on%20Cybersecurity%20Practices_0.pdf (hereinafter "FINRA Report").

36. *See, e.g.,* FINRA Report at Appendix II; *see also* Cybersecurity Risk Management and Best Practices Working Group 4: Final Report, (Mar. 2015), *available at* http://transition.fcc.gov/pshs/advisory/csric4/CSRIC_WG4_Report_Final_March_18_2015.pdf.
37. Cybersecurity Guidance at 2.
38. NIST Framework at 14.
39. NIST Framework at 14.
40. NIST Framework at 14.
41. *See* Cybersecurity Guidance at 2, nn. 7-11.
42. *See* generally *supra* nn. xxi-xxii.
43. NIST Framework at 24-25.
44. Executive Order 13691—Promoting Private Sector Cybersecurity Information Sharing, 80 FR 9347 (Feb. 20, 2015), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-02-20/pdf/2015-03714.pdf.
45. *See supra* n. xviii.

The Treacherous Terrain of Penny Stocks and How Firms are Attempting to Navigate It

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The Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) have made penny stock fraud and related matters a regulatory and enforcement priority over the past several years.[1] They have brought claims against and fined many individuals and entities for engaging in many different types of illegal penny stock activity.[2] These include pump-and-dump schemes; manipulative trading tactics; the sale of unregistered securities; boiler room operations;[3] excessive, undisclosed, markups on penny stock sales; failure to have and implement an adequate anti-money laundering compliance program; violation of the Bank Secrecy Act; failure to enforce supervisory controls and procedures; and failure to have and implement adequate supervisory procedures to, for example, detect and report suspicious activity and determine when securities are part of an illegal unregistered distribution.[4] Sanctions for these activities have included barring individuals and firms from the securities industry, barring them from associating with a broker-dealer and/or participating in a penny stock offering, disgorgement ranging between $4,745 and $9.6 million before pre-judgment interest, which was often applied, and civil penalties ranging between $20,000 and $3.3 million. FINRA has fined firms up to $8 million.

Both the SEC and FINRA have provided guidance to firms as to what they should be doing to guard against some of these issues in their own businesses. Generally, they recommend that firms review their policies and procedures related to these matters to be sure they are conducting adequate due diligence on their customers, their customers' accounts, and customers' claims that particular securities are exempt from registration.

SEC Actions: Complex Fraud and Focus on Gatekeepers

The SEC established a Microcap Fraud Task Force in 2013 and is specifically targeting persons they have identified as "gatekeepers"—broker-dealers, transfer agents, attorneys, auditors, stock promoters, and shell company purveyors, among others. [5]The activities they have uncovered have frequently involved a combination of the illicit activities discussed below.

Pump-and-dump

The SEC has acted against individuals and entities involved in pump-and-dump schemes, which vary widely in complexity and scope.[6] For example, the SEC has prosecuted schemes involving the following activities:

- *Promotion of penny stocks on clients' or others' behalf, through the publication of statements that contained material misrepresentations or omissions, to increase the price per share of the stock*[7]—In these cases the SEC brought claims against both the individual(s) promoting the stocks, the stock promotion company, if applicable, and officers of the company whose stock was being promoted, if they were involved in promoting the stock.[8] The individuals the SEC pursued in these matters were required to disgorge their ill-gotten gains ranging between $91,000 and $605,262 plus pre-judgment interest, and civil penalties ranging between $50,000 and $191,000.[9] A stock promotion company was ordered to disgorge $605,262 plus pre-judgment interest and a $1 million civil penalty.[10]

- *Manipulation by owners of penny stocks and/or executives or directors of the companies whose stock was manipulated to artificially increase demand for the stock by issuing false press releases, facsimile and email spam campaigns, promotional videos, websites, and/or automatic voicemail messages and, often, selling their shares once the price increased*[11]—The Commission pursued individuals, as well as the companies whose stock was being promoted. The individuals promoting the relevant penny stock were ordered to disgorge ill-gotten gains ranging between $40,600 and $7.2 million, plus pre-judgment interest, and civil penalties between $50,000 and $1.3 million.[12] The Commission sued a stockbroker for his role in a scheme that employed this type of activity. He was ordered to disgorge his illicit gains and pay a civil penalty. He was also enjoined from engaging in any future offerings involving penny stocks and barred from associating with any broker or dealer.[13]

