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Securities and Exchange Commission Year in Review: Enforcement Actions and Issues from 2020

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With a historically tumultuous 2020 behind us, we once again take the opportunity to look back on the Securities Exchange Commission's (SEC or Commission) enforcement program during this extraordinary year. Heeding the Confucian dictum, "Study the past, if you would divine the future," we also look ahead to the likely direction of the SEC's Division of Enforcement (Division or Enforcement) in 2021, with our usual caveat that past performance is no guarantee of future results.

Like the country at large, the SEC was dramatically affected by the onset of the COVID-19 pandemic, which has forced nearly all of its Staff to work remotely, posing logistical obstacles to Enforcement's work of investigating and litigating. The crisis also appears to have had a marked impact on the number of enforcement actions: the agency filed approximately 17 percent fewer cases in fiscal 2020 than the year before.

While COVID dominated much of Enforcement's agenda, the Division continued to expend much of its energy on cases involving alleged harm to retail or "Main Street" investors, whom Chairman Jay Clayton has prioritized since his arrival at the Commission in 2017. As a consequence, the enforcement program was once again largely weighted towards relatively smaller-scale actions against investment advisers, retail brokers, and issuers in securities offerings.

This focus almost certainly will change under the incoming Biden Administration, which will bring about a Democratic majority on the Commission, and with it, a realignment of Enforcement's priorities. Based on enforcement patterns at the outset of the Obama Administration, the Division is likely to take a generally more aggressive approach by ramping up the number of investigations and enforcement actions, pushing the boundaries of the securities laws, seeking stiffer corporate penalties, and showing a greater willingness to litigate cases that do not settle. We also anticipate an increased appetite for significant cases against major financial institutions and other systemically important market actors, along with heightened insider trading enforcement, which under the Trump Administration fell to its lowest level since the 1990s.

In this article, we examine SEC enforcement activity and related developments within the agency during fiscal year 2020, which ended on September 30, and explore how these have reflected and shaped the Enforcement program. (We also highlight some noteworthy cases and issues that arose before the end of the calendar year.) In particular, we address:

(1) internal developments of note at the agency, including an overview of Enforcement's performance last year, significant personnel changes, sources of conflict among the commissioners, and the status of Enforcement's whistleblower program; (2) external challenges to the SEC's enforcement powers; and (3) significant enforcement actions in several areas, including investment advisers, broker-dealers, insider trading, market manipulation, Foreign Corrupt Practices Act (FCPA) enforcement, cyber enforcement, issuer reporting, and public finance.

Enforcement in 2020: Continuity and Change Amid Turbulence

Enforcement by the Numbers

At the close of each fiscal year, Enforcement makes the standard disclaimer that its performance should not be evaluated based exclusively on the number of actions it brought during the fiscal year. As we have observed, however, that metric does provide an indication of the Division's aggressiveness in pursuing its priorities. Last year, it also served as a measure of Enforcement's success in maintaining its operations and effectiveness during the pandemic.

By these standards, the Division's performance in fiscal 2020 was mixed. It brought 715 cases last year, down from 862 in fiscal 2019, and the lowest number since 2015, when Enforcement began reporting this statistic in its annual report.[1] Of those cases, 405 were "standalone" actions in federal court or administrative proceedings before the SEC, as distinguished from "follow-on" administrative proceedings, which seek industry bars based on the outcome of actions brought by the SEC, criminal authorities, or other regulators, and from proceedings to deregister public companies (mainly microcap issuers) that were delinquent in making their required SEC filings. Enforcement Director Stephanie Avakian attributed the decrease, in part, to the effects of the pandemic, noting that much of the Enforcement Staff spent "the bulk of [their] time" in the early months of the crisis focused on learning how to manage the transition to working remotely.[2]

The monetary relief that the Division obtained, on the other hand, set a record, amounting to over \$4.6 billion in penalties and disgorgement. Of that amount, disgorgement (including prejudgment interest) made up nearly \$3.6 billion—again, a record for the Division—and penalties of just over \$1 billion.[3] The total, however, was overwhelmingly attributable to the 5 percent of Enforcement cases that resulted in the largest awards, which accounted for approximately \$3.8 billion of the overall monetary relief obtained. These included the SEC's closely-watched June 2020 settlement with Telegram Group, Inc. involving the company's alleged unregistered offering of digital tokens, which resulted in disgorgement of roughly \$1.2 billion and a penalty of \$18.5 million, as well as some notable FCPA actions, which resulted in exceptionally large monetary awards. (We discuss these cases in further detail below.)

The breakdown of standalone enforcement actions by category remained broadly consistent with fiscal 2019 (in approximate percentages): 32 percent involved securities offerings; 21 percent involved investment advisory and investment company issues; 15 percent were issuer reporting or audit and accounting cases; 10 percent involved broker-dealers; 8 percent were insider trading actions; 3 percent involved municipal finance; and 2 percent were FCPA cases.[4] As to Enforcement's oft-stated goal of individual accountability, approximately 72 percent of its standalone cases in fiscal 2020 were brought against individual respondents or defendants.[5]

Enforcement also reported mixed results with respect to the speed of its investigations. In fiscal 2020, the average time to complete an investigation and file an enforcement action was 24.1 months, a slight increase from 2019.[6] Financial fraud and issuer disclosure cases, however, which typically move more slowly than other investigations, took, on average, 34 months, down from 37 months in the previous fiscal year.

With respect to its goal of returning ill-gotten funds to harmed investors, in fiscal year 2020, the Commission reimbursed approximately $602 million to victims, roughly half of the figure of nearly $1.2 billion in fiscal 2019.[7] The US Supreme Court's decision last year in *Liu v. SEC* (discussed below),[8] in which the Court determined that disgorgement should benefit harmed investors, will ratchet up pressure on Enforcement to improve upon this statistic. In furtherance of this objective, the Commission created the Office of Bankruptcy, Collections, Distributions, and Receiverships within the Enforcement Division, which it intends to use to streamline the Commission's processes and procedures for collecting outstanding monetary judgments to return to investors.[9]

Continuing Effects of *Kokesh v. SEC*

The Commission continues to experience fallout from the US Supreme Court's 2017 decision in *Kokesh v. SEC*.[10] There, the Supreme Court held that because disgorgement often serves as a punitive remedy, the Commission's ability to seek disgorgement is subject to the five-year statute of limitations set forth in 28 U.S.C. § 2462. Enforcement reported that in fiscal 2019, the decision caused it to forego approximately $1.1 billion in disgorgement in filed cases.[11] It has responded to *Kokesh* by prioritizing actions within the five-year statute of limitations.[12] This approach appears to have borne fruit in fiscal year 2020, given the record disgorgement amount the SEC reported for last year.[13]

Major Personnel Changes

The SEC saw several noteworthy staffing developments in 2020, both at the Commission-level and within the Division of Enforcement. In a dramatic development, then-Chairman Clayton's position at the helm of the agency became uncertain amid reports in June 2020 that Attorney General William Barr sought to replace the sitting US Attorney for the Southern District of New York with Clayton.[14] Ultimately, Barr and the then-US Attorney, Geoffrey Berman, reached a deal whereby Berman resigned and was succeeded by his deputy, Audrey Strauss, until a successor could be confirmed. US Senate Judiciary Committee Chair Lindsey Graham has stated that Clayton's nomination will not advance without the customary "blue slips" from New York's Senators, both of whom have opposed the nomination.[15] The former Chairman remained at the Commission until his departure at the end of 2020.[16]

In August 2020, the Commission gained a new member, Caroline Crenshaw, following the February resignation of Commissioner Robert Jackson, who rejoined the faculty at New York University School of Law. Crenshaw, an SEC Staffer since 2013, was sworn in to her new position in August as the second of two Democratic commissioners.[17] (Under the Securities Exchange Act, no more than three commissioners may be of the same political party.) Crenshaw had served as counsel to Jackson and to former Commissioner Kara Stein, and previously worked in the Office of Compliance Inspections and Examinations (OCIE) and the Division of Investment Management. She is also a captain in the US Army Reserve, Judge Advocate General's Corps.

