HAYNES BOONE

SEC Enforcement Highlights

Fiscal Year 2021

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Fiscal Year 2021 was a year of transition at the U.S. Securities and Exchange Commission. New leadership under the Biden Administration ushered in new priorities and an aggressive enforcement tone, particularly in the latter half of the year. Along with new management, the Commission brought several first-of-their-kind enforcement actions. In this article, we highlight some of the Commission's significant enforcement actions from FY 2021 — which spanned from October 2020 through September 2021 — with a particular focus on actions against public companies and investment advisers. The actions demonstrate the direction in which the Commission's enforcement program is headed, as well as the emphasis and priorities anticipated as the Commission begins FY 2022.

NEW LEADERSHIP

Former SEC Chairman Jay Clayton resigned his post in December 2020 as is typical when the U.S. Presidency changes hands. President Joe Biden nominated Gary Gensler to chair the SEC in the new administration, and Gensler took his post in April 2021.[1] Gensler formerly served as the chairman of the U.S. Commodity Futures Trading Commission (CFTC) in the Obama Administration and more recently as a professor at the Massachusetts Institute of Technology (MIT) Sloan School of Management, where he also served as Senior Advisor to the MIT Media Lab Digital Currency Initiative. Gensler is credited with establishing the CFTC as an aggressive Wall Street regulator in the Obama Administration and was expected to take a similar approach to enforcement at the SEC. Given his background, he was also expected to focus on matters related to cryptocurrency and digital assets.

Gensler appointed Gurbir S. Grewal as the Commission's new Enforcement Director in June 2021.[2] Grewal is a former state and federal prosecutor and more recently served as the Attorney General for the State of New Jersey. During his tenure as an Assistant United States Attorney, Grewal prosecuted securities fraud, cybercrime, and other white-collar cases. Given his background, Grewal was also expected to take a more aggressive approach to enforcement at the Commission.

FISCAL YEAR 2021 ENFORCEMENT HIGHLIGHTS

Overall enforcement activity in FY 2021 was likely impacted by the pandemic, remote work, and the leadership transition. The Enforcement Division filed 697 actions, down from 715 the prior year and the lowest number of actions since 2013.[3] The number of new or standalone cases filed in FY 2021 increased about 7% compared to the prior year, landing at 434, and the SEC touted that 70% of those standalone actions involved at least one individual defendant or respondent, in line with FY 2020 results.

Total money ordered through disgorgement and penalties was $3.85 billion, a decline from $4.68 billion in FY 2020. About 62% of that total was disgorgement, down from approximately 76% and 75% of total money awarded in the two prior fiscal years respectively. The largest categories of actions filed in FY 2021 related to investment advisers/investment companies, securities offerings, delinquent filings by issuers, broker-dealers, and issuer reporting/audit and accounting, consistent with the Enforcement Division's focus in FY 2020.

The SEC brought several first-of-their-kind cases in FY 2021, including an action against a public company for misleading disclosures regarding the impact of the COVID-19 pandemic, an action against a special purpose acquisition corporation and related entities and individuals for misleading disclosures to investors, an action against an alternative data provider for deceptive practices regarding how its alternative data was derived, and insider trading actions based on the so-called "shadow trading" theory and based on the sale of insider tips on the "dark web."

In both administrative orders and litigation releases, the SEC highlighted cooperation and alleged credit given for taking remedial action before or during an investigation and for assistance throughout the staff's investigation. In a few instances noted below, the cooperation steps

1 https://www.sec.gov/news/press-release/2021-65.

2 https://www.sec.gov/news/press-release/2021-114.

3 https://www.sec.gov/news/press-release/2021-238?utm_medium=email&utm_source=govdelivery; https://www.sec.gov/news/press-release/2020-274.

were outlined in detail to provide a potential roadmap to others who may seek such cooperation credit. Unless otherwise specified, all settled enforcement orders discussed were agreed to on a no-admit, no-deny basis.

I. Pandemic-related Enforcement

The Enforcement Division spent much of its time in FY 2021 monitoring the impact of the COVID-19 pandemic on public markets.

On December 4, 2020, the SEC filed its first pandemic-related enforcement action against a public company and restauranteur for allegedly making **misleading disclosures about the impact of the COVID-19 pandemic** on its business operations and financial conditions.[4] In March and April of 2020, the company issued two separate Forms 8-K with press releases in which it stated its restaurants were operating "sustainably" following a transition from indoor dining to take-out and delivery. According to the SEC, however, the company did not disclose that it had excluded expenses attributable to corporate operations from its claim of sustainability, it was losing approximately $6 million in cash per week, and it had only approximately 16 weeks of cash remaining, among other things. The company also did not initially disclose that it had notified its landlords that it would be withholding rent due to "severely decreased" cash flow. The company ultimately disclosed that information—and information about employee furloughs and reduced compensation for company executives, directors, and others—only after the landlord notices were reported in the media.

Based on these findings, the SEC deemed the company's Forms 8-K materially false and misleading. Without admitting or denying the allegations, the company agreed to a cease-and-desist order and to a $125,000 civil penalty.

The SEC brought ten other enforcement actions related to statements involving COVID-19 between April 2020 and July 2021. For example, on June 11, 2021, the SEC charged a microcap company and a business consultant for making materially **false and misleading statements regarding its COVID-19 at-home test kits and disinfectants**.[5] The defendants allegedly marketed the products and stated the test kits and disinfectants were FDA approved or EPA registered as appropriate when in reality they were not, and the company did not actually have the products to deliver to consumers.