- *Engineering of reverse mergers by individual to obtain shares of companies' stock to then drive up the price of the stock through the dissemination of false and misleading statements and selling the stock for large profits*[14]—That individual was ultimately ordered to pay disgorgement plus pre-judgment interest totaling $921,232.[15]

- *Facilitating a pump-and-dump scheme by selling shares of a particular penny stock on multiple customers' behalf*—The SEC has brought action against a stockbroker it alleged did this and in doing so the stockbroker was said to have ignored red flags and failed to make a reasonable inquiry to determine that his customers were not acting as underwriters.[16] This stockbroker settled the Commission's claims against him and, pursuant to the settlement agreement, paid $313,257 total in civil penalties, disgorgement and pre-judgment interest.[17]

- *Scalping penny stocks*[18]—Scalping, which is similar to pump-and-dump, involves someone recommending the purchase of a stock while being poised to sell the same stock into the market immediately after disseminating the recommendation. The individual scalper was required to disgorge $1.9 million plus pre-judgment interest and pay a $1.7 million civil penalty.[19]

Manipulative Trading

The Commission has sued those individuals who, in an effort to drum-up trading activity in a particular stock, engaged in manipulative trading of penny stocks. The manipulative trading tactics and schemes employed in those cases have included the following:

- *Executing matched orders*[20]—The individuals who attempted to manipulate the market by executing matched orders ultimately were each enjoined from future violations of the Securities Act and/or Exchange Act and were barred from being involved with any penny stock offering.

- *Purchasing shares of the stock to raise its price*[21]—The individual who purchased shares of the penny stock to drive up demand for and thus the price of the stock was required to pay a $120,000 civil penalty.[22]

- *Executing wash sales in a particular penny stock*[23]—The individual, a former stockbroker who executed wash sales in penny stock he owned was not required to pay disgorgement or a civil penalty based on his sworn statement regarding his financial condition.[24] (***Note***: Individuals who employed multiple use of these manipulative trading tactics suffered the same consequences but were required to disgorge a total of $552,579 plus pre-judgment interest.[25])

- The SEC worked with the Federal Bureau of Investigation to uncover schemes in which individuals offered kickbacks to hedge fund managers or pension fund managers in exchange for the fund's investment in particular stocks.[26] In some cases, the kickbacks were to be disguised by fake consulting agreements or invoices for services not actually rendered to the firm.[27] The regulators used undercover agents acting as the hedge fund manager, pension fund manager, or business associate of such manager, who facilitated the scheme to uncover this fraud. The SEC took action against the individuals who perpetrated these schemes as well as the company whose stock was to be sold, if the company also paid kickbacks to the fund manager.[28] One of those individuals was required to disgorge ill-gotten gains of $24,000.[29] The company was enjoined from future violations of the federal securities laws and required to pay a $20,000 civil penalty. However, a federal court dismissed the Commission's requests for disgorgement and pre-judgment interest.[30]

Sale of Unregistered Securities

The SEC has also sanctioned companies and individuals for their roles in issuing or selling unregistered penny stocks. These are examples of such sales activities for which the SEC has sued:

- *Purchasing unregistered shares of penny stocks and selling them to the public without registration statements*[31]—Some individuals engaged in this scheme were required to pay disgorgement in amounts ranging between $4,745and $5.9 million and civil penalties up to $3.3 million.[32] The SEC also brought an action against two firms for facilitating the sale of unregistered securities by its customers. The firms were jointly and severally liable for disgorging $1.5 million and for paying a $1 million civil penalty.[33]

- *Obtaining penny stocks and re-selling them, unregistered, to the public under Rule 504 of Reg D but exceeding the $1 million limit of unregistered securities a company can sell under that exemption*[34]—The SEC sued individuals and entities involved in this activity. The individuals were required to disgorge between $12,500 and $6.2 million plus pre-judgment interest and civil penalties ranging between $13,000 and $273,000.[35]

- The SEC sued individuals and companies alike for issuing unregistered stock, including purportedly under the exemption provided under Section 3(a) of the Securities Act without providing the court all of the information necessary for it to determine whether the settlement is fair as required under Securities Act Section 3(a).[36] Final judgment was entered against a penny stock company engaged in this scheme, which required the company to disgorge $3.5 million plus pre-judgment interest and barred the company from violating sections of the Securities Act and Exchange Act. It did not require the company to pay a civil penalty due to the company's financial condition.[37]

