Q & A with SEC Enforcement Division Co-Directors

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Cobb: Welcome, those of you here in the room and those tuning in from around the country and perhaps other areas of the world to listen to this program via webcast. My name is Jane Cobb. I'm the executive director of the SEC Historical Society. We're a 501(c)(3) nonprofit organization whose mission is to preserve and to make available the history of our securities markets, one of the key underpinnings, I believe, of our nation's economy. You may find our collection of unique manuscripts, themed galleries, oral histories and programs like this in the virtual museum at www.sechistorical.org, which is where you are right now if you're tuned in to the live webcast.

Cobb: I have the pleasure today of introducing our panelists. Our featured guests are Stephanie Avakian and Steven Peikin, co-directors of the SEC's Enforcement Division since June of 2017. Before being named co-director, Stephanie had served as acting director since December 2016 and before that, she was the Division's deputy director serving from June 2014 to December 2016. Before being named deputy director, Stephanie was a partner at Wilmer Cutler, where she served as a vice chair of the firm's securities practice. Stephanie previously worked in the Division of Enforcement as a branch chief in the SEC's New York Regional Office and later served as counsel to former SEC Commissioner Paul Carey. Stephanie received her bachelor's degree from the College of New Jersey and her law degree from Temple University's Beasley School of Law.

Cobb: Steve, before being named co-director, was managing partner of Sullivan & Cromwell's Criminal Defense and Investigations Group. From 1966 to 2004, Steve served as an Assistant U.S. Attorney in the Southern District of New York where he was Chief of the Office's Securities and Commodities Fraud Task Force. Steve received his bachelor's degree from Yale and a law degree from Harvard Law School.

Cobb: Merri Jo Gillette, our moderator today, is Deputy General Counsel of Edward Jones, responsible for regulatory corporate filings and risk. She joined Edward Jones in October 2017. Prior to joining Everett Jones, Merri Jo was a partner at Morgan Lewis, where she led the firm's securities enforcement and litigation practice. Prior to that, she had a 27-year career with the U.S. Securities and Exchange Commission, including serving as head of the SEC's Chicago regional office from 2004 to 2013. She also held a number of enforcement roles, Philadelphia regional office from 1986 to 2004. Merri Jo earned her law degree from Dickinson School of Law in Carlisle, Pennsylvania and her bachelor's degree from Northwestern University here in the Chicago area.

Cobb: I want to thank you all again for joining us today. I'd like to ask those of you in the room to please hold your questions so that we're able to stick with the allotted webcast time frame. Again, thanks for joining us today. With that, I'll turn it over to Merri Jo Gillette.

Gillette: Thank you, Jane. I want to add my thanks to yours and those of others to Steve and Stephanie for making the trip out here. I'm sorry we couldn't deliver a sunny day because sometimes sunny days in Chicago in the fall are really delightful but we're here.

Avakian: [crosstalk 00:03:55] if we get home.

Gillette: So do we, not because you're not welcome to stay but we want you to be happy.

Gillette: So, I thought we could start out, since the Commission just experienced the end of the fiscal year, really asking you if you could give us a preview of what your view is of the takeaways from fiscal year 2019 and I know that typically the Commission puts out an annual report that reflects that at some point after the end of the year and I assume you'll do that this year but any highlights that you could share would be appreciated.

Avakian: Yeah. I mean, we should start by giving our standard disclaimer that the views we express today are our own and do not necessarily reflect the views of the Commission or the Commission staff.

Avakian: So, with that out of the way, yeah. The preview is, and we will put a report out. Our best guess is probably around the first week of November we'll put out what will now be our third Division of Enforcement annual report and look at was an incredibly strong year. I think, from a substantive perspective, we saw really a broad swath of cases across the entire landscape. Obviously, consistent with what we've said publicly and with what the chairman has said, a great priority is placed on protecting retail investors. It always has been at the SEC, so that's not new of course, but we obviously had a handful of initiatives in particular areas of focus over the last year where we try to really showcase that. Then, I'd say you see a broad range of cases that goes all the way over to the more traditional bread-and-butter type financial fraud, disclosure, accounting cases. We had really a substantial number of really strong ones in that regard as well.

Peikin: Yeah. I mean I think the only thing I'd add is sort of another significant priority for our Chairman is some cyber and keeping pace with technological change. So, we've seen that displayed in cases involving cyber intrusion and go to have appropriate disclosures and controls over cyber-related issues and also in the separate, in the initial coin offering space, where I think, when we look back on sort of the way the Commission and the Division of Enforcement have addressed this sort of brand new product that exploded, starting in 2017, I think

we're proud of the thoughtful and incremental way that we've addressed issues there. I think we worked really significant change to the marketplace behavior. That was displayed again last year where we did some things that hadn't been done before.

Avakian: Mm-hmm (affirmative). The one thing I guess that I would add since this is a Historical Society event is the shutdown was obviously a meaningful event government-wide but certainly for us being closed 35 days was a big deal. That's not just 35 days. There's obviously a tail on that, as everybody who's in this room knows, just in terms of scheduling and getting back on pace but I think we feel … One of the things Steve and I have been very focused on over the last couple of years is thinking about different ways where we can bring cases to conclusion faster, different ways we can get resolutions done more expeditiously.

Avakian: I think when we look back over this last year, obviously we're down roughly 10%, it might be a little less, it might be a little more, in terms of personnel from where we were, say, two years ago or two and a half years ago when you think about where we are on personnel, the fact that the government was closed for 35 days in the middle of the year, we expect our productivity to be fairly in line with where it's been traditionally. So, we think that really ultimately is a testament to the fact that people are very focused on getting these, figuring out how we get to the resolutions we need to get to as quickly as we can.