On August 17, 2021, the SEC charged another microcap company and its CEO with making **false and misleading statements related to disinfectant products** the company purportedly launched in response to COVID-19.[6] The defendants allegedly claimed the products and their ingredients were CDC approved or EPA registered when they were not, and they allegedly misled investors about the ingredients in their disinfectant products—purchasing, rebottling, and selling a product produced by another company that was EPA registered as a pesticide and not for use in killing viruses.

These and other pandemic-related actions are detailed on the Commission's website.[7]

II. Cybersecurity Enforcement

The SEC maintained a focus on cybersecurity in FY 2021 as well, with particular attention paid to public companies' disclosure practices and registered entities' compliance with cybersecurity-related obligations under the federal securities laws.

1. Cybersecurity Enforcement Related to Public Companies

In June 2021, the SEC announced settled charges

4 https://www.sec.gov/news/press-release/2020-306
5 https://www.sec.gov/litigation/litreleases/2021/lr25114.htm
6 https://www.sec.gov/litigation/litreleases/2021/lr25172.htm
7 https://www.sec.gov/sec-coronavirus-covid-19-response

against a California-based real estate settlement services company for its alleged **failure to maintain disclosure controls and procedures** concerning cybersecurity vulnerabilities and risks.[8] The company was allegedly notified in May 2019 of a cybersecurity vulnerability that exposed over 800 million title and escrow document images, many of which contained sensitive personal data. While the company issued a press statement and Form 8-K related to the vulnerability, the company's senior executives allegedly were not informed that the company's information security personnel had been aware of the vulnerability since January 2019, nor were they informed that the company had failed to timely remediate the vulnerability in accordance with its policies.

Because this information was relevant to management's assessment of the company's disclosure response, the SEC alleged that the company had failed to maintain disclosure controls and procedures to ensure senior executives received and analyzed all relevant information prior to issuing disclosures related to cybersecurity vulnerabilities and incidents. Without admitting or denying the SEC's findings, the company agreed to a cease-and-desist order and to pay a $487,616 civil penalty.

In August, the SEC announced settled charges against a London-based educational publishing and services company for allegedly making **material misstatements and omissions following a 2018 cybersecurity breach**.[9] The SEC alleged that the company merely referenced the hypothetical "risk of a data privacy incident" in its Form 6-K filed in July 2019 when in fact such an incident had occurred. And in a media statement responding to an inquiry from a national media outlet about the breach, the company stated that the breach *may* have included dates of birth and email addresses, when, in fact, it *knew* that such information had been stolen. The company's media statement also claimed to have "strict protections" in place, when, in fact, the company allegedly failed to patch the vulnerability leading to the breach for six months after it was notified. Further, the media statement omitted the fact that millions of rows of student data had been stolen.

The SEC deemed these disclosures to be material misstatements or omissions and further alleged that the company's disclosure controls and procedures related to cybersecurity were deficient. Without admitting or denying the SEC's findings, the company agreed to cease and desist from future violations and to pay a $1 million civil penalty.

In addition to settled enforcement actions, the SEC's Enforcement Division also began investigating events surrounding the December 2020 announcement by SolarWinds, Inc. that it had suffered a cybersecurity attack affecting its network monitoring platform.[10] The platform was "poisoned" by malicious code, which was then likely spread to thousands of private organizations and federal agencies that were clients of the firm and downloaded software updates for the platform.[11]

In June 2021, the SEC's Enforcement Division began sending investigative letters requesting information about whether recipients were victims of the attack, whether their businesses had been impacted, and what they had disclosed to investors and others. The Division's letters stated that it would not recommend enforcement actions against cooperating companies that voluntarily responded to the extent those voluntary responses showed a failure to make required disclosures or to maintain adequate internal controls surrounding the SolarWinds compromise. Many organizations voluntarily responded to the inquiry. To date, no enforcement actions have been made public.

8 https://www.sec.gov/news/press-release/2021-102

9 https://www.sec.gov/news/press-release/2021-154

10 https://www.sec.gov/enforce/certain-cybersecurity-related-events-faqs

11 SolarWinds Corp., Form 8-K (Dec. 14, 2020), https://www.sec.gov/Archives/edgar/data/0001739942/000162828020017451/swi-20201214.htm

2. Cybersecurity Enforcement Related to Registered Entities[12]

In August 2021, the SEC sanctioned eight broker-dealer and investment adviser firms for alleged **failures in their cybersecurity policies and procedures**. The failures allegedly resulted in the takeover of firm representatives' cloud-based email accounts by unauthorized third parties, thereby exposing the personal information of thousands of customers and clients.[13] In one instance, the firm's policies required multi-factor authentication (MFA) "whenever possible," but allegedly none of the compromised email accounts had MFA turned on. In another instance, a firm recommended use of MFA for email accounts by independent representatives, but allegedly did not require it, even after account takeovers had been discovered.

It appeared that none of the account takeovers resulted in unauthorized trades or fund transfers, but the SEC charged the firms with violating Rule 30(a) of Regulation S-P, which requires broker-dealers and registered investment advisers to adopt written policies and procedures to protect customer records and information. Two of the firms also allegedly **sent breach notifications to their clients that included misleading language** suggesting the notifications were issued much sooner than they actually were after discovery of the incidents. The SEC charged those firms with violating Section 206(4) of the Investment Advisers Act and Rule 206(4)-7 thereunder.

