**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 79083 / October 12, 2016**

**INVESTMENT ADVISERS ACT OF 1940**
**Release No. 4548 / October 12, 2016**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-17622**

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| **In the Matter of**<br><br>**DEUTSCHE BANK SECURITIES INC.,**<br><br>**Respondent.** | **ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER** |

## I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") against Deutsche Bank Securities Inc. ("Respondent" or "DBSI").

## II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

## SUMMARY

1. This matter concerns three separate violations of the federal securities laws by DBSI: (1) the failure to establish, maintain, and enforce policies and procedures reasonably designed to prevent the misuse of material, nonpublic information generated by its equity research analysts, in violation of Section 15(g) of the Exchange Act; (2) the publication of a research report that was falsely certified as accurately reflecting the lead analyst's view regarding the covered company, in violation of Rule 501 of Regulation Analyst Certification ("Regulation AC"); and (3) the failure to preserve and furnish promptly to the Commission staff certain electronic communications relating to DBSI's business as a broker and dealer, in violation of Section 17(a) of the Exchange Act and Rule 17a-4 thereunder.

2. From at least January 2012 through December 2014 ("the relevant period"), DBSI failed to establish, maintain, and enforce policies and procedures reasonably designed to prevent its equity research analysts from misusing material, nonpublic information by, among other things, disclosing analysts' as yet unpublished views and analyses that appeared in subsequent DBSI research reports, certain changes of estimates by analysts, and short term trading recommendations that were inconsistent with the analysts' published long term ratings. The risk that material, nonpublic information could be misused was heightened by deficiencies in DBSI's policies and procedures pertaining to communications between DBSI's equity research analysts and DBSI customers and DBSI sales and trading personnel. In particular, although DBSI had certain policies and procedures and training in place for its equity research analysts, DBSI failed to establish, maintain, and enforce policies and procedures reasonably designed to prevent its equity research analysts from disclosing material, nonpublic information to DBSI customers and DBSI sales and trading personnel through various customer interactions and internal communications with DBSI sales and trading personnel.

3. DBSI violated the analyst certification requirement of Regulation AC. On March 29, 2012, DBSI issued a research report prepared and certified by a senior equity research analyst that was inconsistent with the analyst's personally held view. In the research report, the analyst rated the covered company's stock a "BUY," and certified that his recommendation reflected his personal views. In fact, however, the "BUY" recommendation was inconsistent with the analyst's personal view that the company should have been downgraded.

4. DBSI also failed to preserve, maintain, and timely produce to the Commission staff certain electronic communications that had been conducted on an internal DBSI messaging system, in violation of the record keeping requirements of Section 17(a) of the Exchange Act and Rule 17a-4 thereunder.

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

5. Accordingly, DBSI willfully violated Sections 15(g) and 17(a) of the Exchange Act and Rule 17a-4 thereunder and Rule 501 of Regulation AC.

## RESPONDENT

6. Deutsche Bank Securities Inc., a Delaware corporation with its principal executive offices in New York, New York, is a broker-dealer and investment adviser registered with the Commission pursuant to Section 15(b) of the Exchange Act and Section 203 of the Advisers Act. DBSI is an indirect wholly-owned subsidiary of Deutsche Bank AG, a foreign private issuer whose stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the New York Stock Exchange.

## FACTS

### A. DBSI's Equity Research

7. DBSI's equity research department is comprised of approximately fifty research analysts covering almost nine hundred stocks traded in the United States. DBSI's equity research analysts provide the firm's customers with investment recommendations and analysis on public companies and their stocks through published research reports. For each covered company, DBSI analysts publish reports that include an investment rating that reflects their twelve-month view of the stock's performance, a price target that they expect the stock to reach in twelve months, and estimates of the company's expected upcoming quarterly and annual earnings. During the relevant period, DBSI utilized a three-category investment rating system: BUY, HOLD, and SELL. DBSI equity research reports are sent to DBSI customers electronically and made available to DBSI customers on DBSI's website. DBSI research reports also are made available to others through third-party research service providers.

8. DBSI also allowed its equity research analysts to publish short term trade ideas on a DBSI website named "SOLAR," which is accessible to all DBSI customers. DBSI's policies and procedures required that these short term trade ideas be aligned with the analyst's published long term investment rating for that security, unless the analyst had a published long term rating of HOLD, in which case a short term trade idea was permitted to be either a BUY or SELL.[2]

9. During the relevant period, DBSI encouraged its equity research analysts to have frequent contact with DBSI customers and DBSI sales and trading personnel. Accordingly, DBSI equity research analysts communicated regularly with both DBSI customers and DBSI sales and trading personnel by telephone, email, instant messaging, and in-person to answer questions about the public companies and the industries and industry sectors that the analysts covered. DBSI had policies and procedures, and trained its research analysts, on how to engage in such communications, including that they must speak consistently with their published views. DBSI

[2] DBSI's policies and procedures expressly stated that "if the underlying recommendation is a BUY, the [short term recommendation] may only be a BUY" and "if the underlying recommendation is a SELL, the [short term recommendation] may only be a SELL."

sales and trading personnel conveyed information that they had learned from DBSI equity research analysts to DBSI customers.