- *Selling unregistered shares without a restrictive legend on the basis of a fraudulent attorney's opinion letter stating that the securities could be issued without the legend, or other false documents*[38]—The SEC sued individuals, including an attorney and a stockbroker, and the non-attorney individuals' companies, for these activities. The attorney was required

to disgorge $6,250 and pay a $7,500 civil penalty.[39] Two of the entities were required to jointly and severally disgorge $268,936 and each pay $30,000 in civil penalties.[40] The other entity was required to disgorge $1.4 million and pay a $52,500 civil penalty. One non-attorney, non-stock broker individual was required to pay, jointly and severally with one of the entities disgorgement of $1.4 million as well as a $52,500 civil penalty.[41] Another non-attorney, non-stock broker individual was jointly and severally liable with an entity to disgorge $249,540 and was required to pay a $30,000 civil penalty.[42] In another matter, an attorney engaged in this type of activity was required to disgorge $19,919 and pay a $70,000 civil penalty.[43]

- *Altering debt instruments and a company's balance sheet to permit the company to issue more stock into the marketplace in order to collect the capital raised from the issuance*[44]—The individuals who engaged in this activity also engaged in the activity described immediately above. One of the individuals was required to disgorge $19,919 and pay a $70,000 civil penalty.[45]

- *Obtaining penny stocks through fraudulent S-8 distributions,*[46] *fraudulent manipulation of Rule 144(k),*[47] *and counterfeiting a company's stock to then sell the shares, unregistered or improperly registered, to the public*[48]—The Commission pursued nine defendants including individuals, officers of penny stock companies and owners of the companies' stock who were not company officers, and penny stock companies involved in a single scheme of this kind. Ultimately, judgment was entered requiring some of them to disgorge funds that were illicitly gained, including prejudgment interest.[49] The companies were required to disgorge amounts ranging between $33,300 and $5.1 million including pre-judgment interest. The individual who orchestrated the scheme, who was not an officer of the penny stock companies involved, was sentenced to 21 years in prison in a separate federal criminal action.[50] He was also required to disgorge $4.4 million plus pre-judgment interest and pay a $120,000 civil penalty.[51] Some other individuals involved in the scheme were also required to disgorge between $44,000 plus pre-judgment interest and $150,000 plus pre-judgment interest and to pay civil penalties between $6,500 and $120,000.[52]

The issuance or sale of unregistered securities is of such concern to the SEC that it published a Risk Alert and corresponding FAQs in October 2014 to "remind broker-dealers of their obligations when they engage in unregistered transactions on behalf of their customers."[53]

Boiler Rooms

While boiler room tactics seemed to have fizzled out in the 1990s, the Commission sanctioned individuals involved in such a scheme in 2012. There the individuals ran a traditional boiler room in which they cold-called potential investors to gauge interest in purchasing certain stock, then had "closers" use high-pressure tactics to persuade people who may be interested in purchasing the stock, or people who previously purchased the stock, to buy.[54] The SEC sued a father and his twin sons for engaging in this scheme. These individuals were required to disgorge $9.6 million.[55]

FINRA Actions: Focus on Compliance Programs and Supervision

FINRA has also been active in its regulation of penny stock activities. It has identified microcap fraud, which includes penny stock fraud, as one of its regulatory and enforcement priorities for each of the last three years.[56] In 2014 alone FINRA made more than 700 referrals of potential fraud, including microcap fraud,[57] market manipulation, insider trading and private investment in public equity transactions, to the SEC and other federal regulators.[58] Further, it has fined and otherwise censured entities and individuals for:

- sale of unregistered securities;

- excessive, undisclosed, markups on penny stock sales;
- failure to have and implement an adequate anti-money laundering compliance program, violating the Bank Secrecy Act;
- failure to enforce supervisory controls and procedures; and
- failure to have and implement adequate supervisory procedures to, for example, detect and report suspicious activity and determine when securities are part of an illegal unregistered distribution.

