

Data Dispatch

SEC enforcement unit, stretched thin, faces rising tide of whistleblower tips EXCLUSIVE

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By Declan Harty

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This is the second story in a two-part series about small-cap fraud and regulatory enforcement. Part 1 can be found [here \(/web/client?auth=inherit#news/article?KeyProductLinkType=2&id=45511323\)](/web/client?auth=inherit#news/article?KeyProductLinkType=2&id=45511323).

Yolanda Holtzee still spends most of her days hunting fraudsters.

The Seattle-area whistleblower, who likes to say she has helped put more people behind bars than former U.S. district attorneys Preet Bharara and Rudy Giuliani, began her crusade against bad actors in small-cap stocks nearly 20 years ago.

Holtzee, 62, patrols the internet through social media, chat rooms and emails for suspicious stock recommendations and trading patterns. She then blasts her findings to a rolodex of top officials at the SEC. Her campaigns have earned her titles such as the "SEC Gadfly" and "Yolanda Quixote" from various financial publications.

"I like to do what I can to get the playing field a little bit more level for retail investors," Holtzee said in an interview. "[The SEC hasn't] gotten the funding that they need to not only hire more people, but to keep up with technology."

Wall Street's top regulator has faced budget cuts in each of the last two fiscal years. The SEC's enforcement division, its largest department, has received a thinner and thinner

slice of the agency's budget over the last 12 years, according to a review of SEC budget reports.

Those allocation cuts, along with new threats to investors

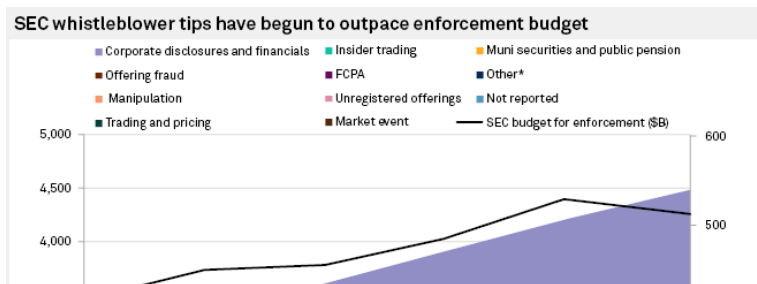
such as fraudulent initial coin offerings, have stretched the regulator's staff thin at a time when it is receiving more tips from unofficial deputies like Holtzee than ever before.

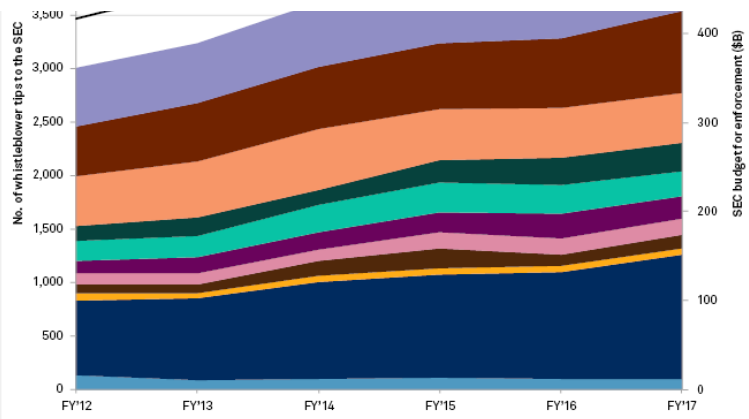
"Every time you cut the SEC's budget, you give an advantage to the market participant who wants to steal from investors," SEC Commissioner [Robert Jackson Jr.](#) ([/web/client?auth=inherit#news/article?KeyProductLinkType=2&id=45872168](#)) said in an interview.

Tips outpacing staff

Holtzee alone has issued more than 50 TCRs — the form market participants use to send tips, complaints and referrals to the SEC — with the agency's Office of the Whistleblower. Holtzee, who said she does not trade the securities she tips off to regulators, has also submitted more than a dozen claims, in which the whistleblower requests the monetary award connected with the enforcement. The SEC has collected on seven of those claims so far.

Now in its seventh year, the SEC's Office of the Whistleblower received a record 4,484 Form TCRs from market participants in fiscal year 2017, a 49.4% increase from fiscal year 2012, its first full year. The SEC, which also gathers tips from market participants who do not wish to or are ineligible to participate in the whistleblower program, has ordered more than \$1.4 billion in financial remedies in cases involving information provided by whistleblowers.





Data compiled Aug. 9, 2018.
 The SEC Whistleblower Office was founded late in fiscal year 2011. Statistics from 2011 were excluded from the chart.
 * Submitters who filed their tips, complaints and referrals in the "Other" category identified the claim as not fitting into any of the other allegation categories listed, according to the SEC.
 Source: SEC