Without admitting or denying the SEC's findings, each firm agreed to cease and desist from future violations, to be censured, and to pay civil penalties between $200,000 and $300,000.

In May 2021, the SEC announced settled charges against a Colorado-based broker-dealer that provides services to employer-sponsored retirement plans.[14] The SEC alleged the broker-dealer **failed to implement its anti-money laundering program consistently** in practice, resulting in the failure to file 130 Suspicious Activity Reports (SARs) after detecting cyber intrusions attempting to gain access to retirement accounts of plan participants. The SEC also alleged the broker-dealer omitted required information about the cyber intrusions from an additional 297 SARs.

This conduct allegedly violated Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-8, which require broker-dealers to comply with the Bank Secrecy Act's SAR-reporting obligations. Without admitting or denying the SEC's findings, the broker-dealer agreed to cease and desist from future violations, to be censured, and to pay a $1.5 million civil penalty. In resolving the matter, the SEC noted the broker-dealer's cooperation and significant remedial measures.

III. Cryptocurrency Enforcement

The cryptocurrency and digital asset market is garnering increased attention from the SEC. Much of the action has focused on whether digital assets being offered to the public are securities—or more specifically, investment contracts—under the test laid out in *SEC v. W.J. Howey Co*.[15]

In December 2020, the SEC sued a digital asset issuer and two of its executives in the Southern District of New York alleging the defendants **improperly offered and sold a digital asset without registering it as a security** or qualifying for an exemption.[16] The executives were charged with aiding and abetting the issuer's violations. The issuer denies the allegations. The litigation has the potential to establish meaningful precedent on the issue of when

12 Additional actions against investment advisers are discussed in Section II.F.

13 https://www.sec.gov/news/press-release/2021-169

14 https://www.sec.gov/news/press-release/2021-82

15 328 U.S. 293 (1946).

16 https://www.sec.gov/news/press-release/2020-338

a digital asset is considered a security, which in turn would likely clarify the scope of the SEC's jurisdiction to regulate digital assets. The SEC seeks injunctive relief, disgorgement with prejudgment interest, and civil penalties.

In July 2021, the SEC announced settled charges against a website operator for allegedly **violating the anti-touting provisions of the federal securities laws**.[17] According to the SEC's order, the website provided site visitors with "listing" profiles of digital tokens and publicized that the listed tokens were selected through a "proprietary algorithm" that determined the "credibility" and "operational risk" for each digital token offering being listed. However, the operator allegedly failed to disclose it received compensation from issuers of the digital assets it profiled. Without admitting or denying the SEC's findings, the operator agreed to cease and desist from future violations of the anti-touting provisions of federal securities laws and to pay $43,000 in disgorgement plus prejudgment interest and a $154,434 penalty.

In August 2021, the SEC announced settled charges against an operator of an online digital asset trading platform, alleging it met the definition of an "exchange" under federal securities laws and had **failed to register as an exchange** or qualify for an exemption.[18] In its order, the SEC alleged the operator had even continued to allow trading of "Digital Asset Securities" that it had deemed a "medium risk" of being considered securities under *Howey*. Without admitting or denying the SEC's findings, the operator agreed to a cease-and-desist order and to pay disgorgement, prejudgment interest, and a civil penalty totaling more than $10 million.

The SEC also announced several other actions for **violations of the registration and antifraud provisions of federal securities laws** in connection with the issuance and sale of digital assets, including charges against an individual for an unregistered offering of digital tokens and for minting unauthorized tokens for himself at no cost and selling them into the secondary market and charges against five individuals for allegedly promoting a global unregistered digital asset securities offering which raised over $2 billion from retail investors.[19]

IV. SPAC Enforcement

The number of transactions involving special purpose acquisition corporations (SPACs) has grown significantly in recent years and have caught the eye of the SEC's Enforcement Division.

In July 2021, the SEC charged a SPAC, its sponsor, its CEO, the proposed merger target—an early-stage space transportation company—and the target's founder and former CEO for **misleading statements to investors**.[20] According to the SEC, the target and its former CEO told investors that the company had "successfully tested" its propulsion technology in space. But in reality, the company's only in-space test had allegedly failed to demonstrate the technology's commercial viability. The company also allegedly downplayed how national security concerns involving its former CEO could impact the company's ability to secure required governmental licenses. Meanwhile, the SEC alleged the SPAC repeated the target's misrepresentations in public filings and failed in its due diligence obligations by neglecting to review the results of the target's in-space test and failing to secure sufficient documents regarding the national security risks surrounding the former CEO. The SPAC's CEO and sponsor allegedly participated in or caused the SPAC's misconduct.

The SPAC, its sponsor, its CEO, and the target consented to an order requiring them to cease and desist from future violations. The SPAC, the SPAC's

17 https://www.sec.gov/news/press-release/2021-125

18 https://www.sec.gov/news/press-release/2021-147

19 https://www.sec.gov/litigation/litreleases/2020/lr24980.htm; https://www.sec.gov/news/press-release/2021-90

20 https://www.sec.gov/news/press-release/2021-124

CEO, and the target agreed to pay civil penalties of $1 million, $40,000, and $7 million, respectively. The SPAC and the target also agreed to provide PIPE (private investment in public equity) investors with the right to terminate their subscription agreements prior to the shareholder vote to approve the merger, the sponsor agreed to forfeit 250,000 founders' shares, and the target agreed to enhance its disclosure controls through the creation of an independent board committee and retention of an internal compliance consultant. Litigation against the target's former CEO is ongoing.