Peikin: Yeah. I think one of the things that the shutdown, it wasn't much of a silver lining in the government shutdown, but one silver lining was a lot of our staff, I think 95% of our staff was not legally permitted to work. It was a real source of frustration. People were really, really anxious to get back to do their jobs and I think very frustrated by their inability to be able to continue their work. I think that actually says a lot about the people that we have and their commitment to our mission. We've said to the staff that we're fortunate to do a job that's meaningful and I think a lot of people in the law and elsewhere sometimes, it's a challenge of struggling to have to do impactful work. At the SEC, it's an incredible privilege to be able to do things that make a difference in that.

Gillette: I agree with that from personal experience, but so sort of bringing that around full circle and looking ahead to the next fiscal year, what can you share with us about what's on the horizon and what the Division's priorities are going into the next year?

Peikin: I don't think you should expect to see a big sea change from last year to next year. I mean, you take a step back, we have such a broad landscape that we're expected to enforce and police. So, regardless of what year it is or whose sitting in these seats, there's going to be huge commonality in the work of the Enforcement Division year over year. Were always going to do insider trading and operating frauds and Ponzi schemes and Foreign Corrupt Practices Act and all that. That's going to take up the bulk of what we're doing. I think you'll

continue to see additional focus in the cyber and ICO space and also in respect of sort of the disclosure conflict of interest-type cases.

Avakian: No. I don't think I've anything more to add. I think in terms of how we do our cases, and, as I mentioned earlier, just sort of trying to get to the end game faster. Whether that end game is a resolution, whether it's litigation or whether it's a closure but getting to it faster. I think we've spent a fair amount of time on that and I would expect people to see that in their dealings with us in terms of, I think the staff trying to give and maintain itself tighter timeframes and other things that I would expect, investigative steps that may be traditionally you've seen sort of happen sequentially start to happen more simultaneously and things like that.

Gillette: Right. So, to shift things a little bit and pick up on something you've said a couple times already, Steve, focusing in the cyber space, it was just about a year ago that the Commission came out with a cybersecurity press release in the 21(a) report, which made it very clear that the Commission's view was that public companies have obligations to maintain sufficient internal accounting controls to appropriately address the threat of cyber fraud.

Gillette: So, in that context now being a year out from that report, wanted to ask you some questions from where you're sitting and what you've seen and whether it's working or is having the impact that you had hoped for.

Gillette: So, the first question I have is whether the Commission would expect the board of a proper company to proactively oversee cyber-related policies and procedures?

Peikin: I don't think that there's anything in the report or otherwise that's prescriptive about how a company has to manage cyber risk, but I think it is incumbent on the board to ensure that cyber risks, which I think are the greatest threat that American companies and the issuers face. So, whether that's by ensuring that management is addressing it or themselves getting involved, I don't think that certainly in the Enforcement Division, we have a view on what the right approach is.

Gillette: Do you have a perspective based on what you've seen in investigations in the last year about how the range of ways companies are doing this and whether you are seeing some boards doing that sort of proactively?

Peikin: Don't know that we have a whole lot of visibility in that.

Avakian: No. I don't think we do.

Gillette: And sort of along the same line, would the Commission expect companies to have a rapid response plan at this point and a team to deal with breaches?

Peikin: So, I think the way we come at it, sort of different approaches for registrants and non-registrants, so there's a prescriptive requirement of procedures that govern the registered community and then issuers are really just governed by the obligation to have appropriate disclosures of material events. The one case that we brought, the Commission has brought in the context of a cyber breach is a case against Yahoo, the successor to the [crosstalk 00:13:18] Altaba. And I think before that case, we had been saying that, I think, in the Enforcement Division, we're sensitive to the issue that companies are victims of crimes when they're in the subject of cyber intrusions. So, I think we have to be very careful and exercise appropriate judgment and restraint in deciding whether someone's conduct was so egregious, notwithstanding they've been the victim of a crime, we nevertheless should be bringing enforcement action.

Peikin: We posited that we could imagine a set of facts that was so egregious that notwithstanding the company's victim status, it'd still be appropriate to bring the case. I think, if you read the Yahoo order, that is such a case, an absolute wholesale failure, a discovery of a cyber event and virtually no effort to determine its scope, its cause, its breadth, or to determine whether or not it should be disclosed.

Peikin: So, that is certainly kind of one loadstar that's out there but I think you also can look at what's happened and obviously most or many American companies have been and issuers and reporting companies have been subject of cyber events. We've sued one of them. So, I think that says something about the way we're thinking about the problem.

Gillette: But, [inaudible 00:14:37], I'm going to ask you the same question slightly differently. If, as you evolve your thinking in this space, and I probably should have asked it this way to start with, as opposed to saying there's something wrong with not having a rapid response plan and team, the question I would have is, if a company does not have a rapid response plan and team, would the Division consider it something that should be disclosed?

Avakian: I think it's really not for us to sort of broadly say what should or shouldn't be disclosed. The Commission has issued guidance on disclosure and those issues. As Steve said, we've brought one true cyber breach disclosure case. I think what we have said publicly is we certainly expect and urge companies to report to appropriate law enforcement. We expect appropriate steps to be taken and, as Steve said, there's a materiality requirement in terms of disclosure.