In August, Commissioner Hester Peirce, a Republican, was sworn in for an additional term that will expire on June 5, 2025.[18] Rounding out the current Commission are Democrat Allison Herren Lee, whose term runs to June 5, 2022, and Republican Elad Roisman, whose term expires on June 5, 2023.[19]

The Division of Enforcement saw the departure of its Co-Directors, Steven Peikin and Stephanie Avakian. Peikin resigned in August to rejoin private practice,[20] and Avakian left the SEC in December.[21] Marc Berger, who had been the Director of the SEC's New York Regional Office, was named Deputy Director of Enforcement in August, and became Acting Director upon Avakian's departure.[22] Richard Best, who had previously served as Regional Director of the SEC's Salt Lake City and Atlanta Regional Offices, was named as Berger's successor in New York. In the Philadelphia Regional Office, G. Jeffrey Boujoukos resigned as Director in

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February to move back into private practice, and was replaced by Kelly Gibson, previously Associate Regional Director in that office.

Enforcement's Cyber Unit, which was formed in 2017 to focus on cyber-related misconduct, had a rotation in leadership in December 2019, when Kristina Littman, previously a Senior Advisor to former Chairman Clayton, was named Chief.[23] She succeeds Robert Cohen, who left the Commission for private practice in August 2019.

Beyond Enforcement, the SEC named its first Chief Data Officer, Austin Gerig, in January 2020. His appointment reflects the Commission's increasing commitment to cultivating in-house expertise in the management and use of data to support its enforcement, examinations, and policymaking. In the Enforcement realm, the use of data analytics has become a standard tool in spotting potential insider trading and issuer disclosure violations. Gerig, who holds a PhD in physics, previously served as Assistant Director of the Office of Data Science in the Division of Economic and Risk Analysis (DERA).[24]

Ideological and Political Divisions Manifest

As is typical, disagreements about enforcement's powers coalesced among commissioners around largely ideological and political lines. These were especially evident in the wake of two significant settlements last year in cases the SEC brought against issuers who sold digital tokens in "initial coin offerings" (ICOs). Since the emergence of these financial products, the Commission has consistently taken the view that these digital assets can constitute securities, which are subject to the registration requirements of Section 5 of the Securities Act of 1933, and has brought a series of successful enforcement actions against issuers that conducted unregistered ICOs.

Critics, however, contend that the SEC's approach to the digital assets space amounts to over-regulation and stifles needed financial innovation. Commissioner Peirce has been a particularly outspoken voice in the debate, issuing two public dissents in 2020 that bluntly criticized settlements in two closely-watched cases against Telegram Group, Inc. and Unikrn, Inc. (We discuss both in further detail below.) Speaking in July at Singapore Blockchain Week, Peirce described the Telegram settlement as "the unsatisfying culmination of an enforcement action that I did not support from the beginning."[25] In September, she issued a public statement on the *Unikrn* case criticizing the Commission for "failing to challenge ourselves to experiment with new approaches to regulation" and "risk[ing] surrendering the fruits of innovation."[26] Such broadsides are unusual for the SEC, which has traditionally sought to maintain an appearance of collegiality, if not unanimity, in its enforcement decisions.

Another publicly-aired ideological disagreement played out in connection with the SEC's September 2020 amendments to, and guidance on, the rules governing its Whistleblower Program in a highly controversial 3-2 vote that split along party lines (also discussed in further detail below). Among other changes, the SEC clarified that the rules give it discretion to reduce the largest awards based on their size, a controversial step that engendered intense opposition from whistleblower attorneys and advocates.

Notably, the amendments were accompanied by dueling public statements from all five commissioners. Then-Chairman Clayton wrote that the amendments "recognize the responsibility that Congress gave [the SEC] to determine the amount of awards" and provide "additional transparency into [the SEC's] award determination process."[27] Commissioner Lee, however, contended that instead of "fixing what is broken," the amendments "run the risk of breaking what works," adding bluntly: "Whistleblowers deserve better."[28]

"Main Street" Remains a Focus

Prioritizing retail or "Main Street" investors has been a central tenet of the Enforcement program under former Chairman Clayton, and the Division continued to pursue this objective on several fronts. Beyond enforcement actions, the Commission continued its outreach efforts to educate retail investors about the financial markets and the variants of fraudulent schemes, including, for example, the Retail Strategy Task Force's efforts to educate the hearing-impaired on spotting fraudulent investment offerings.[29] In February 2020, the SEC Office of Investor Education and Advocacy issued an alert warning investors about COVID-related scams,[30] which were a repeated target of enforcement activity in the subsequent months.

The retail investor theme was a shift in emphasis from that of Clayton's predecessor, Mary Jo White, who adopted a "broken windows" approach, targeting small-scale violations in order to deter more serious misconduct, as well as systemically significant harm to institutional investors following the 2008 financial crisis. With the forthcoming change in presidential administration, however, it is likely that Enforcement's priorities will once again change to reflect the priorities and preferences of Clayton's successor. While we expect retail investor harm to remain an enforcement concern under the new chair, it is likely that the Division's focus will more closely resemble that under former Chair White.

COVID-19 and Enforcement

Like the country as a whole, the COVID-19 pandemic has had a profound impact on the SEC both operationally and programmatically. The government-imposed lockdowns and new work-from-home reality directly affected the Commission's investigations and enforcement actions, forcing the entire Enforcement Staff to transition to remote working by the middle of March, and preventing the Division from using its core investigative tools of live testimony and in-person interviews.[31] Over the following months, the Staff continued to push matters forward by relying instead upon remote testimony, interviews, and Wells meetings via WebEx, and on the cooperation of entities and individuals involved in its investigations.[32]

In terms of enforcement priorities, the Division redirected resources to the pursuit of COVID-related fraud. Shortly after onset of the crisis, the Commission formed the Coronavirus Steering Committee, charged with, among other things, overseeing investigations into pandemic-related misconduct and coordinating efforts across the entire Division.[33] By the end of its fiscal year, Enforcement obtained trading suspensions against 35 issuers based on what it viewed as the questionable accuracy or adequacy of COVID-related information in the public domain about those issuers.[34] The Division also has brought five enforcement actions against issuers and individuals based on allegedly fraudulent claims about access to personal protective and testing equipment. It also reported that it has initiated more than 150 COVID-related inquiries and investigations in total,[35] making it likely that more COVID-related cases will follow in fiscal 2021.

Enforcement also made clear its view that the effects of the economic downturn in the wake of the pandemic pose an increased risk of insider trading and misleading issuer disclosure. In a March 2020 statement, then Co-Directors Stephanie Avakian and Steven Peikin warned that the volatility of the markets created more opportunity for insiders to learn valuable market-moving information, and may be more tempted than in normal times to trade on that information before it is disclosed publicly.[36] The Co-Directors noted that Enforcement is therefore keeping a close watch on potential insider trading during the crisis.

In a May speech, Peikin noted that in addition to insider trading, pandemic-related economic pressures may tempt issuers to downplay the impact of the crisis on their operations and financial performance, and may expose pre-existing accounting or disclosure violations. The Coronavirus Steering Committee has therefore developed a process for reviewing SEC filings of issuers in highly-impacted industries, with a close eye on disclosures that are out of step with those of others in the same industry.[37]

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A Record Year for the Whistleblower Program

Significant Numbers in Fiscal 2020

The Commission established its Whistleblower Program in 2011 under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 in order to incentivize employees and other individuals to report wrongdoing.[38] Based on the SEC's reported metrics, the Whistleblower Program has succeeded in this objective. As of the end of fiscal 2020, the agency, since the Whistleblower Program's inception, has awarded 106 individuals approximately $562 million,[39] and the program has led to enforcement actions resulting in more than $2.5 billion in ordered monetary relief, of which $1.4 billion consisted of disgorgement and $750 million returned to harmed investors.[40]

In fiscal 2020, the Commission awarded whistleblowers approximately $175 million in total awards to 39 different individuals, both of which were program highs.[41] The 39 awardees represent 37 percent of the total individuals who have received awards during the program, and a more than 200 percent increase over the program's previous record.[42] Moreover, the $175 million awarded consists of approximately one-third of all awards during the life of the program. In total, whistleblower tips last year generated $765 million in financial remedies.[43]

In October 2020, the Commission awarded the largest award in the program's history—$114 million to a single whistleblower.[44] The Whistleblower Program's other top largest awards consisted of $50 million to two separate individuals, $39 million, and $37 million.[45] Given the size of and publicity surrounding these awards, we expect that the Whistleblower Program will continue to be a major source of the SEC's investigations and enforcement actions in the foreseeable future.