Also in July, the SEC announced charges against the founder, former CEO, and former executive chairman of an alternative fuel truck manufacturing company for allegedly **disseminating false and misleading information about the company's success** on social media while taking the company public through a business combination with a SPAC.[21]

V. Accounting and Auditing Enforcement

The SEC brought several significant actions alleging accounting and auditing misconduct in FY 2021.

In September 2021, the SEC announced settled charges against a public company and two former officers for alleged **expense management that led to a restatement**.[22] According to the SEC, the company's procurement division recognized supplier discounts and rebates before they had been earned and maintained false and misleading supplier contracts to support the unearned discounts and rebates. The SEC also alleged the company failed to design and maintain effective internal accounting controls for its procurement division resulting in finance and gatekeeping personnel repeatedly overlooking indications that expenses were being improperly accounted for.

The SEC's order found that the public company, the former chief operating officer, and the former chief procurement officer violated the negligence-based anti-fraud, reporting, books and records, and internal accounting controls provisions of the federal securities laws. The SEC further found that the former chief operating officer failed to provide accountants with accurate information and caused the company's reporting, books and records, and internal controls violations. The company and officers agreed to a cease-and-desist order. The company also agreed to pay a civil penalty of $62 million while the former chief operating officer and former chief procurement officer agreed to disgorgement and to civil penalties of $300,000 and $100,000, respectively.

In August, a public healthcare services company agreed to pay $6 million to settle claims that it engaged in **accounting and disclosure violations related to earnings management**.[23] The action is the latest resulting from the Enforcement Division's EPS initiative, an initiative that leverages data analytics to identify accounting and disclosure violations resulting from earnings management practices. In its order, the SEC alleged the company failed to accrue for loss contingencies related to litigation settlements when those contingencies were both probable and reasonably estimable and should have been accrued under U.S. Generally Accepted Accounting Principles. In one instance, the company had mediated a lawsuit, reached a settlement agreement that included a range of compensation to be paid by the company, and had submitted the proposed settlement to a court for approval, yet the company allegedly failed to accrue for the loss contingency in that quarter.

This and other similar conduct allegedly enabled the company to meet analysts' expectations for financial performance and even announce record EPS in certain quarters. According to the SEC, the public company's former chief financial officer failed to direct the recording or disclosure of the related loss contingencies

21 https://www.sec.gov/news/press-release/2021-141
22 https://www.sec.gov/news/press-release/2021-174
23 https://www.sec.gov/news/press-release/2021-162

on a timely basis, and the company's controller made other accounting entries that were not supported by adequate documentation. Without admitting or denying the allegations, the company and the former CFO agreed to cease and desist and to pay civil penalties of $6 million and $50,000, respectively. The CFO also agreed to a two-year suspension against practicing before the Commission. The controller agreed to cease and desist and to pay a $10,000 civil penalty.

In other accounting cases, the SEC announced charges against a retail clothing company for allegedly **failing to disclose it "pulled forward" sales** to meet analyst expectations for certain quarters and a mobile networking software and services company for allegedly **overstating revenues based on non-binding purchase orders** and concealing the practice from its auditors.[24] The SEC also announced charges for violations of accounting, reporting, books and records, and internal controls failures against a specialty leather retailer due to **deficiencies with an inventory tracking system** that resulted in a restatement, as well as a consumer brand-management company for **failing to impair goodwill** following months of declining stock prices.[25] Finally, the SEC charged a coffee company with accounting fraud for allegedly **fabricating retail sales** and attempting to conceal the conduct by inflating expenses and likewise charged two former executives of a network infrastructure company with accounting fraud for allegedly **inflating revenue and misappropriating company funds** for personal use.[26]

In a somewhat novel action, the SEC in April announced settlements with eight companies for failures related to filings of SEC Forms 12b-25 (commonly known as Form NT).[27] Companies file Forms NT to disclose a late 10-K or 10-Q filing, and Rule 12b-25 requires filers to state the reasons for a late filing in reasonable detail. According to the SEC, however, each of the settling companies violated that requirement when they **failed to disclose that their anticipated late filings were the result of an anticipated financial restatement or correction**. Each company allegedly announced a restatement or correction within two weeks of filing their Forms NT. Without admitting or denying the allegations, the companies agreed to cease-and-desist orders and to pay penalties of $25,000 or $50,000 each.

Finally, the SEC settled charges with an audit firm, one of its current partners, and two of its former partners for wrongdoing in connection with the firm's efforts to serve as the independent auditor for a public company.[28] The SEC found that the accounting firm and its partners improperly interfered with the public company's choice of an independent auditor by asking for, and receiving, confidential competitive information from the public company's then chief accounting officer, in **violation of auditor independence and professional conduct rules**. In a separate order, the SEC brought charges against the public company's former Chief Accounting Officer for his role in the selection process.

The audit firm agreed to pay a $10 million civil penalty, and the firm's three partners agreed to pay civil penalties of $15,000, $25,000, and $50,000 each. The partners also agreed to temporary suspensions. The public company's chief accounting officer agreed to a civil penalty of $51,000.

VI. Investment Adviser Enforcement[29]

The SEC remained focused on protecting retail investors in FY 2021 as well, bringing several significant cases against investment advisers and others in the financial services industry.

