

## Assessing the SEC's FY 2018 Enforcement Results

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PRACTICES Litigation

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The SEC's Division of Enforcement recently issued its [annual report](#) detailing enforcement activities, statistics, and changes made in the past fiscal year ("FY 2018"). The report discusses several significant developments in the SEC enforcement landscape, including the creation of new task forces, first-of-their kind enforcement actions, and the impact of the Supreme Court's decision in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017). While the total number of enforcement actions brought by the SEC increased from the prior fiscal year, the increases occurred in areas such as off-market securities offerings and investment adviser matters. Other enforcement program areas, including issuer accounting, financial reporting and disclosure matters, decreased in FY 2018. Moreover, the enforcement program still is performing well behind its FY 2015 and FY 2016 results. Read more for a summary of these developments and their effects, as well as a comparison of the [priorities reported](#) at the close of FY 2017 to the FY 2018 enforcement results.

### The Co-Directors' Opening Message

The annual report opens with a message from the co-directors, Stephanie Avakian and Steven Peikin, describing FY 2018 as "a great success" for the Division of Enforcement. The co-directors emphasized that success is not measured only in numbers, rather the Division measures its success in the "nature, quality, and effects of the Commission's enforcement actions." The co-directors consider a successful year one in which the SEC continues its practice of prioritizing cases that "send clear and important messages to market participants" to deter future harm. Assessing whether the SEC's enforcement program should be viewed as "successful" and where the enforcement emphasis is trending requires a more detailed review of the actions.

### Priorities Versus Results

The number of enforcement actions filed increased from 754 actions in FY 2017 to 821 in FY 2018. Of the 821 enforcement actions filed in FY 2018, 490 were "stand alone" actions while the remaining matters included 210 "follow-on" administrative proceedings involving actions after an individual or company had been enjoined or criminally convicted and 121 were proceedings to deregister public companies for delinquent filings. The uptick in stand alone cases from 446 in FY 2017 nevertheless is a sizeable decrease from the 548 cases and 626 cases in FY 2016 and FY 2015, respectively.

The total money ordered in disgorgement and penalties in the enforcement proceedings also increased slightly from \$3.789 billion in FY 2017 to an estimated \$3.945 billion in FY 2018. A significant portion of this amount, however, can be attributed to the settlement of one major case: *Petroleo Brasileiro S.A. – Petrobras*, Exchange Act Release No. 34-84295, AP File No. 3-18843 (Sept. 27, 2018). The respondent in that case settled with the SEC and the DOJ for \$933 million in disgorgement and \$853 million in penalties although the SEC is likely, according to its annual report, to recover only approximately \$85 million of the \$1.8 billion ordered. It is worth noting that, even with the inclusion of the large single settlement, both FY 2018 and FY 2017 statistics demonstrated an overall decrease from disgorgement and penalties of \$4.1 billion and \$4.2 billion ordered by the Commission in FY 2016 and FY 2015, respectively.

The two most common types of cases the Commission brought in FY 2018 were actions involving securities offerings (25 percent) and those against investment advisers and investment companies (22 percent). The latter category of cases increased in proportion by four percent from 2017, perhaps impacted by the Commission's new Retail Strategy Task Force. The remaining significant case types, in decreasing order of number of actions filed, were actions involving "issuer reporting/accounting and auditing," broker-dealer misconduct, insider trading issues, market manipulation, public finance issues, and violations of the Foreign Corrupt Practices Act. Falling in more than one of these categories were actions brought in response to alleged cybersecurity and cryptocurrency registration violations.

These statistics seem to align with the FY 2018 priorities that the Enforcement Division published in its FY 2017 annual report. The Division announced that it would focus on preventing cyber misconduct, regulating investment adviser activity, addressing issues with financial reporting and disclosure in public companies, and combatting insider trading and market abuse.

The cases highlighted by the report further demonstrate the SEC's effort to deliver on its reported priorities. For example, where the SEC prioritized strengthening cybersecurity enforcement, it brought a case against the entity formerly known as Yahoo! Inc. to demonstrate to companies the importance of disclosing security breaches to investors. In this action, brought in the wake of what the report describes as "one of the world's largest data breaches," the SEC found that Yahoo! failed to "properly assess the scope, business impact, or legal implications of the breach" and failed to properly analyze the manner in which it should have disclosed the breach. As a result, the company was ordered to pay \$35 million in penalties.