Rule Amendments Bring Controversy

In a 3-2 vote, the Commission in September approved several significant amendments to, and interpretive guidance on, the rules governing the Whistleblower Program.[46] Most controversially, the SEC adopted the position that it has discretion to reduce the largest whistleblower awards based on their size. The amendments, first proposed in 2018, have generated substantial opposition from the plaintiffs' bar and within the Commission, and the SEC twice postponed the commissioners' vote while they attempted to reach agreement.[47]

Under the statutory framework, the SEC must pay awards to whistleblowers who voluntarily provide "original information" to the agency that results in a successful enforcement action by the SEC or a "related action" by another law enforcement or regulatory agency (typically the US Department of Justice (DOJ)) or self-regulatory organization. As prescribed by Section 21F(b)(1) of the Securities Exchange Act, the award amount can range from 10 to 30 percent of the total monetary sanctions obtained in the successful action, as determined by the SEC.[48] The new amendments and guidance affect this scheme in several significant ways, for example:

- In the most controversial of the measures announced in October, the SEC clarified that it has discretion under the rules to calculate the size of awards in dollar terms rather than the percentage basis set forth in the statute, in effect allowing it to reduce the amount of the largest awards based on their size.
- Where the statutory maximum amount of an award is $5 million or less (approximately 75 percent of awards to date), the SEC will apply a presumption that the whistleblower is entitled to the maximum 30 percent.
- The amendments provide that whistleblower tips leading to a deferred prosecution agreement or non-prosecution agreement entered into by the DOJ, or a settlement by the SEC in a non-judicial or administrative setting, qualify as an eligible "action," and any money paid under such agreements will be taken into account in calculating a whistleblower award.

- The amendments clarify that if the SEC determines that another agency's whistleblower program more appropriately applies, an action by that agency will not qualify as a "related action."
- In response to the US Supreme Court's 2018 decision in *Digital Realty Trust v. Somers*,[49] in which the Court held that an individual must provide information to the SEC directly to qualify for Dodd-Frank's anti-retaliation protections, the amendments adopt a uniform definition of "whistleblower," which requires individuals to provide information to the SEC in writing and before experiencing any retaliation.
- The amendments clarify that the SEC can bar individuals from submitting whistleblower applications when they are found to have submitted false information or frivolous applications, and make it easier for the Commission to reject applications on common grounds such as untimeliness or failure to follow the SEC's requirements regarding forms and procedures.[50]

Scope of the SEC's Authority Remains Unsettled

SEC v. Liu: US Supreme Court Preserves, but Limits, the Agency's Disgorgement Power

In *SEC v. Liu*, the Supreme Court last June rejected a closely-watched challenge to the Commission's authority to obtain disgorgement, a question left open by *Kokesh*.[51] The Court's ruling upheld the SEC's disgorgement power, subject to limitations that it largely left to the lower courts to clarify. A contrary ruling would have deprived the SEC—at least in federal court actions—of its most significant source of monetary relief.

The case involved enforcement proceedings against petitioners Charles Liu and Xin Wang for their misappropriation of funds received from Chinese investors seeking to participate in the US Immigrant Investor Program.[52] Liu and Wang challenged the lower court's imposition of a $26.7 million disgorgement award, arguing that the Commission does not have the authority to seek a disgorgement award in the federal courts because disgorgement is not an equitable remedy.[53]

Justice Sotomayor delivered the majority's opinion holding that "a disgorgement award that does not exceed a wrongdoer's net profits and is awarded for victims is equitable relief" permissible under the Securities Exchange Act.[54] Based on a survey of the Court's equity jurisprudence, Justice Sotomayor found that "equity practice long authorized courts to strip wrongdoers of their ill-gotten gains," but noted that "to avoid transforming an equitable remedy into a punitive sanction, courts restricted the remedy to an individual wrongdoer's net profits to be awarded for victims."[55] Accordingly, disgorgement awards may not include a wrongdoer's "legitimate expenses."

The holding, however, left unanswered several significant questions.[56] Justice Sotomayor noted the Commission's tendency to deposit disgorgement proceeds into the US Treasury rather than return funds directly to harmed investors, and left it to the lower courts to determine whether this practice is consistent with the equitable requirement that disgorgement be for the benefit of victims. The Court's opinion also concluded that joint-and-several liability for disgorgement of multiple wrongdoers was consistent with the Court's precedent, but again, left it to the lower courts to determine precisely when joint-and-several liability should attach in this context. Finally, the Court did not define the scope of "legitimate expenses" that must be netted out of a disgorgement calculation, again leaving it to future litigation to shed light on this question.[57]

In response to *Liu*, the SEC announced that it would be reevaluating the balance between the penalties and disgorgement it recommends to the Commission to comply with *Liu*.[58] Signaling, in effect, that where *Liu* requires it to reduce a disgorgement amount, it will increase the penalty by a

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corresponding amount where it has statutory discretion to do so.

Continuing Challenges to *Lucia's* Unanswered Questions

The Supreme Court's 2018 decision in *Lucia v. SEC* caused major logistical challenges for the agency by holding that the Commission's administrative law judges (ALJs) were "Officers of the United States" under the US Constitution's Appointments Clause, requiring that they be appointed by an agency head.[59] The Commission responded by staying all of its pending administrative proceedings, reassigning approximately 200 of them to new ALJs, and re-appointing all of its existing ALJs.[60] The *Lucia* decision still looms large over the Commission's administrative proceedings due to the questions it left unanswered: (1) whether the Commission's ALJs are "principal" or "inferior" officers—if the former, only the US President may appoint them; and (2) whether the Commission's current procedure for removing ALJs, which requires "good cause," unconstitutionally insulates them from presidential removal.[61]

The separate question of whether respondents must litigate SEC administrative proceedings to completion before challenging them in federal court under *Lucia* is currently at issue before the US Courts of Appeals for the Fifth and Eleventh Circuits. The Fifth Circuit case was brought by Rachel Cochran, whom an ALJ barred from practicing before the SEC as an accountant and ordered to pay a $22,500 fine before *Lucia* was decided.[62] After re-assigning her case to a new ALJ in light of the decision, the Commission re-commenced proceedings against her in 2019. Cochran appealed, arguing that she is not required to exhaust her administrative remedies before the SEC prior to suing in federal court, claiming that her case falls within an exception to the exhaustion requirement for challenges that are collateral to the subject matter of the enforcement proceedings and are necessary to avoid losing the chance for "meaningful" judicial review.[63] In August, the Fifth Circuit agreed with the Commission's position and concluded that Cochran must fully exhaust her administrative remedies before challenging the constitutionality of the ALJ appointment.[64] In October, the court granted Cochran's petition to rehear the case *en banc*.[65]

In the Eleventh Circuit case, former investment adviser Christopher Gibson filed a petition for *certiorari* in the US Supreme Court, arguing that the Court of Appeals erred when it likewise concluded that Gibson must exhaust all of his administrative remedies before bringing a *Lucia* challenege.[66] A ruling against the SEC in these appeals would provide defendants with a significant weapon with which to complicate the agency's pursuit of administrative proceedings.

Investment Advisers Remain Enforcement Targets

Actions involving investment advisers and investment companies remained prominent in 2020, constituting the second largest category last year (as compared to the largest in fiscal 2019), but the number of actions filed against advisers and investment companies fell dramatically from 191 in 2019 to 87 in 2020.[67] It is as yet unclear whether this decline reflects a diminished interest in these cases on Enforcement's part, the effects of the pandemic, or some combination of both.

Actions against advisers, which are brought primarily by Enforcement's Asset Management Unit (AMU), continued to target violations involving disclosure of conflicts of interest, disclosures concerning risk management practices, misallocation of fees and expenses, and valuation issues. Also consistent with prior years, the charges that the SEC brought against advisers in these areas tended to result in negligence-based disclosure and compliance charges under the Investment Advisors Act of 1940 (Advisers Act), rather than scienter-based (intentional) fraud.

Retail Advisory Clients Still Front and Center

The persistence of the retail investor focus was exemplified last year by the SEC's settled action against Wells Fargo Clearing Services and Wells Fargo Advisors Financial Network, which agreed in February 2020 to pay a $35 million penalty in connection with their advisers' and brokers' alleged recommendations of high-risk single-inverse exchange-traded fund (ETF) investments to retail investors. The SEC charged Wells Fargo with failing to put in place adequate policies and procedures to prevent and detect unsuitable recommendations of that product, and with failure to supervise its employees' recommendations or provide adequate training on single-inverse ETFs.