In numerous cases FINRA disciplined individuals and/or entities for some combination of these activities. These are examples of such cases:

- Where a firm failed to have sufficient anti-money laundering procedures in place to prevent fraudulent and unregistered transfers of penny stocks, failed to address "red flags" in relation to penny stock transfers, and did not comply with Suspicious Activity Report (SAR) filing requirements, FINRA fined the company $8 million, suspended its Chief Compliance Officer for one month and fined him $25,000.[59]
- FINRA fined three broker-dealer firms a total of $1.275 million for failing to have sufficient anti-money laundering procedures in place to detect, prevent and report suspicious transactions, including fraudulent transfers of penny stocks.[60]
- FINRA expelled and banned from the securities industry a firm that it found had failed to have adequate anti-money laundering procedures to detect fraudulent trades and failed to maintain accurate books in conjunction with the sale of particular securities to its customers.[61] The firm's President, Chief Executive Officer, and Chief Financial Officer was fined $50,000, suspended from associating with any FINRA member as a principal for 90 days and required to requalify as a general securities principal.[62]
- FINRA fined a firm $250,000 and suspended it from engaging in certain transactions for one year because it allegedly sold unregistered securities, failed to supervise the firm's compliance with Section 5 of the Securities Act, failed to implement adequate supervisory controls, and failed to supervise the firm's compliance with the Bank Secrecy Act.[63] FINRA also fined, between $5,000 and $40,000, several registered representatives it alleged were involved in this activity and suspended them for three to nine months from associating with any FINRA member in any capacity.[64]
- FINRA fined a broker-dealer firm $335,000 and required it to pay restitution to its customers in the amount of $482,111, plus accrued interest, related to the firm's charging exorbitant markups on certain penny stock transactions, failing to report transactions, failing to enforce its written supervisory procedures relating to markups and principal transactions with customers, failing to maintain and implement adequate supervisory control procedures, committing willful books and records violations, and failing to comply with applicable rules and regulations concerning electronic storage media.[65]
- FINRA fined a broker-dealer $1.425 million for failing to have sufficient anti-money laundering procedures in place to prevent fraudulent and unregistered transfers of penny stocks, as well as for selling more than 1 billion shares of unregistered penny stocks. The firm also agreed to hire an independent anti-money laundering consultant to review the firm's policies.[66]

How Firms Attempt to Protect Themselves

Firms have attempted to protect themselves from disciplinary action in this area by having and consistently implementing strong policies and procedures regarding the firms', their customers', and their employees' penny stock activities. The SEC and FINRA have been clear in communicat-

ing to the securities industry pitfalls that broker-dealer firms and others face related to microcap fraud and what they need to do to avoid them. The SEC has focused its advice largely on the trading of unregistered securities; FINRA advises firms to be vigilant in their supervision of employees who are involved in microcap and low-priced over-the-counter (OTC) securities, and of customer accounts that are selling such securities. And FINRA and the SEC both advise firms to implement appropriate anti-money laundering compliance programs.

The Director of the SEC's Division of Trading and Markets, Stephen Luparello, said that "[b]roker-dealers must be vigilant when facilitating sales on behalf of customers in unregistered transactions and remember that reliance on the broker's [Securities Act Section 4(a)(4)] exemption requires a reasonable inquiry of the customer and the transaction."[67] The SEC staff evaluated the compliance of 22 firms with obligations to (*i*) make a "reasonable inquiry" regarding customers' unregistered sales of securities when relying on the Securities Act Section 4(a)(4) exemption and (*ii*) file SARs required under the Bank Secrecy Act and the Exchange Act when they detect "red flags" related to sales of unregistered securities.[68] The SEC found that most firms had policies and procedures regarding conducting a reasonable inquiry when relying on the Section 4(a)(4) exemption, but they were deficient in design or implementation. [69]Such deficiencies included the following:

- Insufficient detail to help the firm's employees monitor for and detect situations where an exemption the customer claimed may not have applied.
- Some firms relied on the lack of restrictive legend on a certificate or the fact that the shares were delivered to a customer by transfer from a Depository Trust & Clearing Corporation or transfer agent, without further inquiry, in concluding it could be sold in unregistered transactions.
- When asked by a customer to sell shares that had been deposited into his/her account in large quantities, some firms did not ask the customer how the customer had acquired the shares.[70]

The staff also observed firms' failures to file SARs, required by the Bank Secrecy Act, when they encountered "unusual or suspicious activity in connection with customers' sales of microcap securities."[71] Examples of the type of activity firms identified but failed to report include:

- Unusual trading patterns in a particular issuer's securities, including sudden and significant increases in the securities' price and volume.
- Patterns of trading activity common to several customers, including customers selling large quantities of the same issuers' securities.
- Notifications from clearing firms that they had detected activity in certain issuers' securities or certain of that broker-dealer's customer accounts that may be suspicious.
- Certain types of accounts liquidating microcap issuers' securities.
- Requests for information from FINRA regarding certain issuers and the firm's customer accounts.[72]