Avakian: There may be other disclosure obligations. For example, the Facebook case we brought last year, while I don't really put it in a cyber category, is instructive because they had a risk factor. The risk that was spelled out in that risk factor came to pass but it was still presented as a hypothetical. That was the basis for our action against them. I think that's instructive in the cyber space, right?

Gillette: Mm-hmm (affirmative).

Avakian: If you're saying this thing could happen and then this thing has happened, you need to think about what your disclosure obligations are. I think the takeaway for companies in that regard is you need to make sure you've got a process in place so that the people over here who are handling whether it's breaches, whether it's privacy issue, whether it's ignition switches, whatever is over here, if the bad thing's happening, the people who are over here who have an obligation to make sure the disclosure's accurate, to make sure risk factors are up to date, there's some form of communication in there. There's some process.

Gillette: So, I'd like to go back to the Facebook case for a moment, because I have a question about that. So, as I understand it from reading the public papers, Facebook actually did make disclosure. They disclosed it as a hypothetical risk or something that I think the Commission has referred to as a hypothetical risk in some of its public statements about the risk of misuse of Facebook user data but they knew, they had actual knowledge that they had a third-party developer that had actually misused the data.

Gillette: So, my question is have they been completely silent, if they hadn't disclosed at all anything about the risk of the use of user data and it's been the same series of events happened in the wake of that, would the Division take the same view of the disclosure failure or is it because they chose to speak but they didn't actually speak in a comprehensive and honest way?

Peikin: Nobody said there were going to be hypotheticals at this even today.

Gillette: Well, you can decline to answer.

Avakian: No. Look, it's always going to be based on the facts and circumstances and so hard to say what would happened with a different set of facts.

Gillette: Okay. We'll leave that for now.

Gillette: This next question really relates in the context of the sort of internal controls approach to disclosing risk or cyber risk, whether you have seen any change or any evidence of change in how outside auditors are conducting its audits of public companies and public company risk in this area in particular.

Peikin: Yeah. Just don't think that's an area that we have much visibility into. The 21(a) report around business email compromise that the Commission issued earlier this year think looked at business email compromise from the perspective of internal accounting controls. One of the core elements of having adequate internal controls over financial reporting and internal accounting controls is you have to make sure sufficient framework so that transactions are conducted in accordance with the management's direction, right?

Gillette: Mm-hmm (affirmative).

Peikin: And so it looked at these situations, some of which were incredibly egregious, where people masquerading as the CEO got the CFO to send, I think in one case, tens of millions of dollars out the door to fraudsters as sort of reflecting a lack of that sufficient control structure. I just don't think we … It takes some time for us to kind of get the echo back to see whether that message has been received or not. So, I think it's probably too soon for us to see, to tell whether there's been any reformation of behavior as a result of that report.

Gillette: Understand. So, I think you may have answered this already in terms of when you spoke about the extreme scenario and the reason that the case was brought or some of the reasons that the case was brought against Altaba but the question is really can you envision a set of circumstances in which the Commission might bring a failure to have adequate internal controls around cyber risk as a standalone violation without other facts or violations as an enforcement matter?

Peikin: Well, we have pretty creative imaginations, so I don't know.

Gillette: So, you can. Is that the answer?

Peikin: I think it's hard to say definitively what we would do in that situation.

Gillette: Okay. All right. Maybe we can step back a little bit from the cyber topic and just speak a little bit more broadly about public companies and some of the disclosure cases that have been brought in particular over the last year. I want to focus our discussion initially on what I would call non-financial disclosure cases. So, the disclosure failure as opposed to being focused on an accounting treatment that was inappropriate or some kind of fraud in the numbers per se really related to some other set of facts, which might have also had an impact granted on the financials of the company. It seems like there was, I don't know if it rises to the level of a trend, but certainly there were a couple of cases in the past year where the SEC was willing to go after companies for what I would call non-accounting disclosures, including sort of piggybacking on what appeared to be corporate liability with other regulatory agencies and schemes.

Gillette: So, a couple that come to mind for me in that category are the case against Volkswagen, case against Milan. I guess my question is is this a trend that we should expect to see more of and what do you want those who are internal at public companies and responsible for disclosure and their outside advisors to really take away from the cases that were done this year?

Avakian: I guess a couple of thoughts. One, I don't view the description of the conduct of something new in terms of something we're enforcing, right?

Gillette: Mm-hmm (affirmative).

Avakian: I think this is pretty typical and pretty bread and butter in terms of company has a problem that's related to whatever piece of their business and maybe they have an issue with another regulator as a result and whether it's the EPA or some other government, whatever it is and they fail to make appropriate disclosures about it to investors. Then, when oftentimes when the thing does become public, it's obviously material as to the company's securities. That's not unusual for us to bring those cases so yes, you've pointed out a couple that we've brought this year. I think they're probably more that was brought this year as well.

Gillette: Yes, there are.

Avakian: I would expect to continue to see us bring those. I think you suggested the Volkswagen case was piggybacking. I mean, I think we try to be pretty careful not to be, whether it's piggybacking or piling on or whatever it is. I think we've some pretty detailed court filings and it's an active litigation, so I don't think we can get into a lot of detail but we've got some pretty detailed, publicly available court filings that lay out I think pretty concisely our view of why I wouldn't characterize this as kind of a piggybacking-type case.

Peikin: I think one of the things that we very consciously been thinking about is if we're going to be involved in a case there should be a really good reason why that's consistent with our statutory mandate. What I think we both kind of viscerally resist is the idea that there's an alphabet soup of agencies that are clustered around the problem. We want to be there, too, if there's a reason for us to be there, because there's a harm that's going unaddressed or because it implicates sort of our core investor protection in the disclosure mission, then we may well be there alongside a lot of other people but what we're not doing is saying, "This bad thing happened at a public company and they didn't tell anybody about it, therefore we must be there doing something because of a non-disclosure." That may well be a case and there plenty of instances where that is an appropriate case but not every time.