In July of last year, the SEC brought two actions against VALIC Financial Advisors (VFA) for disclosure violations affecting teachers,[68] who, along with current and former military personnel, have been the focus of recent SEC initiatives targeting retail investor fraud.[69] VFA allegedly failed to disclose that its parent company made payments to an entity owned by Florida teachers' unions for 13 years in exchange for the entity's exclusive endorsement of VFA, and provided the entity with three "member benefit coordinators" who held themselves out as employees of the entity, but were in fact VFA employees. The SEC also found that VFA failed to disclose the conflicts that arose from: (1) its alleged avoidance of transaction fees on client trades that it otherwise would have borne under "wrap fee" arrangements (an asset-based fee that covers investment advice and brokerage services, including trade execution) by recommending more expensive mutual fund shares through its clearing broker's no-transaction fee (NTF) program; and (2) its alleged receipt of 12b-1 (mutual fund marketing and distribution) fees and revenue sharing from the broker. VFA agreed to pay a penalty of approximately $40 million to settle the two actions.

Wrap fee structure was again at issue in the SEC's settled action against Morgan Stanley Smith Barney (MSSB), based on allegations that the firm gave advisory clients the misleading impression that wrap fee clients were not likely to incur additional execution costs.[70] According to the SEC's order, that representation was inconsistent with the firm's routine practice of directing trades to third-party brokers, and led to additional fees that were not apparent to clients. MSSB agreed to a $5 million penalty.

Conflict Disclosures Remain under Scrutiny

The adequacy of disclosures of conflicts of interest remained a central Enforcement priority last year. In a November 2019 speech, then Co-Director Avakian affirmed that Enforcement "will continue to allocate [its] resources" to identifying undisclosed conflicts, signaling that advisers should continue to anticipate investigations and enforcement actions in this area in the coming year.[71]

In recent years, the AMU was largely focused on conflicts arising from the "12b-1 fees" that mutual funds pay from fund assets for marketing and distribution to broker-dealers and their registered representatives. The SEC takes the view that 12b-1 fees incentivize advisers with broker-dealer affiliates to steer clients towards mutual fund share classes that charge 12b-1 fees over classes that do not charge fees. In fiscal 2020, Enforcement concluded its Share Class Disclosure Initiative (SCDI), which allowed advisers who self-reported their failure to disclose 12b-1 fees to settle with the SEC without paying a penalty. The agency ultimately ordered nearly 100 self-reporting firms to return more than $139 million to investors under the SCDI.[72] In her November 2019 speech, Avakain made explicit that Enforcement's interest has broadened to include additional conflicts, including those arising from revenue-sharing arrangements, cash sweep programs, and unit investment trusts (UITs).

In the revenue-sharing scenario, clearing brokers agree to share with introducing brokers (which may be dually-registered or affiliated with advisers) a portion of the fees they charge to mutual funds for access to the clearing brokers' platforms. The SEC views these fees as posing a conflict when the adviser recommends share classes for which the adviser or its

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affiliate receives more revenue over those paying less or no revenue. This conflict (along with alleged conflicts arising from 12b-1 fees and undisclosed markups) is at issue, for example, in the federal court action the SEC brought against Cetera Advisors and its broker-dealer affiliate at the beginning of fiscal 2020.[73]

In cash sweep arrangements, cash in advisory accounts is automatically swept into a money market mutual fund or bank deposit sweep program. In the SEC's view, where the clearing broker agrees to share a portion of the revenue from those funds or deposits with the adviser or its broker-dealer affiliate, the revenue-share incentivizes the adviser to favor such programs over other vehicles. In August 2020, it brought a settled action against California-based SCF Investment Advisors, which agreed to disgorge approximately $545,000 and pay a $200,000 penalty arising from its alleged failure to disclose the conflict from its receipt of 12b-1 fees and recommendation of cash sweep mutual fund share classes that resulted in revenue-sharing payments from its clearing broker.[74] The following month, the agency brought a settled action against New Orleans-based Hancock Whitney Investment Services for alleged failure to disclose similar conflicts, resulting in disgorgement of over $1.65 million and a $400,000 penalty.[75]

UITs are investment companies commonly offered in a single public offering and holding a fixed portfolio of securities for a specific length of time, after which the UIT terminates and the proceeds are distributed to investors. A UIT may be sold with multiple fee structures, for example, varying structures for broker-dealer and advisory clients, with the former including sales charges paid to the broker-dealer that are not charged to purchasers under the fee-based advisory structure. Avakian's comments last year suggest that enforcement actions based on this conflict may be forthcoming as well.

Private Funds Remain in Enforcement's Sights

Notwithstanding the SEC's focus on retail advisory clients under former Chairman Clayton, advisers to private funds also have been the subject of significant Enforcement interest in recent years. In particular, Enforcement has focused on conflict disclosure, misallocation of fees and expenses to investors, disclosure of risk management practices, and asset valuation. Last June, the Office of Compliance Inspections and Examination (OCIE) issued a Risk Alert flagging what it found to be a pattern of inadequate compliance by private fund advisers with respect to conflict disclosure and fees and expenses.[76] Since OCIE Risk Alerts are often a harbinger of enforcement action to come, further cases in these areas seem likely.

From the perspective of investor exposure, the SEC's interest in private fund advisers can be viewed as consistent with its retail-oriented focus, even though "Main Street" investors are not typically associated with hedge funds and private equity. As the SEC recognized several years ago, retail investors are in fact exposed to the sector through retirement funds, insurers, endowments, and foundations.[77] Hence, as a former director of the SEC's Office of Compliance Inspections and Examinations observed, "[t]o the extent private equity advisers are engaged in improper conduct, it adversely affects the retirement savings of teachers, firemen, police officers, and other workers across the US."[78] That said, Enforcement's scrutiny of private fund advisers predates Chairman Clayton's arrival, and we expect it to continue under his successor.

Misallocation of Fees and Expenses

In April, the SEC brought a settled action against New York-based Monomoy Capital Management, L.P. for allegedly failing to disclose that it was charging portfolio companies for the costs of operational services provided by its Operations Group.[79] According to the SEC's order, Monomoy used the Group to help its portfolio companies make business improvements, and highlighted the Group's role and value in the private placement memorandum for the relevant fund. Rather than covering the costs of running the Group from its management fee, the SEC found that for over four and a half years, Monomoy charged the portfolio companies an hourly rate to recoup those costs, recovering an amount that was more than 13 percent of Monomoy's overall revenue from the fund. Per the order, neither the reimbursement nor the associated conflicts were disclosed in the governing limited partnership agreement (LPA) or elsewhere. The firm agreed to disgorge over $1.5 million and pay a $200,000 penalty.

In August 2020, Enforcement brought a settled action against Miami-based Rialto Capital Management, LLC, for allegedly charging more than $3 million to two real estate private equity funds for tasks by third parties, including asset-level due diligence, accounting, and valuation, which should have been charged to co-investment vehicles to the funds, for whom those tasks were actually performed.[80] (According to the order, Rialto later reimbursed the funds for those costs.) The SEC also alleged that Rialto represented to the limited partner advisory committee (LPAC) for one of the funds that its costs for third-party tasks were at or below market rates, when it had performed no analysis or other backup for that representation, and failed to disclose to the LPAC that its cost allocation methodology resulted in an increased charge for overhead. Rialto agreed to pay a $350,000 penalty.

Risk Management Disclosures

Enforcement also pursued private fund advisers for allegedly misleading disclosures about their risk management practices. Notably, this area has attracted the interest of the Complex Financial Instruments (CFI) Unit, which has expertise in asset-backed securities, derivatives, and other financial products, along with the AMU.

