

## SEC Enforcement in 2021: A Look Ahead

Written by John W.R. Murray, Christian Garcia

March 11, 2021

*Editors' Note: With the advent of the Biden presidency, we invite you to join us as we examine important trends in white collar law and investigations. Our first entry takes a closer look at SEC enforcement. Up next: a review of sanctions and export controls. We'll be posting on a variety of subjects in the days and weeks ahead as we count down the first 100 days.*

As has been widely reported, the Biden Administration's nomination of Gary Gensler last month as Chairman of the U.S. Securities and Exchange Commission (SEC) signals a more vigorous approach to SEC enforcement. Gensler, who served as Chairman of the U.S. Commodity Futures Trading Commission (CFTC) from 2009 to 2014, is generally viewed as an aggressive regulator. At the CFTC, Gensler presided over the agency's enforcement actions against several major Wall Street banks for manipulation of LIBOR and other benchmark interest rates, resulting in record-setting penalties, as well as the adoption of rules tightening regulation of the swaps markets against the vigorous opposition of the financial industry.

Although a new Director of the SEC's Division of Enforcement (Enforcement) has yet to be named, the agency's enforcement priorities generally follow from the goals of its chair. Gensler's nomination therefore portends a shift away from the agency's de-regulatory bent and prioritization of retail or "Main Street" investors under former Chairman Jay Clayton, and a greater willingness to pursue large banks as well as other systemically important players in the financial markets, and apply its power to seek disgorgement and penalties more expansively.

In these respects, we anticipate that the enforcement program will more closely resemble that under Clayton's predecessor, Mary Jo White, who served as SEC Chair under the Obama Administration. (While Gensler's nomination is pending, [Commissioner Allison Herren Lee](#), a former SEC enforcement staffer generally viewed as pro-enforcement, will serve as Acting Chair.)

The SEC has already demonstrated a more aggressive enforcement posture in [announcing last month](#) that it is restoring delegated authority to issue Formal Orders of Investigation, which permit enforcement staff to subpoena witnesses and documents, to senior officers in Enforcement. The Commission had previously delegated this authority in the wake of the 2008 financial crisis, but in 2017, restricted it to the Director of Enforcement. The renewed delegation will streamline the investigative process and make it easier for Enforcement staff to build its cases. In quick succession, the SEC [announced two days later](#) that Enforcement will no longer recommend settlements to the Commission that are conditioned on granting a waiver from automatic disqualifications that arise from certain violations or sanctions, reversing another change made under Clayton.

Changes in Enforcement's priority areas are likely to take shape more gradually. The Division's staff will remain busy with existing investigations, which on average take roughly two years to complete, along with pending litigations initiated under the previous chairman. We nevertheless expect to see the Enforcement program change in several respects over the course of 2021.

### Enhanced Disgorgement Authority

At the start of the year, Congress responded to recent Supreme Court decisions limiting the SEC's ability to seek disgorgement by [amending the Securities Exchange Act of 1934](#) in an obscure provision of the National Defense Authorization Act (NDAA). The amendments provide the SEC with express statutory authority to seek disgorgement "of any unjust enrichment by the person who received such unjust enrichment as a result of [a] violation" in federal court actions. They also extend the statute of limitations for disgorgement claims arising out of scienter (intentional fraud)-based violations, and apply to "any action or proceeding that is pending" at the time of their enactment.

The amendments will likely embolden the SEC to test the limits of its new disgorgement power. They followed the U.S. Supreme Court's 2020 decision in [Liu v. SEC](#), which held that the Exchange Act authorized the SEC to seek disgorgement, but limited the remedy to a wrongdoer's net profits and called into question the Commission's practices of seeking disgorgement jointly and severally from multiple wrongdoers and depositing disgorgement proceeds into the U.S. Treasury. The SEC may take the position that the new statutory provisions in the NDAA supersede these limitations.

The amendments will also likely incentivize the SEC to investigate conduct older than five years, and may make it more reluctant to settle non-scienter based charges, which remain subject to the shorter five-year statute of limitations. Moreover, inasmuch as they apply to "pending actions," they may also lead the SEC to expand disgorgement claims in pending litigation to include the last ten years of profits (though that position would raise [constitutional questions](#)).

## Individuals

Individual accountability has been a persistent theme for the SEC both before and during Clayton's tenure. Because more aggressive enforcement implies more frequent charges against individuals, and the SEC has frequently been accused of reluctance to charge executives responsible for corporate misconduct, we expect this focus to intensify under Gensler, and anticipate that the Enforcement staff likely will be more insistent upon charging individuals in both scienter-based and non-scienter cases. Moreover, to the extent that the NDAA amendments lead the SEC to push for more scienter-based charges, they will also likely result in more charges against individuals, given the SEC's general reluctance to bring scienter-based charges against entities without also charging responsible officers or employees.