Gillette: So, is it fair to say, at least with regard to those two cases, to summarize and say that the reasons were, that there was some kind of, in the Commission's and the Division's view, some kind of disclosure failure that was material and that affected U.S. investors at a minimum?

Peikin: Yeah. Absolutely. That's the core of the allegations in those cases.

Gillette: What I would think.

Gillette: So, on Milan, though, I want to go back to that for a minute because I think, again, reading only what's publicly available, if … I may not have all the information but as I understand it, in Milan, there had been a DOJ probe ongoing for a couple of years. Ultimately, it was into whether Milan had overcharged Medicaid for its EpiPen. That was its single largest source of

revenue and I guess most important product. Those are my words, not theirs, and, that, if you look at the Commission's releases and the complaint, it seems to suggest that the fact that the company was facing what turned out to be a pretty large settlement with DOJ should have been disclosed, whether the fact of it should have been disclosed, or whether it should have been reflected in a loss contingency or an accrual for an estimated loss. Frequently, those types of DOJ investigations in particular are being conducted in a non-public way.

Gillette: I guess the question with that long introduction is, at what point when you, as a public company, are engaged in a as yet not resolved or quantified or public investigation by another regulator, whether it's U.S. or international, in the Commission's view, does that obligation to disclose or reflect in some way in the lost contingency and the accruals?

Peikin: I mean, I think the answer is an accounting question, not a view of the Commission. It's the compliance with ASC 450, which, as you know,-

Gillette: Right. Agreed. Probable and estimable.

Peikin: ... depends on whether it's probable and estimable, right, or whether it's more likely than remote that there will be a resolution. You know, there's a set of questions-

Gillette: Mm-hmm (affirmative).

Peikin: … that have to be answered. I think if you look at the Milan case, the Milan case doesn't say every time there's a DOJ investigation, it has to be disclosed. What it does say is, as that investigation develops into a material event, probable material event, and after you put money on the table to settle it, the idea that you don't disclose or accrue is inconsistent with the way ASC 450 operates. I don't think that order draws any kind of bright line as to the moment when that disclosure has to occur.

Peikin: I would say one interesting thing about the Milan case was Milan, as you would expect, had a whole variety of different government investigations. This was the one that wasn't disclosed while many others, which were apparently less serious and less advanced, were disclosed.

Avakian: That also had a risk factor disclosure in that as well. I just sort of points to it because I talked about it a little bit earlier but it was sort of another one that said, "The government may disagree with our categorization," or something like that, when in fact the government had, as we allege in the complaint, told them that [inaudible 00:27:46].

Gillette: Right. Yeah. I was actually going to ask that as my next question, whether that was a factor at all. So, all right.

Gillette: Well, moving away from that a little bit but really still sort of sticking with this topic of non-financial disclosure cases, wanted to ask about Nissan and Ghosn, the CEO or former CEO, and also, again, Volkswagen I think would fall into this category. That is really to understand the Division's thinking about allocating enforcement resources to and bringing cases where really you're dealing with foreign companies, companies that are located elsewhere. The hook, I presume, in both cases is either the willingness to go after them based on either corporate bond offerings that are ongoing or corporate bonds that are being traded or ADRs that are being traded in the U.S. Just, if you think of that as sort of a separate category that's of importance and the thinking behind that or whether, again, it just sort of falls in line with the court cases and all of the factors that you look at in every case.

Avakian: Yeah. I think it goes back to what you sort of posited not that long ago. These are U.S. investors. I'm not sure … I mean there are different product but they're U.S. investors, and so I'm not sure that we take a particularly different view because it's an ADR versus being traded on the New York Stock Exchange.

Peikin: Yeah. I mean, I think it's one of the things that we think about when is there a significant interest or impact here that warrants-

Avakian: What is it?

Peikin: … the devotion of our resources. So, I think the question you ask is a fair one and one that we ask ourselves. In those two cases, obviously we concluded that the balance tipped in favor of expending resources but there are many others where the impact is non-material, I don't mean that in the capital M but with a lowercase M that we wouldn't think that's an appropriate expenditure of resource.

Gillette: So, I guess, to push on that a little bit, and not to disagree but another way to look at this issue of the decision to expend resources on those types of cases whether it's these that are non U.S.-based companies, I'll put it that way, so foreign. I think that's politically non-correct today, which I apologize to anyone who's offended but also the prior category that we were talking about where there are other regulators or law enforcement folks that are already going after a company, U.S.-based or otherwise, for underlying conduct whether that … What is the additive piece, recognizing that you can get different sanctions and that you do have a legitimate mission-driven reason for going after them, for going after those cases when eventually those facts are being developed, they're likely going to come out. I don't know if you even make those decisions but how do you weigh that sort of from the Division's perspective?

Peikin: It's really the same answer that in respect of sort of getting involved with multiple U.S. agencies, which is, is there an interest that we can vindicate and that merits the devotion of resources? The fact that a foreign regulator or enforcement authority in maybe its primary jurisdiction or can achieve results

for the broad group of investors, that may be enough to make us conclude that it's not worth getting involved in but oftentimes that isn't the case and we conclude otherwise.