The SEC itself discovered other suspicious activity that it identified was "readily discoverable by the broker-dealer[,]" including:

- Changes in issuer information, such as frequent changes in the entity's name, the type of business in which the entity was engaged, and names of directors or management;
- Entities having "nominal assets and low operating revenue"; *and*
- Sales through the firm by "individuals known throughout the industry to be stock promoters."[73]

FINRA is similarly focused on firms' policies and procedures and advised firms to review their policies and procedures to be sure they comply with FINRA rules and federal securities laws.[74]

Specifically, FINRA advised that firms should do the following:

- Exercise heightened supervision of employees who have outside business activities related to microcap and OTC companies, as well as employees trading penny stocks;
- Ensure that the research they produce on penny stock companies "is accurate and balanced and appropriately discloses risks to investors";
- Monitor those customer accounts selling penny stock to make sure the firm is not facilitating or participating in the distribution of unregistered securities;
- Exercise heightened supervision of its activities where a firm affiliate is the transfer agent for penny stocks;
- Implement anti-money laundering procedures that require the firm to "monitor for suspicious activity and file [SARs] where warranted"; and
- Monitor its employees' solicitation of customers to trade penny stocks to make certain that the recommendations are balanced and suitable for the customer.[75]

In its 2015 regulatory and examination priorities report, FINRA again reminded firms to "tailor [their] customer trading surveillance around the [anti-money laundering] risks inherent in their business lines and customer basis[,]" which "can involve different types of suspicious activity reportable on [SARs], including… microcap fraud."[76]

Conclusion

We have attempted to provide an overview of the types of claims regulators have brought against individuals and firms for activities related to penny stocks, as well as insight into what firms are doing to attempt to avoid liability related to penny stock activity. While the types of fraud that may be perpetuated can be complex, a simple approach—focus on compliance procedures and supervision—may be key for firms trying to manage risk related to penny stock activities.

NOTES

1. The actions taken by regulators discussed below typically involved complex schemes in which multiple entities and individuals were the subject of the regulators' action. In an attempt to provide an efficient overview of the regulators' activities related to penny stocks, we have not included information regarding all of the individuals or entities named in some of the actions.
2. A "penny stock" is a security of a small company that trades at less than $5 per share. Securities issued by private companies with no active trading market may also be a penny stock. Penny stocks are typically traded over-the-counter and are considered speculative investments. Securities and Exchange Commission, Penny Stock Rules, http://www.sec.gov/answers/penny.htm (last visited Jan. 29, 2015).
3. *See* Section I below.
4. *See* Section II below.
5. Press Release, Securities and Exchange Commission, *SEC Announces Enforcement Initiatives to Combat Financial Reporting and Microcap Fraud and Enhance Risk Analysis* (July 2, 2013), *available at*: http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171624975. Between October 2010 and August 2013, the SEC brought actions against 40 individuals and 24 companies, including broker-dealers and their employees, penny stock companies, stock promoters, and attorneys. Press Release, Securities and Exchange Commission, *SEC Announces Charges Against Florida-Based Penny Stock Schemes* (Aug. 14, 2013), *available at*: http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539776014#.Umw5Yfmsim4.
6. In almost every instance in which the Commission was successful in its action against or settled its claims against an individual(s), the individual was enjoined from committing future violations of particular sections of the Securities Act of 1933 and/or the Exchange Act of 1934 and/or were barred from promoting penny stocks, engaging in the offering of any penny stock and, in certain cases, were prohibited from being an officer or director of any public company. Some individuals were also barred from associating with a broker or dealer.
7. *S.E.C. v. Eiten*, 2014 WL 4965102 (D. Mass. 2014); *S.E.C. v. Wall Street Capital Funding, LLC*, 2011 WL 2295561 (S.D. Fla. 2011); *SEC v. Plummer, et al.*, Civil Action No. 14-CV-5441 (S.D. N.Y.); *SEC v. Hunter*, Civil Action No. 12-CV-3123 (S.D. N.Y.).