As mentioned in the co-directors' opening, the SEC focused its FY 2018 efforts on cases that could send clear messages to market actors. In this vein, the SEC brought stand alone actions against SeaWorld Entertainment, Inc. and its former CEO for failing to disclose to investors the impact an expository documentary known as Blackfish had on its reputation and sales. Additionally, Ameriprise Financial Services, Inc. paid \$4.5 million in a settlement with the SEC following Ameriprise's failure to implement sufficient internal controls to prevent the misappropriation of its clients' assets. In another matter, a company CEO was charged with fraud in connection with representations in a social media post. The SEC settled with the CEO and the company, agreeing to \$40 million in penalties, the resignation of the CEO as chairman, and the hiring of independent directors to oversee the CEO's communications.

### **New in FY 2018**

To accomplish its stated goal of protecting the Main Street investor, the SEC created the Retail Strategy Task Force (RSTF) in FY 2018. This task force conducted lead-generation initiatives based on data analytics to examine issues such as market manipulations and disclosures regarding conflicts of interest, among other issues affecting the retail investor.

Cyber-related misconduct continued to be a focus in FY 2018. The SEC continued to push for registration of cryptocurrency and virtual market investments, a priority it articulated in its "DAO Report" in 2017, and continued to look closely at alleged fraud by those engaging in coin offerings. FY 2018 additionally marked a focus on ensuring the legitimacy of Initial Coin Offerings (ICOs). To this end, the Commission suspended trading in over a dozen publicly traded issuers' stock, alleging in part that their assertions regarding ICO investments and cryptocurrency platform operations were inaccurate. The SEC also announced its first enforcement action against a public company alleging a failure to disclose a cyber intrusion and brought its first enforcement action alleging violations of

Regulation S-ID, also known as the Identity Theft Red Flags Rule. According to the SEC, the Staff had more than 225 ongoing investigations related to cyber security at the end of FY 2018.

Also new in FY 2018 was the SEC's focus on extracting new types of undertakings from settling respondents. For example, as a result of a CEO's allegedly false and misleading Twitter posts referenced above, the Commission ordered the CEO to step down as chairman and ordered the company to hire independent directors, appoint a committee to adopt controls and procedures to oversee the CEO's public communications about the company, and hire experienced securities counsel to advise on disclosure issues. In its action against Theranos, Inc., the Commission ordered the CEO to relinquish her voting controls. It further ordered the company to guarantee that the CEO would not profit from her ownership of the company until investors had been repaid \$750 million allegedly solicited based on inflated claims about the company's technology, business, and financial performance.

The SEC launched the Share Class Selection Disclosure (SCSD) Initiative to remedy investment adviser misconduct in relation to marketing and distribution fees paid by retail investors. The initiative focused on tackling instances where an undisclosed conflict of interest caused an adviser to recommend an expensive mutual fund share class when a less expensive share class for the same fund was available. The SCSD initiative encouraged investment advisers to self-report their failure to disclose these conflicts of interest. In exchange for self-reporting, investment advisers could avoid being charged penalties in their settlement with the SEC. Additionally, the Enforcement Division would recommend settlements with standardized terms, namely antifraud charges and disgorgement.

## Challenges

The SEC also recognized the challenges it faces in the enforcement landscape. For example, the SEC recognized the impact of the Supreme Court's holding in *Kokesh*, and its effects may have been felt in the increase of enforcement actions filed in FY 2018. The Commission reported that this holding has limited its ability to pursue complete disgorgement in many cases. Specifically, the Commission estimated in its annual report that the *Kokesh* holding would cause it to "forgo up to approximately \$900 million in disgorgement." Though not discussed in the report, the holding will likely change the Enforcement Staff's calculus in making charging recommendations. The holding could also remove some of the Commission's leverage in negotiating settled enforcement actions.

The SEC also recognized the impact of a hiring freeze that has been in place since late FY 2016. According to its report, the number of Division employees and contractors supporting the Commission's investigation and litigation efforts is down 10 percent over the last two years.

## The Takeaway

Looking solely at the numbers, FY 2018 appears to have been a strong one for SEC enforcement. Enforcement actions and amounts recovered both increased compared to FY 2017. However, looking more qualitatively at the cases the SEC filed and the initiatives it launched may suggest a slightly different story. In the SEC's continued focus on protecting Main Street investors and working on matters related to cyber security, the focus on public companies has decreased and the emphasis on off-market matters has increased. If you have questions regarding the evolving landscape of SEC investigations and enforcement, please contact one of the Haynes Boone attorneys listed below.