Gillette: While we're on this general topic, I wanted to turn for a minute to the experience and also thinking of the two of you on bringing enforcement cases against individuals and gatekeepers and particularly in the financial reporting and certification process space. Obviously, there are ample bases on which you could do that under certain fact patterns. I think the ultimate question, when we're talking about individuals, is when does the division consider suing them and really what are the factors that come into play in making that decision?

Avakian: I think, broadly speaking, we consider whether there are individuals in every case. I mean, we're always thinking about that. There may be a small number for which it's sort of obvious right away that that's not the case but typically that's going to be a front burner question for us. Now, there are some category of cases where we ultimately charge only the company. It's typically circumstances where the conduct or the problem that was at issue really is ... There's not one or two people who are responsible, right?

Gillette: Mm-hmm (affirmative).

Avakian: This is diffuse area of responsibility, the company lacked the proper structure to deal with a disclosure issue or lacked policies and procedures or something like that. It really is not appropriate to hold any one or a small number of individuals responsible, but for the most part, I would say, roughly speaking, over time and it goes up and down but roughly 70% of our cases include charges against individuals over time. So that's a pretty high number.

Avakian: I think it's fair to say that in any case where we see the evidence of individual wrongdoing that rises to the level of whether it's a fraud charge or something else, we pursue it. I think, look, we've said this. We say this in our annual report and we've said it publicly lots of times. We really do think individual accountability is critical in an effective enforcement program but we also think it's probably the most critical deterrent in terms of the term other conduct by other people.

Gillette: What are the challenges that you have faced in terms of holding folks in the c-suite responsible for high-level fraud? I mean, two of the cases we've talked about, Volkswagen and Nissan, you did, in fact, sue the former CEOs in those cases but I don't think the world's changed that much since when I was there that those are always tough cases to make, or I shouldn't say, "Always," but frequently.

Peikin: Yeah. I mean, but the challenges are that those individuals are often highly incentivized to fight charges, because they can be career-ending or otherwise. So, I think when we contemplate charges against individuals, we have to be

prepared to litigate them. We settle a lot of cases against individuals but some people choose to challenge those cases. We have to be prepared to go forward and prove them, if we're going to threaten them.

Gillette: Mm-hmm (affirmative). Okay. I'm going to slide back a little bit towards technology for a minute here. Just a couple additional questions I wanted to ask you there and particularly around emerging technology blockchain and even more so cryptocurrency. You already have referenced the cases relating to ICOs. It seems to me that at least some of those have been straight-out fraud cases. You had the Floyd Mayweather and Khaled Khaled for failing to disclose compensation for promoting, but more recently or maybe throughout the year but certainly one that just caught my attention. You've also brought some pretty big actions against non-fraud violations and I'm thinking most particularly, even though it's technically in this fiscal year, the case against Telegram Group Inc. that was just filed about a week and a half ago as an emergency matter in the Southern District and wondered if you could talk a little bit about, from a programmatic standpoint, what is your strategy? I mean, I assume if you see fraud, you're going to try and go after that but reaching into areas like unregistered digital offerings is …

Peikin: I think the enforcement of the registration provisions is a critically important part of what we tried to accomplish here. The reasons are pretty simple. So, in 2016, I think there was a hundred million dollars raised in initial coin offerings. I think the number was like 15 billion or something like that in 2018. So, just an enormous explosion. A lot of that was being sold to U.S. investors. If the thing that you're selling, no matter what label you put on it, if it meets the definition of an investment contract, you can't sell it to the U.S. investing public unless you're exempt from registration and not provide any disclosure of the kind that U.S. investors are entitled to.

Peikin: When you think about the volumes, the amount of money that's being raised and the absence of even the most basic kinds of disclosures that we're used to seeing in connection with an investment product like who is the management, what is the business, what is the financials, what are the risks? That cries out, I think, for enforcement.

Peikin: So, I think you've seen us do a whole range of things in the registration space including suing to enjoying company from distributing when we can tender unregistered securities, litigating with Kik Digital over a non-registration issue and then resolving cases that provide sort of a pathway to compliance. Those were the Airfox and Paragon and I think maybe one other case-

Gillette: Mm-hmm (affirmative). [inaudible 00:37:57].

Peikin: … where the Commission laid out, having made an unregistered distribution, how do you get into compliance with the law? So, I think those are an important framework for what we've done.

Avakian: Yeah. I don't have much to add to that. I think just going back to one piece, your question, which is what's your strategy? I think even taking a broader setback. Steve covered all this stuff we've been doing but we really did approach this strategically. So, if you think about it, from day one, the first thing that the Commission did was the 21(a) report on the Dow and sort of laid out here's the framework, here's how we're thinking about it. Same security, same concepts, same laws apply. We sort of try to move forward strategically. As you said, fraud cases, when we see the fraud cases and can bring the fraud cases and we did a lot of traditional stuff like training suspensions and other things but in the non-fraud or the stuff that it was a mix, we really did take a step back and say, "How can we be most impactful? We cannot bring every single case that's out there. Maybe someday we can, but right now we can't bring every single case that's out there. So, let's bring some in each thing that's likely to reverberate and really send a message."

