

SEC Discusses Enforcement Statistics and Settlement Practices

On May 17, 2012, the Director of the Enforcement Division for the U.S. Securities and Exchange Commission (“SEC”), Robert Khuzami provided testimony before the House Committee on Financial Resources, regarding the settlement practices of the SEC. Defending the SEC’s settlement policies, Khuzami cited 2011 enforcement statistics, emphasizing that 2011 was a record breaking year for the SEC, having filed 735 enforcement actions, and obtaining \$2.8 billion in penalty and disgorgement orders. Of the enforcement actions filed, 146 were related to investment advisers and investment companies, which was a 30% increase over 2010. To date, the SEC has filed actions and obtained orders for \$2 billion against 102 individuals and entities, including 55 individual CEOs, CFOs and other senior compliance officers.

Currently, defendants are able to settle cases with the SEC on a “neither admit nor deny” basis. This policy has been under scrutiny recently, and most notably in the November 2011 case of *SEC v. Citigroup Global Markets*, where a NY District Court judge rejected a \$285 million proposed settlement of securities fraud charges because he claimed that without an admission of guilt or agreed-upon facts there was no basis for an approval of the settlement. The ruling was appealed and on March 15, 2012, the Second Circuit made a motion for a stay, sending the case back to District Court to be heard again. Khuzami contends that if “neither admit nor deny” settlements were eliminated a lot more cases would be pushed towards litigation thereby delaying compensation to injured parties. By having to admit to wrongdoing, many companies would be exposing themselves to additional lawsuits by private litigants, and such admissions can be used in establishing elements of criminal liability.

Department of Labor: Deadline for 401(k) Plan Service Providers to Comply with Section 408(b)(2) Set for July 1

On May 7, 2012, the U.S. Department of Labor (“DOL”) released Field Assistance Bulletin 2012-02 (“Bulletin”) providing guidance to the disclosure requirements of Rule 408(b)(2), which is effective July 1, 2012 (the “Effective Date”). The regulation has been delayed, having first been introduced in 2007, with an interim final rule released in 2010. In the Bulletin, the DOL explained that, “In light of the significance of these required disclosures and the already extended delay in the implementation of the regulations, the department does not believe further broad-based extensions are appropriate.” While the DOL will utilize a “good faith standard” in determining the adequacy of disclosure, it will be limited to cases where facts unquestionably demonstrate that the regulated entity lacked the time to implement systems necessary to comply with the rule.

Final Rule 408(b)(2), which was released on February 3, 2012, governs fee disclosures by Employee Retirement Income Security Act (“ERISA”) plan providers. Upon the Effective Date, the DOL has established its expectation that all 401(k) plan providers should be compliant with the requirements. Under the final rule, covered service providers (“CSPs”) must provide the plan’s participants and beneficiaries with pertinent information to assess the reasonableness of both direct and indirect total compensation received by the CSP, to identify conflicts of interest that may exist, and fulfill the reporting requirements under Title I of ERISA. According to the rule, CSPs include, but are not limited to, investment advisers registered under Federal or State law, record-keepers or brokers making designated investment alternatives available to the covered plan, and providers receiving indirect compensation for accounting, custodial, insurance, legal, record keeping, and valuation services to the covered plan. The final rule applies solely to

HIGHLIGHTS

SEC defends enforcement and settlement practices

Department of Labor issues guidance on ERISA Rule 408(b)(2) fee disclosures

SEC illustrates the importance of identifying and disclosing conflicts of interest

Final rules and guidelines issued for SIFI designations

ERISA-covered defined benefit and defined contribution pension plans, and does not govern simplified employee pension plans (“SEPs”), SIMPLE retirement accounts, IRAs, and certain annuity contracts and custodial accounts described in Internal Revenue Code Section 403(b)

SEC Enforcement Action Illustrates the Perils of Side-by-Side Management

Last week, the U.S. Securities and Exchange Commission (“SEC”), together with their U.K. counterpart, the Financial Services Authority (“FSA”), fined Martin Currie nearly \$14 million alleging that the asset manager fraudulently advised a U.S. mutual fund to invest in the bonds of a printer cartridge company, in order to bolster a hedge fund, also run by Currie. The SEC’s order noted that the portfolio manager operated with “very little supervision” despite the fact that he oversaw nearly a third of the firm’s assets. The fiduciary relationship requires an investment adviser to treat each client with disinterested loyalty and requires full and fair disclosure of conflicts of interest.

This SEC enforcement action illustrates the importance of carefully scrutinizing and identifying potential conflicts of interest and highlights what can go wrong when firms manage mutual funds and hedge funds side-by-side.

SIFI Designation Process Moves Forward

On April 3, 2012, the Financial Stability Oversight Council (“FSOC”) unanimously approved the release of final rules and guidelines (“Final Release”) for how it will designate non-bank entities as systematically important financial institutions (“SIFIs”). Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), FSOC was authorized to designate a non-bank financial institution as a SIFI if: “its material financial distress or the nature, scope, size, scale, concentration, interconnectedness, or mix of its activities could pose a threat to the financial

stability of the United States.” Firms that receive the SIFI designation (and their subsidiaries), will be subject to increased liquidity requirements, leverage limits, and risk-based capital requirements under the supervision of the Federal Reserve.

Non-bank activities were defined broadly in the Final Release, encompassing many activities that have not traditionally been viewed as financial in nature or systematically risky. FSOC estimated that fewer than fifty entities would be tagged with the SIFI designation, though there is industry speculation that this estimate may be conservative given the broad definitions included in the Final Release. A recent Moody’s report estimates that roughly one hundred asset managers and at least seven money market funds satisfy the preliminary criteria for SIFI designation. Additionally, there is speculation that federal regulators are looking to FSOC with its SIFI designation oversight as a means of bolstering money market fund regulation if the U.S. Securities and Exchange Commission fails to enact money market fund reform measures.

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