HAYNES BOONE

SEC Enforcement Highlights

Fiscal Year 2024

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FISCAL YEAR 2024 ENFORCEMENT HIGHLIGHTS

After another year of aggressive SEC enforcement, the agency is on the precipice of significant change. Following the presidential election, Chair Gary Gensler indicated his intention to step down on Jan. 20, 2025. And on Dec. 4, 2024, President-Elect Donald Trump announced his intention to nominate former SEC Commissioner Paul Atkins as the next SEC Chair. We expect that former Commissioner Atkins will be confirmed by the Senate and that he will make meaningful changes to the SEC's enforcement program. However, we also know from experience that agency transitions take many months or even years to complete. Therefore, as we look to 2025, it remains as important as ever to carefully study the significant actions recommended by the SEC Staff and approved by the Commission during FY 2024 – which spanned from October 2023 through September 2024 – with a particular focus on actions against public companies and investment advisers.

In FY 2024, Chair Gensler's final full year at the helm of the SEC, the Division of Enforcement obtained a stunning record of $8.2 billion in monetary relief, a 66 percent increase over the already elevated levels of monetary relief ordered in FY 2023. While the SEC's 583 filed actions during the year represented a 26 percent decline compared to the prior fiscal year, the agency's pursuit of punishing remedies largely defined the enforcement environment. This past year, the SEC remained particularly focused on off-channel communications by investment advisers and broker-dealers, the cryptocurrency industry's evolving product lineup and rule-violation sweeps against public companies and asset managers, regardless of whether those violations caused direct investor harm.

I. Introduction

In summarizing FY 24 results, the Enforcement Division emphasized obtaining $8.2 billion in total monetary relief. However, the Division also noted that this eye-popping total was due in large part to a single award of more than $4 billion in disgorgement and a $420 million penalty following a jury verdict against cryptocurrency platform Terraform Labs PTE, Ltd. and its founder Do Kwon following the collapse of Terraform's purported algorithmic stablecoin. Even backing out the anomalous Terraform relief, the SEC's aggregate disgorgement of around $4.1 billion remained very high by historic standards, but more in line with other fiscal years during Chair Gensler's leadership. Perhaps more importantly, the $2.1 billion in aggregate civil penalties in FY 24 constituted the second-highest total on record, reflecting the Division's determination to ratchet up penalties for many technical, non-fraud violations, including violations related to off-channel communications recordkeeping, the Marketing Rule and the Whistleblower Protection Rule.

The types of cases filed by the SEC during FY 24 generally tracked recent years.[1] Among notable trends, the SEC filed only 2 FCPA cases (down from 12 the prior FY), while filing more cases against investment advisers (+5 percent), which likely reflected the focus on off-channel communications cases against advisers and Marketing Rule violations. The SEC filed fewer cases against public issuers and auditors (-4 percent), which we believe may have been driven in part by the diminishing pipeline of cases stemming from SPAC transactions. SEC cases involving securities offerings also saw a slight decline (-4 percent), which we believe was driven by the SEC focusing on cases against cryptocurrency trading platforms, as opposed to individual crypto securities offerings.[2]

The SEC brought several first-of-their-kind cases in FY 24, including actions alleging:

- Three investment advisers made false or misleading statements regarding their use of artificial intelligence technology in their investment process;
- A public company director violated proxy disclosure rules by standing for election as an independent director without informing the board of his financial relationship and close personal friendship with one of the company's high-ranking executives;
- Various crypto lending and staking-as-a-service products constituted investment contracts; and
- An exempt reporting adviser and its principal committed *fraud* by misrepresenting to investors that the funds it managed were audited annually.

[1] https://www.sec.gov/files/fy24-enforcement-statistics.pdf

[2] Id.

In FY 24, the SEC received a record 45,130 tips, complaints and referrals, including more than 24,000 whistleblower submissions.[3] Notably, the SEC disclosed these numbers were skewed by the receipt of more than 14,000 tips from *just two individuals*.[4] While the aggregate number of tips from the whistleblower pipeline remained strong, this flood of public tips presents significant challenges for agency Staff to engage in meaningful triage. Whistleblower awards totaled around $255 million in FY 24, and while that's less than half of the record total of nearly $600 million in total awards from the prior year, we don't think that trend is significant because whistleblower award totals can be heavily influenced by a few large awards in any given year.[5]

In the press release announcing the FY 24 results, Acting Enforcement Director Sanjay Wadhwa touted that in general, market participants had "stepped up efforts to self-report, remediate and meaningfully cooperate in our investigations, answering our call to foster a culture of compliance."[6] However, the SEC offered no statistics in support of these claims, and the calculus for determining the risk versus reward for self-reporting violations remains elusive. The Commission noted that it had rewarded public companies, investment advisers and broker-dealers for self-reporting and proactive compliance measures with reduced or no civil penalties in matters involving the misstatement of financials, off-channel communications recordkeeping, and disclosure controls involving cybersecurity incidents.[7] But unlike certain units within the Department of Justice, the SEC has yet to quantify the benefits of self-reporting, remediation and extraordinary cooperation, and the evaluation of these criteria appears to largely reside with line investigative Staff, and therefore, in our view, it has remained highly subjective and variable.

With respect to operations, the SEC announced this summer that it will close the Salt Lake Regional Office.[8] The Salt Lake Regional Office was by far the smallest of the 11 offices, with only around 20 Enforcement Staff. Going forward, the Denver Regional Office will assume primary jurisdiction for Enforcement efforts in Utah, after having taken over examination responsibility for Utah several years ago. The Enforcement Division also quietly disbanded its Climate and ESG Task Force. We had always viewed this Task Force as a bit of a paper tiger because it was comprised of volunteer Staff that remained in their ordinary supervisory structure, and the Task Force was credited with bringing only a handful of cases since its inception in March 2021.

Throughout FY 24, many SEC Staff worked remotely four days per week under a liberal telework policy previously negotiated with the NTEU (the union which represents line SEC staff). There is a significant likelihood that such policies will be tightened or perhaps eliminated

[3] https://www.sec.gov/newsroom/press-releases/2024-186

[4] Id.

[5] Id.

[6] Id.

[7] Id.

[8] https://www.sec.gov/newsroom/press-releases/2024-67

altogether under the incoming Trump administration.[9] President-Elect Trump also has indicated his intention to issue an executive order broadening the number of federal employees not subject to statutory civil service protections under "Schedule F," which theoretically would enable his administration to terminate and replace certain SEC Enforcement Division Senior Staff. At this point, it remains unclear how quickly these changes may be implemented, whether such changes would survive judicial challenge or what the ultimate impact will be on SEC Enforcement Staff.

Against that general backdrop of the SEC's enforcement year, we examine below the basic programmatic areas and actions of significance. Unless otherwise specified, all settled enforcement orders discussed below were agreed to on a no-admit no-deny basis.

II. Issuer Disclosure

In FY 24, the SEC brought cases against public issuers across a broad waterfront that included, among other things, public corruption schemes, misstatements regarding revenue and sales prospects, director independence, perquisite disclosure, Reg FD violations and a beneficial ownership reporting sweep.

While *domestic* bribery schemes involving public companies are uncommon in the SEC's enforcement program, in September 2024, the SEC charged the **former CEO of a public company with orchestrating a massive scheme to pay bribes to the Speaker of the state's House of Representatives** with the intent to incentivize the Speaker to support legislation that benefitted the company.[10] To effectuate the fraudulent scheme, the Commission alleged that the former CEO secretly funneled payments to the state House Speaker via tax exempt 501(c)(4) organizations, and following the state House Speaker's arrest on criminal corruption charges, misled investors by insisting that with respect to the matter, the company had acted "ethically" and "transparently." The former CEO was also charged with lying to the company's auditor, and aiding and abetting the company's failure to devise and maintain internal accounting controls and the company's misrepresentations and omissions made by the company in an SEC filing. The company agreed to settle the charges and paid a civil penalty of $100 million. The former CEO was indicted on parallel charges by the Ohio Attorney General's Office in February 2024, and that matter, as well as the SEC's enforcement case, remain pending.[11]

This past fiscal year, the SEC continued its close scrutiny of representations made by issuers and their executives in connection with IPOs. In January 2024, the SEC **charged a SPAC and**

9 https://www.usatoday.com/story/money/2024/11/26/trump-musk-ramaswamy-federal-workers-return-to-office/76568215007/

10 https://www.sec.gov/enforcement-litigation/litigation-releases/lr-26105

11 https://www.ohioattorneygeneral.gov/Media/News-Releases/February-2024/Former-PUCO-Chairman-Former-FirstEnergy-Executives

imposed a $1.5 million civil penalty based on alleged false statements that the company had not initiated any substantive discussions with any potential target companies prior to its IPO.[12] In February 2024, the SEC charged an electric vehicle truck manufacturer with **misleading investors about the timeline for delivery and the sales prospects** by exaggerating the demand of the company's flagship vehicle.[13] Among other things, the Commission alleged that the company touted more than 100,000 "pre-orders," which, in reality, were one-page, non-binding form agreements, many of which turned out to be fictitious or from prospective customers that did not even have vehicle fleets. In settling the matter, the company agreed to a cease-and-desist order and disgorgement of $25.5 million. And in September 2024, the SEC settled charges against a **biotechnology company for allegedly misleading IPO investors about the company's overall market potential, revenue prospects and customer pipeline** for its only commercially available product.[14] The company agreed to a cease-and-desist order and to pay a civil penalty of $30 million.