Avakian: So, Steve said, "You can look at them across a spectrum," like the first I think standalone Section 5 we brought I think was Munchee, which was they basically within a day gave all the money back and sort of did everything you would want a cooperating entity to do. We did that as a no penalty case. Then came Airfox and Paragon I think. Ultimately Gladius that had a pathway. We had the case, as Steve said, Kik and now Telegram but we also did some other things in there in addition trading suspensions. Well, I should say, as you said, the 17(b) cases that we brought against the promoters. Then, we did some platform cases, which I can never remember what the platform case is called but I'm sure I have it in my notes here somewhere. It's like … No, it's like … Oh, there. Wait. Wait. I see it coming. TokenLot and there was one other one, where looked at the platform and the ICO Superstore and that whole thing, but then we did some very unique things that we hadn't done before as a division we thought that I'm aware of like making public statements. So, coming back to the 17(b) cases and the Mayweather and DJ Khaled, before we brought those cases, we put out a public statement after the … There was a Times article?

Gillette: Mm-hmm (affirmative).

Avakian: There was some article that sort of laid out that all these promoters out there promoting this [inaudible 00:40:30] don't know if we're getting paid. We put out a public statement that addressed two constituencies, one addressed people who were getting paid to promote and the other was investors. We saw a complete drop-off in the social media presence of this sort of promotion. Then, ultimately we brought a case but I think, in this space in particular, we've issued now a couple of public statements. So, we've tried to think creatively, out-of-the-box, differently, whatever it is. We're not that creative. So, I mean, a public statement is not that earth-shattering.

Peikin: We're not lawyers, after all.

Avakian: But we did try to think about what are ways we can signal to the market how we're thinking about this.

Gillette: Okay. Why don't I shift gears a little bit and talk about some process and policy questions or I think of them that way anyway and just get some feedback from the two of you on them. So, to start out with, I just wanted to ask a little bit about some of the self-reporting initiatives that you have done and most recently of course as the share class reporting initiative and really just interested in your perspective on the benefits and the challenges and should we expect more to come?

Avakian: So, the benefits and the [inaudible 00:41:47] sort of tell you why we did it. This was a problem that we kept seeing, so we've been bringing cases in this space for a number of years. We went and sort of looked at how long it took us to bring these cases and saw that, on average, it was taking us 22 months from opening to resolution. OC kept seeing this problem as it went into registrants and kept referring them to us. So, we had probably at least a dozen open ongoing investigation but when we sort of sat back and said … We sat down with the asset management unit folks and said, "What can we do about this problem," because we could devote just crazy resources and be investigating these things till the end of the time and came up with this initiative. From our perspective, it's been wildly successful. It was created in order to do two things. One was get money back to investors and two, incentivize as many people as possible to come in.

Avakian: So, I think all in, we've brought 90 some cases. We've ordered the return of over 135, almost $140 million to investors. I think there'll be some large number of investors who ultimately got moved into the non-prepaying share class, so will reap benefits for dividends from that for years to come.

Avakian: So, I think from our perspective, it's incredibly successful both in terms of getting money back to retail investors but also we did it in a year, probably a year and a month, if you count the shutdown so but we did it in a year. That was a great use of resource. I mean, if you think about one or two people being devoted to each of these cases for 22 months on average, this was really a way to do something very impactful effectively and quickly. So, from that perspective, we view it as a huge success.

Avakian: Now, there's not a lot that obviously lends itself to this sort of initiative. We've done other initiatives in the past. I wouldn't rule out ones in the future, but it takes sort of a unique set of circumstances for this to work I think. Even this, look, every firm or at least a lot of the firms came in with different arguments and different ways of calculating numbers and different ... So, this is not okay an obvious cookie-cutter situation but I think it's the kind of template that can work in the right circumstance.

Gillette: Mm-hmm (affirmative). Do you make the production or a process, for lack of a better verb, the initiative that if a firm self-reports, they're absolutely getting an enforcement outcome? I mean, I realize that's part of the incentive to participate but is there any effort to analyze and consider …

Peikin: Yeah. We had normally elected not to bring some cases against self-reporting entities for a variety of reasons including-

Gillette: What were the types of variables that might have weight?

Peikin: The de minimis ones, primarily. We had a de minimis threshold that we concluded wasn't worth bringing an action against, but some of the reporting companies had disclosure that they argued was adequate and we ultimately agreed that it didn't merit an enforcement action, so but I think the thing about the initiative, we laid out clearly up front obviously what the terms were. You were going to be sued on this charge and you were going to have to make disgorgement but you were going to forego having a penalty assessed against you or other charges assessed against you. I think, realistically, we thought the initiative was designed to incentivize self-reporting but we weren't sure. When the day came for the deadline, we had our fingers crossed hoping somebody would self-report. It turned out to be … We actually had a broker-dealer. I think two broker-dealers self-reported. They weren't ineligible to report. It was only for investment advisors, so it was more successful than we ever even thought.

Gillette: Okay. That's great. Thanks. I want to for a minute to hold over and then [inaudible 00:46:08] would love to hear from one or both of you from your view on sort of when are the appropriate and how is [inaudible 00:46:16]?

Peikin: So, I mean I think with the issue of tolling has had a spotlight shined on it by Kokesh and we're operating under even the knowledge that some of our most important relief may not be available after five years. What I think we don't want to see tolling agreements used for is, "I can't possibly do this investigation in five years so I need a tolling agreement so I have more time to do it." That's not how we're thinking about it. What we're thinking about it primarily is we know on day one that there might be disgorgement available and that will be lost during the two years that it takes us to complete this investigation. In those circumstances, we think it may very well be appropriate to protect this money that would ultimately go back to investors by having tolling agreement but we continue to … We have a centralized approval process for tolling and go through our office.

Peikin: So, I don't think any of us want to see every subpoena that is served come with a tolling agreement stapled to the back of it but the reality is that a Kokesh decision imposes additional burdens on us.