24 https://www.sec.gov/news/press-release/2021-78; https://www.sec.gov/enforce/33-10975-s

25 https://www.sec.gov/news/press-release/2021-133; https://www.sec.gov/litigation/litreleases/2020/lr24981.htm

26 https://www.sec.gov/news/press-release/2020-319; https://www.sec.gov/news/press-release/2021-127

27 https://www.sec.gov/news/press-release/2021-76

28 https://www.sec.gov/news/press-release/2021-144

29 Cybersecurity-related enforcement actions against registered entities are discussed in Section II.B.

In August 2021, the SEC instituted settled charges against a San Francisco-based robo adviser for **breaching its fiduciary duties to clients** in connection with the investment of client assets into two ETF funds sponsored by the robo adviser's parent company. According to the SEC's order, the investment adviser sold client positions in third-party ETFs and placed them into ETF funds sponsored by the adviser's parent, triggering immediate tax consequences for many clients. The SEC found that the adviser failed to disclose conflicts of interest associated with these transactions to its clients before selling the positions. On a no-admit, no-deny basis, the adviser consented to a cease-and-desist order, a censure, and a penalty of $300,000.[30] In resolving the matter, the SEC noted the adviser's cooperation and remedial measures.

In July, the SEC charged 27 investment advisers and broker-dealers for **failing to file and deliver their client relationship summaries** (Form CRS) to their retail investors.[31] The SEC adopted Form CRS in June 2019, and it requires registered investment advisers and broker dealers to provide certain information to retail investors about the services a firm offers, its fees, and conflicts of interest, among other items. Firms subject to the rule were required to post the CRS "prominently" on their website, to file the CRS with the SEC, and to deliver it to their retail investors by June 30 or July 30, 2020, depending on whether investors were new or existing clients.

The SEC's order found that each of the settling firms missed the regulatory deadlines, even after being provided with two reminders. Without admitting or denying the findings in the order, all 27 firms agreed to be censured, to cease and desist from future violations, and to pay civil penalties ranging from $10,000 to $97,523, calculated based on each firm's assets under management.

In June, the SEC charged two investment firms and a Miami-based investment adviser representative with **engaging in a "cherry-picking" scheme** by which they funneled millions of dollars in trading profits to certain preferred accounts.[32] The alleged misconduct was uncovered by the Enforcement Division Market Abuse Unit's Analysis and Detection Center. The SEC complaint alleged that the defendants used a single account to make trades without designating the intended recipient until after a position had been established. If the position increased during the trading day, defendants typically closed it out and allocated the profits to two preferred accounts, which were held by the representative's relatives. If the value decreased, the unprofitable trades were allocated to other client accounts. The defendants allegedly unloaded more than $5 million in first-day losses to at least 75 non-preferred clients. The SEC also named the preferred clients—who allegedly benefited from this scheme to the tune of $4.6 million—as relief defendants.

The SEC's complaint alleges violations of the antifraud provisions of the federal securities laws and seeks permanent injunctions, disgorgement, prejudgment interest, and civil penalties. At the outset of the case, the SEC secured an emergency order freezing defendants' assets as well as requiring an accounting and expedited discovery.

In August, the SEC charged a hedge fund sub-adviser, its principal, and a trader for **providing erroneous order-marking information to broker-dealers, causing those broker-dealers to violate Regulation SHO**.[33] According to the SEC's order, the respondents provided incorrect order-marking information to broker-dealers for hundreds of sales from their hedge fund clients. This in turn caused those broker-dealers to erroneously mark those clients' sales as long when they should have been marked as short because the clients were not "deemed to own" the stock being

30 https://www.sec.gov/enforce/ia-5826-s

31 https://www.sec.gov/news/press-release/2021-139?utm_medium=email&utm_source=govdelivery

32 https://www.sec.gov/news/press-release/2021-105

33 https://www.sec.gov/news/press-release/2021-156

sold and did not have a net long position in the stock. This conduct allegedly resulted in the clients avoiding the costs associated with borrowing the relevant stock, among other benefits. Without admitting or denying the findings, all three respondents agreed to cease-and-desist orders, and the firm and its principal agreed, jointly and severally, to disgorgement of $7 million and prejudgment interest of $1,078,183 and agreed to undertakings regarding future compliance with Regulation SHO. The firm, the principal, and the trader each also agreed to pay civil penalties of $800,000, $75,000, and $25,000, respectively. In resolving the matter, the SEC noted certain remedial undertakings by the adviser.

In September, in a first-of-its-kind enforcement action, the SEC announced settled **fraud charges against a leading alternative data provider** for the mobile app industry as well as its co-founder and former CEO and Chairman.[34] "Alternative data" is data that is not available in public company financial disclosures or other traditional sources of information, and it can be very valuable to firms in making trading decisions. The data provider in this matter gathered data from public companies regarding their mobile app performance, including the number of times a company's app is downloaded, how often the app is used after download, and the amount of revenue the app generates.

According to the SEC's order, the data provider promised companies whose data it acquired (as well as trading firms who purchased the data) that the data would be aggregated and anonymized before being used in statistical modeling to project performance. However, the SEC found that the firm used non-aggregated and non-anonymized data to inform its modeling, making it more valuable to sell to trading firms, and in some cases recommended ways the firms could use the data for trading. The SEC also alleged the provider touted how closely their models correlated with actual company performance and stock prices.

The SEC found that this conduct violated securities laws prohibiting deceptive conduct in connection with the purchase or sale of securities. Without admitting or denying the allegations, the data provider and its former CEO and Chairman agreed to a cease-and-desist order and to pay civil penalties of $10 million and $300,000, respectively. The former CEO and Chairman also agreed to a three-year officer and director bar.