In September 2024, the SEC announced a rare case charging **a director with proxy violations for standing for election as an independent director while concealing his financial relationship and close personal friendship** with one of the company's high-ranking executives.[15] Among other things, the Commission alleged that the director paid more than $100,000 in travel expenses for the company's executive, encouraged the executive to conceal their close friendship and shared confidential details about the company's succession process to better position the executive for succession in the future. The executive settled the matter by consenting to a cease-and-desist order, payment of a civil penalty of $175,000 and a five-year officer-and-director bar.

In FY 24, the Commission also continued its focus on perquisite disclosures. For example, in March 2024, the SEC settled charges against a **public company for the failure to disclose payments that benefitted the company's executives and their immediate family members.**[16] According to the SEC's order, the company failed to disclose the employment of two relatives of an executive, a consulting relationship with a person who shared a household with another executive and that two executives owed more than $120,000 to the company for personal expenses initially covered by the company that they had not repaid. To settle the matter, the company agreed to a cease-and-desist order and to pay a civil penalty of $1.25 million.

[12] https://www.sec.gov/newsroom/press-releases/2024-10

[13] https://www.sec.gov/newsroom/press-releases/2024-29

[14] https://www.sec.gov/newsroom/press-releases/2024-129

[15] https://www.sec.gov/enforcement-litigation/litigation-releases/lr-26145

[16] https://www.sec.gov/newsroom/press-releases/2024-33

In September 2024, the SEC charged a public company with **violating Reg FD in connection with selective disclosures made on the CEO's social media accounts.**[17] The order alleged that, acting on the company's behalf, a third-party investor relations firm published a post on the personal social media account of the company's CEO that stated the company was seeing strong growth. However, the company had not disclosed its quarterly financial results or otherwise publicly disclosed the information contained in the posts. The company agreed to a cease-and-desist order, to pay a civil penalty of $200,000 and undertakings to comply with required Reg FD training for employees with corporate communication responsibilities.

Finally, the SEC continued its use of proactive data analytics to identify technical rule violations by public companies, followed by large sweeps. In September, the SEC settled charges against **23 public issuers and individual executives for failing to timely report information about their holdings and transactions in public company stock.**[18] The order alleges that the individuals and entities failed to abide by the reporting requirements of Schedules 13D and 13G and Forms 3, 4 and 5. All of the charged public issuers agreed to cease-and-desist orders and to pay civil penalties ranging from $40,000-375,000. The charged individuals who served as officers, directors and/or the beneficial owners of publicly traded companies paid civil penalties ranging from $10,000-200,000. Notably, the Commission charged two public companies with contributing to individual executives' filing failures and the failure to report delinquencies and imposed $200,000 civil penalties against each of them.

III. Accounting and Auditing

In a novel theory, in November 2023, the Commission charged a public company with internal accounting controls violations stemming from the inclusion of improper provisions in a stock buyback program.[19] Rule 10b5-1 under the Exchange Act, which allows corporate insiders to trade their respective company's securities without being liable for insider trading, requires, among other things, that once a company adopts a trading plan, the company and its employees must not be able to change planned sales and purchases.

The Commission alleged that in implementing nine different buyback plans over a five-year

[17] https://www.sec.gov/newsroom/press-releases/2024-149

[18] https://www.sec.gov/newsroom/press-releases/2024-148?utm_medium=email&utm_source=govdelivery

[19] https://www.sec.gov/newsroom/press-releases/2023-235

period, the company included so-called "accordion" provisions that allowed the company to change the amount and timing of planned buybacks after the plan started. As a result, the Commission alleged that the company failed to implement appropriate internal controls to ensure compliance with Rule 10b5-1. The company agreed to pay a $25 million civil penalty to settle the charges.[20]

Also in November 2023, the SEC announced **charges against a pharmaceutical company for failing to disclose potential liability from overcharging Medicaid for its flagship drug.**[21] The Commission alleged that despite receiving multiple notices from the Centers for Medicare and Medicaid Services (CMS), that the company was using the wrong rebate rate for the drug and receiving a civil investigative demand under the False Claims Act from a U.S. Attorney's Office, and the company failed to disclose the potential loss on its quarterly and annual reports. The loss ultimately amounted to $640 million, and the company declared bankruptcy after CMS prevailed against it in litigation. The Commission alleged that the company failed to report the reasonably possible material loss contingency relating to the rebate issue, and the potential reduction in future sales of the drug at issue. Additionally, the Commission alleged that the company's filings contained misleading and inadequate disclosures about the CMS investigation and that the company had insufficient accounting and disclosure controls. The company agreed to a cease-and-desist order and to retain a compliance consultant. In announcing the settlement, the Commission alluded to the company's financial condition (bankruptcy) and retention of a compliance consultant, but it then took the unusual step of *quantifying the $40 million civil penalty that it elected not to impose*.

In August 2024, the Commission alleged **a public shipbuilding company and its subsidiary engaged in a scheme to artificially reduce estimated costs on long-term shipbuilding projects.**[22] The complaint alleges that the company lowered its cost estimates to meet certain financial targets, despite knowing that costs were rising. Based on these sham projections, the company recognized revenue prematurely, allowing it to meet consensus analyst earnings targets. To settle the matter, the company agreed to pay a $24 million civil penalty. The company additionally agreed to plead guilty to criminal charges and settle a False Claims Act lawsuit brought by the

[20] This year, the SEC imposed a $1.2 million "springing penalty" if an issuer fails to remediate continuing internal accounting controls deficiencies. See, https://www.sec.gov/enforcement-litigation/administrative-proceedings/34-100845-s. The Commission alleged that this oil and gas issuer, a former SPAC, had failed to implement proper controls at a legacy company that it had acquired as a new subsidiary, which resulted in accounting errors in its expense accruals, accounts payable, and balance errors in other accounts.

[21] https://www.sec.gov/enforcement-litigation/administrative-proceedings/33-11256-s

[22] https://www.sec.gov/newsroom/press-releases/2024-108

Department of Justice.[23] Last year, the Commission brought charges against three company executives alleged to have carried out the scheme.[24]

In September 2024, the SEC **charged a public company's former CEO, CFO and audit committee chair with inflating the company's reported revenue.**[25] The SEC alleged that shortly before its IPO, the company recognized more than $1 million in revenue—which constituted nearly all of the company's reported revenue—from a test of the company's flagship software program, despite the CEO's knowledge the test never occurred. The Commission further alleged that during a secondary stock offering, the company's former CFO and audit committee chair learned that the software tests had not been performed, but rather than investigating or correcting the misrepresentations, they perpetuated the scheme by making false statements about the revenue at issue. All three individuals also were charged with lying to the company's auditor about the revenue from the test. The former CEO also was charged and pled guilty to criminal charges related to this scheme.[26]

In May 2024, the Commission **charged an audit firm and its owner with intentionally failing to comply with Public Company Accounting Oversight Board (PCAOB) standards, fabricating documents to disguise these failures and falsely stating to clients and in SEC filings that the firm met PCAOB standards.**[27] In essence, the Commission alleged that the auditor was an illicit audit mill, and that at least three-quarters of the firm's 1,500 filings on behalf of 500 companies over more than two years failed to comply with PCAOB standards. The SEC alleged egregious violations, including that the firm reused audit workpapers from previous audit periods and passed them off as new work, including purporting to document meetings and work that never occurred. To settle the charges, the firm agreed to pay a $12 million civil penalty and its owner agreed to pay a $2 million civil penalty. The firm and its owner also agreed to permanent suspensions of their ability to appear before the Commission as accountants.