10. DBSI's performance evaluation and compensation system for its equity research analysts, during the relevant period, took into consideration customer assessments of DBSI's research analysts.[3] DBSI measured customer satisfaction with its research analysts based, in part, on certain independent surveys of investors and other consumers of equity research, such as the *Institutional Investor* magazine's "All-America Research Team" and Greenwich Associates' "Greenwich Research Team Survey," as well as votes that each analyst received directly from institutional investors through a process known as "broker votes." These three rankings accounted for more than forty percent of an analyst's internal performance rating, making them when combined the largest component of a research analyst's performance evaluation. One DBSI analyst acknowledged a customer's positive appraisal of his work and the customer's vote for him in the *Institutional Investor* poll, by responding in an email: "[I]t's how we get 'paid,' so thanks very much." This evaluation and compensation structure created a risk that DBSI equity research analysts would share their potentially market-moving nonpublic views about covered companies with DBSI customers.

11. Many institutional investors rate research analysts and other "sell side" broker-dealer personnel by assigning "broker votes" to those whom they want to reward for good service, and then allocate their trading, and resulting commissions, to the firms whose personnel they have rated the most highly. DBSI research analysts were aware of the importance that DBSI placed on broker votes and investor surveys. For example, in early March 2012, DBSI held an equity research analyst meeting to emphasize to DBSI's research analysts and sales personnel the importance of *Institutional Investor* votes to DBSI. Slides used during the meeting, and subsequently distributed to DBSI's analysts, described a campaign that DBSI intended to conduct to generate *Institutional Investor* votes for the firm and its employees with the goal of becoming a top five bank in *Institutional Investor* voting.

## B. DBSI Failed to Establish, Maintain, and Enforce Policies and Procedures That Were Reasonably Designed to Prevent DBSI Equity Research Analysts from Disclosing Material, Nonpublic Information Regarding, Among Other Things, Their Views and Analyses of Covered Companies

12. During the relevant period, DBSI's policies and procedures governing the conduct of its equity research department were primarily set forth in two documents: (1) "Research Policies and Procedures Manual – Markets US" ("Research Manual") and (2) the "Research Integrity and Cross-Divisional Interactions Policy – Corporate and Investment Bank" ("CIB"). These documents included, in some instances, overlapping policies and procedures. During the relevant period, DBSI equity research analysts also received training on the firm's policies and procedures, including

[3] NASD Rule 2711(d)(2), which was in effect during the relevant period, required broker dealers to consider, among other things, "the overall ratings received from clients, sales force, and peers independent of the member's investment banking department, and other independent ratings services" in determining the compensation of their research analysts. The rule did not, however, prescribe the relative weight that a firm ought to assign to any of the factors.

during mandatory annual compliance trainings for equity research personnel, and also received training and email alerts regarding emerging compliance issues.

### i. Analysts' Views and Analyses Intended for Publication in Forthcoming DBSI Research Reports and Estimate Changes of Less Than Ten Percent

13. DBSI's policies and procedures required the broad public dissemination of all DBSI research reports. To ensure simultaneous public dissemination, DBSI's policies and procedures generally prohibited equity research analysts from sharing forthcoming research, deemed "research in process," with anyone outside of the firm's equity research department. DBSI's policies and procedures also required equity research analysts to publish a research report before sharing a "change in view, recommendation, rating, price target or estimate" with select DBSI customers and DBSI sales and trading personnel. These policies and procedures, which were designed to prevent the misuse of material, nonpublic information generated by DBSI's equity research analysts, were not reasonably designed in two key respects.

14. DBSI's written policies and procedures stated that "research in process" includes two periods (1) "the time frame beginning the moment an analyst begins drafting a report and ending when the report is published," as well as (2) an "earlier time period … beginning when an analyst has definitely decided to publish a report and has a developed thesis for that report." This policy, however, was susceptible to differing interpretations.[4]

15. For example, DBSI compliance and equity research personnel who were responsible for providing guidance and training to analysts and others on DBSI's policies and procedures believed that "research in process" did not exist until an equity research analyst had a developed thesis for a forthcoming research report, regardless of whether the analyst or the analyst's team had decided to publish a research report or even begun drafting a research report, as stated in the first prong of DBSI's written policy. Similarly, a senior equity research analyst ("Analyst A") claimed that because he had not yet developed an investment thesis following a non-deal road show, his team did not have "research in process" even after he had directed a junior analyst who reported to him to begin drafting a research report that they intended to publish two days later. In the meantime, Analyst A proceeded to speak with DBSI customers regarding his materially changed views of the issuer.

16. DBSI's policies and procedures stated that analysts "must safeguard research in process" and that research in process "must not be shared with clients or potential clients (external or internal) prior to publishing." DBSI's policies and procedures also directed equity research analysts to "take steps to ensure that the contents of a pending research report cannot be viewed by those outside of the research department," and DBSI had established other controls to address these risks, such as restricting access to the floor where fundamental equity analysts worked and maintaining a policy that prohibited all "market-sensitive research reports" from being written on

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4 Under DBSI's policies and procedures, DBSI equity research personnel were directed to contact DBSI's Legal and Compliance departments for guidance "should there be any question concerning whether there is 'research in process.'"

the sales and trading floor. However, these policies and procedures did not address the ambiguity in DBSI's definition of "research in process."