Throughout FY 2021, the SEC continued to bring **share class disclosure cases related to Rule 12b-1 fees**. In 2018, the SEC launched its Share Class Selection Disclosure (SCSD) Initiative to allow investment advisers to self-report that they had failed to disclose conflicts of interest in connection with the receipt of 12b-1 fees.[35] Generally, if a firm self-reported and returned money to harmed investors, they would not face civil penalties for the misconduct. The window for self-reporting closed in June 2018, and many advisers participated in the initiative.

Many of the cases brought in FY 2021 were against firms who chose not to self-report under the SCSD Initiative. These recent orders have explicitly noted that the firms elected not to self-report and as a result, the SEC often brought additional charges against the firms, including allegations of best execution failures, and sought increased penalties. For example, in June 2021, the SEC ordered an investment adviser to pay over $1.2 million, including a $250,000 civil penalty, for disclosure failures related to the receipt of 12b-1 fees.[36] The order announcing the settled charges included best execution failures as well as disclosure failures and noted that the adviser "although eligible to do so, did not self-report to the Commission" pursuant to the SCSD Initiative. Similar language, along with allegations of best execution failures and civil penalties, has appeared in several settled cases

34 https://www.sec.gov/news/press-release/2021-176?utm_medium=email&utm_source=govdelivery

35 https://www.sec.gov/news/press-release/2018-15

36 https://www.sec.gov/enforce/34-92095-s

this year.[37] Follow-on cases like these show that the voluntary SCSD self-reporting initiative had a tangible benefit for firms that elected to participate.

There were several other notable actions against investment advisers and related persons in FY 2021, including:

- a $170 million settlement with a UK-based investment adviser as a result of alleged **inadequate disclosures, material misstatements, and misleading omissions** surrounding its transfer of its highest-performing traders from its flagship investment fund to a proprietary fund benefitting the firm's own personnel;[38]
- a $97 million settlement with an investment adviser alleging **inaccuracies and misleading statements related to conflicts of interest** in recommending rollover of clients' retirement assets;[39]
- an action against an investment adviser for alleged **compliance failures associated with sales of a volatility-linked exchange-traded product** as part of the Enforcement Division's ETP Initiative;[40]
- a civil action against mutual fund advisers alleging the advisers and their portfolio managers made **false and misleading statements to investors regarding risk management practices**, including misleading statements regarding the use of historical event stress testing and prioritizing a consistent risk profile over returns;[41] and
- charges against two investment advisers, their owners, and their managers alleging the defendants made a series of **false representations and misstatements to three private funds** regarding conflicts, security of funds, valuation of assets, and other items and causing a private fund to engage in conflicted transactions.[42]

VII. Insider Trading and Regulation FD Enforcement

The detection and prosecution of insider trading violations has been an SEC enforcement priority for many years. That focus continued in FY 2021 and included a few first-of-their-kind cases.

In March 2021, the SEC announced its first enforcement action involving securities law violations on the dark web.[43] In that case, the SEC alleged an individual perpetrated a fraudulent scheme to **sell purported "insider" stock tips on various dark web marketplaces**. Several users allegedly bought these tips using bitcoin and traded securities based on the information. The SEC charged the individual with securities fraud, and the defendant agreed to a bifurcated settlement that permanently enjoined him from further violating those provisions and reserved the determination of disgorgement and civil penalties for a later date.

The SEC announced a second action with similar factual allegations in July.[44] The defendant in that case was recently detained in Peru pursuant to a request

37 *See e.g.,* https://www.sec.gov/litigation/admin/2021/ia-5719.pdf (ordering a total of approximately $975,000 in disgorgement, interest, and penalties); https://www.sec.gov/litigation/admin/2021/ia-5820.pdf (ordering a total of approximately $700,000 in disgorgement, interest, and penalties) and https://www.sec.gov/litigation/admin/2021/ia-5832.pdf (ordering a total of approximately $1.9 million in disgorgement, interest, and penalties for share class selection disclosure issues and other alleged violations).

38 https://www.sec.gov/news/press-release/2020-308

39 https://www.sec.gov/news/press-release/2021-123

40 https://www.sec.gov/news/press-release/2021-130

41 https://www.sec.gov/news/press-release/2021-89 The SEC separately settled charges with one of the adviser's chief risk officers, and the Commodity Futures Trading Commission instituted a parallel action against the advisers and all three individuals.

42 https://www.sec.gov/litigation/litreleases/2021/lr25128.htm

43 https://www.sec.gov/news/press-release/2021-51

44 https://www.sec.gov/news/press-release/2021-122

by the U.S. Department of Justice related to a parallel criminal investigation and is awaiting extradition.

In August, the SEC charged the former head of business development at a mid-sized biopharmaceutical company with insider trading in advance of the company's announcement that it would be acquired by a well-known pharmaceutical giant.[45] The SEC alleged that the defendant bought short-term stock options in a rival, comparable mid-sized biopharmaceutical company within minutes of learning that his company was going to be acquired. The **use of nonpublic information held by insiders to trade in stock of economically linked firms** (like the two mid-sized biopharmaceutical companies here) has been dubbed "shadow trading," and could be used to circumvent insider trading regulations and SEC scrutiny. As in the "dark web" cases above, the SEC charged the defendant with violating the antifraud provisions of the federal securities laws. The SEC seeks a permanent injunction, a civil penalty, and an officer and director bar.