In September 2024, an audit firm agreed to pay $1.95 million dollars to settle two separate enforcement actions against it.[28] One action alleged that **in auditing now-defunct crypto trading platform FTX, the firm lacked the requisite technical competency and resources** to understand the increased risk stemming from the relationship between FTX and Alameda Research, LLC, a crypto hedge fund controlled by FTX's CEO. The firm also settled a separate SEC

[23] https://www.justice.gov/opa/pr/us-navy-shipbuilder-pleads-guilty-financial-accounting-fraud-scheme-and-obstructing-defense

[24] https://www.sec.gov/newsroom/press-releases/2023-69

[25] https://www.sec.gov/enforcement-litigation/litigation-releases/lr-26107

[26] https://www.justice.gov/usao-sdny/pr/former-ceo-kubient-inc-charged-and-pleads-guilty-connection-accounting-fraud-scheme

[27] https://www.sec.gov/newsroom/press-releases/2024-51

[28] https://www.sec.gov/newsroom/press-releases/2024-133

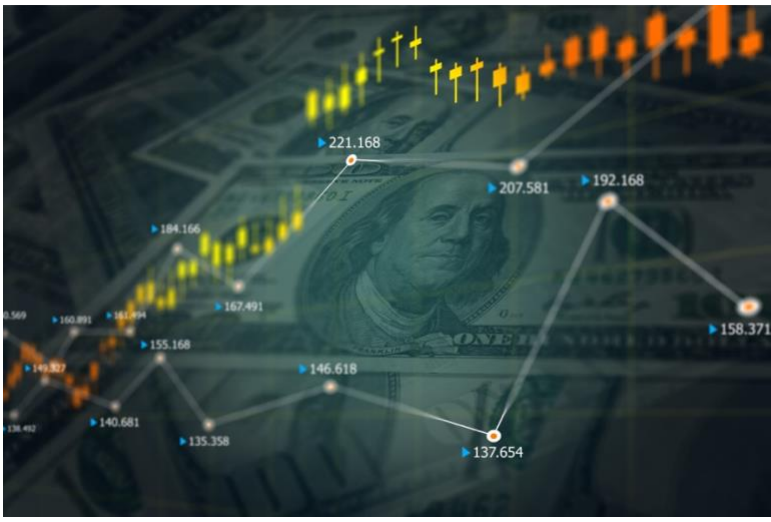
enforcement action that had been pending since 2023 which alleged that the firm had **violated auditor independence rules by including indemnification provisions in engagement letters** for more than 200 audits, reviews and exams.

Finally, as in past years, for public issuers that restated financial results, the SEC **sought clawback of compensation pursuant to Section 304 of the Sarbanes-Oxley Act ("SOX 304")**. Under SOX 304, the SEC can require CEOs and CFOs of public companies to return to the company a portion of their incentive-based compensation if the company is forced to restate its financial statements due to misconduct (even if the CEO and CFO did not personally engage in misconduct).[29]

IV. Investment Advisers

While undisclosed conflicts of interest and issues involving fees remain perennial areas of concern for the SEC, in FY 24, the Division of Enforcement also focused significant resources on alleged violations of the Marketing Rule, as well as 204A and Compliance Rule violations related to maintaining policies and procedures to prevent the misuse of material nonpublic information.

In April 2024, the SEC announced it had settled charges against five registered investment advisers for **advertising hypothetical performance on the public-facing areas of their websites without implementing policies to ensure the performance was relevant to the intended audience's financial situation and investment objectives as required by the Marketing Rule.**[30] In essence, the SEC has taken the position that for public-facing website materials, hypothetical performance advertising is prohibited because there is no way for investment advisers to collect and analyze the requisite materials from all members of the intended audience. The SEC also alleged that one of the investment advisers made false and misleading statements in its advertisements, including misleading statements regarding model performance and performance claims. All five investment advisers consented to a cease-and-desist order, the payment of penalties ranging from $20,000 to $100,000 and a censure.



In September 2024, the SEC charged nine investment advisers with **violating the Marketing Rule by disseminating advertisements that included untrue or**

[29] https://www.sec.gov/enforcement-litigation/administrative-proceedings/33-11285-s

[30] https://www.sec.gov/newsroom/press-releases/2024-46

unsubstantiated statements of material fact, or testimonials, endorsements or third-party ratings that lacked required disclosures.[31] The claims included advertisements touting conflict-free advisory services, claims of awards provided to a firm principal, and dissemination of advertisements claiming to contain testimonials that did not actually come from current clients. One of the investment advisers allegedly failed to disclose that an advertised endorser was a paid, non-client of the investment adviser, whereas four of the investment advisers allegedly failed to disclose that third-party ratings included in their advertisements were more than five years old. Each of the advisers agreed to cease-and-desist orders, compliance with certain undertakings surrounding their violations and the payment of civil penalties ranging from $60,000 to $325,000.

In FY 24, the SEC continued to scrutinize whether investment advisers maintained and enforced written policies and procedures reasonably designed to prevent the misuse of material nonpublic information ("MNPI"). In December 2023, the SEC alleged that **a registered investment adviser repeatedly disclosed to current investors, prospective investors and industry contacts merger-related MNPI and confidential fund performance claims.**[32] The order further alleged that the investment adviser violated Section 204A and the Compliance Rule. The adviser consented to a cease-and-desist order, censure and a civil penalty of $4 million.

In August 2024, the SEC charged an investment adviser with **failing to establish policies to prevent the misuse of MNPI while trading collateralized loan obligations ("CLOs").**[33] The Commission alleged that the investment adviser violated Section 204A and the Compliance Rule by selling two CLO equity tranches containing loans to a distressed borrower while in possession of MNPI, resulting in significant losses for the buyers when the information became public. The investment adviser consented to a cease-and-desist order, a censure and a civil penalty of $1.8 million.

In September 2024, the SEC charged a registered investment adviser with **failing to establish adequate policies to prevent the misuse of MNPI while participating in ad hoc creditors' committees.**[34] Specifically, the Commission alleged that the investment adviser traded in securities relating to an issuer without restricting its trading until it entered into a non-disclosure agreement, (although notably, the Commission did not claim the investment adviser actually received or misused MNPI). The investment adviser agreed to cease-and-desist from future violations of Section 204A and the Compliance Rule, a censure and a $1.5 million civil penalty.

[31] https://www.sec.gov/newsroom/press-releases/2024-121?utm_medium=email&utm_source=govdelivery

[32] https://www.sec.gov/enforce/ia-6514-s

[33] https://www.sec.gov/newsroom/press-releases/2024-106

[34] https://www.sec.gov/newsroom/press-releases/2024-158

In a first action extending severe remedies for fund audit failures, in August 2024, the SEC **alleged breach of fiduciary duties and fraud by an investment adviser and its principal for failing to complete fund audits as contemplated in the respective fund offering documents**.[35] The SEC alleged that for a period of more than three years, the adviser and its principal misrepresented to investors that the funds it managed were audited annually by an independent auditor, despite knowing that the auditor had not finalized any audit reports. In past actions concerning the failure to obtain audits for private funds, the Commission charged only Custody Rule violations. But here, the SEC alleged violations of Section 17(a)(2) of the Securities Act of 1933, Section 204A, 206(2), and 206(4) of the Advisers Act, and Rule 206(4)-(8) thereunder. While the settlements are subject to court approval, the adviser and its principal were ordered to each pay civil penalties of $145,000, the adviser was ordered to review and correct all necessary disclosure documents concerning audits of the funds and the principal was barred from serving as an officer or director of public companies for three years.

In September 2024, the SEC **charged eleven investment advisers with failing to file Forms 13F,** despite the fact that each of them had discretionary authority over more than $100 million in certain securities.[36] In addition to the failure to file Forms 13F, two of the investment advisers were also charged with failing to file Forms 13H as required for large traders who trade a significant amount of exchange-listed securities. All eleven firms agreed to settle the charges, however, only nine of the investment advisers were required to pay civil penalties totaling $3.4 million. Two firms were not ordered to pay any civil penalties because they self-reported the violations.

In August 2024, the SEC brought an enforcement action against an investment adviser for **violations of Rule 206(4)-5 of the Adviser's Act (aka the "Pay-to-Play" Rule).**[37] The Pay-to-Play Rule is technical, and the Commission has applied a strict liability standard when enforcing the rule. In this case, the SEC alleged that in 2020, the adviser hired an individual for a position that made them a "covered associate" who, just one year prior, had made campaign contributions totaling $7,150 to a state government official. The contribution and status as a "covered associate" triggered the "look-back" provision subjecting the employee to the two-year prohibition on solicitation of government entities on behalf of the investment adviser. The SEC found that the investment adviser violated the Advisers Act by continuing to provide investment advisory services to a state public retirement fund within two years of the campaign contribution. The adviser consented to a cease-and-desist, along with a civil money penalty of $95,000 and a censure.

[35] https://www.sec.gov/enforcement-litigation/litigation-releases/lr-26080

[36] https://www.sec.gov/newsroom/press-releases/2024-135?utm_medium=email&utm_source=govdelivery

[37] https://www.sec.gov/enforcement-litigation/administrative-proceedings/ia-6662-s

V. Recordkeeping

The Commission's three large off-channel communications sweeps against investment advisers and broker-dealers in FY 24 mirrored the huge civil penalties and significant remedial undertakings that we've seen in each of the past three fiscal years.

In February 2024, the SEC announced a sweep that imposed over $81 million in civil penalties against 16 firms, including five broker-dealers, seven dually registered broker-dealers and investment advisers, and four affiliated investment advisors.[38] In August 2024, the SEC announced another off-channel communications sweep wherein 26 firms agreed to pay a total of more than $390 million in civil penalties for off-channel communications recordkeeping and supervisory failures.[39] Finally, in September 2024, the Commission announced that eleven firms agreed to pay over $88 million combined to settle charges of pervasive recordkeeping deficiencies.[40] In the September sweep, the SEC noted that it had declined to impose a civil penalty against a twelfth firm, and that two other firms paid substantially lower penalties, because each of the firms had self-reported their violations, had engaged in varying degrees of proactive cooperation with the Staff's investigation and had remediated past recordkeeping and supervisory failures.

