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SEC's Emphasis on Individual Accountability Drives Settlement Pace Toward Seven-Year High

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The U.S. Securities and Exchange Commission's (SEC's) promise to hold more individuals accountable was realized in the First Half of Fiscal Year 2012 (1H12) in a 20% jump in the number of SEC settlements with individuals. 1H12 ran from October 1, 2011 to March 31, 2012. The SEC settled 286 cases with individuals in the first half of this year, putting it on pace for 572 settlements in FY12, which would be the most since 2005.[1] This marks a shift from the end of fiscal 2011, when we reported that the SEC's promise to hold more individuals accountable was borne out in the value, but not in the number, of settlements with individuals.

Total SEC settlements are also up, but the increase is entirely explained by the rise in settlements with individuals. The SEC settled with 379 defendants in 1H12, putting it on pace for 758 settlements in FY12. This would constitute a 13% increase from the SEC's 670 settlements in 2011 and would constitute the most annual settlements since 2005. The pace of settlements with companies is down slightly, with 93 settlements, consistent with an annual pace of 186, as compared with 196 in FY11 (see Graphic).

The increase in individual settlements is driven primarily by allegations relating to insider trading. The increase from 63 insider trading settlements in FY11 to an annualized number of 120 projected for FY12 accounts for more than half of the observed increase in settlements in 2012.[2] The SEC also increased its settlement activity with individuals in matters relating to Ponzi schemes. Settlements with individuals relating to public company misstatements rose to an annualized pace of 78 settlements, up from a low of 60 in 2011, but still well below the 91 settlements in 2010.

Settlements with companies related to Ponzi schemes increased from 27 in FY11 to a projected 42 in FY12. However, this increase was more than offset by decreases in settlement activity relating to misrepresentations to customers and misappropriation of funds by financial services firms, FCPA violations, and illegal securities offerings and market manipulation.

Top Settlements

The 10 largest settlements for the first half of fiscal year 2012 range in value from $285 million to $13.4 million.[3] The highest value settlement of 1H12 was the $285 million settlement with Citigroup Global Markets, Inc., announced on October 19, 2011. As we discuss in detail below, the settlement is still under appeal after its initial rejection by U.S. District Judge for the Southern District of New York Jed S. Rakoff. The SEC alleged that Citigroup materially misled investors by marketing

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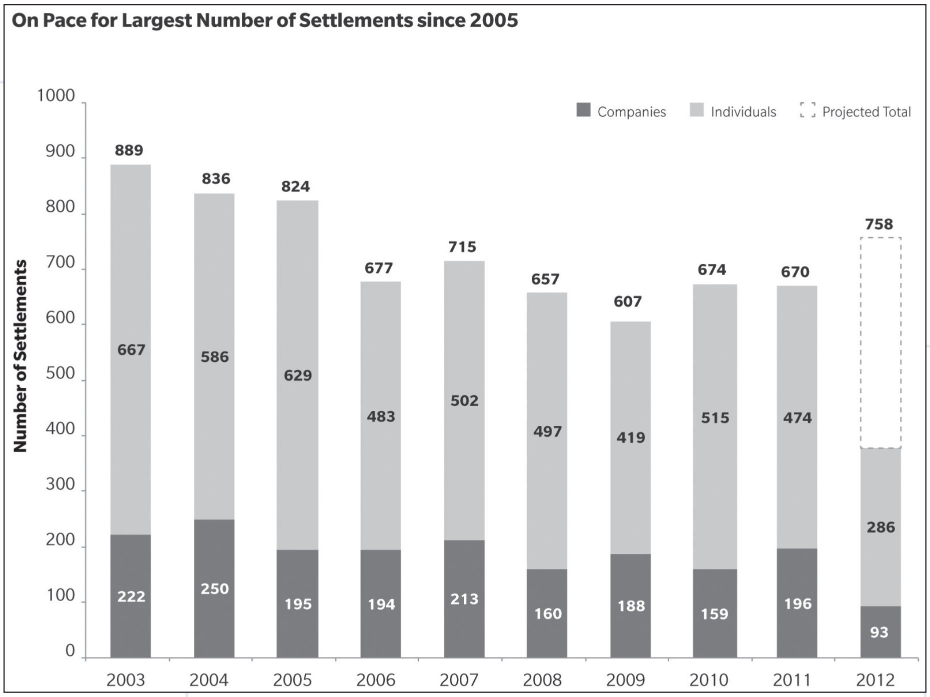

a $1 billion collateralized debt obligation (CDO) while failing to disclose that Citigroup had a short position against the offering and that Citigroup had selected the assets comprising the CDO. Various individuals and other corporations affiliated with the CDO offering also agreed to settle charges with the SEC in related administrative actions. If it is ultimately allowed to stand, it would be the 12th largest settlement with the SEC in the post-Sarbanes-Oxley (SOX) era.

In another highly publicized settlement, the SEC obtained a $92.8 million civil penalty in November 2011, against Raj Rajaratnam of Galleon Management, LP for insider trading violations. This civil penalty joins more than $60 million in criminal fines and disgorgement, along with 11 years of imprisonment, assessed by the U.S. Justice Department in the parallel criminal case. Mr. Rajaratnam was accused of trading on material, nonpublic information obtained through paid networks of informants. The SEC's investigation of Mr. Rajaratnam has spawned dozens of settlements and ongoing investigations against individuals associated with the scheme.

In December 2011, Magyar Telecom, the largest telecommunications provider in Hungary, and its parent company, Deutsche Telekom, settled charges with the SEC for a total of $95 million, alleging violations of the Foreign Corrupt Practices Act (FCPA) in Macedonia and Montenegro. The SEC claimed that Magyar senior executives used sham consulting and marketing arrangements to pay bribes to government officials in both countries in order to block the issuance of licenses to potential competitors and to secure regulatory approval for a corporate takeover. Deutsche Telekom was charged with internal control violations in failing to adequately oversee the actions of its subsidiary.

In the fourth largest action of 1H12, George David Gordon, an Oklahoma attorney, was ordered by the U.S. District Court for the Western District of Oklahoma to pay more than $50 million in disgorgement, prejudgment interest, and civil penalties for stock price manipulation, penny stock fraud, and illegal securities offerings. According to the SEC, Mr. Gordon assisted in reverse mergers and the improper issuance/transfer of purportedly unrestricted stock; issued fraudulent legal opinion letters regarding the tradability of stock; and arranged with the other primary members of the scheme to engage in coordinated trading.

NOTES

1. NERA has developed a proprietary database of settlements and judgments in U.S. Securities and Exchange Commission (SEC) enforcement actions since the passage of the Sarbanes-Oxley Act (SOX) in 2002 by reviewing every litigation release and administrative proceeding document published since July 21, 2002. This article provides an update on trends in the number of settlements and settlement values in fiscal year 2012 (FY12).
2. The authors discuss insider trading settlements in further detail in the full report, available here http://www.securitieslitigationtrends.com/PUB_SEC_Trends_Update_0612.pdf.
3. In this article and in the full report, 1H12 refers to the first half of the SEC and federal fiscal year 2012, which began on October 1, 2011. References to settlements in other years also refer to the fiscal year.