

Dissecting the SEC's favorite weapon: Rule 102(e)

By: Joseph J. Floyd and Derek J. Miller – September 14, 2017



Approximately 76 percent of the Securities and Exchange Commission's Accounting and Auditing Enforcement Releases reported during the quarter ended June 30 are for Rule 102(e) sanctions against individuals — a quarterly percentage that reflects a record high for at least the prior five-year period.

Evaluating and understanding the facts and trends within the Rule 102(e) population can provide valuable insights for defense counsel and people involved in SEC enforcement investigations,

including:

- What types of sanctions are most often administered?
- Who receives sanctions?
- When negotiating sanctions, are certain terms and provisions under the rules more favorable than others?

For background, under Rule 102(e), the SEC has the power to suspend and disbar professionals from appearing or practicing before the commission on behalf of public registrants. Of note, there are three types of Rule 102(e) actions, simply denoted by section as (1), (2) and (3).

The first category, Rule 102(e)(1) actions, involves censuring a person or denying that person, temporarily or permanently, the "privilege of appearing or practicing" before the SEC based on findings that the individual:

- does not possess the requisite qualifications to represent others;
- is lacking in character or integrity or has engaged in unethical or improper professional conduct; or
- has willfully violated, or willfully aided and abetted the violation of, any provision of the federal securities laws or the rules and regulations thereunder.

Importantly, with respect to those licensed to practice as accountants, "improper professional conduct" under Rule 102(e)(1)(ii) means:

- Intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards.
- Either of the following two types of negligent conduct:
- A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted.
- Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the commission.

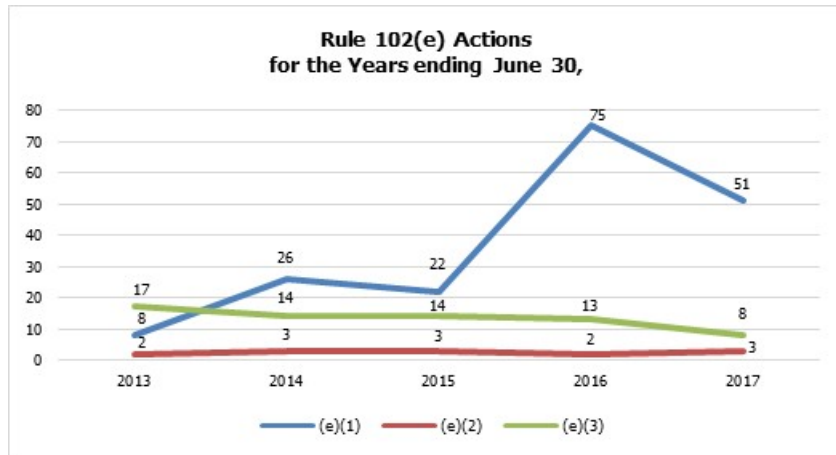
The second category, Rule 102(e)(2) actions, is specifically for people who have had a professional license suspended or revoked, or have been disbarred by a federal or state. This category also includes any person who has been convicted of a felony or a misdemeanor involving moral turpitude.

Finally, the third category, Rule 102(e)(3) actions, is limited to temporary suspensions stemming from proceedings brought by the commission in any court of competent jurisdiction.

As described above, Rule 102(e) actions represent a significant portion of total reported Accounting and Auditing Enforcement Releases. Remarkably, over the last five years, more than 260 people have received Rule 102(e) sanctions, and such actions account for almost 50 percent of all AAERs during that period.

What types of sanctions are most often administered?

As illustrated below, the increase in Rule 102(e) actions in recent years is concentrated in sanctions that cite Rule 102(e)(1). Actions filed under the other two provisions remained relatively consistent over the same time period.