In FY 24, the Commission also **expanded the types of registrants it pursued for off-channel recordkeeping deficiencies**. In September, the SEC announced charges against six credit rating agencies for recordkeeping deficiencies and failure to maintain and preserve electronic communications regarding ratings decisions.[41] The credit rating agencies agreed to pay combined civil penalties in excess of $49 million and cease-and-desist orders. Four of the six firms will be required to retain a compliance consultant to review the firms' policies and procedures and address non-compliance among employees. The other two firms were not required to do so due to their extraordinary cooperation with the investigation and significant remedial efforts. The SEC also settled charges against a dozen municipal advisers and imposed a total of $1.3 million in civil penalties stemming from their failure to maintain and preserve off-channel communications, in violation of various provisions of the Exchange Act and Municipal Securities Rulemaking Board Rules.[42]

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[38] https://www.sec.gov/newsroom/press-releases/2024-18

[39] https://www.sec.gov/newsroom/press-releases/2024-98?utm_medium=email&utm_source=govdelivery

[40] https://www.sec.gov/newsroom/press-releases/2024-144?utm_medium=email&utm_source=govdelivery

[41] https://www.sec.gov/newsroom/press-releases/2024-114

[42] https://www.sec.gov/newsroom/press-releases/2024-132?utm_medium=email&utm_source=govdelivery

VI. Broker-Dealers

While we expected more vigorous enforcement of Regulation Best Interest ("Reg BI") than came to pass in FY 24, we did see the SEC expand its pursuit of violations to include each of Reg BI's four component obligations and yet another Form CRS sweep.

In February 2024, the SEC charged a broker-dealer with **failing to comply with Reg BI's Disclosure Obligation, Care Obligation and Compliance Obligation, all of which concerned recommendations to retail customers to open certain types of retirement accounts that limited their access to less expensive funds.**[43] The SEC alleged that the broker-dealer recommended that retail customers select investments from a "core menu" of affiliated investments and failed to disclose conflicts of interest and that substantially equivalent, lower-cost share classes of affiliated funds were available in the alternative brokerage window. The SEC found that over 94% of the firm's customers invested only through the core menu, resulting in them paying substantially more than they would have through the brokerage window and demonstrating that the broker-dealer did not act in its customers' best interests. To settle this matter, the broker-dealer agreed to $1.25 million in civil penalties, nearly $1 million in disgorgement and a cease-and-desist order.

In September 2024, the SEC charged a broker-dealer with **violating Reg BI in connection with recommending complex products (structured notes) to retail customers.**[44] The SEC alleged that following the merger of two broker-dealers, system compatibility issues prevented the firm from accessing accurate information for more than 5,000 customers necessary to review the propriety of structured note recommendations, and that certain registered representatives lacked access to exception reporting to review structured notes transactions flagged as potentially non-compliant. The broker-dealer consented to a $325,000 civil penalty and a cease-and-desist order.

The SEC also settled charges against five broker-dealers in September 2024 for **failure to include all of the information required in Form CRS filings.**[45] Four of the five firms failed to make a mandatory disclosure concerning the firm or its financial professionals' legal or disciplinary histories. The fifth firm filed a Form CRS that failed to include required information and prescribed language and failed to timely file and deliver the Form CRS according to regulatory deadlines.[46] In settling these actions, each of the broker-dealers agreed to cease-and-desist orders and the payment of civil penalties ranging from $12,000 to $60,000.

[43] https://www.sec.gov/newsroom/press-releases/2024-22

[44] https://www.sec.gov/newsroom/press-releases/2024-136

[45] https://www.sec.gov/enforcement-litigation/administrative-proceedings/34-101183-s

[46] https://www.sec.gov/files/litigation/admin/2024/34-101183.pdf

The SEC also maintained its focus on the obligations of broker-dealers to make timely filings of Suspicious Activity Reports ("SARs"). In August 2024, the SEC charged a broker-dealer that operated three ATS platforms for **failing to file a single SAR over a three-year period.**[47] According to the SEC, the ATSs failed to adopt or implement reasonably designed AML policies and procedures to detect suspicious, manipulative trading activity. The broker-dealer agreed to pay a $1.19 million civil penalty and agree to a cease-and-desist order to settle the charges. The SEC also required the broker-dealer to retain a compliance consultant to improve the firm's AML policies and procedures.

VII. Cybersecurity

The Commission had a busy year in cybersecurity enforcement in FY24. In May 2024, the SEC announced settled charges with the operator of a securities trading marketplace and nine of its subsidiaries -- including the New York Stock Exchange -- for failing to immediately notify the SEC of a cyber intrusion, as required by Regulation Systems Compliance and Integrity ("Regulation SCI").[48]

According to the SEC's order, after being informed by a third party of a vulnerability in one of its devices used by employees to access its corporate network, the operator investigated immediately and determined that a threat actor had inserted malicious code into the device. Rather than notifying the SEC, the operator's information security team continued to analyze and respond to the cyber intrusion. Additionally, in violation of its own internal cyber incident reporting procedures, the information security team allegedly failed to notify the company's legal and compliance personnel until five days after being notified of the intrusion. As a result of these failures, the operator's subsidiaries did not properly assess the intrusion to fulfill their own cyber intrusion-reporting obligations under Regulation SCI and did not comply with their own internal policies regarding regulatory compliance. The operator agreed to pay a civil penalty of $10 million.

In June 2024, the SEC announced settled charges with a global provider of business communication and marketing services for **failing to design effective controls and procedures to report cyber incidents to the personnel responsible for making disclosure decisions and failing to carefully assess and timely respond to internal intrusion system alerts.**[49] According to the SEC's order, the failures were especially concerning because the company was in the business of storing and transmitting large amounts of data, including sensitive and confidential client data. In addition, the company's internal controls deficiencies, including allocating insufficient resources to review and investigate alerts, allegedly led to a failure to timely respond to a ransomware network intrusion in 2021. That

[47] https://www.sec.gov/newsroom/press-releases/2024-96?utm_medium=email&utm_source=govdelivery

[48] https://www.sec.gov/newsroom/press-releases/2024-63.

[49] https://www.sec.gov/newsroom/press-releases/2024-75.

intrusion resulted in encryption of computers, exfiltration of data and business service disruptions. The company agreed to pay a civil penalty of $2.13 million, with the SEC's order clarifying that the Staff arrived at this penalty amount by considering the company's self-disclosure of the ransomware intrusion, voluntary revision of its policies and procedures, adoption of new cybersecurity technology and controls, update of employee training, increase in cybersecurity personnel and cooperation with the SEC's investigation.

In August 2024, the SEC announced settled charges **with a transfer agent for failing to assure that client securities and funds were protected against theft or misuse,** which led to a net loss of $4.1 million of client funds from two cyber incidents.[50] Specifically, in September 2022, an unknown threat actor hijacked a pre-existing email chain between the transfer agent and one of its public company clients. The threat actor was then able to deceive the transfer agent into issuing millions of the issuer's shares, liquidating them and sending the proceeds to bank accounts in Hong Kong. Then, in April 2023, another unknown threat actor used stolen Social Security numbers to gain access to some of the agent's online accounts -- even though other personal information did not match the accounts -- and then liquidated clients' shares in those accounts and sent the proceeds to external bank accounts. In both instances, the transfer agent did not notice or discover the fraudulent transfers on its own. The SEC alleged that the transfer agent's conduct failed to comply with an Exchange Act rule requiring transfer agents to assure that all securities in their custody or possession are held in safekeeping, handled in a manner reasonably free from risk of theft, loss or destruction, and protected against misuse. The transfer agent agreed to pay a civil penalty of $850,000, with the SEC's order clarifying that this penalty amount took into account the hiring of a chief control officer to oversee cybersecurity, engagement of a third-party cybersecurity firm to conduct a forensic review of the agent's systems and reimbursement of its clients for losses resulting from the two cyber incidents.

Finally, in October 2024, the SEC charged four current and former public companies for **negligently minimizing or misrepresenting aspects of the SolarWinds Orion hack in their respective public disclosures.**[51] All four companies learned that the threat actor likely behind the large-scale SolarWinds hack[52] had compromised their systems. The first company's public disclosure represented the risks from the hack as hypothetical when in reality it had involved exfiltration of gigabytes of confidential and/or proprietary data. The second company's disclosure misrepresented the number and types of documents the threat actor had accessed. Disclosures by the third company

[50] https://www.sec.gov/newsroom/press-releases/2024-101.

[51] https://www.sec.gov/newsroom/press-releases/2024-174.