17. At the same time, however, DBSI's policies and procedures permitted equity research analysts to communicate with DBSI customers and DBSI sales and trading personnel about companies that were the subjects of research in process if the communications "did not reflect or signal a material change from the analyst's prior published view."

18. DBSI's policies and procedures did not adequately define what constituted a "material change." DBSI also failed to provide adequate guidance and training to its equity research analysts regarding what constituted "a material change from the analyst's prior published view." For example, under DBSI's written policies and procedures, an analyst's rating or price target change was deemed to be always material, but an estimate change by an equity analyst was considered material only when the change was greater than ten percent.[5] Furthermore, DBSI equity research and compliance personnel applied the ten percent threshold based solely on changes in an analyst's annual, not quarterly, estimates. Thus, DBSI policies and procedures permitted equity analysts to disclose to customers other than in published research reports greater than ten percent changes in quarterly estimates, as long as such changes did not also result in a greater than ten percent change in their annual estimates.

19. An equity analyst's change of ten percent or less in estimates of annual or quarterly corporate financial performance – particularly when the analyst is highly regarded – can be, and often is, highly relevant and material to investors.[6]

20. Accordingly, by adopting a threshold of ten percent for materiality with regard to analyst estimate changes, and limiting the policy only to changes in annual estimates, DBSI created a risk that analysts would disclose to certain customers material, nonpublic information regarding changes to annual and quarterly estimates without first publishing such information in research reports.

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[5] In contrast to the unqualified statements contained in the firm's written policies that analyst's price target changes always were material, DBSI's Supervisory Analyst Handbook, which governed the conduct of DBSI equity research personnel responsible for reviewing and approving DBSI research reports, specified that only changes to price targets of ten percent or greater were required to be published in research reports. Moreover, DBSI's policies concerning communications between equity research personnel and investment banking personnel provided that "analysts may never provide Banking (*or any other party*) with an advance notification of a pending rating, price target, *or estimate change*." (Emphases added.) This policy did not condition the restriction on whether an estimate change was material or greater than ten percent.

[6] The materiality standard applied by the courts to Section 10(b) and Rule 10b-5 of the Exchange Act, a principal antifraud provision of the federal securities laws applies in the context of Section 15(g). Information is deemed material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-232 (1988), *citing TSC Industries, Inc. v. Northway,* 426 U.S. 438, 449 (1976). An omitted fact is material if there is a substantial likelihood that the disclosure of that fact would have been viewed by a reasonable investor as having significantly altered the total mix of information made available. *Id.*

21. DBSI's policies and procedures did not specify what other types of pre-publication information, apart from ratings, price targets, and certain estimate changes, was deemed to be material, and therefore, could only be disclosed in a published research report.

22. As a result of these weaknesses in its policies and procedures, DBSI failed to prevent the disclosure of potentially market sensitive information that was to be included in forthcoming DBSI research reports and analysts' estimate changes of ten percent or less. For example:

a. On February 2, 2012, a DBSI senior equity research analyst ("Analyst B") published a research report on Company A. In the report, Analyst B estimated that the company's 2012 first quarter earnings before interest, taxes, depreciation, and amortization ("EBITDA")[7] would be $850.6 million, which included a first quarter EBITDA of $430.9 million for a region of Company A's business ("Region A"). Approximately two months later, on April 9, 2012, the Analyst B told certain DBSI customers and DBSI sales and trading personnel that he expected Company A's first quarter EBITDA to be higher than his previously published estimate, explaining that he had calculated a first quarter EBITDA of $490 million for Region A. This change in the analyst's Region A estimate represented a 13.7% increase from his earlier estimate for Region A and a 6.9% increase from his earlier estimate for Company A in total. Ten days later, on April 19, 2012, the Analyst B published another research report on Company A, in which he raised his estimate of Company A's first quarter EBITDA to $906 million, based largely on an increase in his estimate for Region A's first quarter EBITDA to $479.5 million.

b. On February 21, 2012, Analyst B published a research report on Company B. In the report, Analyst B estimated that the company's 2012 first quarter EBIDTA would be $125.7 million. Two months later, on April 23, 2012, the day before Company B was scheduled to release its 2012 first quarter earnings, the analyst told certain DBSI customers that he expected Company B's first quarter EBITDA to be as high as $139 million, which was a 10.6% increase from his earlier estimate. The next day, the analyst emailed a DBSI salesperson stating that even a first quarter EBITDA of $134 for Company B was a "meaningful beat." Analyst B never issued a research report with the revised estimate for Company B.

c. On March 28, 2012, Analyst A hosted a non-deal road show for Company C.[8] Beginning at about 7:30 a.m. and continuing until about 3:15 p.m., the company's executives met privately with DBSI customers. Analyst A attended all of these meetings. Shortly after the meetings had ended, Analyst A contacted certain DBSI customers, sharing his impressions from the meetings and his view of the company's prospects for the quarter. That night, Analyst A sent an email to the head of DBSI's Institutional Client Group for North America, stating that he had a "note hitting in the a.m. [that] will likely rattle the stock." The following morning, March 29, 2012, Analyst A published a

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7 EBIDTA is used by some research analysts as a measure of a company's profitability.

