Securities
Regulation Daily

Wolters Kluwer

March 20, 2018

Agencies Indicate Efficient, Targeted Enforcement Priorities That Rely on Self-Disclosure

By David Meister, Jocelyn E. Strauber, Pippa Hyde, Eli S. Rubin
Skadden, Arps, Slate, Meagher & Flom LLP

More than one year into the Trump administration, it remains difficult to forecast what lies ahead with respect to regulatory and white collar enforcement activity. Perhaps most instructive are recent public statements of officials at the Securities and Exchange Commission (SEC), Department of Justice (DOJ) and Commodity Futures Trading Commission (CFTC), which suggest that vigorous regulatory and enforcement activity will continue, albeit with a focus on targeted enforcement actions that use the government's resources as efficiently as possible.

A Move Away From 'Broken Windows' Strategy

With the SEC's new chairman and two new co-directors of enforcement now in office, Co-Director of Enforcement Steven Peikin has suggested that, in light of limited resources, the agency may take a "more selective" approach to regulatory enforcement rather than continue on the Division of Enforcement's pursuit of a "broken windows" strategy to policing the securities markets, under which it actively prosecuted even minor and technical violations.

While Co-Director Peikin did not specify the types of cases on which the SEC might choose to focus, they are likely to include those intended to protect so-called Main Street investors. The division recently created the Retail Strategy Task Force, which leverages agencywide resources to analyze trends affecting retail investment, with a focus on Ponzi schemes, microcap or offering fraud, and investment professional malpractice. The division also created a specialized Cyber Unit to investigate and prosecute cyber-related misconduct, including hacking to obtain material nonpublic information, market manipulation schemes involving false information spread through electronic and social media, and fraud involving cryptocurrency.

How this potential new approach may impact enforcement actions remains to be seen. In 2017, the division brought 446 stand-alone actions (102 fewer than in 2016) and imposed monetary penalties totaling $832 million ($441 million less than in 2016). Given that enforcement actions generally span more than one year, the declines were presumably caused by factors other than the division's "more selective" approach. In explaining the decline, the SEC noted that its Municipalities Continuing Disclosure Cooperation Initiative, which in 2016 led to 84 actions related to material misstatements and omissions in municipal bond offering documents, expired in 2017. Changes in personnel and the demands of the transition also were likely at work.

Just last month, Co-Director Peikin confirmed that the SEC is "not slowing down," and will continue to pursue traditional white collar fraud while expanding its focus to include cybercrime and cryptocurrency, likely generating more enforcement actions to come.

'Piling On'

The DOJ also has signaled its desire to make white collar crime enforcement more efficient by limiting the number of agencies that investigate and punish companies for the same underlying misconduct — a practice referred to by Deputy Attorney General Rod Rosenstein as "piling on." The phenomenon occurs both internationally, with foreign regulators and prosecutors, and domestically, among federal agencies and state actors. In a November 2017 speech at The Clearing House's Annual Conference, Deputy Attorney General Rosenstein stated that duplicative investigations and penalties "undermine the spirit of fair play and the rule of law" and deprive targeted companies of "certainty and finality."

The DOJ continues to prioritize international coordination and has expressed a commitment to working with foreign authorities to reduce the risk that companies will face prosecutions and penalties in multiple jurisdictions for the same conduct. This commitment is particularly significant with respect to the DOJ's Foreign Corrupt Practices Act (FCPA) cases, which appear to continue to be an enforcement priority. These cases require international cooperation and coordination but are vulnerable to overlapping enforcement. In recent cases, authorities from multiple jurisdictions worldwide appear to have been working collaboratively to divvy up investigations that cross jurisdictional lines, pursuing separate but coordinated prosecutions. The goal is to limit duplicative work and expedite the route to prosecution or settlement.

The Rolls-Royce corruption probe that concluded in January 2017 is one example where U.S., U.K. and Brazilian authorities engaged in parallel investigations, assisted by law enforcement agencies in Austria, Germany, the Netherlands, Singapore and Turkey. The company entered into deferred prosecution agreements with U.K. and U.S. authorities, executed a leniency agreement with the Brazilian Ministério Público Federal, and was required to pay penalties exceeding $800 million, apportioned among the three authorities.

International coordination must be carefully managed, lest it jeopardize the DOJ's cases. Standard and lawful investigative practices in foreign countries may raise substantial constitutional issues in the United States. In United States v. Allen, the U.S. Court of Appeals for the Second Circuit ruled in July 2017 that the use of evidence derived from testimony lawfully compelled by foreign authorities violated the Fifth Amendment. As a result, the court vacated the convictions of two London-based traders for conspiring to fix the London Interbank Offered Rate (Libor).