8. *Eiten*, Civil Action No. 1:11-CV-12185; *Wall Street Capital Funding, LLC*, Civil Action No. 11-CV-20413-DLG; *Plummer*, Civil Action No. 14-CV-5441.
9. *Id.*
10. *Eiten*, Civil Action No. 1:11-CV-12185.
11. *SEC v. Concorde America, Inc., et al.*, Civil Action No. 05-80128-CIV-ZLOCH (S.D. Fla.); *see also SEC v. Dynkowski, et al.*, Civil Action No. 1:09-361 (D. Del.); *SEC v. Reynolds, et al.*, Case No. 3-08 CV-438-B (N.D. Tex.); *Plummer, et al.*, Civil Action No. 14-CV-5441; *LeBlanc*, S.E.C. Admin. Proc. File No. 3-10065 (2003); *Franklin*, S.E.C. Admin. Proc. File No. 3-12228 (2006).
12. *Concorde America, Inc.*, Civil Action No. 05-80128-CIV-ZLOCH; *Dynkowski*, Civil Action No. 1:09-361; *Plummer*, Civil Action No. 14-CV-5441; *LeBlanc*, S.E.C. Admin. Proc. File No. 3-10065; *Franklin*, S.E.C. Admin. Proc. File No. 3-12228.
13. *SEC v. ConnectAJet.com, Inc. et al.*, Case No. 3-09 CV-01742-B (N.D. Tex.).
14. *SEC v. Carley*, Civil Action No. 1:14-CV-01643 (E.D. Va.).
15. *Id.*
16. *ConnectAJet.com, Inc.*, Case No. 3-09 CV-01742-B.
17. *Id.*
18. *SEC v. Babikian*, Civil Action No. 14-CV-1740 (S.D. N.Y.) (Babikian is a fugitive, the case is not yet closed/adjudicated). The SEC claimed that the defendants in *SEC v. Franklin,* No. 3:02CV0084 DMS (RBB) (S.D. Cal.) engaged in scalping as part of their scheme. (See Dkt. 1).
19. *Babikian*, Civil Action No. 14-CV-1740.
20. *Steinberg*, S.E.C. Admin. Proc. File No. 3-10556 (2001); *SEC v. Dynkowski, et al.*, Civil Action No. 1:09-361 (D. Del.).
21. *Vindman*, S.E.C. Admin. Proc. File No. 3-11247 (2006).
22. *Id.*
23. *SEC v. Crane*, Civil Action No. 1:13-CV-00261-CMH-IDDVAED (E.D. Va.); *Dynkowski*, Civil Action No. 1:09-361. "A wash sale occurs when [one] sell[s] or trade[s] a security at a loss and within 30 days before or after the sale [that person]: "[(*i*)] buy[s] substantially identical stock or securities, [(*ii*)] [a]cquire[s] substantially identical stock or securities in a fully taxable trade, or [(*iii*)] [a]cquire[s] a contract or option to buy substantially identical stock or securities." Securities and Exchange Commission, Wash Sales, http://www.sec.gov/answers/wash.htm (last visited Jan. 29, 2015).
24. *Crane*, Civil Action No. 1:13-CV-00261-CMH-IDDVAED.
25. *Dynkowski*, Civil Action No. 1:09-361.
26. *SEC v. Wheeler, et al.*, Civil Action No. 11-CV-12117 (D. Mass.); *Jordan*, S.E.C. Admin. Proc. File No. 3-16142 (2014); *SEC v. Klein, et al.*, Civil Action No. 0:11-CV-61457 (S.D. Fla.); *SEC v. Molinari, et al.*, Civil Action No. 9:13-CV-80807 (S.D. Fla.); *Reda*, S.E.C. Admin. Proc. File No. 3-16152 (2014); *Black-White*, S.E.C. Admin. Proc. File No. 3-16143 (2014).
27. *Wheeler*, Civil Action No. 11-CV-12117*; Jordan*, S.E.C. Admin. Proc. File No. 3-16142.
28. *See, e.g.*, *Klein*, Civil Action No. 0:11-CV-61457.
29. *Wheeler*, Civil Action No. 11-CV-12117. One individual defendant was convicted of violations of the Exchange Act and sentenced to 30 months in prison plus 12 months of supervised release. The SEC's case against that individual has not concluded. *Jordan*, S.E.C. Admin. Proc. File No. 3-16142. Another individual that was convicted of violations of federal law and sentenced to prison, was also required to pay $40,000 in restitution and therefore was not required to pay disgorgement or a civil penalty in the SEC matter. *Molinari*, Civil Action No. 9:13-80807.
30. *Id.* Two actions the Commission brought against individuals for their roles in similar kickback schemes are currently pending. *Reda*, S.E.C. Admin. Proc. File No. 3-16152 (2014); *Black-White*, S.E.C. Admin. Proc. File No. 3-16143 (2014).
31. *SEC v. Lybrand, et al.*, Civil Action No. 00-1387 (S.D. N.Y.); *SEC v. CMKM Diamonds, Inc., et al.*, Civil Action No. 08-CV-0437 (D. Nev.). The CMKM Diamonds matter was a large scheme that involved many of the fraudulent schemes we have identified in this memorandum including pump-and-dump. *CMKM Diamonds, Inc.*, Civil Action No. 08-CV-0437.
32. *Id*. The defendants who were required to disgorge $5.9 million were jointly and severally liable for that amount with several other defendants. *Lybrand*, Civil Action No. 00-1387.
33. *E*Trade Securities, LLC, et al.*, S.E.C. Admin. Proc. File No. 3-16143 (2014).
34. *Kramer, et al.*, S.E.C. Admin. Proc. File No. 3-15621 (2013); *SEC v. Garber, et al.*, Civil Action No. 12-CV-9339 (SAS) (S.D. N.Y.); *SEC v. Offill, Jr., et al.*, Civil Action No. 07-CV-1643-D (N.D. Tex.).
35. *Id*. The defendants that were required to disgorge the $6.2 million were jointly and severally liable for that amount. *Id*. Some of the companies that participated in the sale of unregistered securities were jointly and severally liable for disgorging the $1 million were ordered to pay total civil penalties of $260,000. *Kramer*, S.E.C. Admin Proc. File No. 3-15621. Another entity was barred from future violations of the Securities Act. *Garber*, Civil Action No. 12-CV-9339 (SAS). Also, some individuals were barred for seven years from participating in the offering of penny stocks. *Offill, Jr.*, Civil Action No. 07-CV-1643-D.