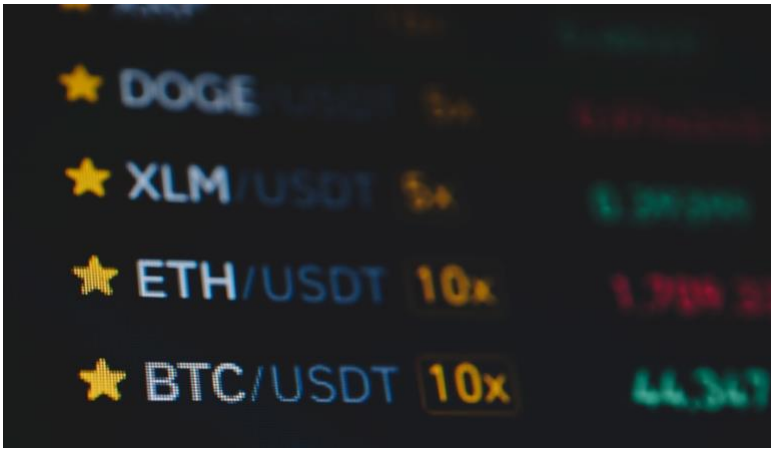
[52] https://www.haynesboone.com/news/alerts/judge-curtails-secs-cybersecurity-claims-against-solarwinds-setting-precedent-for-future-cases.

described the existence of intrusions in generic terms and omitted new and material cybersecurity risks arising out of the SolarWinds hack. And the fourth company's disclosure minimized the hack by failing to disclose the nature of the code the threat actor exfiltrated and the number of customers whose credentials or server and configuration information were compromised. Notwithstanding that the four companies cooperated with the SEC's investigation, including by voluntarily providing analyses or presentations and taking steps to enhance their cybersecurity controls, the SEC required each of them to consent to cease-and-desist orders and imposed civil penalties ranging from $990,000 to $4 million.

VIII. Crypto

By all indications, the incoming Trump administration will seek to curtail, and perhaps even reverse or halt, the SEC's vigorous pursuit of the crypto industry that we have seen over the past two SEC Chairs.

It remains to be seen whether the administration can forge sufficient consensus in Congress to prescribe a comprehensive regulatory framework for crypto or delineate whether cryptocurrencies should be categorized as commodities to be regulated by the Commodity Futures Trading Commission or securities to regulated by the SEC. Regardless of the next chapter in crypto regulation (or deregulation), this past fiscal year, the SEC maintained a busy docket of cryptocurrency enforcement, which likely will take time to recede.



In November 2023, the SEC **charged a digital cryptocurrency exchange platform for failing to register as a securities exchange, broker-dealer, and clearing agency.**[53] Similar to the high-profile charges against other cryptocurrency platforms brought in FY 23, the SEC predicated its charges on allegations that many of the digital assets traded on the platform are securities under the *Howey* test. The SEC further accused the platform of commingling customer funds and lacking sufficient internal controls. In ongoing litigation, in August 2024, a federal judge in California denied the platform's motion to dismiss and ruled that the SEC plausibly alleged that selling cryptocurrency on the primary and secondary markets is an investment contract that would subject the platform to securities regulation.[54]

[53] https://www.sec.gov/newsroom/press-releases/2023-237.

[54] *Sec. & Exch. Comm'n v. Payward, Inc.*, No. 23-CV-06003-WHO, 2024 WL 4511499 (N.D. Cal. Aug. 23, 2024).

In FY 24, the SEC continued its pursuit of crypto lending and staking-as-a-service products (wherein customers deposit or lend their cryptocurrency or digital assets to third parties in exchange for returns based on the loaned assets). In August 2024, the SEC **charged a crypto platform with failing to register the offer and sale of its cryptocurrency lending program.**[55] The lending product at issue allowed U.S. investors to tender their crypto assets to the platform in exchange for its promise to pay a variable interest rate generated by the platform's use of investors' crypto assets in various ways to then create income for itself and to fund interest payments. The SEC also **accused the platform of operating as an unregistered investment company because the entity held more than 40% of its total assets in what the Commission deemed investment securities**, including loans of cryptocurrency to institutional borrowers. The platform agreed to settle the matter by agreeing to injunctive relief and the payment of a $3 million civil penalty, which is still pending court approval.[56]

In September 2024, the SEC **charged a DeFi platform and its co-founders with fraud and broker-dealer registration violations based upon the offer and sale of tokens,** which represented returns owed stemming from their cryptocurrency loans.[57] The SEC charged that the defendants misled investors by representing that clients' assets would automatically rebalance over time when in fact the DeFi platform had to manually rebalance the accounts. To settle the matter, the DeFi platform and its co-founders agreed to various forms of relief, including permanent injunctions, civil penalties, disgorgement with prejudgment interest and, with respect to the co-founders, five-year equitable officer-and-director bars along with five-year conduct-based injunctions barring them from participating in the issuance, purchase, offer or sale of crypto assets offered and sold as securities, except for their own personal accounts.

In June 2024, the SEC **charged a company with engaging in the unregistered offer and sale of securities and operating as an unregistered broker for providing crypto staking and swap services without registering.**[58] Using the Ethereum blockchain and smart contracts, the company had developed a software program offering crypto staking services and swaps. The staking service accepts customer assets to stake while customers receive liquid staking tokens that may be freely exchanged. The swap product effectuates swaps from one crypto asset to another and utilizes third-party liquidity providers to offer the "best" price for customers. The SEC alleged that the developer's collection of fees for both services constituted unlawful transaction-based compensation in

[55] https://www.sec.gov/newsroom/press-releases/2024-105.

[56] In March 2024, another crypto lending platform – which had frozen investor withdrawals after it and two affiliates filed for Chapter 11 bankruptcy in 2023 – agreed to a permanent injunction and the payment of a $21 million civil penalty. https://www.sec.gov/newsroom/press-releases/2024-37

[57] https://www.sec.gov/newsroom/press-releases/2024-138.

[58] https://www.sec.gov/newsroom/press-releases/2024-79

violation of the broker registration provisions and that by participating in the distribution of the staking programs the developer engaged in the unregistered offer and sale of securities. The litigation of this matter is ongoing.

IX. Greenwashing Enforcement Has Been De-Prioritized

Throughout his tenure, SEC Chair Gensler expressed concern that public companies and asset managers often seize on the latest hot topic or trend in the marketplace and mislead investors regarding their commitment to or capabilities in that area.

In FY 21 and FY 22, for example, the SEC devoted significant resources to rooting out so-called "greenwashing," or misleading investors regarding an organization's commitment to environmental, social and governance issues. In FY 23 and FY 24, the SEC's attention largely shifted to "AI washing," or overstating the benefits of artificial intelligence or the extent to which an organization leverages AI or understating the risks of AI. We expect continued scrutiny of AI disclosures by the Staff and expect more cases to come in this area.

In March 2024, the SEC announced settled **charges against two investment advisors for making false and misleading statements regarding their purported use of artificial intelligence in their investment process.**[59] The settled orders alleged that the firms made false and misleading statements in SEC filings, press releases, social media posts, and on their websites. For example, one firm claimed that it "put collective data to work" so its AI could "predict which companies and trends are about to make it big." The SEC alleged that neither firm had the AI capabilities they claimed and charged both firms with violating Section 206(2) of the Advisers Act and the Marketing Rule. Both firms consented to censures, cease-and-desist orders, and civil penalties of $175,000 and $225,000, respectively.

Despite apparently deemphasizing environmental, social, and governance disclosure matters, in September 2024, the SEC **charged a public company with making inaccurate statements regarding the**

[59] https://www.sec.gov/newsroom/press-releases/2024-36

recyclability of single-use coffee pods.[60] The SEC's order alleged that the company's annual reports for 2019 and 2020 included statements that the company had testing that "validate[d] that [the pods] can be effectively recycled." However, the disclosures omitted the practical reality that two large recycling companies had expressed concern about the recyclability of the pods and even refused to accept the pods for recycling at their facilities. The Commission alleged this omission was material given that beverage pod sales comprised "a significant percentage of net sales" of the relevant business segment and that research conducted by the company's subsidiary "indicated that environmental concerns were a significant factor" consumers considered in making purchasing decisions. While the company was not charged with fraud, the SEC alleged violations of Section 13(a) of the Securities Exchange Act and Rule 13a-1 thereunder. To settle the matter, the company consented to a cease-and-desist order and to pay a civil penalty of $1.5 million.

Also in September 2024, the SEC announced a **settled action against an investment advisory firm for inconsistent application of investment procedures** (specifically ones designed to ensure the firm invested in line with stated religious guidelines and values).[61] That inconsistent application—and lack of written policies and procedures designed to ensure compliance—resulted in the firm investing in companies that (i) did not align with its stated investment criteria and, in fact, (ii) engaged in business practices that did not align with certain "biblical values" and in which the firm had specifically represented it would *not* invest.

These actions notwithstanding, **multiple news outlets reported that the SEC had "quietly disbanded" the Enforcement Division's Climate and ESG Task Force.**[62] And last year, the Division of Examinations removed ESG from its annual list of examination priorities. Both of these events signal that the SEC no longer considers ESG greenwashing to be a priority, a perspective that almost certainly will be shared by the agency's incoming senior leadership.

X. Insider Trading

The most notable development in insider trading enforcement during Chair Gensler's tenure was the SEC's successful pursuit of a novel theory of insider trading deemed "shadow trading."