In January 2020, the AMU and the CFI Unit brought a settled administrative proceeding against New York-based Catalyst Capital Advisors LLC and its CEO, as well as an injunctive action in federal court against one of its senior portfolio managers, for alleged misrepresentations to investors that Catalyst followed specific risk parameters in managing a mutual fund that invested primarily in options on S&P 500 index futures contracts.[81] According to the SEC's order, Catalyst told investors that it had implemented stop loss measures and triggers to limit losses to 8 percent, but failed to follow those parameters for a majority of trading days between December 2016 and February 2017, causing the fund to lose approximately 20 percent of its value. The SEC brought negligence-based charges against Catalyst and the CEO, who the SEC alleged caused Catalyst's violations and failed to supervise the senior portfolio manager. The Commission charged the senior portfolio manager with both scienter-based and negligence-based violations of the Advisers Act. Catalyst agreed to disgorgement of over $8.8 million and a $1.3 million penalty, while the CEO agreed to a $300,000 penalty.

In April, the SEC brought a settled action against Florida-based Everest Capital and its sole managing member, who also served as its chief investment officer (CIO), for failing to follow its stated risk management procedures with respect to currency positions in its Capital Global Fund.[82] According to the SEC's order, the offering documents for the Fund represented that Everest's "disciplined investment management style" was "driven by risk management," and that Everest would not take concentrated positions in any single geographic region. In 2014 and 2015, however, Everest and the CIO allegedly made highly concentrated investments in the Euro to Swiss Franc exchange rate, increasing the Fund's gross exposure to that position from 400 percent to over 900 percent, and failed to apply the risk management described in the offering materials. The SEC charged Everest and the CIO with negligence-based violations of the Advisers Act. Everest agreed to disgorgement of approximately $2.5 million and to a joint and several penalty of $750,000 with the CIO.

Valuation

Fund valuation practices have been a primary AMU concern in recent years. This includes the

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SEC's notable 2019 action against Deer Park Capital Management and its chief investment officer last year for alleged compliance failures that allowed its traders to mark up the price of residential mortgage-backed securities (RMBS) gradually rather than mark those assets to market.[83]

In April 2020, the SEC brought a settled action against New York-based mutual fund adviser Semper Capital Management, L.P. for allegedly mispricing non-agency mortgage-backed securities (NA MBS) purchased in odd lots (less than $1 million in size).[84] According to the SEC's order, Semper used pricing data from third party pricing vendors that were appropriate for round lots, even though it had no reasonable basis to believe that the pricing vendor marks accurately reflected the price the fund would receive for its NA MBS positions in a current sale. As a result, Semper allegedly overstated its net asset value and made misleading disclosures to investors about the reasons for the fund's reported performance, resulting in negligence-based compliance and disclosure charges, for which it agreed to disgorgement and prejudgment interest of approximately $128,000 and a $375,000 penalty.

Broker-Dealers and Market Integrity

As is typical, Enforcement's broker-dealer cases encompassed a broad range of misconduct, such as violation of Regulation SHO (governing short selling practices), failure to comply with prospectus delivery requirements, and unsuitable recommendations to clients. Several noteworthy broker-dealer cases in fiscal 2020 were focused on the integrity of the securities markets, a longstanding Enforcement theme that Director Avakian reaffirmed in the Division's Annual Report.[85]

The "pre-release" of American Depository Receipts (ADRs) has been a leading market structure concern for the SEC in recent years. ADRs are securities traded in the United States that represent shares of a foreign company and generally require that a corresponding number of foreign shares be held at a depositary bank. Pre-release allows the issuance of ADRs without the deposit of foreign shares, as long as the broker receiving them has a "pre-release agreement" with the bank. Those agreements typically require the broker to own, or take reasonable steps to determine that the customer owns, the same number of shares represented by the ADR. Since 2017, the SEC has brought 19 actions against banks, brokers and individuals based on their failure to follow these requirements. In fiscal 2020, these included settled cases against Jefferies LLC and ABN AMRO Clearing Chicago LLC involving alleged negligence-based anti-fraud violations under the Securities Act of 1933 and failure to supervise charges for allegedly borrowing pre-released ADRs from other brokers despite knowing that those brokers did not own the foreign shares needed to support the ADRs.[86]

Broker order routing practices were another market integrity issue for Enforcement last year. In May 2020, the SEC charged Bloomberg Tradebook LLC for allegedly misleading customers by representing in marketing materials that orders would be routed by its own "advanced" technology, when in fact the firm allowed unaffiliated broker-dealers to make order routing decisions.[87] In August, it brought a settled case against Millington Securities, Inc. for alleged misrepresentations about payment-for-order-flow it received for routing orders to certain executing brokers.[88]

The obligation to file Suspicious Activity Reports (SARs) was at issue in the SEC's settled action against Interactive Brokers LLC, which agreed to pay a total of $38 million in penalties to the Commission and to the Commodity Futures Trading Commission (CFTC) and Financial Industry Regulatory Authority (FINRA) in parallel actions.[89] Under the Exchange Act, broker-dealers are required to file a SAR with the Financial Crimes Enforcement Network (FinCEN), a division of the US Treasury Department, when they know, suspect, or have reason to suspect that a transaction involves illegal activity or lacks a legitimate business purpose. Here, the SEC found that Interactive Brokers failed to meet this requirement in more than 150 instances involving potential microcap fraud in customer accounts.

Insider Trading Still in Focus, but Filed Cases Remain at a Low Ebb

Insider trading has been a perennial focus for Enforcement since the SEC's seminal 1961 decision in *Matter of Cady, Roberts & Co*. that Rule 10b-5 prohibits insiders from trading on the basis of material, non-public information unless they disclose that information before trading.[90] The Division's enthusiasm for these cases, however, has waxed and waned over the years, and under the Trump Administration, its insider trading actions have fallen to their lowest level since the mid-1990s.[91] Last year, the SEC brought 33 standalone cases, up slightly from 30 in fiscal 2019. [92] It is probable that the arrival of the Biden Administration next year will bring about an increased interest in insider trading more in line with the higher numbers of filed cases under previous Democratic administrations.

The Commission nevertheless brought some notable insider trading actions last year, primarily though Enforcement's Market Abuse Unit (MAU), including "classic" insider trading cases involving corporate insiders as well as "misappropriation" cases involving the misuse of material non-public information by "outsiders" who owe a duty to the source of that information. In building these cases, the MAU has continued to utilize extensively the SEC's data analytic capabilities, which allow the Staff to analyze massive amounts of trading data in order to spot suspicious trades.[93]

Among its other significant insider trading cases in fiscal 2020:

- In September 2020, the Commission brought a settled action against a former senior tax manager at Amazon for allegedly tipping her husband and father-in-law with details about Amazon's financial performance in advance of earnings announcements. According to the SEC's order, the tips resulted in trading profits of approximately $1.4 million based on the manager's tip. All three consented to final judgments ordering them to pay total disgorgement of approximately $1.4 million and penalties north of $1.1 million.[94]
- The Commission charged five friends who allegedly traded repeatedly on earnings information of a Silicon Valley cloud-computing company in an ongoing federal court action. According to the SEC's complaint, a former IT administrator of the company used his credentials to obtain confidential information, which he then transmitted to his friends in exchange for kickbacks from the trading profits.[95]
- The Commission brought charges in an ongoing federal court action against a senior index manager who allegedly purchased call or put options of publicly traded companies before those companies were added or removed to/from stock market indices. The SEC alleged that the manager learned of the information through his employer, and used an acquaintance who managed a sushi restaurant to place the options in an attempt to mask the scheme, which netted them more than $900,000 in ill-gotten profits.[96]

In addition to pursuing individuals for insider trading, Enforcement is closely focused on potential compliance failures by companies, investment advisers, and broker-dealers. (Advisers are subject to Section 204A of the Investment Advisers Act,[97] which requires them to have in place written policies and procedures reasonably designed to prevent the misuse of material non-public information.) For example, the Commission brought a settled Section 204A action in February 2020 against Wyoming-based Cannell Capital, LLC for allegedly failing to maintain a list of securities that could not be traded after the firm came into possession of material non-public information, and for failing to provide written guidance on business-specific risks or when trading should be restricted.[98]

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In March, the then Co-Directors of Enforcement issued a public statement noting the heightened incentives to engage in insider trading during the COVID-19 pandemic, and admonishing employers to ensure "maximum protection" against insider trading through their disclosure controls and procedures, insider trading prohibitions, codes of ethics, and Regulation FD and selective disclosure prohibitions.[99] Given this express warning, charges against entities for inadequate insider trading policies and procedures may be on the horizon for 2021.