36. *SEC v. Lefkowitz, et al.*, Civil Action No. 8:12-CV-1210 (M.D. Fla.).
37. *Id*.
38. *SEC v. Scucci, et al.*, Civil Action No. 6:12-CV-646-RBD-KRS (M.D. Fla.); *SEC v. CMKM Diamonds, Inc., et al.*, Civil Action No. 08-CV-0437 (D. Nev.); *Garber*, Civil Action No. 12-CV-9339 (SAS); *SEC v. Gandy, et al.*, Civil Action No. 4:13-CV-2233 (S.D. Tex.).
39. *Scucci*, Civil Action No. 6:12-CV-646-RBD-KRS. He was also enjoined from violating Section 5 of the Securities Act, barred from providing legal services regarding securities and barred from engaging in penny stock offerings. *Id*.
40. They too were enjoined from violating Section 5 of the Securities Act and from engaging in penny stock offerings. *Id.*
41. *Id*.
42. *Id*.
43. *Gandy*, Civil Action No. 4:13-CV-2233. In yet another case, similar penalties were assessed against individuals and entities involved in this kind of scheme. *CMKM Diamonds, Inc.*, Civil Action No. 08-CV-0437. The penalties in that case included payment of disgorgement and prejudgment interest, permanent bars from participating in offerings involving penny stocks, permanent injunctions not to commit future violations of the federal securities laws, and civil penalties. *Id*.
44. *Gandy*, Civil Action No. 4:13-CV-2233.
45. *Id*.
46. Form S-8 is used by publicly traded companies to register securities it will offer to its employees through benefit or incentive plans. The form is effective on filing and allows the company to issue the shares without a restrictive legend.
47. Before someone who holds restricted securities can sell them to the public, the seller or the securities must qualify for an exemption from the registration requirements. Rule 144 provides a safe harbor exemption for sellers of restricted or control securities who meet certain requirements. The Commission amended Rule 144 in 2007 and eliminated Rule 144(k), which allowed a non-affiliate to resell restricted securities to the public without registration if they had fulfilled the Rule 144 requirements, were not affiliated with the issuer and had not been affiliated with the issuer in the last three months, and had held the securities for two years or more. *See e.g.*, Securities and Exchange Commission, Securities Act Release No. 33-8869 (December 6, 2007), *available at*: http://www.sec.gov/rules/final/2007/33-8869.pdf.
48. *U.S. S.E.C. v. Custable*, 2003 WL 22848962 (N.D. Ill. 2003).
49. *Id.* Some of the entities were permanently enjoined them from committing future securities violations. Some entities were also barred from participating in any future offerings involving penny stocks. *Id.*
50. Other individuals were enjoined from violating certain sections of the Securities Act and Exchange Act, barred from participating in penny stock offerings. Some were also barred from serving as an officer or director of a public company. *Id*.
51. *Id*.
52. *Id*.
53. Press Release, Securities and Exchange Commission, *SEC Staff Issue Risk Alert and FAQs on Customer Sales of Securities* (Oct. 9, 2014), *available at*: http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543133529.
54. *Bugarski, et al.*, S.E.C. Admin. Proc. File No. 3-14496 (2012).
55. *Id*.
56. Financial Industry Regulatory Authority, 2013 Regulatory and Examination Priorities Letter (Jan. 11, 2013), *available at*: http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p197649.pdf; Financial Industry Regulatory Authority, 2014 Regulatory and Examination Priorities Letter (Jan. 2, 2014), *available at*: http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p419710.pdf; Financial Industry Regulatory Authority, 2015 Regulatory and Examination Priorities Letter (Jan. 6, 2015), *available at*: http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p602239.pdf.
57. Microcap fraud is fraud perpetrated in securities sold in the over-the-counter market, which is for and made up of companies that have low stock prices and small total assets.
58. Financial Industry Regulatory Authority, 2015 Regulatory and Examination Priorities Letter (Jan. 6, 2015), *available at*: http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p602239.pdf.
59. *Brown Brothers Harriman & Co.*, FINRA AWC No. 2013035821401.
60. *J.P. Turner & Co., LLC, et al.*, FINRA AWC No. 2007007138003; *Park Financial Group, Inc.*, FINRA AWC No. 2008011713701; *Legent Clearing LLC*, FINRA AWC No. 2007007133001.
61. *Barron Moore, Inc.*, FINRA AWC No. 2006003672401.
62. *Id*.
63. *World Trade Financial Corp.*, FINRA AWC No. 2010022543701.
64. *Id*.
65. *Max International Broker-Dealer, Corp.*, Disciplinary Proceeding No. 20070072538-03.