In August 2021, the SEC alleged that a public biopharmaceutical company executive, armed with knowledge of an imminent acquisition of his employer, bought short-term stock options *of another biopharmaceutical company* the stock value of which he expected to materially increase when the acquisition of his employer became public.[63] The SEC's untested theory

[60] https://www.sec.gov/newsroom/press-releases/2024-122

[61] https://www.sec.gov/newsroom/press-releases/2024-139

[62] https://news.bloomberglaw.com/esg/sec-quietly-dissolves-climate-and-esg-enforcement-task-force

[63] https://www.sec.gov/enforcement-litigation/litigation-releases/lr-25970.

survived numerous legal challenges by the defendant, and in April 2024, the SEC prevailed in a jury trial.[64] However, we do not expect this case to bring about a sea change in insider trading enforcement. The case at hand included unusually compelling facts that strengthened the SEC's theory, and the practical difficulties of defining when MNPI about one's own company could be used to advantageously trade in other issuers that may be peers or otherwise trade in tandem will likely dissuade heavy enforcement focus in this area. This will nonetheless be a topic to watch under the new administration.

In January 2024, the SEC announced settled charges against a multinational investment bank and the former head of its equity syndicate desk for **fraud involving the disclosure of confidential information about the sale of large blocks of stock ("block trades") and for failing to enforce its policies concerning the misuse of MNPI related to block trades.**[65] The SEC found that over a period of more than three years, the former head of the equity syndicate desk disclosed to certain buy-side investors non-public, potentially market-moving information concerning impending, private block trades that the company had been invited to bid on or was in the process of negotiating with selling shareholders. The buy-side investors used the MNPI to take short positions in the companies subject to the block trades while also requesting and receiving allocations from the block trade to cover their short positions. In this scheme, the investment bank reduced its risk in purchasing the block trades while allowing buy-side investors to make illicit profits from the MNPI. The investment bank agreed to disgorge more than $138 million it allegedly made in profits from 28 trades, plus pay prejudgment interest of over $28 million and a civil penalty of $83 million. The former head of the equity syndicate desk consented to a cease-and-desist order, the payment of a $250,000 civil penalty, and associational, penny stock, and supervisory bars.

XI. FCPA

The SEC announced settled charges in January 2024 against a global software company for allegedly channeling bribes to government officials in seven countries in Africa and Asia to obtain and retain business over four years.[66]

According to the order, the company's local subsidiaries used third-party intermediaries and consultants to bribe government officials. The SEC further alleged that an employee of the company's Azerbaijani subsidiary made improper gifts to officials of Azerbaijan's state-owned oil company to secure a transaction and back-dated the transaction documents to claim

[64] The executive was ordered to pay a civil penalty of over $320,000, but he has recently appealed the jury verdict to the Ninth Circuit Court of Appeals.

[65] https://www.sec.gov/newsroom/press-releases/2024-6.

[66] https://www.sec.gov/newsroom/press-releases/2024-4.

a commission before the employee became ineligible for the commission.

In settling parallel FCPA actions by the SEC and DOJ, the company agreed to pay disgorgement of $94 million to the SEC and $118 million in civil penalties to the DOJ, with approximately $59 million in disgorgement deemed satisfied by the company's prior settlements with the South African government. In determining to accept the company's settlement, the SEC and DOJ claimed to have credited the company's cooperation and remedial measures, but the DOJ nevertheless required the company to undertake further improvements to its corporate compliance program and a three-year annual review and reporting requirement.

In September 2024, the SEC announced settled charges against an agricultural machinery and heavy equipment manufacturer for allegedly **bribing Thai government officials and employees of a private company to win government contracts and sales, respectively.**[67] The SEC alleged that beginning with the acquisition of the foreign subsidiary in late 2017 and continuing through 2020, the foreign subsidiary engaged in bribery of Thai government officials to win government contracts and bribery of employees of a private company to secure sales to the company through cash payments and lavish entertainment. The SEC alleged the company **failed to promptly integrate the foreign subsidiary into its existing compliance and control environment,** resulting in inaccurate recording of the improper payments in the company's books and records, and contributed to the failure to identify and prevent the misconduct. To settle the matter, the company agreed to a cease-and-desist order, $5.4 million in disgorgement, and a $4.5 million civil monetary penalty.

XII. Whistleblower Protection

In January 2024, the SEC announced settled charges against a dually registered investment adviser and broker-dealer, alleging that confidentiality provisions in the firm's settlement and release agreements with retail clients violated the Whistleblower Protection Rule.[68]

In the settled order, the SEC alleged that **even though the firm's standard settlement and release terms permitted clients to *respond* to SEC inquiries, the agreements nonetheless ran afoul of rules against impeding**

[67] https://www.sec.gov/newsroom/press-releases/2024-124.

[68] https://www.sec.gov/newsroom/press-releases/2024-7.

whistleblowers because they did not permit clients to *voluntarily contact* the SEC.[69] To settle the matter, the company consented to a cease-and-desist order and the payment of an $18 million civil penalty.

Additionally, the SEC continued to bring whistleblower impeding claims against **companies that imposed agreements on employees requiring them to waive their right to possible whistleblower monetary awards.** In September 2024, the SEC announced settled charges against seven public companies for allegedly violating the Whistleblower Protection Rule by requiring current, former and departing employees as well as contractors to waive their right to possible whistleblower monetary awards through using employment, separation and other agreements.[70] The seven companies agreed to pay more than $3 million in civil penalties to settle the matters.

The SEC also alleged that **a company violated the Whistleblower Protection Rule by including restrictive language in non-disclosure agreements with *prospective employees*.** In September 2024, the Commission charged an investment adviser with impeding potential whistleblowers by having twelve prospective employees sign non-disclosure agreements, which permitted job candidates to *respond* to requests for information from the SEC but required notification to the investment adviser of SEC information requests and prohibited them from responding to requests arising from a candidate's voluntary disclosure.[71] Similar to many past whistleblower protection enforcement actions, the SEC refused to credit conflicting provisions in the NDAs and, in fact, alleged that the conflicting provisions created confusion that raised an impediment to whistleblowing.

The SEC further alleged that the investment advisor entered into a settlement agreement with one former employee whose counsel said they intended to report potential securities law violations to the SEC. The settlement agreement included language acknowledging nothing in the agreement prohibited the employee from reporting possible securities law violations, participating in the SEC whistleblower program, or receiving a whistleblower award. However, the settlement agreement also required the former employee to represent that they had not sought to initiate an investigation, were aware of

[69] https://www.haynesboone.com/news/alerts/sec-expands-enforcement-of-whistleblower-impeding-rule-to-confidentiality-agreements

[70] https://www.sec.gov/newsroom/press-releases/2024-118.

[71] https://www.sec.gov/newsroom/press-releases/2024-150

no facts to form the basis of an investigation and would withdraw any statements already made that would form the basis of an investigation. In settlement, the investment advisor consented to a cease-and-desist order and to pay a $500,000 civil penalty.

XIII. Self-Reporting and Cooperation Credit

While Division of Enforcement settlements continue to list certain *proactive actions* that the Commission has viewed as extraordinary cooperation, the Commission has generally declined to provide objective criteria regarding *how such actions were credited or quantify the benefits of self-reporting and cooperation*. As a result, the decision whether to self-report potential violations remains a difficult one that must be made on a situational basis.

In February 2024, **based upon self-reporting, remedial actions and extensive cooperation, the SEC declined to impose a civil penalty** against a China-based cloud communications company, notwithstanding that two former senior managers of the company had orchestrated a fraudulent misstatement of the company's revenue.[72] According to the SEC's order, two senior managers of the company, whose American depository shares had traded on the NYSE, directed employees to recognize revenue on contracts for which work had not been completed or, in some cases, not yet started. This caused the company to overstate both unaudited financial results as well as announced revenue guidance.

In a settled order, the Commission explained several specific actions that enabled the company to avoid the imposition of a civil penalty, including: (i) self-reporting the accounting violations to the SEC within only a few days of starting its internal investigation; (ii) providing "substantial" cooperation throughout the investigation, including summarizing interviews of witnesses in China and identifying (and translating) key Chinese-language documents to the staff; and (iii) undertaking significant, prompt remedial measures, including terminating or disciplining the employees involved, reorganizing departments involved in the misconduct, strengthening internal accounting controls, retraining company executives and employees, and clawing back bonuses paid to the CEO and CFO accrued

[72] https://www.sec.gov/newsroom/press-releases/2024-15

during the time when the fraud was ongoing (even though they were not directly involved).

In September 2024, the SEC declined to impose a civil penalty against a technology manufacturer charged with misleading statements regarding the company's 2019-2021 financial performance and related internal accounting issues **based on the company's self-report, prompt remediation and extraordinary cooperation.**[73] According to the SEC's complaint, the company's finance director falsified financial results for one of the company's business units, misled management and auditors, fabricated bank confirmations and falsified certifications. The SEC's settled order against the company also found that the company failed to maintain sufficient accounting and financial controls, and these failures prevented the company from identifying or curtailing the finance director's fraud.

In resolving the case against the company without imposing a civil penalty, the Commission cited the company's: (i) self-report of violations shortly after commencing an internal investigation; (ii) summarization of interviews of key witnesses located abroad; and (iii) adoption of prompt remedial measures, including strengthening internal controls, hiring additional personnel and canceling scheduled bonus compensation to a former company officer. Additionally, the company agreed to cooperate fully in the SEC's litigated case against the company's former finance director, including by making its employees, officers and directors available for interviews.