Gillette: Has there been any discussion or consideration of whether you could do sort of a targeted tolling agreement, so for example that you would draft the

agreement in such a way that the recipient, excuse me, would agree that they would toll the statute on your ability to collect disgorgement, assuming that you can make the underlying case?

Peikin: Okay. I can't say we've given any thought to that issue.

Avakian: Yeah. No.

Gillette: Okay. Just threw it out there.

Gillette: I have heard that, on occasion, counsel for targets … Well, I know you don't have targets. People who you are investigating receive calls from the staff seeking a tolling agreement and it's sort of put forward as a way to continue to demonstrate cooperation with the investigation and sometimes explicitly with what I'm going to call, what feel somewhat like threats that if you don't, that there's going to be an expedited investigation and deliberation.

Gillette: So, I guess that my question is, from the standpoint of a perception of fairness of your process, is that a sanctioned approach, number one, and number two, do either the Division or the Commission, however you get people into a tolling agreement or however, even if they just agree on their own, view that as cooperation when it gets to the Commission and it's being reviewed on an enforcement recommendation?

Peikin: Yeah, I certainly don't think either one of us equate tolling with cooperation. I think we think about those things differently. I will say that absolutely if we know that we are potentially losing available relief and you appropriately within your rights say, "I'm not going to toll," you can expect that you're not going to be afforded all the courtesies that you would to spend nine months collecting and producing your email.

Gillette: We are going to move fast.

Peikin: Yeah. We're going to move fast. I mean we had a case that I can think of where we were losing disgorgement every day. So, when the recipient refused to toll, we welcomed that day. We may be faced with the situation where we'll conduct our investigation using sort of civil discovery process rather than forego available relief. So, I don't think, while it's certainly … There's no legal requirement to toll and you're giving up a legal right when you toll or you may be. So, it's certainly within your purview to decline but you can't expect that-

Gillette: We're just going sit there.

Peikin: … we're just going to sit here and you've got vacation plans. Those aren't going to weigh very heavily on [crosstalk 00:50:40].

Avakian: On the cooperation point, though, I think it's a little more nuanced. Actually, talk it through just a little bit. One, as Steve said, it's certainly not our perspective. We should not be asking for a tolling agreement to show cooperation. I think each company, each individual, each entity, whatever it is. If somebody wants to cooperate and wants cooperation credit at some point, they need to figure out what they're comfortable with and how they … Certainly we're happy to have that dialogue. What would be helpful? What wouldn't be helpful? But people shouldn't be asking for tolling agreements as evidence of cooperation or to show us you're cooperating.

Avakian: Now, that said, there's a flip side of that, which is that, in fact, if someone has given us a bunch of tolling agreements, we should view that favorably when we get to the end of the road. That is something to be considered. I mean, I put it sort of in the privileged waiver category. It's very similar in that regard. We should not be asking for privilege waivers for cooperation. People may offer them because they want cooperation credit and they may get cooperation credit but you don't get a demerit for not doing it.

Gillette: Yeah. I hear what you're saying.

Peikin: You can't be penalized for going to trial but you can get leniency for pleading guilty.

Gillette: So, I guess I would just point out that the difference would be because I wasn't really suggesting that companies were raising their hand to say, "Hey. We'd like to sign a tolling agreement so we can get credit for cooperation." I'm more concerned about the staff representing that signing a tolling agreement would be another indicator of cooperation, because I also think about the same analogy about the waiver of privilege. The difference between those two is that the Commission or the Division has the policy that the staff is not supposed to explicitly ask for a waiver but companies can offer that, in which case it may be taken into account, whereas here it seems that at least … I'm not saying it's part of your program but there are staff people who are asking to let you sign tolling agreements and that you do so or your failure to do so will be construed to be a failure to cooperate. So, does-

Peikin: So you just tell us who they are. We'll talk to them.

Gillette: After this program. Okay. We are getting short on time, so I'm going to switch topics again and wanted to touch base a little bit on the DC Circuit Court's decision earlier this year in the Robare case in which the court adopted the view that a willful securities violation requires intentional or extremely reckless conduct. My question is what the Division's thinking is and has it affected how and where you choose to file cases in the wake of that decision?

Peikin: So, I think Robare, at least our view is that Robare stands for a much more narrow proposition, which is not that all willful violations of the federal

securities laws require proof of intentionally reckless conduct but rather that, under Section 207, which was the statute that was at issue there, that standard is in the DC Circuit the standard that applies.

Peikin: So, and I think that you can expect us to take a consistent position that Robare is limited to that statute and doesn't expand to the rest of the world. I don't know whether it's going to affect our choice of venue. I guess I should … I haven't really thought that much about it.

Gillette: Okay. That's fair. What is the current thinking, again within the Division, about the usefulness and receptivity of white papers and also Wells submissions, whether that's helpful to your process, when it's helpful, if it ever is?

Avakian: I mean, look. I think process, broadly speaking, is something that's very important to Steve and me, so we've spoken publicly a lot about that. We found the Wells Process incredibly useful as well as the white paper process. I mean, there's a place for it, right?

Gillette: Right.

Avakian: We don't want a white paper on every issue. We don't want 60 pages on every issue, but it is incredibly useful at different stages. White paper can be perfectly appropriate. I mean it's more often at the end of the case but it can be perfectly appropriate earlier and middle of the case. If there's really a dispositive legal issue or something that should be tee'd up early on so that we can all figure out, "Okay. Should we be here or should we not be here?"