To achieve better coordination and minimize the risk to future convictions, the DOJ may expand its "division of labor" approach, whereby cooperating enforcement authorities divvy up prosecutions of individuals to best suit each country's prosecutorial needs and constraints. This tactic could allow governments to more effectively allocate their resources and tailor investigative approaches to the particular jurisdiction that anticipates prosecuting each individual. It also may limit the number of regulators with which a potential defendant might choose to cooperate.

The DOJ also has expressed a commitment to coordination domestically, though the form such coordination may take remains unclear and could be challenging in the current environment, in which some state attorneys general have pledged to step up enforcement actions to fill a perceived vacuum in federal enforcement activity.

Individual Liability

Consistent with the goals of the prior Administration, the DOJ continues to emphasize the importance of holding individuals – as well as entities – accountable for wrongdoing.

Deputy Attorney General Rosenstein has stated that "[e]ffective deterrence of corporate corruption requires prosecution of culpable individuals. We should not just announce large corporate fines and celebrate penalizing shareholders." More recently, he emphasized the importance of individual liability not just as a deterrent to future wrongdoing but also as a matter of fairness, stating, the goal is to "avoid imposing penalties that disproportionately punish innocent employees, shareholders, customers, and other stakeholders. Corporate misconduct can be serious or pervasive enough that an entity-level criminal resolution is warranted. We will pursue that outcome when appropriate. But we think carefully about accountability and fairness."

The DOJ is currently reviewing the Yates memorandum but, consistent with these views, is expected to follow its basic guidelines and continue to prioritize the pursuit of individual accountability.

Self-Reporting

Finally, in recent public statements the DOJ, CFTC and SEC have emphasized the benefits of corporations self-reporting wrongdoing and cooperating with the government. This suggests that these law enforcement entities remain committed to pressuring companies with the threat of prosecution to maintain the leverage necessary to compel companies to come forward voluntarily. At the same time, the statements may signal the agencies' increasing reliance on self-disclosure as a way to efficiently settle enforcement actions.

In November of last year, the DOJ announced a revised FCPA Corporate Enforcement Policy that updates and codifies the FCPA pilot program that was in place for the past 18 months. The revised policy, while similar in many respects to the pilot program, appears to further encourage voluntary disclosure of FCPA-related misconduct. Under the program, a company can presume enforcement will be declined if it voluntarily self-discloses the alleged misconduct, fully cooperates with the DOJ, and timely and appropriately remediates the situation. Even if there is enforcement action, the DOJ would recommend a 50 percent reduction off the low end of the U.S. sentencing guidelines fine range and not require, in certain circumstances, appointment of a compliance monitor.

In March of this year, the acting Assistant Attorney General for the Criminal Division, John Cronan, and the Chief of the Securities and Financial Fraud Unit, Benjamin Singer, said that the department would use the FCPA policy as nonbinding guidance in other types of criminal investigations. Referring to a recent resolution in which the DOJ declined to bring charges against a financial institution that voluntarily disclosed its alleged misconduct, cooperated, and remediated, Cronan stated that the DOJ's approach would have been very different in the absence of the institution's voluntary actions.

Similarly, the CFTC published an advisory in 2017 highlighting the benefits of self-reporting for all potential enforcement actions. Director of Enforcement James McDonald estimated that deserving parties could receive a 50 to 75 percent reduction in civil monetary penalties. The CFTC may even decline to prosecute in "extraordinary circumstances," for example "where misconduct is pervasive across an industry and the company or individual is the first to self-report," Director of Enforcement McDonald said in a September 2017 speech at the NYU Program on Corporate Compliance and Enforcement. While not going as far as the CFTC, the SEC also has reaffirmed that companies or individuals could avoid enforcement if they cooperate fully.

Federal regulatory and law enforcement authorities have long encouraged voluntary self-disclosure, but by clearly restating to companies and individuals the benefits of self-disclosure — and the magnitude of the benefits offered — authorities may be indicating a new focus on efficient regulation and law enforcement.

Conclusion

Though the DOJ, SEC and CFTC leadership all appear committed to continued enforcement activity, we expect they will employ new approaches to prosecutions, work collaboratively internationally and locally where possible, and rely on self-reporting and cooperation to meet their goals in the most efficient way.