

## Investment Management White Collar Criminal Defense

November 13, 2019

# The SEC Division of Enforcement Publishes 2019 Results

By **H. Gregory Baker**, **David L. Goret**, **Rachel Maimin**, **Scott H. Moss**, and **Alexandra S. Droz**

On Nov. 6, 2019, the Securities and Exchange Commission's Division of Enforcement (the Division) published its 2019 Annual Report (the Report), which details the Division's fiscal year (FY) 2019 accomplishments and key initiatives. The Division remarked that "[b]y any measure," they "had a very successful year," notwithstanding the government shutdown and a "35-day lapse in appropriations."<sup>1</sup>

Overall, enforcement actions, disgorgement and penalties, and monies returned to harmed investors increased as compared to FY 2018. In FY 2019, the Division brought 862 enforcement actions (as compared to 821 in FY 2018), obtained judgments and orders of over \$4.3 billion in disgorgement and penalties (as compared to \$3.9 billion in FY 2018), and returned approximately \$1.2 billion to harmed investors (as compared to \$794 million in FY 2018). The number of stand-alone actions brought was 7 percent higher in FY 2019 (526) than in FY 2018 (490), and total monetary relief obtained was \$404 million higher in FY 2019, representing a 10 percent increase. The increase in the number of year-over-year cases was largely the result of the Division's Share Class Selection Disclosure Initiative (the Share Class Initiative), a one-off initiative in which 95 investment advisory firms that voluntarily self-reported to the Division agreed to return \$135 million to affected mutual fund investors.

The majority of the Division's stand-alone cases concerned investment advisory and investment company issues (36 percent), followed by securities offerings (21 percent), with issuer reporting and accounting and auditing matters

coming in third (17 percent). Other significant matters concerned broker-dealer misconduct (7 percent), insider trading (6 percent), market manipulation (6 percent), the Foreign Corrupt Practices Act (3 percent), and public finance (3 percent). The Division obtained nearly 600 bars or suspensions against market participants, suspended trading in the securities of 271 issuers, and obtained 31 court-ordered asset freezes.

The Report articulated the Division's five core principles: (1) focus on the retail investor, (2) focus on individual accountability, (3) keep pace with technological change, (4) impose remedies that most effectively further enforcement goals, and (5) constantly assess the allocation of resources.

The Report described the Division's initiatives and areas of focus in FY 2019 as follows:

- **Focus on the Retail Investor.** In furtherance of its effort to protect retail investors, in February 2018, the Division launched the Share Class Selection Disclosure Initiative, which authorized standardized settlement terms against investment advisory firms that self-reported failures to disclose conflicts of interest relating to the receipt of certain fees by the advisers or their affiliates. Under this initiative, in FY 2019, the Division ordered 95 investment advisers to return over \$135 million to affected investors. The impacted firms also agreed to align their practices and disclosures going forward to help clients make more informed decisions regarding fees. The Division's

<sup>1</sup> Report at 1.

Retail Strategy Task Force (RSTF) continues to focus on two main objectives: (1) to develop data-analytics strategies to identify harmful practices in the markets and (2) to collaborate within and outside the SEC on retail investor advocacy and outreach.

- **Focus on Cyber-Related Misconduct.** The Division's cyber unit focuses on violations involving distributed ledger technology, digital assets, initial coin offerings (ICO), cyber intrusions, and hacking to obtain material, nonpublic information. While the Division remains focused on cyber-related fraudulent conduct, the cyber unit investigated and recommended several non-fraud ICO matters in FY 2019. These included the Division's first contested litigation against a digital asset issuer alleging solely non-fraud charges, and settlements in three actions charging ICO issuers with violating the registration requirements of the Securities Act of 1933. The cyber unit focused on protecting investors from cybersecurity threats and issued a report recommending that issuers and other market participants implement and maintain sufficient internal accounting controls to safeguard against spoofed or manipulated electronic communications. Recent enhancements to the Division's technological capabilities have given the cyber unit the ability to bring a substantial number of trading-related cases, which required analysis of voluminous amounts of trading data and communications metadata.

The Report also noted the Division's focus on individual accountability, which it describes as the SEC's "most effective method of achieving deterrence."<sup>2</sup> In FY 2019, 69 percent of the Division's stand-alone actions (excluding those brought against entities under the Share Class Initiative) involved charges against one or more individuals, including chief executive officers, chief financial officers, chief operating officers, chief compliance officers, accountants, auditors, and attorneys.

Division Co-Directors Stephanie Avakian and Steven Peikin called this a "successful year ... despite the lapse in appropriations" and despite recent Supreme Court (the Court) decisions

adverse to the SEC.<sup>3</sup> In its 2017 *Kokesh* decision,<sup>4</sup> the Court held that SEC claims for disgorgement are subject to a five-year statute of limitations, and in its 2018 *Lucia* decision,<sup>5</sup> the Court held that the SEC's administrative law judges are "Officers of the United States" rather than federal government employees and thus must be appointed by the President, a court, or a head of department. The Supreme Court's upcoming and much-anticipated decision in *Liu v. SEC*<sup>6</sup> could significantly reduce the Division's future activity and results if the Court eliminates or curtails the SEC's authority to obtain disgorgement of ill-gotten gains.<sup>7</sup>

## Takeaways

The Report suggests the Division is continuing to bring a significant number of enforcement actions, with continued emphasis on matters affecting retail investors and cyber-related misconduct. The 2019 enforcement statistics also suggest that the Division continues to carefully scrutinize conduct by investment advisers and investment companies, and that the Division is also placing an increased emphasis on holding individuals (rather than entities) accountable for misconduct.

The lifting of the hiring freeze in 2019 means that the Division will be able to allocate additional resources to its enforcement program in 2020. We see no signs of a significant drop-off in the Division's enforcement activity over the coming year, and we encourage all investment advisers and financial market participants to place continued emphasis on ensuring the quality of their compliance programs, and to remain vigilant in light of the Division's active pursuit of enforcement actions in furtherance of its stated initiatives.

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<sup>2</sup> Report at 17.

<sup>3</sup> Report at 14.

<sup>4</sup> *Kokesh v. SEC*, 137 S. Ct. 1635, 1644 (2017). A five-year statute of limitations applies to any "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise." 28 U.S.C. § 2462.

<sup>5</sup> *Lucia v. SEC*, 138 S. Ct. 2044, 2051, 201 L. Ed. 2d 464 (2018).

<sup>6</sup> On Nov. 1, 2019, the Supreme Court granted certiorari in *Charles C. Liu, et al. v. SEC*, No. 18-1501, 2019 WL 5659111 (U.S. Nov. 1, 2019).

<sup>7</sup> See <https://www.lowenstein.com/news-insights/client-alerts/supreme-court-to-review-the-sec-s-right-to-seek-disgorgement-white-collar>.

# Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

**H. GREGORY BAKER**

Partner

**T: 212.419.5877**

[hbaker@lowenstein.com](mailto:hbaker@lowenstein.com)

**DAVID L. GORET**

Partner

**T: 646.414.6837**

[dgoret@lowenstein.com](mailto:dgoret@lowenstein.com)

**RACHEL MAIMIN**

Partner

**T: 212.419.5876**

[rmaimin@lowenstein.com](mailto:rmaimin@lowenstein.com)

**SCOTT H. MOSS**

Partner

**T: 646.414.6874**

[smoss@lowenstein.com](mailto:smoss@lowenstein.com)

**ALEXANDRA S. DROZ**

Associate

**T: 646.414.6968**

[adroz@lowenstein.com](mailto:adroz@lowenstein.com)

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NEW YORK

PALO ALTO

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