In charging dozens of broker-dealers and investment advisers for violations related to off-channel communications, the SEC has emphasized reduced penalties against a handful of firms for self-reporting those violations. For example, in September 2024, the SEC announced that it was not imposing a civil penalty against an investment adviser for off-channel communications violations due to the **firm's prompt self-report after the failure to preserve the off-channel communications was discovered while complying with an SEC subpoena during an investigation of a third party.**[74]

XIV. Rulemaking

A handful of new or amended regulations affecting SEC registrants went into effect in FY24. On May 15, 2024, the SEC adopted amendments to Regulation S-P -- the first significant changes to Regulation S-P since its initial adoption in 2000. Applicable to registered investment companies, investment advisers and broker-dealers, the rule is intended to enhance the protection of personal information of customers and clients of financial institutions.

Key changes introduced by the rule include:

- A requirement that financial institutions adopt written policies and procedures for the disposal of consumer report

[73] https://www.sec.gov/newsroom/press-releases/2024-116

[74] https://www.sec.gov/newsroom/press-releases/2024-143

information, including shredding, pulverizing or burning paper records and erasing electronic media so that the information cannot be read or reconstructed;

- Mandating that financial institutions develop and implement a response program to address incidents of unauthorized access to customer information, including procedures for notifying affected customers;

- A requirement that financial institutions encrypt customer records and information both in transit and at rest using strong encryption methods; and

- A modification of the scope and delivery methods of the privacy notices that financial institutions must provide to their customers and clients as well as an allowance for firms to use alternative forms of notice for certain types of information sharing.

By setting higher standards for data protection, the rule aims to create a safer financial environment in an era of growing cyber threats and is part of the SEC's ongoing efforts to enhance the protection of consumer financial information. For a more detailed analysis of the amended regulation, please read our Haynes Boone Client Alert: Amendments to Regulation S-P Create New Cybersecurity Requirements for Financial Institutions.

On Aug. 28, 2024, the **Financial Crimes Enforcement Network (FinCEN) issued a final rule to combat illicit finance and national security threats in the investment adviser sector,** requiring certain advisers to implement anti-money laundering and countering the financing of terrorism (AML/CFT) programs and report suspicious activities. FinCEN delegated its examination authority for the rule to the SEC as the federal functional regulator responsible for the oversight and regulation of investment advisers.

The rule applies to registered investment advisers and exempt reporting advisers, with some exclusions based on the size, location and type of advisory activities. The rule was designed to enhance the transparency and integrity of the U.S. financial system and prevent criminals, foreign adversaries and other illicit actors from exploiting the investment adviser industry.

Key requirements of the rule include:

- Implementation of a risk-based and reasonably designed AML/CFT program;

- Filing of certain reports, such as SARs, with FinCEN and compliance with the requirements to file Currency Transaction Reports;

- Keeping certain records, such as those relating to the transmittal of funds (i.e., compliance with the Recordkeeping and Travel Rules); and

- Fulfilling information-sharing obligations applicable to financial institutions subject to the Bank Secrecy Act and FinCEN's implementing regulations, including the information-sharing provisions of Sections 314(a) and 314(b) of the USA PATRIOT Act.

The compliance date for the rule is Jan. 1, 2026. For a more detailed analysis, please read our Haynes Boone Client Alert: FinCEN Issues Final Anti-Money Laundering Program Rule for Investment Advisers.

Finally, on March 6, 2024, **the SEC adopted final rules requiring public companies to disclose certain information about climate-related risks that materially affect their business, operations and financial condition.** Among other things, the rules mandate specific disclosures regarding governance, such as the board's oversight of climate-related risks and management's role in assessing and managing these risks. They also establish presentation, submission and attestation requirements for the climate-related disclosures. The rules will be phased in over several years depending on the size and status of the registrant. For a more detailed analysis of the rules, please read our Haynes Boone Client Alert: Overview and Status of SEC Climate-Related Disclosure Rules.

Notably, on April 4, 2024, less than one month after adoption, **the SEC voluntarily stayed its Climate-Related Disclosure Review** pending the completion of judicial review of consolidated petitions challenging the rules pending in the U.S. Court of Appeals for the Eighth Circuit. Given the high likelihood that incoming SEC Chair nominee Atkins will not support the Climate-Related Disclosure Rules, we anticipate that at some point in 2025, the Commission may seek to scale back or repeal the rules in their entirety.

XV. Significant Court Decisions and Other Developments

A handful of key court decisions took some of the wind out of the SEC's enforcement sails in FY24.

a. *SEC v. Jarkesy*

On June 27, 2024, the United States Supreme Court resolved a major challenge to the constitutionality of the SEC's administrative forum when it held that **imposing civil penalties in an SEC administrative proceeding violated the Seventh Amendment's right to a trial by jury.**[75] Specifically, the Supreme Court held that civil penalties were designed to be punitive and "are a type of remedy at law that could only be enforced by common law courts," thus implicating Seventh Amendment protections for trial by jury. The Court did not address the other constitutional grounds considered by the lower appellate court.[76]

[75] *SEC v. Jarkesy*, 144 S. Ct. 2117 (2024).

[76] Two years ago, the Fifth Circuit held that SEC administrative proceedings were unconstitutional on three grounds: (i) the SEC's use of the forum to pursue fraud claims and seek civil penalties violated the respondent's Seventh Amendment right to a jury trial; (ii) under Article I of the Constitution, Congress unconstitutionally delegated legislative power to the executive branch when it gave the SEC the power to choose between district courts and its administrative forum without providing an intelligible principle to guide the SEC's decision; and (iii) the two-layered for-cause removal protections applicable to SEC administrative law judges unconstitutionally restricted the President's removal powers under Article II of the Constitution.

Even before the adverse ruling in *Jarkesy*, The Division of Enforcement had limited filing *litigated* administrative proceedings to circumstances where the agency's statutory authority did not extend to U.S. District Court (e.g., proceedings to suspend accountants or attorneys pursuant to Rule 102(e) of the SEC's Rules of Practice). In August 2024, the Commission dismissed two contested Rule 102(e) proceedings against accountants for their alleged failure to conduct audits in accordance with professional standards. Notably, only one of those cases had sought civil penalties, suggesting that the Commission now believes that *Jarkesy* precludes litigating Rule 102(e) proceedings administratively. Instead, beginning in September 2024, the Commission began addressing alleged audit failures by seeking conduct-based injunctions in federal court.[77]

b. Successful Challenges to Private Fund Adviser Rules and Expanded Dealer Definition

On June 5, 2024, **the Fifth Circuit Court of Appeals struck down the SEC's Private Fund Adviser Rules (PFAR) in their entirety,** by holding that the Commission had exceeded its statutory authority to promulgate the rules pursuant to Sections 206(4) and 211(h) of the Advisors Act.[78] Among other things, the court found that Section 211(h) of the Advisers Act "has nothing to do with private funds" because it applies only to "retail customers." The court also found that the Commission's claimed authority to promulgate PFAR under Section 206(4) was "pretextual" because the SEC had not articulated a "rational connection" between fraud and any part of PFAR. The SEC declined to appeal the Fifth Circuit's ruling to the Supreme Court by the Sept. 5, 2024 deadline, thereby concluding any effort to restore PFAR.

In February 2024, the SEC finalized a new rule that greatly expanded the definition of "dealer" to include proprietary traders and some private funds that, "as part of a regular business," engaged in two types of activities: (i) regularly expressing trading interest that is at or near the best available prices on both sides of the market; and (ii) collecting revenue chiefly from "capturing bid-ask spreads, by buying at the bid and selling at the offer or from capturing any incentives offered by trading venues to liquidity supplying trading interest" (Dealer Rule).[79] However, in November 2024, a Texas federal judge struck down the Dealer Rule, finding that "the SEC exceeded its statutory authority by enacting such a broad definition of dealer untethered from the text, history, and structure of the Exchange Act."[80] While the SEC may appeal this decision to the Fifth Circuit, we think it more likely that the agency will decline to further defend the Dealer Rule.

c. Solar Winds

[77] https://www.sec.gov/newsroom/press-releases/2024-157

[78] *Nat'l Ass'n of Priv. Fund Managers v. SEC*, 103 F.4th 1097 (5th Cir. 2024)

[79] https://www.sec.gov/files/34-99477-fact-sheet.pdf

[80] https://assets.bwbx.io/documents/users/iqjWHBFdfxIU/rr6hc21ox2Lc/v0

On July 18, 2024, a federal judge in the Southern District of New York dismissed a large portion of the SEC's cybersecurity enforcement action against a software producer and its Chief Information Security Officer (CISO). In a notable setback to the SEC, the court rejected the agency's novel theories that the company's cybersecurity failures and subsequent disclosures regarding the breach violated the internal accounting controls and disclosure controls provisions of the federal securities laws.[81]

Back in December 2020, an unknown threat actor compromised the company's flagship software product. According to the SEC, hackers infiltrated the software producer's corporate VPN, conducted reconnaissance, collected data, identified vulnerabilities and harvested credentials of software producer's employees. The SEC sued the software producer and its CISO, alleging violations of the antifraud, internal accounting controls and disclosure controls provisions.