## Issuer Disclosure and Financial Reporting

While the SEC in recent years has brought some notable financial reporting and disclosure cases against issuers resulting in significant monetary relief, as reported in a [prominent study](#) last year, the Commission in fiscal year 2020 brought its lowest number of cases against public companies since fiscal 2014 – a decline very likely due in part to the obstacles that the COVID-19 pandemic posed for Enforcement.

We expect issuer financial reporting and disclosure cases to rebound in 2021. In addition to the SEC's more muscular enforcement posture, the agency has invested heavily in pursuing financial reporting and disclosure violations through the continuing work of Enforcement's [Coronavirus Steering Committee](#), which was formed last year to focus on potential areas of pandemic-related misconduct, as well as sophisticated [data analytic technologies](#) that have enhanced its ability to spot violations.

## Private Funds

Although advisors to private funds have been a repeated target of Enforcement under Clayton, the former chairman's prioritization of retail investors relegated private funds to a less prominent position on the Enforcement agenda than was the case under his predecessor. Enforcement also relied more heavily on the exam staff in the Office of Compliance Inspections and Examinations (OCIE) (renamed the Division of Examinations late last year) to address violations in the private funds space through deficiency letters rather than enforcement action.

We expect these trends to reverse. Especially given Gensler's record of targeting systemically important financial actors, we anticipate more frequent investigations and enforcement actions against private fund advisors. In particular, Enforcement is likely to ratchet up its existing focus on disclosure of conflicts of interest, fees and expenses, policies and procedures governing misuse of material non-public information, and risk management practices. The first three were the subjects of an [OCIE Risk Alert](#) last June, and all have been the subjects of notable enforcement actions in recent years. Because referrals from the exam staff are a frequent source of enforcement activity, we expect those issues to be at the forefront of the Enforcement program in the near term.

We also anticipate that advisors managing complex financial products, such as collateralized loan obligations and mortgage-backed securities, will be of particular interest to the SEC staff, including the Division of Examinations, which identified them as one of its [Examination Priorities](#) for 2021. Enforcement's Complex Financial Instruments Unit has closely focused on such advisors (see, for example, [here](#)), and Gensler's support for rigorous oversight of the derivatives markets at the CFTC suggests that Enforcement scrutiny in this area will continue in 2021.

## Reg BI

In 2019, the SEC adopted Regulation Best Interest (Reg BI), which requires broker-dealers to act in the “best interest” of their retail customers. It did so in the face of intense criticism within the Commission and from Congress and consumer advocates, who had called for the SEC to impose upon broker-dealers the same fiduciary standard that applies to investment advisors. Reg BI’s opponents view the best interest standard as inadequate to the task of protecting retail clients. Notably, as chairman of the Maryland Financial Consumer Protection Commission from 2017 to 2019, Gensler [supported](#) a proposed fiduciary standard for broker-dealers under Maryland law.

Although calls for the SEC to rescind Reg BI persist, given the heavy burden of revising its rule-making and the vehement opposition of the industry, the Commission is likely, at least in the near term, to rely on vigorous enforcement of the rule. Broker-dealers were required to comply with Reg BI last June. Last spring, OCIE issued a [Risk Alert](#) advising that during the year following the compliance date, it planned to conduct exams focusing on firms’ design and implementation of Reg BI policies and procedures. We anticipate that enforcement action will result from this initiative during 2021.

### Insider Trading

Under the Trump Administration, SEC insider trading enforcement fell to its [lowest level](#) since the mid-1990s. We expect that these numbers will trend upward over the coming year. Enforcement sharpened its focus on insider trading following the onset of the COVID-19 pandemic last year, [warning of an increased risk](#) of misuse of material non-public information due to increased market volatility and the volume of market-moving information passing through the hands of insiders. Those conditions will persist in 2021, and we expect that, with them, Enforcement’s heightened interest in insider trading. Moreover, the SEC’s data analytic capabilities, which have significantly enhanced its ability to identify both potentially illegal trades as well as participants in insider trading schemes, will reinforce this trend.

We also expect that the Chairman nominee’s record of prioritizing market integrity and targeting misconduct by significant market actors will provide an impetus for increased enforcement activity against insiders and tippees at major Wall Street banks and private funds, comparable to that in the years following the 2008 financial crisis.

### Market Manipulation

Manipulative trading practices have been a core component of the SEC’s enforcement program since the agency’s inception. More recently, price volatility associated with trading by retail investors in stocks such as GameStop have led the SEC to [focus anew](#) on market manipulation. In view of these recent events and Gensler’s track record of support for assertively regulating potentially destabilizing market activity, we expect that Enforcement’s Market Abuse Unit, which focuses on market integrity, will take a heightened interest in manipulation, including traditional “pump-and-dump” schemes as well as newer variants of manipulation such as “spoofing” (placing orders to buy or sell with no intention of executing the trade) and cross-market manipulation (trading an asset in one market with the intent of manipulating the price of a different asset).

