

SEC/SRO Update:

SEC Charges China-Based Longtop Financial Technologies for Deficient Filings; SEC Commissioners Aguilar and Gallagher Confirmed; SEC Inspector General Releases Report on Destruction of Investigative Documents

BY PETER H. SCHWARTZ &
CRYSTAL L. GORDON

Peter H. Schwartz is a partner in the law firm of Davis Graham & Stubbs LLP and Crystal L. Gordon is Vice President and Associate General Counsel at Air Methods Corp., both in Denver, Colorado. The authors gratefully acknowledge the assistance of Beth C. Kramer in the preparation of this article. Contact: peter.schwartz@dgsllaw.com or cgordon@airmethods.com.

SEC Charges China-Based Longtop Financial Technologies for Deficient Filings

On November 10, the Securities and Exchange Commission's (SEC's) Division of Enforcement charged China-based Longtop Financial Technologies Ltd. with failing to file current and accurate financial reports with the SEC.¹ The SEC previously filed a subpoena enforcement action against Deloitte Touche Tohmatsu CPA Ltd. in Shanghai for failing to produce documents related to the SEC's investigation into possible fraud by Longtop, the audit firm's longtime client.²

According to the press release, the SEC's Division of Enforcement alleged that "Longtop failed to comply with its reporting obligations because

it failed to file an annual report for its fiscal year that ended March 31, 2011 ...[and that] Longtop's independent auditor stated in May 2011 that its prior audit reports on Longtop's financial statements contained in annual reports for 2008, 2009 and 2010 should no longer be relied upon."

Section 12(j) of the Securities Act of 1934 provides that the SEC is authorized to bring an administrative proceeding to determine whether to revoke or suspend the registration of a security, if a public company fails to comply with the federal securities laws. If the administrative law judge overseeing the proceeding were to revoke the registration of Longtop's securities, broker-dealers would be prohibited from executing any trades in those securities. Revocation also would make Longtop ineligible as a public shell company.

In this litigated administrative proceeding, Longtop will have an opportunity to refute the Division's allegations. The administrative law judge will then determine whether the allegations are true and whether the registration of Longtop securities should be suspended for a period not exceeding 12 months, or revoked altogether. Longtop is required to file periodic reports with the SEC until a final decision is made in this proceeding.

SEC Commissioners Aguilar and Gallagher Confirmed

On October 21, the U.S. Senate confirmed Luis A. Aguilar to serve a second term and Daniel M. Gallagher to serve as a commissioner of the SEC.³ Commissioner Gallagher, a Republican, was appointed to fill the vacancy created at the end of Commissioner Kathleen Casey's term. He had formerly served on the SEC staff, including as Deputy Director of the Division of Trading and Markets.

Commissioner Aguilar, a Democrat, began his first term as an SEC Commissioner on July 31, 2008.

SEC Inspector General Releases Report on Destruction of Investigative Documents

On November 1, the SEC's Office of the Inspector General (OIG) released its report regarding

the investigation into the SEC's policy of destroying documents gathered in preinvestigation inquiries (known as Matters Under Inquiry, or MUI), as well as statements made by the Commission to the National Archives and Records Administration (NARA) regarding that policy.⁴

On July 15, after receiving a letter from Gary Aguirre, counsel for Darcy Flynn (an SEC staff member who became a whistleblower), the Inspector General commenced its investigation regarding the alleged improper destruction of documents. The Inspector General found that the SEC had a long-standing policy calling for the destruction of documents even though the documents should have been preserved. The Inspector General also found that, when asked by NARA about the destruction of documents, representatives of the SEC did not disclose the existence of the policy and incorrectly stated it did not know if such documents had been destroyed.

The Inspector General stated that it did not find an improper motive for the policy; however, the OIG report did indicate that "there was a lack of clarity as to the rationale for the policy." Similarly, according to the report, the Inspector General was "not aware of a particular investigation that was hampered by the destruction of records for a MUI, although the OIG has not conducted an exhaustive audit or review..."

The OIG investigation also found that the SEC's Enforcement staff destroyed documents related to closed MUIs that should have been preserved as federal records, including anonymous correspondence and complaints, correspondence from the SEC requesting documents from companies in the course of a MUI, and correspondence accompanying companies' document production responses.

The report contained several recommendations for the Division of Enforcement, including:

- taking appropriate steps to determine what federal records from closed MUIs are retrievable, and ensure that any such federal records are retained in the same manner that investigative records are retained pursuant to the current schedule with NARA;

- working with the SEC's Office of Records Management Services and NARA to determine which MUI and investigative records are legally required to be retained;
- determining if there are additional federal records that, while not legally required to be retained, should be retained as a matter of policy; and
- review its guidance, including as it relates to automatically generated e-mails, to ensure that all guidance is consistent with federal record retention legal obligations.

NOTES

1. See SEC Press Rel. No. 2011-241 (Nov. 10, 2011), available at <http://www.sec.gov/news/press/2011/2011-241.htm>. See also SEC Rel. No. 34-65734 (Nov. 10, 2011), available at <http://www.sec.gov/litigation/admin/2011/34-65734.pdf>.
2. See SEC Press Rel. No. 2011-180 (Sept. 8, 2011), available at <http://www.sec.gov/news/press/2011/2011-180.htm>. See also SEC/SRO Update, *Wall Street Lawyer*, October 2011 (vol. 15, no. 10) © West Services, Inc., a division of Thomson Reuters.
3. See SEC Press Rel. No. 2011-219 (Oct. 21, 2011), available at <http://www.sec.gov/news/press/2011/2011-219.htm>. See also SEC Press Rel. No. 2011-232 (Nov. 7, 2011), available at <http://www.sec.gov/news/press/2011/2011-232.htm>.
4. "Destruction of Records Related to Matters Under Inquiry and Incomplete Statements to the National Archives and Records Administration Regarding that Destruction by the Division of Enforcement," *Report of Investigation, United States Securities and Exchange Commission, Office of Inspector General*, Case No. OIG-567 (Oct. 5, 2011); available at <http://www.sec.gov/foia/docs/oig-567.pdf>.