United States v. Blaszczak: Expansion of Insider Trading Liability

The courts have spent significant time and energy in recent years addressing thorny questions surrounding the scope of liability under Section 10(b) of the Securities Exchange Act and Rule 10b-5 of "tippees"—individuals who trade on material non-public information provided by a "tipper." In particular, the Second Circuit has held that for liability to attach under those provisions, the tipper must have provided inside information in exchange for a "personal benefit," and the tippee must have known that.[100] In some cases, this has proven a difficult evidentiary hurdle for the SEC and DOJ to clear.

In late 2019, however, the US Court of Appeals for the Second Circuit ruled in *United States v. Blaszczak* that the government has an alternative and less burdensome path under the federal criminal insider trading, conversion, and wire fraud statutes, which do not impose a "personal benefit" requirement.[101] Although these statutes are not available to the SEC, the decision is nevertheless significant from an SEC Enforcement perspective because the SEC and DOJ routinely work together in insider trading investigations, and the SEC's investigative record often serves as a basis for the DOJ's charges.

David Blaszczak was a former employee of the Centers for Medicare & Medicaid Services (CMS) and maintained contacts within CMS when he transitioned into his short-lived career as a "political intelligence" consultant for hedge funds. Between 2009 and 2014, Blaszczak used his contacts within CMS to discover proposed CMS initiatives with negative implications for healthcare companies, which he then disclosed to healthcare-focused hedge fund Deerfield Management and its principals.[102] Deerfield then used that information to trade in the securities of several companies.[103] Blaszczak and several others were charged with insider trading under Section 10(b) and Rule 10b-5 (which are codified at Title 15 of the United States Code) and under the criminal securities fraud statute, 18 U.S.C. § 1348, along with federal wire fraud. At trial, Blaszczak was acquitted of the Title 15 charges, but convicted of the Title 18 counts.[104]

Blaszczak and the other appellants challenged their convictions under Title 18 because the district court had not instructed the jury that Blaszczak must have provided the information in exchange for a "personal benefit." The Second Circuit explained that the personal benefit requirement does not come from the text of Title 15, but from "judge-made doctrine premised on the Exchange Act's statutory purpose … to protect the free flow of information into the securities markets[.]"[105] Concluding that neither Title 18 nor the other statutes under which the appellants were convicted involve the same statutory purposes as the insider trading prohibitions under Title 15, the Second Circuit declined to read in a personal benefit requirement to those statutes.[106] The Second Circuit denied Blaszczak's motion for rehearing *en banc* last April.[107]

Insider Trading Prohibition Act Still Awaiting Action by Congress

The proposed Insider Trading Prohibition Act (ITPA), which would dramatically simplify the prosecution of insider trading cases, failed to move forward in Congress in 2020. The ITPA would eliminate the requirement under the Exchange Act that the tippee be aware of the personal benefit to the tipper, and would expand the prohibition on insider trading to include deceptive or wrongful taking of material, non-public information, even absent a breach of fiduciary duty.[108] The House of Representatives passed the ITPA in December of 2019 by a 410-13 vote, and the bill was referred to the Senate Committee on Banking, Housing and Urban Affairs, which to date has not acted upon it. It is possible that the ITPA was overshadowed by the presidential impeachment proceedings in early 2020 or that enthusiasm was dampened by the public outcry over possible insider trading by members of the Senate last year.[109] For now, the legislation appears stalled, though it is possible that the ITPA will find renewed impetus under the new presidential administration and in a new session of Congress.

Market Manipulation: Focus on Spoofing

Though one of the smaller categories of standalone enforcement actions, constituting approximately 5 percent in fiscal 2020, market manipulation has been at the core of the SEC's mission since the agency was established. In enacting the Securities Exchange Act of 1934, Congress viewed manipulative trading practices, such as "stock pools," to be a primary cause of the stock market crash of 1929, and they have since been a regular target of Enforcement.

The forms of manipulation have continually evolved over time, and Enforcement has sought to keep pace. Last year, the Division's most noteworthy manipulation cases involved "spoofing," in which a trader places a large buy or sell order without intending to execute the order, thereby creating a false impression of market demand. The trader (or spoofer) simultaneously places a smaller order for the same security on the other side of the market, which the spoofer does intend to execute. (For example, a spoofer may place an order to buy 100,000 shares and a simultaneous order to sell 10,000 shares.) By creating a fictitious appearance of trading interest that moves the market price, the trader is able to profit by executing on the other side of the market (in the foregoing example, selling shares at a higher price). Spoofing in the commodities markets has long been a focus for the CFTC, and the SEC has likewise targeted the practice in the securities markets under Section 17(a) of the Securities Act and Sections 9(a)(2) and 10(b) of the Exchange Act.

In late 2019, the SEC won victories in federal court against the participants in an alleged scheme involving a variant of spoofing known as "layering." In that scheme, Ukraine-based trading firm Avalon FA Ltd. entered spoofed orders at multiple price levels, and engaged in "cross-market" manipulation by buying and selling stocks to artificially affect options prices, through New York-based broker dealer Lek Securities Corp.[110] According to the SEC's complaint, the scheme generated more than $25 million in profits. In October, the Commission settled with Lek and its CEO, resulting in a three-year injunction restricting the broker-dealer's business with foreign customers and nearly $2 million in monetary relief.[111] The following month, Enforcement won a jury verdict against Avalon and its owners.

In September 2020, the SEC brought a settled action against the broker-dealer subsidiary of JPMorgan Chase & Co. for spoofing trades in US Treasury bonds, resulting in disgorgement of $10 million and a $25 million penalty against the entity.[112] (The DOJ and CFTC announced parallel cases for manipulative trading in the precious metals and Treasuries markets, bringing the total paid to resolve the three actions to more than $920 million.) Notably, the broker-dealer admitted the findings in the SEC's order—a rare departure from Enforcement's usual practice of "no admit, no deny" settlements, in which settling parties do not admit, but agree not to deny, the alleged violations. Under former Chair Mary Jo White, the SEC adopted a policy of seeking admissions in certain cases, but Enforcement has disfavored the practice under former Chairman Clayton. The inclusion of admissions in this settlement suggests that Enforcement views spoofing as a particularly egregious violation.

In another alleged international spoofing scheme, the SEC in October 2020 brought an emergency action and obtained an asset freeze against 18 China-based traders alleged to have placed spoofed

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trades in over 3,000 US-listed securities, reaping over $31 million in profits.[113] The DOJ brought parallel criminal charges against two of the traders.

FCPA Enforcement: High-Profile Cases, Massive Penalties

Though the SEC brought only 10 FCPA cases in fiscal 2020, these enforcement actions often result in exceptionally large penalties, and therefore typically account for a significant share of the monetary relief that Enforcement obtains each year.[114] As we show below, last year was no exception in that regard. As is also typical, the SEC brought most of these cases in parallel with the DOJ, with which it shares responsibility for enforcing the FCPA.[115] The two agencies' interest in FCPA enforcement is unlikely to slacken, and may well increase, under the incoming Democratic administration.

In addition to prohibiting bribery, the FCPA contains provisions requiring issuers (and their subsidiaries and affiliates) to keep accurate books and records and maintain internal controls reasonably designed to ensure accurate financial reporting.[116] As in prior years, the SEC brought several FCPA actions based solely on alleged books and records and internal controls violations, without any accompanying charges of bribery. Although this practice has been widely criticized as stretching the FCPA beyond its intended purpose,[117] as discussed below, the SEC shows no signs of retreating from this approach.

United States v. Hoskins: Potential Limitation of the SEC's Enforcement Powers

The scope of the SEC's and DOJ's ability to prosecute bribery outside the United States was called into question by a February 2020 ruling granting a defendant's motion for acquittal on bribery charges.[118] A Connecticut jury had convicted the defendant, Lawrence Hoskins, for participating in a scheme by the French power and transportation company Alstom S.A. and its consortium partner, Marubeni Corporation, to channel payments to Indonesian officials in order to obtain a $118 million power contract for Alstom's US subsidiary. Although the government presented evidence that Hoskins had helped select third-party consultants who paid the bribes, he worked for a separate Alstom entity in France, never set foot in the United States, did not work for a US entity, and only communicated with US-based conspirators by phone or email from France.