The SEC also continued its recently renewed interest in Regulation FD enforcement—a topic often discussed alongside insider trading—in FY 2021. In March, the SEC charged a telecommunications company and three of its executives with repeated violations of Regulation FD, which generally prohibits selective disclosure of material nonpublic information.[46] The SEC alleged the three executives **privately disclosed material nonpublic information to 20 different research analyst firms**, leading the analysts to substantially reduce their forecasts of the company's quarterly revenue so that the company would not fall short of analysts' estimates for the quarter when revenue was later reported to the public. The SEC is seeking permanent injunctive relief and civil monetary penalties against each defendant.

VIII. Foreign Corrupt Practices Act Enforcement

Each year, the SEC brings a few significant cases alleging violations of the Foreign Corrupt Practices Act (FCPA).

In January 2021, the SEC announced settled charges against a multinational bank for allegedly engaging foreign officials (along with their relatives and associates) as third-party intermediaries, business development consultants, and finders to obtain and retain global business, in violation of the FCPA.[47] The SEC's order also alleged the bank **failed to assess bribery risk or failed to mitigate that risk and lacked sufficient internal accounting controls related to payments to third-party intermediaries**. Bank employees allegedly paid $7 million in bribe payments or payments for unknown, undocumented, or unauthorized services and then allegedly falsified invoices and documentation as support to record such payments as legitimate business services.

The SEC charged the bank with violating the FCPA's books and records and internal accounting controls provisions, and the bank agreed to a cease-and-desist order and to pay disgorgement of $35 million. The bank also entered into a three-year deferred prosecution agreement with the U.S. Attorney's Office for the Eastern District of New York and agreed to pay a $79 million criminal penalty.

The SEC also announced several other actions for violations of the FCPA, including:

- charges against a Brazilian meat producer and its principals for allegedly making $150 million in bribe payments in part to facilitate a large acquisition;[48]
- charges against an advertising group that had recently acquired majority interests in a number

45 https://www.sec.gov/news/press-release/2021-155
46 https://www.sec.gov/news/press-release/2021-43
47 https://www.sec.gov/news/press-release/2021-3
48 https://www.sec.gov/news/press-release/2020-254

of local ad agencies in high-risk markets but allegedly **failed to implement top-down internal accounting controls and compliance policies** leading to the agency's inability to identify signs of corruption and control failures;[49]

- charges against a financial services company related to an alleged bribery scheme by which former senior executives **used a third-party intermediary to bribe government officials** to obtain business from a Malaysian government-owned investment fund;[50]

- charges against a company that provided project, engineering, and technical services to energy and industrial markets for allegedly **making improper payments to Brazilian officials in an effort to obtain an oil and gas engineering and design contract** from a Brazilian state-owned oil company and establish a business presence in Brazil;[51] and

- a settlement with a former financial services executive who was previously charged with **facilitating a bribery scheme** to help a client obtain Ghanaian approval of an electrical power plant project in violation of the FCPA's anti-bribery provisions and then concealing the misconduct from his employer.[52]

LOOKING AHEAD

I. Areas of Focus

The Commission's enforcement actions in the latter half of FY 2021 shed light on what we can expect moving forward. We expect the Commission to remain focused on cybersecurity disclosures for public companies, cybersecurity policies and practices for regulated entities, and disclosures surrounding SPAC transactions.

Climate and Environment, Social, and Governance Issues (ESG) is a priority for the SEC's Chairman and is expected to be an emphasis within the Enforcement Division in the coming months. In March 2021, the SEC announced a task force within the Enforcement Division "to identify any material gaps or misstatements in issuers' disclosure of climate risks under existing rules" and to "analyze disclosure and compliance issues relating to investment advisers' and funds' ESG strategies." The SEC's Examination Division also included climate-related risks in its 2021 priorities,[53] and more recently, the SEC's Division of Corporation Finance published a sample comment letter to a hypothetical public company inquiring about the adequacy and accuracy of its climate-related disclosures.[54] These steps often are a precursor to increased enforcement activity.

We also expect the Commission to remain focused on cryptocurrency and to stake a broad claim of enforcement authority in that space. Chair Gensler has stated publicly, "Right now, we just don't have enough investor protection in crypto. Frankly, at this time, it's more like the Wild West. If we don't address these issues, I worry a lot of people will be hurt."[55] He went on to say that many of the tokens offered in the cryptocurrency market are securities subject to SEC regulation, claiming there was "a lot of clarity on that

49 https://www.sec.gov/news/press-release/2021-191?utm_medium=email&utm_source=govdelivery
50 https://www.sec.gov/news/press-release/2020-265
51 https://www.sec.gov/news/press-release/2021-112
52 https://www.sec.gov/litigation/litreleases/2021/lr25121.htm
53 https://www.sec.gov/news/press-release/2021-39
54 https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures
55 https://www.sec.gov/news/public-statement/gensler-aspen-security-forum-2021-08-03

front." He further warned that cryptocurrency trading platforms, lending platforms and other "decentralized finance" platforms and investment vehicles providing exposure to cryptocurrency assets will garner a lot of the SEC's attention going forward.

Chair Gensler has also suggested a focus on Exchange Act Rule 10b5-1 related to director and officer stock trading plans. He has asked the Commission Staff to make recommendations to the Commission regarding proposed rulemaking and has provided his own view on what that rulemaking might cover, including a mandatory cooling off period between adoption of a 10b5-1 plan and the first trades under the plan, prohibitions against having multiple 10b5-1 plans at the same time, limitations on the ability to cancel 10b5-1 plans at any time, and enhanced public disclosure of 10b5-1 plans.[56] New rules along these lines are expected, and we may see the Enforcement Division Staff apply more scrutiny to 10b5-1 plans and associated trades in the meantime.