Avakian: But we found the Wells Process in particular incredibly useful. We have asked for white papers on issues where teams have come to us and said, "Here's where we are. Here are all the issues." We've said, "You know what? I'd like to hear what they have to say on X or Y or Z issues." Go and see if there was a white paper, but we take them very seriously. We read them all. We have a lot of Wells meetings. We've talked a bit about this publicly and Steve gave a speech about it a year or so ago. Just in terms of Wells meetings or even white paper meetings, whatever they are. We've very engaged. You should assume we've read all of the materials before you come in. We've met with our team obviously, so we have their perspective. We have your perspective in writing. I think we find those meetings can be incredible useful if people use them well and come in and discuss the points that are sort of the greatest issue in the case.

Avakian: I mean, we don't need a lecture on the elements of 10b-5 and here's how we need each one, but it's a much more effective presentation, I think if someone comes in and says, "Look. We can argue about these three elements. We have arguments but really, we think it's think its materiality or it's whatever but we think this is really where your problem is and let us talk about that." Those meetings can be very effective, I think.

Peikin: Yeah, I think and if any of you looked if there were a scoreboard and you looked at it, it would prove that there is a significant impact that these meetings are useful. They're useful for, on the one hand, driving settlement because people have escalated things to as high as they can go and sometimes very useful for a client to know that they've been heard at the highest levels and their position's either been rejected or accepted. That drives us toward a resolution.

Peikin: On the other hand, I think our view is often changed, not … I don't know whether it's on a percentage basis but cases and opposed cases have been declined entirely, charges have been changed, remedies have been changed. So, it is absolutely not a useless or fruitless exercise.

Gillette: Okay, so we're getting to the end of our time. I'm going to ask you one last question, which is what are the greatest challenges facing the Division and the Commission today?

Peikin: For me, I always think it's resources.

Avakian: Yeah. That's what it is.

Peikin: We had a hiring freeze for two and a half years, where we not only couldn't add anybody, we couldn't replace people that were leaving. Now, we've gotten limited hiring authority and, importantly, we can now replace people who left after, I think, April 1st. So, that's been a little bit of a sort of a release of a pressure valve but those resources, which are sort of on a decline because we have natural attrition, I think people out in the world likely expect us to continue to do the same job. That has required us to be thoughtful about how we allocate those resources.

Avakian: Yeah, and I think the other really big challenge is we don't know what we don't know. We try to do lots of things to position ourselves to deal with stuff as it comes up, which I think the cyber space is a great example of how we were able to pivot to that quickly and deal with it. We've got a TCR system in place that we really put a lot of time and resources into hopefully not miss anything. We've got a process in place but you don't know what's happening out there in the market. We don't know what the next big thing is. We just need to try to be ready for it and we put in place all kinds of things to try to proactively find it.

Peikin: [inaudible 00:59:30]. If you know,-

Avakian: If you know …

Peikin: … don't keep it to yourself.

Gillette: Well, with that, I just want to say thank you to both of you for making the trip out to Chicago but also for your time and your thoughtful comments. Thank you

to the audience both here in the room and those of you on the webcast and for those who are participating through the webcast, this concludes the webcast.

Gillette: Okay. For those of you who are still here in the room,-

Avakian: Oh, boy.

Gillette: ... Steve and Stephanie have been gracious enough to say that they would be willing to take a handful or fewer than a handful, I'm not sure, of questions from the audience. So, now's your chance to offer up a question.

Female: Yeah.

Des Carrigan: I'm sorry to pull you back to cyber and I'll try to put this in [crosstalk 01:00:32]-

Gillette: They've got to identify who they are.

Des Carrigan: … the answer, so [inaudible 01:00:39]. Very prevalent situation today-

Gillette: I'm sorry for interrupting you. Could you just identify who you are or where you're from, what-

Des Carrigan: [Des Carrigan 01:00:41].

Gillette: Thank you.

Des Carrigan: [crosstalk 01:00:41]. So, very prevalent situation today is obviously the falsifying of business email where executive, directors, perhaps getting some form of advice, especially [inaudible 01:00:50] today and what do you decide disclosure issues in a framework protects companies as cybersecurity frame [inaudible 01:01:20] at work.

Des Carrigan: I'm wondering, what other factors do you two consider in looking at information like that from a performance framework perspective, knowing that [inaudible 01:01:30] out there?

Peikin: That's strict liability, in my view. I mean, of course, those are the kinds of things that we would take into account. The fact that people fail in an otherwise well-designed system doesn't cry out for enforcement action, depending on what's involved, obviously, right?

Avakian: Right. In the 21(a), some of those circumstances really were … I mean, people just went around the existing system 100%. No one sat back and said, "Well, wait a minute. We need two signatures," or, "Wait a minute. Did anybody actually talk to the CEO," or, "Wait a minute." Instead, it was like, "You got to keep this quiet."

Avakian: So, I mean the facts can be pretty bad, but as Steve said, it's really a balancing. I mean, we're the first one to say, "We recognize the victim status." The same time, you're stewards of shareholder money. So, it's kind of both of weighing them against each other.

Gillette: Surely there's at least one or two more questions.

Male: [inaudible 01:02:45].

Avakian: Of that, but I think it's really too early and we're too preliminary to give you anything useful but that I would expect to see in coming months, us start to put some meat on the bones there and [inaudible 01:03:28] what we're going to do.

Peikin: This is a topic that the full Commission testified before the House Financial Services Committee. This was a topic. Of course, several members of Congress refer to Reg BI as Reg B1, so that's what we call it internally now.

Gillette: Anyone else? All right. Can we show our appreciation to Steve and Stephanie?