The DOJ charged Hoskins with conspiring with, and aiding and abetting the bribery of, the US subsidiary, as well as acting as an "agent" of the subsidiary. In 2018, the Second Circuit rejected the first two theories because they did not come within the "carefully drawn limitations" on the categories of individuals and entities subject to the FCPA.[119] The case proceeded to trial on the third (agency) theory, leading to Hoskins's conviction.

In granting Hoskins's motion for acquittal, the district court set a high bar for establishing agency under the FCPA: among other elements, the government must show that the principal (in this case, the US subsidiary) had "interim control," involving "the right to give interim instructions or directions to the agent once their relationship is established," and not merely control over "aspects of the transaction."[120] Here, the court held, the government failed to make this showing. The DOJ has appealed the ruling.[121]

Significant FCPA Disgorgement and Penalties

Notable FCPA actions in 2020 included:

- In a culmination of coordinated law enforcement efforts arising from the 1Malaysia Development Berhad (1MDB) scandal, which involved bribes to senior government officials in Malaysia and Abu Dhabi to obtain underwriting business involving approximately $6.5 billion in bond offerings for 1MDB, Goldman Sachs agreed to pay more than $2.9 billion to resolve charges by the SEC and DOJ. The resolution sets a record as the largest combined FCPA settlement to date.[122] In the SEC action, the Commission found that Goldman violated the FCPA's anti-bribery, books and records, and internal controls provisions, and the bank agreed to disgorgement of $606.3 million and a $400 million penalty.[123]

- In December 2019, the SEC charged former Goldman Managing Director Tim Leissner with using a third-party intermediary to pay the 1MDB bribes and violating the same FCPA provisions.[124] Leissner was permanently barred from the securities industry and agreed to pay disgorgement of $43.7 million, offset by amounts he paid pursuant to a criminal forfeiture order in the DOJ's parallel prosecution.
- In December 2019, the SEC brought a settled action against Swedish telecommunications giant Ericsson for allegedly orchestrating a scheme to use third parties to bribe officials in Saudi Arabia, China, and Djibouti, including trips and entertainment for those officials and their families, to win business, and using slush funds, code names, and sham transactions and invoices to channel bribes in Vietnam, Indonesia, and Kuwait.[125] The SEC charged violations of the FCPA's anti-bribery, books and records, and internal controls provisions, for which Ericsson agreed to pay more than $539 million in disgorgement and prejudgment interest. The company also agreed to pay a $520 million criminal penalty in the parallel DOJ action.[126]
- The SEC brought a settled action in June 2020 against pharmaceutical and healthcare company Novartis AG for alleged violations of the FCPA's books and records and internal controls provisions that, according to the SEC's order, enabled schemes by Novartis subsidiaries to make "improper payments" in South Korea, Vietnam, and Greece in exchange for prescribing Novartis products.[127] The company agreed to disgorgement and prejudgment interest of over $112 million, while its subsidiaries agreed to more than $233 in criminal fines in the parallel DOJ action.
- In August 2020, the SEC charged Herbalife Nutrition Ltd. with books and records and internal controls violations related to alleged payments, meals, and gifts from the company's Chinese subsidiaries to officials in China to obtain sales licenses, curtail government investigations, and eliminate negative coverage in state-run media.[128] Herbalife agreed to pay disgorgement and prejudgment interest of more than $67 million and a criminal fine of more than $55 million in the parallel DOJ case.

Cyber Enforcement: Continued Wins in Digital Asset Cases

On the cyber front, enforcement activity in 2020 was largely concentrated on issuers of digital assets in "initial coin offerings," or ICOs, that allegedly conducted offerings without registering those assets as required under Section 5 of the Securities Act of 1933. These actions are part of a now long line of cases that followed the Division's 2017 DAO Report of Investigation under Section 21(a) of the Exchange Act,[129] in which it warned that digital assets, including tokens, may qualify as securities, and therefore be subject to Section 5. (Enforcement issues such reports when it determines that providing guidance on an enforcement issue is more appropriate than bringing an action.) Following the DAO Report, the SEC brought several settled cases against ICO issuers who agreed to reimburse investors, register their offerings, and/or pay penalties.[130]

The SEC added to its string of successful ICO cases in two closely-watched federal court actions that came to a head in 2020. In both, issuers unsuccessfully challenged the SEC's determination that their digital tokens qualified as securities under the 1946 test developed by the US Supreme Court in *SEC v. W.J. Howey Co.* (the *Howey* test).[131] Under the *Howey* test, an asset qualifies as a security where there is: (1) an investment of money; (2) in a common enterprise; (3) with a reasonable expectation of profits; and (4) resulting from the efforts of others.[132]

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In the first case, the SEC won a preliminary injunction against Telegram Group Inc. and its subsidiary TON Issuer Inc. (together, Telegram), which sold interests in its digital currency, called "Grams," to high-net worth investors to finance the development of its proprietary blockchain.[133] Telegram structured the offering to consist of a two-step process involving the sale of rights to receive Grams to accredited investors, followed by the delivery of Grams upon launch of its blockchain, arguing that the two steps should be analyzed separately, and that neither involved the sale of a security.

The court disagreed. Applying the *Howey* factors to the two transactions as a whole, the court found that the Grams amounted to securities. It found the requisite "common enterprise" because Telegram pooled the money it received from the initial purchasers to develop the blockchain, the ability of each purchaser to profit depended entirely on the success of the blockchain, and Telegram's fortunes were tied to the success of the purchasers' investments. Moreover, disregarding the contrary language in the purchase agreements, the court found that the purchasers bought Grams with an expectation of profit in the resale of the Grams to the public through the blockchain. Finally (and again despite disclaimers in the agreements), the court found the "efforts of others" prong satisfied since, in order to realize a return, the purchasers were "entirely reliant" on Telegram to "develop, launch, and provide ongoing support for the TON Blockchain and Grams."

Shortly after the ruling, Telegram's founder announced that its blockchain project would be shut down. The company subsequently reached a settlement with the SEC, agreeing to pay approximately $1.2 billion to investors and a penalty of $18.5 million, along with an injunction against further violations of Sections 5(a) and 5(c).[134] As noted above, Commissioner Peirce sharply criticized the settlement as an "unsatisfying culmination of an enforcement action that I did not support from the beginning" and that threatens to stifle innovation in the United States.[135]

Six months after the *Telegram* decision, the SEC won summary judgment on its Section 5 claims against Kik Interactive, an issuer of a cryptocurrency known as "Kin."[136] Kik sought to expand its business to digital currency by issuing Kin using an already existing blockchain. Again, the SEC persuaded the court that the *Howey* test was satisfied. The court found a common enterprise because Kik deposited the offering proceeds into a single bank account, used them for its operations, including the construction of the digital ecosystem it promoted, which "drove demand for Kin and thus dictated investors' profits." The court also concluded that the investment in Kin came with an expectation of profits from the efforts of others, since the profitability of the cryptocurrency hinged upon Kik's successful development of a digital ecosystem for it.

In September, the SEC brought a settled administrative proceeding against online eSports gaming and gambling platform operator Unikrn Inc., which raised approximately $31 million in 2017 through the unregistered offering of its UnikoinGold (UKG) token.[137] Unikrn agreed to pay a $6.1 million penalty and return that amount to investors, and to disable the UKG and request removal of the token from digital asset trading platforms. Commissioner Peirce again issued a dissenting statement arguing that the action and sanctions imposed will "enervate innovation and stifle the economic growth that innovation brings."[138]

Commissioner Peirce has proposed Securities Act Rule 195, which would provide a three-year safe harbor exempting companies from registration requirements while they develop a decentralized network not dependent upon a single person or entity, at which point tokens would no longer qualify as securities.[139] To date, the Commission has not acted on this proposal, and is unlikely to do so under the incoming Biden administration. Rather, with a Democratic majority, the SEC can be expected to continue its pursuit of ICO issuers through enforcement action.

Issuer Reporting, Accounting and Auditing: Newsworthy Cases, but Numbers Down

As in years past, issuer reporting/accounting and auditing cases were an Enforcement mainstay, constituting the third largest category of standalone actions in fiscal 2020. The number of standalone cases, however, fell sharply, from 92 in fiscal 2019 to 62 last year.[140] As with investment adviser cases, it remains unclear whether this decline is the result of diminished Enforcement interest and/or the effects of the pandemic on the Division's operations. Despite the numbers, the SEC brought several noteworthy disclosure and financial reporting cases against issuers, including those we highlight below. (We discussed the Commission's COVID-related cases separately above.)