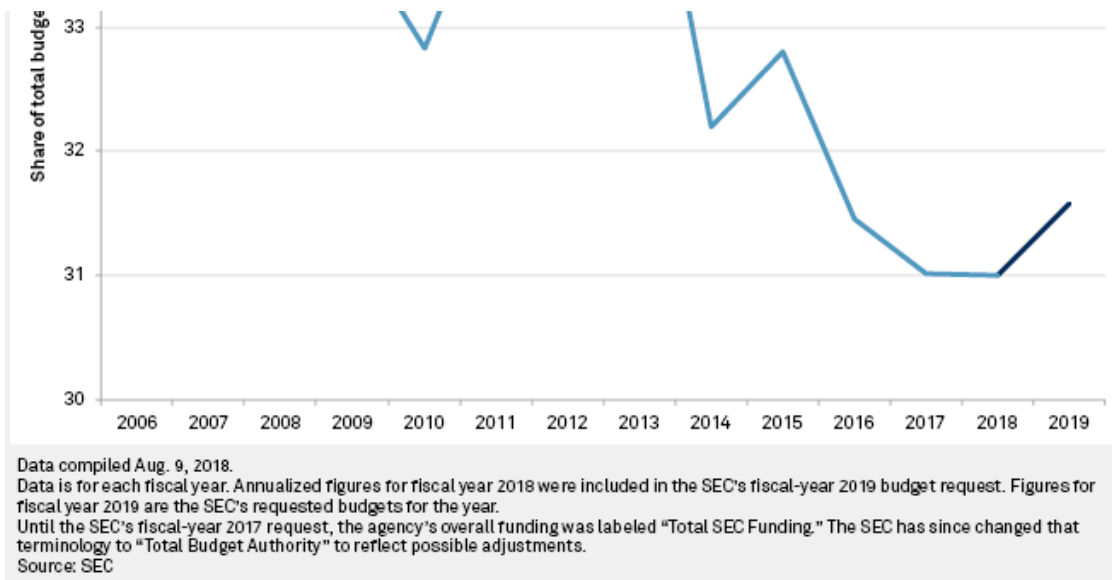
At the same time, the SEC's enforcement division is being allocated less of the regulator's budgetary resources. The division is set to receive \$505.8 million in fiscal year 2018, 31% of the agency's overall budget. That figure marks the smallest share that the division has received from the SEC's total budget since at least fiscal year 2006.

Each individual tip received by the SEC is "thoroughly evaluated" by the regulator's Office of Market Intelligence, which is housed with the enforcement division. The SEC does not break out Office of Market Intelligence staff figures separately.

But the growing number of tips has outpaced the enforcement division's staffing as a whole. In fiscal year 2017, there were 3.22 Form TCRs filed for every enforcement division staff member. That was up 30.9% from fiscal year 2012, when 2.46 Form TCRs were filed per staffer.

SEC enforcement division's share of overall budget has diminished (%)





The pink sheets

Whistleblowers have become especially prized in the sprawling market where most small-cap stocks list and trade: [the pink sheets \(/web/client?auth=inherit#news/article?KeyProductLinkType=2&id=45511323\)](#).

Officially known as the over-the-counter market, this opaque marketplace is home to over 10,000 securities, more than twice the number of domestic and foreign operating companies listed on exchanges owned by [Intercontinental Exchange Inc. \(/web/client?auth=inherit#company/profile?KeyProductLinkType=2&id=4099823\)](#) and [Nasdaq Inc. \(/web/client?auth=inherit#company/profile?KeyProductLinkType=2&id=4057757\)](#) at the end of 2017, according to data from University of Florida finance professor Jay Ritter.

With looser listing and trading requirements, the over-the-counter venues can be hotbeds for scams including pump and dumps, insider trading and fraudulent offerings. Regulators rely on other market participants to help oversee this space as companies that trade over the counter do not face the same disclosure requirements that most publicly traded companies do.

"Doors just slam shut anytime [the SEC] tries to get information normally," said Nathan Anderson, CEO and co-founder of hedge fund research firm [ClaritySpring Inc. \(/web/client?auth=inherit#company/profile?KeyProductLinkType=2&id=5274610\)](#), in an interview. Anderson has submitted about 25 Form TCRs with the SEC. "They rely on other people to be their eyes and ears to the

outside world."

In 2010, the SEC launched a microcap fraud working group designed to operate across its departments. Three years later, the regulator created its Microcap Fraud Task Force, which consists of a specialized group of enforcement attorneys and staffers dedicated to the small-cap stock market.

Pump and dumps have been one of the most pervasive forms of fraud in this market, with about 86% of such schemes from 2002 to 2015 taking place there, according to a 2017 study from Thomas Renault, assistant professor at the Université Paris 1 Panthéon-Sorbonne.

Through these frauds, criminals generate investor interest in thinly traded stocks by publishing false and misleading information to drive up the share price. The criminals will eventually sell their holdings in the stock at a profit, sending the share price spiraling.

Fraudsters used to run large call-center operations known as boiler rooms and mailed out thousands of pamphlets to promote these stocks. Those strategies started to change in the late 1990s with the rise of the internet, said John Reed Stark, a cybersecurity consultant who previously led the SEC's Office of Internet Enforcement, in an interview.

Today, bad actors rely on cheaper, widely used platforms such as social media, message boards and search engines to spread their campaigns. About 6% of active investors end up trading a stock targeted in a pump-and-dump scheme and see an average loss of 30% in the process,

according to a 2017 study from University of Chicago economics, finance and accounting professor Christian Leuz and four other economists.

"Fraudsters are always going to be looking for the newest way to rip people off. Sometimes it's by phone and sometimes it's by internet," SEC Commissioner [Hester Peirce \(/web/client?auth=inherit#news/article?KeyProductLinkType=2&id=45863113\)](#) said in an interview. "We're doing our best to use our resources wisely to catch ... problems, no matter what medium they occur in."

The SEC requested \$1.66 billion for fiscal year 2019, which would be the regulator's largest budget in three years.

But the recent budget cuts have created "an impossible situation" for staffers, one short seller who asked not to be named due to the confidentiality of whistleblower submissions, said in an interview. That is partly why the individual believes other market participants need to step

individual believes other market participants need to step up.

"There currently is a bit of an absence of gatekeepers in the marketplace," said the short seller, who has submitted more than two dozen Form TCRs with the SEC. "This is really a burden that falls on everyone."

Rachel Stone contributed to this article.

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