66. *Oppenheimer & Co., Inc.*, FINRA AWC No. 2009018668801.

67. Press Release, Securities and Exchange Commission, *SEC Staff Issue Risk Alert and FAQs on Customer Sales of Securities* (Oct. 9, 2014), *available at*: http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543133529. In the same vein, in its recent Risk Alert and related FAQs, the Commission reminded firms that a broker-dealer may claim the Section 4(a)(4) exemption [from registration of securities sold by a broker on behalf of a client] if, after reasonable inquiry, the broker-dealer is not aware of circumstances indicating that the customer would be violating Section 5, such as when the customer is an underwriter with respect to the securities or that the transaction is part of a distribution of securities of the issuer. In conducting the reasonable inquiry under Section 4(a)(4), broker-dealers may consider the matters set forth in Note (ii) to Rule 144(g)(4). *Id.* at 2.

68. Broker-Dealer Controls Regarding Customer Sales of Microcap Securities, National Exam Program Risk Alert (OCIE, Washington, D.C.), Oct. 9, 2014, at 1 (*available at*: http://www.sec.gov/about/offices/ocie/broker-dealer-controls-microcap-securities.pdf).

69. *Id*.

70. *Id.* at 4-5.

71. *Id.* at 5.

72. *Id*. at 5-6.

73. *Id.* at 5-6.

74. Financial Industry Regulatory Authority, 2013 Regulatory and Examination Priorities Letter (Jan. 11, 2013), *available at*: http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p197649.pdf.

75. *Id.* at 4; Financial Industry Regulatory Authority, 2014 Regulatory and Examination Priorities Letter (Jan. 2, 2014), at 5-6, *available at*: http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p419710.pdf.

76. Financial Industry Regulatory Authority, 2015 Regulatory and Examination Priorities Letter (Jan. 6, 2015), *available at*: http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p602239.pdf.

The Street, the Bull and the Crisis: A Survey of the US & UK Financial Services Industry

State of Play: Unethical Behavior Continues to Persist

A REPORT BY THE UNIVERSITY OF NOTRE DAME & LABATON SUCHAROW LLP

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Nearly seven years after the global financial crisis rocked investors' confidence in the markets and financial services in general, our survey clearly shows that a culture of integrity has failed to take hold. Numerous individuals continue to believe that engaging in illegal or unethical activity is part and parcel of succeeding in this highly competitive field. With legal and regulatory sanctions coming out on almost a daily basis, the industry has a long way to go to regain the confidence of the public.

- 47% of respondents find it likely that their competitors have engaged in unethical or