Securities Regulation Daily Wrap Up, ENFORCEMENT—Avakian highlights enforcement efforts involving ICOs, share class disclosures, (Sept. 21, 2018)

Securities Regulation Daily Wrap Up

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As she approaches the end of her first full fiscal year as Co-Director of the SEC's Enforcement Division, Stephanie Avakian highlighted what she regards as some of the Division's greatest success stories during her tenure. In particular, she focused on the Division's approach to dealing with initial coin offerings (ICOs) and mutual fund share class disclosures. Avakian's remarks came before the University of Texas School of Law's 5th Annual Government Enforcement Institute in Dallas, Texas.

ICOs. Avakian noted that ICOs have reportedly raised over $16.7 billion as of the second quarter of 2018, which compares to less than $100 million in 2016. Although the novelty of ICOs and the excitement about the underlying blockchain technology have made these offerings particularly enticing for some investors, this exuberance can obscure the riskiness of these investments, with some offerings being outright frauds. Accordingly, the Enforcement Division's work in this area seeks to balance the need to protect investors from these risks with the potential that distributed ledger technology could have for capital formation.

Avakian stated that the Commission has taken several important actions since the creation of its Cyber Unit and the issuance of the DAO Report in the last fiscal year. Where the technology has provided merely a veneer for an alleged fraud, the SEC has taken enforcement action. In some cases, these actions have included obtaining court orders appointing receivers to identify and take control over the defendants' digital assets for the protection of investors.

The Commission has also suspended trading in the stock of nine different issuers when there was a question about the information available to investors about a security. Avakian observed that this approach has been particularly important when publicly traded companies have suddenly claimed to shift to blockchain-related businesses or when there is confusion about products that are being quoted.

Avakian stressed, however, that the Enforcement Division has tried to be thoughtful about how to handle ICO registration cases that do not involve fraud. For example, the SEC brought a non-fraud enforcement action against Munchee, an issuer that, after the release of the DAO Report, conducted an unregistered securities offering through an ICO. In that case, the Commission did not order Munchee to pay a penalty because it cooperated quickly and refunded its proceeds back to investors. She cautioned, however, that the Division will likely recommend more substantial remedies against issuers that fail to comply with securities registration requirements.

Summing up, Avakian said that the Enforcement Division has approached ICO and digital asset matters with a focus on bringing cases that deliver broad messages and have an impact beyond the individual cases. She said that the Division is very focused on considering—at the outset—whether and why pursuing a particular matter is a good use of its resources.

Share Class Selection Disclosure Initiative. Avakian said that the Enforcement Division has also been thinking strategically about ways to identify and pursue misconduct occurring at the intersection of investment professionals and retail investors. For example, the Division has been focusing on whether an adviser is accurately disclosing its practices regarding the selection of a more expensive mutual fund share class when a lower-cost share class for the same fund is available, especially when the adviser benefits from the more-expensive class. If an adviser decides to invest a client in a higher-cost share class when a lower-cost share

class of the same fund is available, the adviser must make full and fair disclosure regarding that decision so that the client can make an informed decision about its relationship with the adviser.

She noted that the Commission has brought more than 15 cases since 2013 involving disclosure issues surrounding advisers' decisions to invest their clients in higher-cost share classes. Despite these past enforcement actions and warnings from OCIE, however, problems have persisted. Accordingly, in February 2018 the SEC rolled out the Share Class Disclosure Initiative as a voluntary program for investment advisers to self-report to the Commission their failures to disclose their financial conflicts of interest relating to compensation they received in the form of 12b-1 fees.

In an effort to maximize the number of advisers that would self-report and make payments to investors, the Enforcement Division stated that it would recommend that the Commission not impose a penalty in these cases. Given the difficulty of detecting these sorts of violations, Avakian said, the Division believes that this was a worthwhile tradeoff. She observed that the SEC has received a substantial number of self-reports and expects to return money back to investors on a much broader scale, much more quickly, than would have occurred if the SEC had continued to pursue these investigations in the traditional way. The Share Class Disclosure Initiative thus exemplifies the Enforcement Division's focus on Main Street investors, imposing remedies that further the Commission's enforcement goals while assessing how to best allocate resources.

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