8 A non-deal road show is a series of meetings between company management and representatives of institutional investors, typically hosted by a broker-dealer, during which the participants discuss the performance and future prospects of the company, but no securities are offered for sale.

research report on Company C that contained information that was substantially the same as the information that he had conveyed to at least one of the DBSI customers with whom he spoke the day before, as reflected in notes that were taken by that particular DBSI customer.

d. In an instant message to a junior equity research analyst sent on April 4, 2012, Analyst A described his practice of previewing his forthcoming research for certain customers. After the junior analyst had asked Analyst A whether he was going to issue a research report following a meeting that the senior analyst had hosted between the management of a company that he covered and certain DBSI customers, Analyst A responded that he would not publish immediately, and explained that he usually waited two days following such a meeting before publishing a report because it "give[s] clients the opportunity to trade on what they lea[rned] and more importantly allows me to talk about it before telling the world." The junior analyst replied, "understood and makes sense."

### ii. Unpublished Short Term Trade Recommendations That Were Inconsistent With An Analyst's Long Term Published Ratings

23. In addition to publishing long term ratings based on their twelve-month view of a stock, DBSI's equity research analysts also were permitted to publish short term trade ideas on DBSI's SOLAR website. DBSI's policies and procedures expressly stated that SOLAR was "the only setting wherein an analyst may express a short term trade idea." DBSI's policies and procedures prohibited equity research analysts from selectively disclosing any trading recommendation that was contrary to their long term published ratings. Similarly, all DBSI research reports issued during the relevant period included the following standard disclosure regarding short term trade ideas: "Deutsche Bank equity research analysts sometimes have shorter-term trade ideas (known as SOLAR ideas) that are consistent or inconsistent with Deutsche Bank's existing longer term ratings. These trade ideas can be found at the SOLAR link at http://gm.db.com." In addition, DBSI's policies and procedures stated that pending SOLAR ideas must be treated as material, nonpublic information, and accordingly, all DBSI customers had to have equal access to them.[9]

24. DBSI's policies and procedures with regard to short term trade ideas were not reasonably designed because they failed to clearly define what constituted a "short term trade idea." Indeed, DBSI's public disclosures on the SOLAR website and in blast emails sent to DBSI customers announcing new SOLAR ideas were inconsistent with DBSI's policies and procedures.[10] The SOLAR website and the blast emails stated that SOLAR ideas were limited to short term trade ideas that an analyst believed would be valid for at least two weeks. The disclosure stated, in pertinent part, that: "Analyst believes the stock will out [or under] perform

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[9] The firm's training materials during the relevant period reiterated these concepts. For example, the slides for an annual compliance training for research analysts in 2011 included the following guidance: "Never Write or Say Anything Contrary to Your Published Investment View," "Never Contradict Published Investment View Even If You Are Not the Lead Analyst," "Never Traffic In Material Nonpublic Information," and "Use SOLAR to Express All Short Term Trade Ideas."

[10] They also were inconsistent with the public disclosure made in all DBSI research reports issued during the relevant period that short term trade ideas could be found on the SOLAR website.

the market and/or sector delineated *over a time frame of no less than 2 weeks* with a high to moderate [or moderate to low] return to risk profile." (Emphasis added). However, DBSI's policies and procedures failed to address the risk that in disseminating short term trade ideas of less than two weeks conviction, which were not required to be published on the SOLAR website, research analysts could divulge material, nonpublic information regarding changes in their views of a company and provide trade ideas that ran counter to their published long term ratings, in violation of DBSI's policies and procedures.

25. As a result of these weaknesses in its policies and procedures, DBSI failed to prevent research analysts from disclosing short term trade ideas that were not published in SOLAR, some of which were inconsistent with the analyst's published long term rating, in communications with DBSI customers and DBSI sales and trading personnel. For example:

a. In a May 3, 2012 instant message, Analyst A told DBSI's head trader responsible for trading consumer stocks to "short" a stock for which the analyst had a published HOLD rating. Similarly, in an October 10, 2012 email to DBSI sales and trading personnel, which he copied to three junior equity research analysts who reported to him at the time, the same analyst recommended a "buy" for a stock for which he had a published HOLD rating.

b. In an April 24, 2012 instant message, Analyst B told a DBSI customer to "get out" and "puke" a stock for which he had a published HOLD rating. Similarly, in a May 20, 2012 email, Analyst B told another DBSI customer to "short" a different stock for which the analyst had a published HOLD rating.

## C. <u>DBSI Failed to Establish, Maintain, and Enforce Reasonable Policies and Procedures For Communications Between DBSI Equity Research Analysts and DBSI Customers and DBSI Sales and Trading Personnel</u>

26. DBSI's failure to establish, maintain, and enforce policies and procedures reasonably designed to prevent its equity research analysts from disclosing material, nonpublic information was further amplified by shortcomings in its policies and procedures pertaining to communications between DBSI's equity research analysts and both DBSI customers and DBSI sales and trading personnel. In particular, DBSI failed to establish, maintain, and enforce reasonable policies and procedures to prevent its equity research analysts from using various customer interactions and internal communications with DBSI sales and trading personnel, including, but not limited to, morning calls, squawks, idea dinners, and non-deal road shows to disclose potentially market sensitive information to DBSI customers and DBSI sales and trading personnel. These deficiencies created a risk that material, nonpublic information generated by DBSI equity research analysts might be misused.