A significant trend in this area last year was Enforcement's continued use of risk-based data analytics. Over the past decade, the SEC has developed a formidable set of technological tools and expertise that have enabled it to analyze massive amounts of data quickly and efficiently in order to identify possible disclosure and financial reporting violations. These include the SEC's Division of Economic Risk Analysis (DERA), Enforcement's Office of Market Intelligence (OMI), the Retail Strategy Task Force, the agency's establishment last year of the position of Chief Data Officer, and its adoption of the Inline XBRL software standard for public company filings. While Enforcement tended in earlier years to focus its data analytic capabilities on insider trading cases, it has more recently brought these resources to bear on corporate disclosures, whether of a single company or across entire industries, by using them to spot inconsistences, unusual disclosures, or specific risks that may be indicators of material misstatements or omissions.

Misleading Disclosures

In an action brought in parallel with a criminal case by the DOJ, the SEC charged Wells Fargo & Co. for allegedly making misleading public statements to investors about the success of its "cross-selling" business strategy while opening unauthorized accounts and selling unnecessary products that went unused.[141] The Commission alleged that between 2012 and 2016, Wells Fargo characterized the strategy, which involved selling additional financial products to existing customers, as a primary element of its financial success, when in reality the bank's performance was inflated by the fake accounts and unneeded products. Wells Fargo agreed to pay a $500 million penalty as part of a combined $3 billion settlement with the SEC and DOJ.

Also in February, the SEC sued SCANA Corporation, its former CEO, a former Executive Vice President, and one of its subsidiaries, based on alleged false and misleading statements about progress on a nuclear power plant expansion that SCANA ultimately abandoned.[142] The SEC claimed that the defendants touted the company's progress on the project in its SEC filings, on earnings calls, in press releases and video presentations, and in filings and testimony before the South Carolina Public Service Commission, even though they were allegedly aware that the plant had no realistic prospect of completion. According to the complaint, the allegedly misleading statements enabled the company to bolster its stock price, sell $1 billion in bonds at favorable rates, and obtain regulatory approval to charge customers more than $1 billion in higher rates to finance the project. The case against the companies settled in December, with the entities agreeing to pay $112.5 million in disgorgement and prejudgment interest (which was deemed satisfied by their settlement payments in related rate payer and shareholder litigation) and SCANA agreeing to a $25 million penalty.[143]

Notably, the SEC's focus in this area was not limited to disclosures to shareholders. In September, the Commission brought a settled action against automaker BMW AG and two of its US subsidiaries, alleging that the company misled bond investors about its retail sales volume in seven private offerings

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that raised approximately $18 billion between 2015 and 2019.[144] According to the SEC's order, one of the subsidiaries kept a reserve of unreported retail vehicle sales, known within the company as the "bank," which it used to meet internal sales targets, regardless of when the sales actually occurred. The subsidiary also allegedly paid dealers to designate vehicles as "demonstrators" or "loaners" so they could be included in reported retail vehicle sales, even though the dealers had not actually sold them. The SEC further found that the subsidiary changed its retail sales reporting calendar in order to meet internal sales targets or bank excess sales for future use. The order alleged that, as a result, the information that BMW's US financing subsidiary gave investors and credit rating agencies in offering memoranda and investor presentations was materially misleading. The companies agreed to a joint penalty of $18 million.

Financial Reporting Violations in the Crosshairs

In a notable hybrid disclosure and financial reporting action, the Commission in July 2020 brought a settled case resulting in negligence-based charges and a $45 million penalty against Bausch Health, as well as its predecessor company Valeant Pharmaceutical's former CEO, CFO, and controller, for alleged improper revenue recognition and misleading disclosures in SEC filings and earnings presentations.[145] According to the SEC's orders, Valeant failed to disclose material information in connection with its use of GAAP and non-GAAP measures, including, among others, "same store organic growth," a non-GAAP measure for growth rates of businesses owned for a year or more.

Specifically, the Commission found that the company touted double-digit same organic store growth over five consecutive quarters, without disclosing that much of that growth came from sales to a mail order pharmacy that the company helped establish and whose future performance was questionable at best. The company also allegedly failed to disclose the material impact on its GAAP and non-GAAP measures of revenue it received from drug wholesalers following a 500 percent increase in the price of a single drug that Valeant acquired in April 2015, and instead attributed the resulting revenue to more than 100 unrelated products without recording any as related to the drug.

Just before the end of its fiscal year in September, the SEC brought three significant data-driven financial reporting cases, including the first actions to stem from Enforcement's Earnings Per Share (EPS) Initiative, which uses data analytics to uncover misleading earnings management and related misconduct.[146] In the first action, the SEC charged Interface, Inc., a Georgia-based carpet manufacturer, and two former executives, alleging that the company inflated its reported income and EPS by making unsupported, non-GAAP-compliant manual accounting adjustments over five quarters in 2015 and 2016, for example, reducing the company's accruals for non-discretionary bonuses, in order to increase earnings and meet EPS consensus estimates. Interface agreed to a $5 million penalty.

In the second case, the SEC charged Fulton Financial Corporation, a Pennsylvania-based financial services company, with allegedly smoothing its reported earnings in late 2016 and early 2017, resulting in a $1.5 million penalty. [147] The Commission found that Fulton took a valuation allowance for mortgage servicing rights in two quarters when it was on track to meet or exceed consensus EPS estimates, using a different methodology than the one it told investors it followed, and then belatedly reversed the allowance in mid-2017 to avoid falling short of EPS estimates for later quarters and create the false appearance of consistent earnings across quarters.

The third case involved charges against Hilton Worldwide Holdings for allegedly failing to disclose in its proxy statements approximately $1.7 million worth of travel-related perquisites and personal benefits the company paid to, or on behalf of, various officers, including its CEO.[148] Hilton agreed to pay a $600,000 penalty. The SEC noted in announcing the case that it "was generated by the Division of Enforcement's use of risk-based data analytics" to uncover violations related to executive perks.

Auditors Charged for Backdating Work Papers

The SEC brought comparatively few major auditing cases last year. In a noteworthy action, it charged accounting firm PLS, CPA and three individual auditors under SEC Rule of Practice 102(e) based on allegations that the individuals created and backdated audit work papers after the relevant audit reports were issued.[149] The SEC also found that the auditors failed to perform adequate engagement quality reviews. Backdating of work papers is a longstanding issue for Enforcement. Not every audit failure results in an enforcement action, but charges are significantly more likely where, as alleged here, there is evidence that the auditor has doctored the documentation of audit work.

Public Finance Remains at Center of Retail Investor Focus

The SEC last year reiterated its view that retail investors are especially vulnerable to fraud in the public finance space given their broad exposure to municipal securities. In a public statement last May, then-Chairman Clayton and Office of Municipal Securities Director Rebecca Olsen noted that at the end of 2019, Main Street investors held, directly and indirectly through funds and other managed products, over 72 percent of the market, amounting to roughly $3 trillion of outstanding municipal securities.[150] Accordingly, public finance remained a significant component of Enforcement's "Main Street" investor focus in fiscal 2020.

In particular, the Division continued to target the practice of "flipping" municipal securities to circumvent the priority given to retail investors in new issue municipal bond offerings. Municipal issuers typically sell these securities subject to "order period" restrictions specifying that retail orders be given priority. In several enforcement actions last year, broker-dealers participating in these offerings sought to evade these restrictions by allocating bonds to "flippers," who immediately resold the bonds to other broker-dealers at a profit, in violation of Municipal Securities Rulemaking Board rules. These cases also led to failure to supervise charges against the broker-dealers.

Significant flipping cases in 2020 included settled actions against: UBS and two of its registered representatives, resulting in a $1.75 million penalty and disgorgement and prejudgment interest of over $8 million against the bank;[151] New York-based Boenning & Scattergood, Inc. and two of its registered representatives, with the broker-dealer agreeing to a $75,000 penalty and over $130,000 in disgorgement and prejudgment interest;[152] and New York-based Roosevelt & Cross, Inc. and two of its registered representatives, resulting in disgorgement and prejudgment interest of over $800,000 and a $200,000 penalty against the broker-dealer.[153]

Ms. Wood and **Mr. Murray** are partners, and **Mr. Garcia** and **Ms. Chávez** are associates, at Foley Hoag LLP.

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