### ESG

President Biden has been explicit in [calling for companies to disclose more detail](#) about their environmental risks and impacts. His nomination of Gensler, who has not shied from rule-making in a lightly regulated space, along with [already existing support](#) within the Commission for enhanced corporate disclosure on environmental, social, and governance (ESG) factors, indicates that the SEC is likely to adopt rules requiring more extensive ESG reporting by issuers and regulated entities. Last month, the SEC took a substantial step in this direction by naming its first [Senior Policy Advisor for Climate and ESG](#) in the office of Acting Chair Lee.

Consistent with these priorities, the Commission on March 4 [announced](#) the formation of a Climate and ESG Task Force within the Division of Enforcement to “develop initiatives to proactively identify ESG-related misconduct and “coordinate the effective use of Division resources,” including data analysis to “mine and assess information across registrants” in order to identify violations. The Task Force’s initial focus will be “to identify any material gaps or misstatements in issuers’ disclosure of climate risks under existing rules.”

The announcement also noted that the Task Force will “analyze disclosure and compliance issues relating to investment advisers’ and funds’ ESG strategies.” This work will build upon the recent focus on this area by the Division of Examinations, which has sought information from registered investment advisers about their ESG disclosures, and included the topic among its [Examination Priorities](#) for 2021.

### Cryptocurrency

In its 2017 [DAO Report of Investigation](#), Enforcement articulated its view that cryptocurrency may qualify as a security under the

Securities Act of 1933, and thus, be subject to the Act's registration requirements. It has since brought several successful actions against cryptocurrency issuers for unregistered "initial coin offerings," or ICOs, a source of [sharp disagreement](#) among the commissioners.

Gensler has [substantial expertise](#) on the blockchain and the digital asset industry, leading some to speculate that he may prove more receptive to arguments against aggressive enforcement than his predecessor and the Democratic commissioners. However, he has also [labelled](#) cryptocurrencies a "speculative asset class" and observed that digital asset exchanges were "not yet appropriately brought within public policy frameworks." It remains to be seen whether Gensler's knowledge of the industry will result in a modified enforcement approach, but his pro-regulatory record and apparent acknowledgement of the need for regulation suggest that ICOs will remain under Enforcement scrutiny in 2021.

## FCPA Enforcement

Despite public statements by former President Trump and Clayton that some viewed as calling into question the government's commitment to FCPA enforcement, the number of corporate resolutions by the SEC and Department of Justice was broadly consistent with earlier years, and both agencies obtained record monetary relief in FCPA cases. That said, given the generally more aggressive approach to corporate accountability expected on the SEC front, an uptick in FCPA enforcement activity over the coming year appears likely.

We also expect that the SEC will continue its regular practice of charging issuers under the FCPA's books and records and internal control provisions without any accompanying charges of bribery, a practice that critics have attacked as distorting the purpose of the FCPA. In addition, we anticipate that the levels of international cooperation among law enforcement agencies and regulators, which has increasingly become the norm in FCPA investigations, will continue in 2021.

## Whistleblower Program

We expect that the SEC's Whistleblower Program will continue to be a major driver of enforcement activity. In fiscal year 2020, the SEC paid approximately \$175 million in whistleblower awards to 39 individuals, and last October, paid a [record award](#) of \$114 million to a single whistleblower. Notwithstanding [controversial amendments](#) to the rules last year, in which the SEC claimed authority to limit the size of the largest awards, we expect that the massive financial incentives under the Program will continue to propel the SEC's enforcement program in fiscal year 2021.

In particular, whistleblowers will likely continue to originate matters involving corporate disclosure and financial reporting, offering fraud, manipulation, insider trading, ICO and cryptocurrency-related misconduct, and FCPA violations, which were the most frequent subjects of whistleblower tips in fiscal 2020, according to the Office of the Whistleblower's [Annual Report to Congress](#).

We will continue to follow and provide updates on Enforcement's priorities throughout the year.

## RELATED PRACTICES

- [White Collar Crime & Government Investigations](#)
- [Securities Litigation](#)

---

This communication is intended for general information purposes and as a service to clients and friends of Foley Hoag LLP. This communication should not be construed as legal advice or a legal opinion on any specific facts or circumstances, and does not create an attorney-client relationship.

United States Treasury Regulations require us to disclose the following: Any tax advice included in this document was not intended or written to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code.

Attorney advertising. Prior results do not guarantee a similar outcome. © 2017 Foley Hoag LLP. All rights reserved.