### i. Morning Calls and Squawks

27. For most days the stock market was open, DBSI held a premarket internal "morning call" during which DBSI equity research analysts provided information and recommendations to the DBSI sales staff on the companies and stocks that they covered. During the day, DBSI research

analysts also communicated breaking news and recommendations on the companies and stocks that they covered to the DBSI sales staff over an internal intercom system known as a "squawk box." DBSI asserts that it had an unwritten policy of allowing research analysts to speak on morning calls generally if they were discussing only recently-published research. Similarly, DBSI asserts that research analysts were only permitted to speak on the squawk box if they were discussing recently-published research or responding to publicly-available information, such as breaking market news, earnings, or a corporate event. Nevertheless, at various times, morning calls and squawks were not monitored or were inadequately monitored and remarks made by analysts that went beyond that which was permitted were not subjected to follow-up by compliance personnel or supervisory analysts.[11]

28. DBSI sales personnel were permitted to share the information and recommendations that they learned during these morning calls and over the squawk box with DBSI customers. This created a risk that DBSI equity research analysts could disclose unpublished market sensitive information during morning calls and squawks, which DBSI sales personnel in turn could relay to external and internal customers. DBSI failed to establish, maintain, and enforce policies and procedures reasonably designed to address the risk that research analyst participation in morning calls and squawks could result in the disclosure of material, nonpublic information.

29. Prior to the time, in early 2013, when DBSI became aware of the Commission staff's investigation, DBSI lacked policies and procedures reasonably designed to prevent the disclosure of potentially material, nonpublic information with regard to morning calls and squawks. For example, compliance personnel did not regularly monitor the information that research analysts and others shared during morning calls and over the squawk box, and DBSI compliance did not maintain any record of the information that research analysts shared during their squawks. Consequently, hundreds of morning calls and squawks were conducted without any oversight from DBSI compliance personnel or supervisory analysts.

30. Moreover, during the relevant period, DBSI failed to enforce even the limited policies and procedures that the firm had established pertaining to morning calls and the squawk box. For example, with respect to squawks, DBSI's policies and procedures required that to "relay information intraday [on the squawk box] (including rating, estimate, or price target changes and newsworthy items), Analysts must contact the Equity Focus Group prior to publication of [research reports], and should email the main points to the Equity Focus Group." However, DBSI equity research analysts regularly failed to email their main points to the Equity Focus Group, but nonetheless, were still permitted to relay information on the squawk box. Similarly, with respect to morning calls, DBSI's policies and procedures prohibited equity research analysts who had not very recently published a research report from commenting during morning calls without first having contacted the Equity Focus Group to preview their planned comments. However, this procedure was seldom followed. The head of DBSI's Equity Focus Group acknowledged that this procedure "did not reflect how it actually happens."

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[11] Personnel from DBSI's Equity Focus Group, which is a group within DBSI's research department, organized and hosted the morning calls and squawks. Although the Equity Focus Group was not part of DBSI's compliance department, it had established controls over the morning meetings and squawks, such as controlling which particular analysts could provide commentary and retaining the ability to cut off an analyst if any commentary was inappropriate.

31. As a result of these deficiencies, DBSI failed to prevent the disclosure of potentially market sensitive information during morning calls and over the squawk box. For example:

a. On March 22, 2012, Analyst C spoke about Company D during a morning call, after he had published a research report on the company earlier that morning in which the analyst had upgraded his rating for its stock from a HOLD to a BUY and increased his price target for the stock to $100. During the morning call, Analyst C stated his view that, assuming Company D had fifteen percent earnings per share growth for 2013, the company was a "$110 to $115 stock." A week later, on March 28, 2012, Analyst C spoke about Company D during another morning call, having published a research report on the company earlier that morning. The analyst once again gave an estimated future price of the stock that was above his published $100 price target: "My price target is $100 right now just cause I haven't revised the model ahead of the [company's fourth quarter earnings] call. But I can, as I said last week, I can get to a midterm target of $110 or even a little higher." Analyst C never published a research report containing his midterm price target of at least $110. There is no record that DBSI compliance or research supervisors noted this statement or took any corrective measures with regard to Analyst C.

b. On March 29, 2012, Analyst A spoke about Company C during a morning call, having published a research report on the company earlier that morning that had maintained both his BUY rating and price target. During the morning call, Analyst A explained that he had maintained his BUY rating because "obviously we just had them in town so it's not kosher to downgrade on the heels of something like that." Analyst A also said, "[B]ut more importantly than that, I think there's obviously time left in the quarter" and that he and his team were "gonna do our homework on it" and "gonna be in front of 'em." Less than a month later, on April 24, 2012, the morning after Company C had issued an unexpected press release forecasting negative first quarter comparable store sales, which resulted in the company's stock losing almost one-quarter of its value in one day, Analyst A spoke about Company C on another morning call. After discussing the company's disappointing first quarter sales figures, he stated: "[F]ortunately, we told many clients a few weeks back to sell the stock…. I think the writing was on the wall [that] we were getting concerned about it, but I was trying to maintain, you know, my relationship with them. So that's why we didn't downgrade it a couple weeks back."