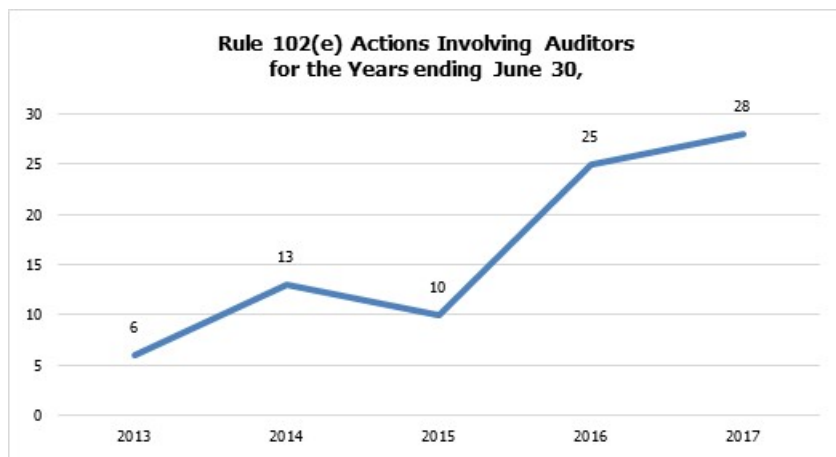


Who receives sanctions?

Among the population of people receiving Rule 102(e) sanctions from the SEC are "C" level executives, finance and accounting personnel, attorneys, auditors and others. Auditors, however, stand out when observing trends among these groups.

The chart below reflects the increase in Rule 102(e) actions involving auditors. In fact, auditors received almost the same number of Rule 102(e) sanctions as corporate officers for the five years ended June 30, 2017, with an increasing volume for auditors in more recent years.

Notably, sanctions for auditors exceeded those for corporate officers during the 12 months ended June 30, 2017, by a 2-to-1 margin.



Interestingly, there is a link between the increases in sanctions for auditors and Rule 102(e)(1) actions. In fact, more auditors are being sanctioned, and more often than not, under Rule 102(e)(1).

When negotiating sanctions, are certain terms and provisions more beneficial than others?

Facts and statistics can be very interesting; however, they become even more valuable when used in a meaningful way.

As described below, we analyzed the Rule 102(e) data to determine if any observations or trends exist that may be beneficial in negotiations with the SEC. Specifically, we sorted the data to assess the impact of various trends and types of Rule 102(e) sanctions on individuals with the potential to be reinstated to appear and practice before the SEC after receiving a Rule 102(e) sanction.

Our process involved compiling information about the people receiving sanctions during the five-year period ended June 30, 2017, and comparing the results to those being reinstated during the same period. The specific information we gathered for our comparison included the type of Rule 102(e) sanction and key terms and restrictions made in the sanction — notably, the terms “denial of privilege,” “suspension” and “cease and desist.”

We further separated the first two categories into those requiring a time period prior to applying for reinstatement and those without a time period. Cease and desist orders do not deny an individual the privilege of appearing or practicing, therefore a waiting period is not applicable.

Importantly, for Rule 102(e)(1) and (3) sanctions, an individual may reapply at any time unless a specific waiting period is defined. For Rule 102(e)(2) sanctions, an individual may reapply only if there is a reversal of the conviction or termination of the underlying suspension, disbarment or license revocation that gave rise to the sanctions.

Based on our analysis of this data, we made the following observations:

- People receiving Rule 102(e)(3) sanctions are disproportionately more likely to be reinstated than those receiving Rule 102(e)(1) sanctions.
- No one sanctioned under Rule 102(e)(2) received a reinstatement.
- Of significance, only people who received a defined waiting period are granted a reinstatement.

Therefore, when assessing this information, receiving a Rule 102(e)(3) sanction with a defined waiting period would appear to be the preferred treatment if one wishes to return to practicing and appearing before the SEC at some point in the future.

Finally, one other very significant observation stood out while we reviewed the data: a gender imbalance problem. Notably, the SEC issued 13 percent of the Rule 102(e) sanctions for the five-year period to women, while none were reinstated during that time period.

Unfortunately, the SEC reports who is sanctioned and who is reinstated, but nothing is reported on who applies for reinstatement, leaving a list of open questions as to whether women are less apt to re-apply, or to be reinstated after re-applying. In any case, it's a peculiar result.

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