Gensler has also shown interest in expanded enforcement related to "meme" stock trading, the "gamification" of investing, and payment for order flow, all topics that should be watched closely by broker-dealers and other registered entities and public companies who may be impacted by such trading activity or associated regulation.[57]

II. Enforcement Trends

Aside from these areas of focus, we expect companies and regulated entities to see increased enforcement activity out of the Commission under Gensler's and Grewal's leadership. Having a former prosecutor at the helm of the Enforcement Division often results in increased enforcement activity, and Grewal has vowed to enforce the securities laws aggressively.[58] And in February 2021, then-Acting Chair Allison Herren Lee authorized senior officers in the Enforcement Division to approve the issuance of formal orders of investigation, a practice which was established in 2009 but had been discontinued in 2017 under the prior SEC administration.[59] Since 2017, the authority to approve formal orders authorizing the Staff to issue subpoenas for documents and testimony rested with the Enforcement Division Director. Re-instituting the delegation of that authority to senior Enforcement Division officers in the SEC's home office and regional offices streamlines the process and will likely lead to more matters being approved for investigation—or at least approved more quickly.

The number of tips received by the Commission through its whistleblower program is also on the rise. The program received 12,200 tips in FY 2021, a 76% increase from the 6,911 tips received in the prior fiscal year.[60] The major categories of allegations, as described by the whistleblowers, included manipulation, corporate disclosures and financials, offering fraud, trading and pricing, and initial coin offerings and cryptocurrencies. In FY 2021, the Commission made more awards (approximately $564 million) to more individuals (108) than in all prior years of the program combined and crossed a milestone of awarding more than $1 billion to whistleblowers since the inception of the program in 2011. The Enforcement Division also continued to bring enforcement actions for allegedly impeding or retaliating against whistleblowers.[61] We expect whistleblower complaints to remain a key source of leads for the Enforcement Division going forward.

We also expect increased penalties being sought and imposed by the Enforcement Division. In September, one Commissioner expressed concern about corporate penalties that place too much

56 https://www.sec.gov/news/speech/gensler-cfo-network-2021-06-07
57 https://www.sec.gov/news/testimony/gensler-testimony-20210505
58 https://www.sec.gov/news/speech/grewal-sec-speaks-101321
59 https://www.sec.gov/news/public-statement/lee-statement-empowering-enforcement-better-protect-investors
60 https://www.sec.gov/files/2021_OW_AR_508.pdf
61 https://www.sec.gov/enforce/34-92237-s; https://www.sec.gov/news/press-release/2021-24

emphasis on complicated measurements of corporate benefit and investor harm, and she expressed her view that penalties should focus on punishment and deterrence.[62] Statements like this, combined with tough talk from Gensler and Grewal, suggest the Commission may seek stiffer penalties in its enforcement actions for the foreseeable future.

Finally, we expect the SEC to deploy prophylactic enforcement tools more aggressively moving forward. In recent years, the Commission has generally settled enforcement matters on a no-admit, no-deny basis. But Enforcement Division Director Grewal recently announced the Division will seek admissions in appropriate circumstances, specifically "in cases where heightened accountability and acceptance of responsibility are in the public interest."[63] He also stated that officer and director bars, conduct-based injunctions, and undertakings will be more common under his leadership.

III. An Update on the SEC's Disgorgement Authority

Securities enforcement practitioners have closely watched developments related to the SEC's disgorgement authority. In 2017, the U.S. Supreme Court unanimously held in *Kokesh v. SEC* that claims for disgorgement brought by the SEC were subject to a five-year statute of limitations.[64] Then, in June 2020, the Supreme Court in *Liu v. SEC* limited the SEC's disgorgement authority to the net income generated from misconduct and held that disgorgement must be for the benefit of investors.[65]

In the latest development on this topic, the National Defense Authorization Act, passed on January 1, 2021, codified the SEC's ability to obtain disgorgement subject to a five-year statute of limitations, and further ***extended*** that limitations period to ten years in cases involving fraud or other scienter-based violations. The limitations on disgorgement expressed in *Liu* still apply, as the Commission has seemingly acknowledged in recent enforcement actions.[66] In more recent actions, the Commission's settled orders state, "The disgorgement and prejudgment interest ordered in paragraph IV.C.1. is consistent with equitable principles and does not exceed Respondent's net profits from its violations and will be distributed to harmed investors to the extent feasible."

CONCLUSION

The SEC's enforcement priorities will become clearer as we leave the period of transition to new leadership at the Commission, and the Enforcement Division finds its stride in FY 2022. We will monitor developments closely and look forward to advising our clients on these and other topics in the securities enforcement space.

62 https://www.sec.gov/news/public-statement/crewnshaw-information-bundling-2021-09-03

63 https://www.sec.gov/news/speech/grewal-sec-speaks-101321

64 137 S. Ct. 1635 (2017).

65 140 S. Ct. 1936 (2020).

66 *See, e.g.,* https://www.sec.gov/litigation/admin/2021/ia-5781.pdf; https://www.sec.gov/litigation/admin/2021/ia-5830.pdf

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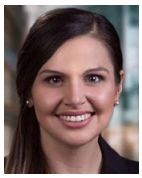

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