c. On April 10, 2012, Analyst A spoke about Company E on the squawk box shortly after the company had announced its fourth quarter earnings. Later that same day, the analyst issued a research report on Company E. The report included substantially the same information that the analyst had shared in his earlier squawk, as shown below.

| **DBSI Sales Employee's Notes of Squawk** | **April 10, 2012 Research Report** |
|---|---|
| Going to get a relief rally here. | Relief Rally on Tap |
| Looking at their guidance, we simply do not think it's achievable. | Guidance Looks Optimistic, In Our View |

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|---|---|
| Very curious as to why they've put out such high expectations. Net net we don't think they'll be able to deliver. | [Company E] would have been better served giving more conservative guidance. |
| Comp is a little better | ID's [identical store sales]- Better-Than-Expected |
| Staying on the sidelines. | Net, we remain comfortably uninvolved (i.e., HOLD rating). |

**ii. Idea Dinners**

32. Consistent with DBSI's practice of encouraging its equity research analysts to interact with DBSI customers, DBSI research analysts were permitted to participate in "idea dinners" hosted by the firm. Idea dinners[12] presented another opportunity for equity research analysts to discuss the public companies and stocks they covered with DBSI customers in an informal setting. Under the typical format, DBSI equity research analysts as well as DBSI customers were expected to share at least one buy or sell investment idea. The idea dinners created a heightened risk that DBSI equity research analysts could disclose material, nonpublic information to selected customers, in order to receive positive assessments, such as *Institutional Investor* votes, from those DBSI customers for the analysts' annual evaluations by DBSI. DBSI failed to take reasonable steps to prevent material, nonpublic information from being disclosed at these dinners.

33. DBSI failed to monitor whether its equity research analysts were violating DBSI's policies and procedures at idea dinners, by, for example, offering trade recommendations that were inconsistent with their published long term ratings. DBSI had no policies and procedures and no formal trainings specifically related to such dinners. Moreover, DBSI compliance personnel did not attend idea dinners nor did they preview or subsequently review the trade ideas shared during these dinners. DBSI also did not maintain any record of the investment ideas shared at idea dinners.

34. As a result of these deficiencies, DBSI failed to prevent the disclosure of short term trade ideas that were not published on SOLAR and were inconsistent with analysts' published ratings. For example, at an April 26, 2012 idea dinner hosted by DBSI, which was attended by approximately ten DBSI customers, a DBSI junior equity research analyst who attended together with Analyst A shared two trade recommendations for companies that he covered along with Analyst A that were inconsistent with their published HOLD ratings.

**iii DBSI Customer - Issuer Meetings Conducted by DBSI Research Analysts**

35. DBSI also encouraged its equity research analysts to interact with DBSI customers by, among other things, organizing or hosting events such as non-deal road shows, company tours, and other similar issuer/customer meetings, which provided DBSI customers an opportunity to meet directly and interact with management of the companies covered by DBSI

[12] Occasionally, these events were held during lunches, but for ease of reference, all are referred to collectively as idea dinners herein.

analysts. DBSI research analysts that hosted such events often issued research reports on the companies shortly after the events. The reports typically included the analyst's key impressions from the meetings. Under these circumstances, there was a heightened risk that, during the period after the event until the publication of a report by the hosting analyst, an analyst could disclose material, nonpublic information regarding the analyst's views of the company as a result of information learned or impressions formed during the event that later would appear in a published research report. DBSI also lacked policies and procedures reasonably designed to determine whether DBSI equity research personnel who attended the events with company management were divulging or acting upon material, nonpublic information obtained from company management.

36. Despite these risks, DBSI failed to establish, maintain, and enforce policies and procedures reasonably designed to prevent its equity research analysts from disclosing material, nonpublic information to certain DBSI customers and DBSI sales and trading personnel following these events and prior to the publication of research reports that contained information that the analyst may have learned and views that the analyst may have formed during these events. DBSI had no policies and procedures that addressed these events, apart from a prohibition against DBSI research and investment banking personnel jointly attending or organizing non-deal road shows. DBSI did not provide any specific training for its analysts related to these events or on how to conduct customer contacts subsequent to these events. DBSI compliance personnel did not attend or monitor these events or chaperone the analysts' contact with customers immediately after these events and prior to the publication of post-event research reports.

37. As a result, on several occasions during the relevant period, DBSI failed to prevent equity research analysts from disclosing nonpublic market sensitive information that they had learned or developed during these issuer/customer events to certain DBSI customers and DBSI sales and trading personnel before the same information appeared in DBSI research reports. For example:

a. As discussed above, on March 28, 2012, Analyst A disclosed the substance of his forthcoming research report on Company C to certain DBSI customers immediately after hosting a non-deal road show for the company.

b. On April 3, 2012, Analyst A hosted ten DBSI customers for a headquarters trip to Company F. Beginning at approximately 2:00 p.m., Analyst A and DBSI customers met privately with Company F management. Early the next morning, Analyst A emailed his impressions from the trip to select DBSI customers and DBSI sales and trading personnel. The subject line of his emails varied for different DBSI customers, ranging from "these are full notes" to "some good color for you today … get long brotha." In the email, the analyst emphasized that in his opinion Company F "sounded rock solid." One DBSI customer who received the email thanked Analyst A for his "great summary." Later that same day, the junior equity research analyst who was working on an initial draft of the forthcoming Company F research report emailed Analyst A that he had emphasized points from Analyst A's email in his draft of the research report. On April 9, 2012, Analyst A published a research report on Company F that increased his price target from $49 to $52 and contained information that was substantially the same as the information that he had conveyed in his April 4, 2012 email.

