sense of what the priorities are or what are some of your goals?

Steve Peikin: I mean, look, this question is ... we get it all the time. And to some degree its an odd question because, and I'm not criticizing for asking it, but-

Ben Indek: I wrote it, it's okay.

Steve Peikin: Yes, no. Look, the things the Enforcement Division does year over year, 85% of it is constant. We don't ... nobody can come and sit in these seats and say "Yes, we're not really interested in Ponzi schemes this year." We're always going to do those. And we're always going to do offering fraud, and we're always going to do financial statement fraud and insider trading and FCPA and all those things. So really, I think you shape it around the margins a bit. I think this year, I think we're going to see the share class selection disclosure initiative come to fruition this year. I think you're going to see significant developments in the cyber space because that unit was just stood up and is just out of its toddler phase I think now and is learning to run. But there are a lot of investigations, and those are moving through the pipeline. And I think we'll continue to see actions as Stephanie talked about against individuals and [inaudible 00:52:55] disclosure, etc.

Steve Peikin: The one thing you can't really control for is we're living in a relatively calm market environment and stable market environment where we have very high asset values and so a lot of trends of intense enforcement activity come in the wake of a change of that. I'm not looking for market cataclysm, but if there is some event in the market or around asset values then maybe our priorities will get pushed, and we'll be reacting to that. We just don't know.

Ben Indek: Can I come full circle as we end here? Tim and Jane talked about this being part of the SEC Historical Society and preserved for future, and we couldn't let you go without asking for you to comment on what your legacy, what you want your legacy to be when you move on? You come in a long line of outstanding Directors of Enforcement and when you look back on your career or others do, what do you guys want to be remembered for?

Stephanie Avakian: I think it's still too soon to tell, but I hope that people look at it through the prism of the five guiding principles that we set out in our annual report last year, because that is how we think about things, and I hope folks look at what we do and say it made sense. They brought good cases. We understand why they brought those cases. The remedies that they sought most cases made good sense. We'll probably have a more developed view a year from now, but I don't know. Steve?

Steve Peikin: Yes, I just hope people don't remember me as Stephanie's deputy. That's my principal goal.

Stephanie Avakian: I won't.

Steve Peikin: No, seriously, beyond that. If I look back to, I don't have the longest historical lens, but if I look back on what Andrew did that made a lasting impact was he made some terrific personnel decisions and left us in a position with really strong and improved staff. Before him, Rob made some tremendous structural changes to the division that I think really impact the way we go about doing our work every day. Hopefully we'll leave the division in a better condition than we found it, and we'll have empowered the staff to do their jobs more efficiently, more effectively than they were the day we walked in the door.

Ben Indek: Okay. Well, thank you both. This has been a terrific panel and we really appreciate it. Thank you very much for coming.

Stephanie Avakian: Thank you.

Steve Peikin: Thank you, too.