

SEC Enforcement Director Emphasizes Continued Focus on Pay-to-Play Issues

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On October 13, 2016, U.S. Securities and Exchange Commission (SEC) Enforcement Director Andrew Ceresney gave the keynote address at the Securities Enforcement Forum in Washington, DC. This year, Director Ceresney highlighted the SEC's work in the public finance arena, both through the Enforcement Division's Public Finance Abuse Unit and the SEC's Office of Municipal Securities. The municipal securities market consists of securities valued at over \$3.7 trillion, while public pensions hold over \$3.8 trillion in assets. As a result of the huge sums at stake, and the corresponding incentives to cheat to obtain that business, Director Ceresney's remarks focused on the Division's increased enforcement of the SEC's pay-to-play rules. The SEC's investigations and enforcement actions related to public finance have grown dramatically, resulting in civil and, in some cases in conjunction with federal prosecutors, criminal charges being levied against municipalities, entities, and individuals. Included in that speech was a nod to a notable case the SEC brought earlier this year, which expanded the traditional pay-to-play allegations outside the context of those participants regulated as investment advisers.

According to the SEC's complaint, in 2010, State Street Bank and Trust Company (State Street) was among the banks flocking to bid on subcustodian business for four Ohio state pension funds. State Street's vice president in charge of that business is alleged to have engaged in a scheme to funnel money to an Ohio Deputy Treasurer in exchange for his awarding the contracts to State Street. In addition to receiving certain kickbacks, the Deputy Treasurer was concerned that the State Treasurer was not raising enough money for his reelection, and demanded that State Street make contributions to the Treasurer's election campaign fund to obtain the business. In response, State

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Street hired Robert Crowe (Crowe), who was the co-chair of a national law firm's government relations practice, to facilitate the campaign contributions. Crowe is then alleged to have set out to illegally raise money for the Treasurer's campaign by exceeding individual campaign donations, creating fake invoices, and helping to hide State Street's conflict of interest. Ultimately, the state Treasurer lost his campaign, the scheme was uncovered, and on January 14, 2016, State Street agreed to pay \$4 million in disgorgement and an \$8 million penalty to resolve the SEC's allegations.

Crowe was sued the same day by the SEC. Unlike traditional pay-to-pay cases, however, this one was not brought under the Investment Adviser Act rules, but instead as a standard securities fraud suit under Sections 10(b) of the Securities and Exchange Act and 17(a) of the Securities Act. Crowe cried foul, and in his motion to dismiss argued that the SEC had no jurisdiction over his activities because, among other things, his activities did not fall under the Adviser's Act Rule 206(4)-5, the SEC's issued pay-to-play regulations. Exactly one week after Director Ceresney's speech, the district court issued an order denying Crowe's motion to dismiss. In its ruling, the court found that the fact that the pay-to-play rules did not apply to Crowe was irrelevant to the SEC's allegations because it did not charge him with a violation of those rules. Moreover, and perhaps most importantly for the SEC's case and others going forward, the court noted that "'pay to play' is not a term of art in federal securities laws, nor does the term appear in Rule 206(4)-5. Rather, 'pay to play' is a shorthand way to describe certain conduct," which can be regulated under Sections 10(b) and 17(a) against "any person," including those unaffiliated with a regulated entity. Thus, any individual or entity engaging in pay-to-play conduct has securities law exposure, regardless of whether they are an investment adviser or otherwise covered by the traditional pay-to-play rules.

In the SEC's press release at the time it filed its complaint against Crowe and settled the action against State Street, the SEC stated "[p]ay-to-play schemes are intolerable, and lobbyists and their clients should understand that the SEC will be aggressive in holding participants accountable." Despite the fact that State Street was not acting as an investment adviser, the SEC was able to utilize the general anti-fraud provisions of the securities laws to address this conduct, resulting in a substantial fine. Given Director Ceresney's decision to highlight this case and the additional activity this focus portends, any financial entity, regardless of whether the SEC's investment adviser pay-to-pay rules apply, would do well to take note and evaluate how it gets business from public entities and who it uses to facilitate that process.

Our team regularly counsels financial institutions on compliance with the various state and federal pay-to-play regulations. We also defend SEC, CFTC, and criminal investigations involving allegations of wrongdoing in the public finance sector.

For more information, please contact one of the authors listed.