**D. DBSI Issued a Research Report by a Senior Equity Research Analyst That Was Inconsistent With His Personally Held View**

38. On March 29, 2012, DBSI issued a research report by Charles P. Grom, a DBSI senior equity research analyst, on Big Lots, Inc., in which Grom reiterated his BUY rating. As required by Regulation AC, Grom signed an analyst certification that was included at the end of the report, which stated: "The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer." In fact, however, his BUY rating was inconsistent with his personal view that the company should have been downgraded. As discussed above, during a morning call with DBSI's sales and trading staff on the day that his research report was published, as well as on at least two subsequent occasions, Grom stated that he wanted to, but did not, downgrade Big Lots in order to maintain his relationship with its management. Grom subsequently repeatedly stated that at about the time that he had published the report in question, he had told certain DBSI customers to sell Big Lots stock, notwithstanding his published BUY rating.[13]

**E. DBSI Failed to Timely Produce and Preserve Internal DB Chat Communications**

39. In early 2015, during the course of the Commission staff's investigation into DBSI's policies and procedures, DBSI discovered a problem with the software responsible for preserving electronic communications sent and received through DBSI's internal "DB Chat" messaging system. DBSI personnel, including equity research personnel, used DB Chat to conduct DBSI business. Indeed, DBSI's policies and procedures specifically stated that the DB Chat system was "for business use only."

40. After discovering the problem, DBSI was able to recover a substantial amount of the DB Chat communications sent and received by DBSI equity research personnel during the relevant period, although it could not represent that it had recovered all of the called-for communications. Accordingly, DBSI failed to preserve for three years and preserve in an accessible place for two years certain internal DB Chat communications. DBSI also failed to promptly furnish copies of certain DB Chat communications that had been requested by the staff during the investigation.

[13] On February 17, 2016, the Commission instituted a settled public administrative and cease-and-desist proceeding against Grom for violating Rule 501 of Regulation AC. *See In re Charles P. Grom*, Exchange Act Rel. No. 77150 (February 17, 2016). Without admitting or denying the Commission's findings, Grom consented to the entry of the Commission's order and agreed to pay a $100,000 civil penalty and to be suspended from the securities industry for a year.

## LEGAL ANALYSIS

### A. Section 15(g) of the Exchange Act

41. Section 15(g) of the Exchange Act requires registered broker-dealers to establish, maintain and enforce written policies and procedures, reasonably designed, taking into consideration the nature of the broker-dealer's business, to prevent the misuse, in violation of the Exchange Act or the rules and regulations thereunder, of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer.[14] The internal controls requirements imposed by Section 15(g) are essential to protect against the risk of misuse of material, nonpublic information, which can undermine investor confidence in the integrity of the markets. Section 15(g) is intended to guard against a broad range of potential market violations, including insider trading and trading in advance of material research changes. *See* 143 Cong. Rec. E3078-04, 1988 WL 180248 (Sept. 13, 1988) (stating that "misuse of material, nonpublic information" as used within Section 15(f) was intended to include a broad range of market abuses, such as insider trading, scalping, and front running).

42. Broker-dealers must be cognizant of their duties under Section 15(g) and the need to tailor their policies and procedures to the specific activities of the individual firm, particularly as their businesses evolve. The Commission consistently has made clear that the requirement that broker-dealers implement and maintain policies and procedures consistent with the nature of its business "is critical to effectively preventing the misuse of material, nonpublic information." *In re Gabelli & Co., Inc.*, Exchange Act Rel. No. 35057 (Dec. 8, 1994). The Commission also has consistently made clear that broker-dealers must take seriously their responsibilities to design and enforce sufficiently robust policies and procedures to prevent the misuse of material, nonpublic information. *See, e.g., In re Goldman, Sachs & Co.*, Exchange Act Rel. No. 66791 (April 12, 2012) (finding Section 15(g) violation where Goldman Sachs had not established, maintained, and enforced adequate policies and procedures concerning its trading "huddle" program); *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Exchange Act Rel. No. 59555 (March 11, 2009) (finding Section 15(f) violation where Merrill Lynch failed to limit or monitor traders' access to the equity squawk box which broadcast material nonpublic information); *In re Banc of America Securities LLC*, Exchange Act Rel. No. 55466 (March 14, 2007) (finding Section 15(f) violation where Banc of America failed to establish, maintain, and enforce policies and procedures to protect against the misuse of material nonpublic research information). The mere establishment of policies and procedures alone is not sufficient to prevent the misuse of material, nonpublic information. It also is necessary to implement measures to monitor compliance with and enforcement of those policies and procedures. *See, e.g., In re Monness, Crespi, Hardt & Co., Inc.*, Exchange Act Rel. No. 72886 (August 20 2014) (finding Section 15(g) violation where Monness failed to enforce existing policies and procedures designed to protect against the misuse of material, nonpublic information); *In re Morgan Stanley & Co. Inc., et al.*, Exchange Act Rel. No. 54047 (June 27, 2006) (finding Section 15(f) violation where Morgan Stanley failed to enforce existing policies and procedures concerning surveillance over a four-year period). These obligations are important even if no questionable trading has occurred.