In July 2024, the court granted much of the company's motion to dismiss. With respect to the SEC's internal accounting controls claims, the court flatly rejected the SEC's theory that "the company's source code, databases and products were its most vital assets, but as a result of its poor access controls, weak internal password policies and VPN security gaps, the company failed to limit access to these 'only in accordance with management's general or specific authorization.'" The court reasoned that the internal accounting controls statute was designed to regulate a company's controls related to its *financial statements and accounting systems*, which did not extend to all systems public companies use to safeguard assets. For a more detailed analysis of the *SolarWinds* opinion, please read our Haynes Boone Client Alert regarding the District Court's order.

[81] *SEC v. SolarWinds Corp.*, No. 1:23-CV-09518 (S.D.N.Y. July 18, 2024)

LOOKING AHEAD

Elections have consequences, and like all federal agencies, we expect noticeable changes to the SEC's Division of Enforcement in FY25.

SEC Chairs enjoy broad discretion to modify the priorities and practices of the Enforcement Division. We have a high degree of confidence that if confirmed by the Senate, former Commissioner Atkins will ramp down the aggressive civil penalties sought by the agency over the past four years, which former Enforcement Director Grewal had characterized as a "recalibration." Commissioners Peirce and Uyeda both worked as Staff counsels to former Commissioner Atkins during his previous tenure, and therefore we anticipate the three GOP Commissioners (in the majority come 2025) will be closely aligned in lowering civil penalties. A strong indicator is that, while in the minority under Chair Gensler, Commissioners Peirce and Uyeda repeatedly filed public dissents in enforcement actions advocating for lower penalties or no penalties, particularly in matters where there was no identifiable investor harm. Specifically with respect to penalties against public companies, we expect that the SEC will require a more robust analysis of corporate benefit versus harm resulting from the conduct at issue, in keeping with the Commission's civil penalty guidance dating back to 2006.[82]

With respect to off-channel communications, we believe that the SEC will dial back the eye-popping civil penalties, while not wholly eliminating enforcement actions for violations. In our current technology environment, virtually everyone uses a smartphone for business purposes and sends text messages that sometimes relate to work. Because some text messages sent on personal devices will remain highly relevant to SEC investigations, we expect that Examination and Enforcement Staff will focus instead on requiring registrants to *remediate* systemic lapses.

Until former Commissioner Atkins (or a subsequent nominee) is confirmed and has some time to implement his or her policy agenda, it is more difficult to forecast whether Enforcement will continue to conduct sweeps involving almost every conceivable violation of the federal securities laws as it has in recent years. In our view, sweeps have become more prolific because (i) the SEC is becoming more sophisticated in using proactive data analytics to identify many basic rule violations; (ii) sweeps often enable the agency to leverage Staff to bring more cases and impose more civil penalties; and (iii) sweeps tend to generate more press coverage, thereby amplifying the agency's compliance messaging across the financial services industry.

While the incoming leadership may be less interested in setting new high-water marks for the number of cases or civil penalties, the reality is that sweeps may remain attractive for some types of violations. Our hope is that the next administration will more frequently employ other methods of promoting compliance, such as issuing Division of Examination Risk Alerts. We are cautiously optimistic that there will be *fewer* Enforcement Division sweeps, particularly those involving technical rule violations. We also hope that if the next Commission continues some

[82] https://www.sec.gov/news/press/2006-4.htm

sweeps, they will do away with opaque and non-negotiable penalty matrices for alleged violations, which in our view often failed to adequately consider the facts and circumstances unique to each matter. However, until we see evidence that their use has subsided, we caution clients regarding the likelihood of continuing or additional sweeps in the following areas:

- For all registrants, sweeps related to potentially misleading disclosures regarding the use of artificial intelligence, the nature/extent/impact of cybersecurity incidents or violations of the Whistleblower Protection Rule.
- For public companies, sweeps related to untimely filings on Form 4, Schedule 13D and Schedule 13G; Form NT filings without adequate disclosure of anticipated restatements; and close scrutiny of related party transactions and perquisite disclosures, particularly regarding executives' use of aircraft for personal travel.
- For investment advisers, sweeps related to violations of the Marketing Rule, particularly testimonials, endorsements, and hypothetical performance advertising; Custody Rule violations and related Form ADV disclosures, including the failure to timely disseminate audited financials to private fund investors; and Form 13F filings.
- For broker-dealers and dual registrants, sweeps related to off-channel communications recordkeeping; Reg. BI's duty of care obligations for financial products that have suffered significant losses; and AML programs and SARs filings.

We expect that the onslaught of proposed and finalized rulemaking under Chair Gensler will be greatly curtailed and that some recent controversial rules will be repealed, including the Commission's Climate Disclosure Rule. In our view, it is too early to forecast whether the Commission will seek to scale back or repeal the Cybersecurity Risk Management and Disclosure Rules, the Rule on SPACs, Shell Companies and Projections, and Whistleblower Confidentiality. The Courts have already struck down the Private Fund Adviser Rules and the Commission's attempt to expand the definition of securities dealers.

Finally, in the coming year, we anticipate that the SEC will significantly curtail enforcement actions involving cryptocurrency and digital assets. How this is accomplished, however, remains to be seen. While many in the crypto industry have advocated delineating the CFTC as the primary regulator, there may not be sufficient consensus in Congress to pass legislation defining cryptocurrency as a commodity. The SEC's Division of Enforcement also remains locked in hard-fought litigation against numerous prominent industry players, including Binance, Coinbase and Ripple Labs. Many crypto industry executives and their political allies have suggested pausing or even dismissing the SEC's ongoing registration cases not involving fraud. If the new Commission allows these cases to proceed, their outcome

will have massive and potentially long-lasting implications for the industry. If, on the other hand, the new Commission seeks to settle, narrow or dismiss these cases, there is no such roadmap for how to conduct such an unprecedented reversal of policy.

One thing is certain – 2025 will be a year of significant change at the SEC's Division of Enforcement, and we look forward to assisting clients in facing whatever comes their way.

MEET THE AUTHORS

KIT ADDLEMAN chairs the firm's national Securities Enforcement Defense group and is a member of the Investment Funds Practice group. Kit defends companies, executives and directors against government charges of misconduct, particularly investigations and litigation by the SEC and DOJ. Many of her matters involve allegations of accounting and financial fraud, insider trading, hedge fund and advisor fraud, and Foreign Corrupt Practices Act violations. Prior to joining Haynes Boone, Kit was the Regional Director of the SEC's Atlanta Regional Office and spent more than 20 years prosecuting matters in four SEC offices around the country.

RON BREAUX is a veteran trial lawyer, who has represented companies in mission-critical litigation and investigations for more than three decades. Ron has detailed knowledge of complex commercial litigation; products liability; internal and governmental investigations; securities, healthcare and environmental fraud; antitrust; and data security. He has tried bench and jury trials and argued critical motions in venues across the country, including state, federal and bankruptcy courts

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NICK BUNCH is an experienced trial lawyer, appellate advocate, and former federal prosecutor, who brings an insider's perspective on how the government investigates and prosecutes white-collar criminal and civil matters. Nick gained that unique insider's perspective over nearly 11 years at the U.S. Attorney's Office for the Northern District of Texas where he served as an Assistant United States Attorney, Deputy Criminal Chief, and Deputy Section Chief, investigating, prosecuting, and supervising healthcare, corruption, national security, cybercrime, and economic crime offenses

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KURT GOTTSCHALL focuses on representing public companies and their officers and directors, auditors, investment advisers, broker-dealers and individuals in investigations by the U.S. Securities and Exchange Commission (SEC) and other government agencies, as well as internal investigations and regulatory compliance. Prior to joining Haynes Boone, Kurt was the Regional Director of the SEC's Denver Regional Office, where he managed more than 100 staff and oversaw all of the office's enforcement investigations, litigation and examinations of SEC registrants in an eight-state region.

TIM NEWMAN represents clients in government enforcement actions, cybersecurity investigations, and complex litigation. He has extensive experience representing organizations and executives under investigation by the SEC, DOJ, FINRA, and state regulators and conducting internal investigations related to suspected accounting fraud, offering fraud, insider trading, and other securities law violations. Tim has been recognized in *The Best Lawyers in America*, Woodward/White, Inc., for Criminal Defense: White Collar and was recently featured in D Magazine's "Best Lawyers in Dallas" List.

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CARRINGTON GIAMMITTORIO focuses on securities law defense including both investigations and litigation. Her experience with both government enforcement and private securities litigation makes her uniquely suited to guide companies and individuals though parallel proceedings—helping her clients build a solid defense on all fronts. Carrington has been recognized in "Ones to Watch" by *Best Lawyers in America.*

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ASHLEY KOOS focuses her practice on government investigations and white-collar defense. She was a judicial clerk for the Honorable Fernando Rodriguez, Jr. in the U.S. District Court for the Southern District of Texas before joining Haynes Boone. Additionally, prior to law school, Ashley served as a Teach for America corps member in Houston, Texas, where she taught middle school mathematics and English Language Arts.

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