[14] Section 15(g) of the Exchange Act was formerly Section 15(f) of the Exchange Act. The provision was renumbered in 2010 by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

43. DBSI's policies and procedures were not reasonably designed, given the nature of its business, to prevent the misuse of material, nonpublic information generated by its equity research analysts. DBSI failed to establish clear and consistent policies and procedures to prevent its equity research analysts from disclosing material, nonpublic information, such as information that was to be included in forthcoming DBSI research reports, estimate changes of less than ten percent, and short term trading recommendations that were inconsistent with the analyst's published long term ratings. These failures were further compounded by deficiencies in DBSI's policies and procedures pertaining to communications between DBSI's equity research analysts and both DBSI customers and DBSI sales and trading personnel. In particular, DBSI failed to establish, maintain, and enforce policies and procedures reasonably designed to prevent its equity research analysts from using various customer interactions and internal communications with DBSI sales and trading personnel, including, but not limited to, morning calls, squawks, idea dinners, and non-deal road shows to disclose material, nonpublic information in the form of unpublished market sensitive information to select DBSI customers and DBSI sales and trading personnel. These failures are amplified in light of a compensation structure that heightened the potential for the selective disclosure and misuse of material, nonpublic information generated by DBSI equity research analysts. Nonetheless, despite these risks, DBSI failed to establish, maintain, and enforce policies and procedures reasonably designed to prevent its equity research analysts from disclosing to firm customers, either directly or indirectly through DBSI sales and trading personnel, material, nonpublic information.

44. As a result of the conduct described above, DBSI willfully[15] violated Section 15(g) of the Exchange Act.[16]

## B. <u>Rule 501 of Regulation AC</u>

45. Rule 501 of Regulation AC requires that brokers, dealers, and certain persons associated with a broker or dealer, including research analysts, include in their research reports a prominent certification by the research analyst that the views expressed in the research report accurately reflect the research analyst's personal views about any and all of the subject securities or issuers. On March 29, 2012, DBSI issued a research report by Grom on Big Lots in which Grom reiterated his BUY rating. Grom signed the Regulation AC certification for this research report. However, as described above, Grom believed he should have downgraded Big Lots in his March 29, 2012, research report and repeatedly stated that he did not downgrade Big Lots at the time because he wanted to maintain his relationship with its management. Accordingly, Grom's March 29, 2012, research report did not accurately reflect his personally held view.

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[15] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id*. (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

[16] There is no requirement under Section 15(g) of the Exchange Act that there be an underlying insider trading violation or any other violation of the Exchange Act or the rules thereunder. *See In the Matter of New York Stock Exchange LLC, et al.*, Exchange Act Release No. 72065, 2014 WL 1712113, at *5 fn. 13 (May 1, 2014); *In the Matter of Certain Market Making Activities on NASDAQ*, Exchange Act Release No. 40910, 1999 WL 6716, at *6 fn. 3 (Jan. 11, 1999).

46. As a result of the conduct described above, DBSI willfully violated Rule 501 of Regulation AC.

**C. <u>Section 17(a) of the Exchange Act and Rule 17a-4 Thereunder</u>**

47. Section 17(a)(1) of the Exchange Act requires that broker-dealers "shall make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this chapter." The Commission has emphasized the importance of the records required by the rules as "the basic source documents" of a broker-dealer. *Statement Regarding the Maintenance of Current Books and Records by Brokers and Dealers*, 4 SEC Docket 195 (April 6, 1974). The record keeping rules are "a keystone of the surveillance of broker and dealers by [Commission] staff and by the securities industry's self-regulatory bodies." *Edward J. Mawod & Co.*, 46 S.E.C. 865, 873 n.39 (1977) (citation omitted), *aff'd*, 591 F.2d 588 (10th Cir. 1979). Rule 17a-4(b)(4) of the Exchange Act requires each broker-dealer to 'preserve for a period of not less than three years, the first two years in an accessible place.... [o]riginals of all communications received and copies of all communications sent . . . by the … broker or dealer (including inter-office memoranda and communications) relating to its business as such." Rule 17a-4(j) of the Exchange Act requires broker-dealers to "furnish promptly to a representative of the Commission legible, true, complete, and current copies of those records of the . . . broker or dealer that are required to be preserved under this section … that are requested by the representative of the Commission."

48. DBSI failed to preserve for three years and preserve in an accessible place for two years certain internal DB Chat communications. In addition, DBSI failed to promptly furnish copies of all DB Chat communications that had been requested by the staff during the investigation.

49. As a result of the conduct described above, DBSI willfully violated Section 17(a) of the Exchange Act and Rule 17a-4 thereunder.

## <u>REMEDIAL EFFORTS</u>

50. In determining to accept the Offer, the Commission considered remedial acts taken by DBSI.

## IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 203(e) of the Advisers Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 15(g) and 17(a) of the Exchange Act and Rule 17a-4 thereunder and Rule 501 of Regulation AC;

B. Respondent is censured;

C. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $9,500,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying DBSI as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Yuri B. Zelinsky, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-5041.

By the Commission.

Brent J. Fields
Secretary