

What 2021 Enforcement Results Say About SEC's Agenda

By **Daniel Michael, Andrew Hanson and Christopher Herlihy** (November 29, 2021, 5:02 PM EST)

In mid-November, the U.S. Securities and Exchange Commission's Division of Enforcement **released its results** for its 2021 fiscal year, which ran from October 2020 to September 2021. Unlike in previous years, the Enforcement Division issued a press release and an addendum with statistics, rather than a report, that summarize and assess the accomplishments during the fiscal year.

The press release highlights the Enforcement Division's efforts to enforce the securities laws through first-of-their-kind actions in new areas, such as decentralized finance, crowdfunding and alternative data.

In addition to the numerous commission orders and complaints finding or alleging harm to retail investors, the press release reflects an emphasis on protecting market integrity in the form of actions against auditors, providers of market data — from pricing data to index pricing — and others that play pivotal roles in securities markets.

The addendum to the press release demonstrates that the Enforcement Division has remained active despite formidable challenges, as the SEC filed 434 stand-alone enforcement actions, a 7% increase over the previous year.

While the 2020 fiscal year had a historically low number of stand-alone actions, the similar number of actions filed across the two years is nevertheless notable. Decreased enforcement activity typically accompanies transitions in government administrations due to the difficulties involved with resolving enforcement actions amid changing priorities.

In addition, this was the division's first full year dealing with the challenges that the pandemic posed to many aspects of its work, such as taking testimony, gathering evidence and litigating in court.

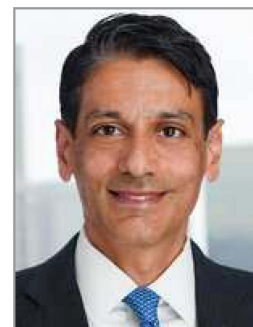
Enforcement Division Priorities

Given the average duration of SEC investigations, most, if not all, of the investigations underlying the enforcement actions filed in the fiscal year were commenced prior to Chair Gary Gensler's arrival in April. It is possible, however, to get a sense of the current leadership's priorities by examining particular actions that were relatively close in time to the relevant conduct, which suggests they may have been prioritized.

Assessing these expedited actions in concert with public statements by SEC leadership and broader agency initiatives reveals a focus on crypto, special purpose acquisition companies (or SPACs), Regulation Best Interest and cybersecurity.

Crypto

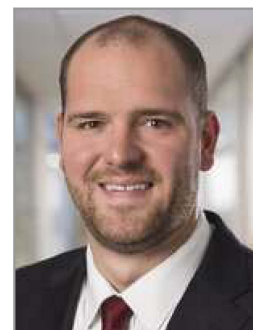
Against the backdrop of Gensler's statements regarding the regulatory risk he perceives involving digital assets that the SEC considers to be securities, the SEC brought multiple actions during the



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fiscal year charging issuers of various digital assets for selling securities. Some of these actions were filed relatively close in time to the misconduct they describe, and one was filed within just several months of the conduct alleged.

Among these reported actions, the SEC's litigated action against Ripple Labs Inc., the filing of which predated Gensler's tenure, is perhaps the most notable. SEC v. Ripple does not involve fraud and turns on the question of whether Ripple's digital asset, XRP, is a security. A decision on the merits could serve as an inflection point for the agency's enforcement approach to digital assets.

A notable trend this year is an apparent expansion of the agency's focus to include crypto exchanges, lending platforms and others that facilitate the trading of digital assets.

The action against Poloniex LLC, finding that it operated as an unregistered digital asset exchange, as well as recent statements by Gensler on crypto exchanges, signal that the Enforcement Division's attention and resources are squarely turned to these platforms.

SPACs

When the SEC announced settled charges in connection with the Stable Road Acquisition Company SPAC, it did so after only seven months of the charged conduct, which is one-third of the typical lifespan of an investigation.[1] This, combined with the rare step by an SEC chair of making a statement in a press release announcing the action and reports of a SPAC sweep launched by the Enforcement Division several months before, underscores that this is a priority area for the agency.

In the Stable Road action, the SEC not only charged the SPAC target that made the relevant statements, but also found that the SPAC sponsor disseminated them without adequate due diligence.

Additionally, the SEC's push for individual accountability — in this case, charging the CEOs of both the SPAC and the SPAC target — and tailored relief, requiring that the SPAC sponsor forfeit its founder shares, further highlights the areas of possible exposure.

Cybersecurity

In stark contrast to the three prior fiscal years — during which the SEC published an investigative report in lieu of enforcement actions against victims of cyber intrusions and filed only two enforcement actions involving extreme facts[2] — this past year saw five settled actions filed in rapid succession, several of which involved relatively recent conduct from 2020, and a sweep launched in the wake of the SolarWinds Corp. cyberattacks.[3]

These five actions reflect that enforcement in this space may no longer be reserved for extreme cases, as they involve facts common in a typical disclosure case, such as equivocal statements that a breach may have occurred when a known breach did occur and what the commission considered to be an unreasonable delay for the initial disclosure of a cybersecurity breach.

Notably, the **action** against First American Financial Corp. involved its handling of a vulnerability that was not exploited, which suggests the agency's approach to its enforcement authority in this area has evolved to prevent and not just redress potentially harmful incidents.

Regulation Best Interest

The filing of **27 settled actions** involving failures to timely file and deliver Forms CRS, which are required disclosures by broker-dealers and investment advisers that summarize aspects of their relationship with the customer or client, serves as evidence of an appetite to enforce a new regulation that has been emphasized in speeches by Gensler, Allison Herren Lee and Enforcement Director Gurbir Grewal.

The commission did not file any actions during the most recent fiscal year involving breaches of Regulation Best Interest's care, disclosure, conflicts or compliance obligations. However, the absence of actions may not be particularly informative.

Given the regulation's effective date of June 30, 2020, any viable case would require a period of conduct since that effective date, after which the Enforcement Division would need to identify and investigate the alleged misconduct. The upcoming fiscal year, therefore, should be more instructive.

A Proactive Enforcement Division

The Enforcement Division's results suggest that it is continuing to take a proactive approach to identifying misconduct. In addition to using data analytics in traditional areas — such as insider trading — the SEC announced a risk-based initiative targeting unsuitable recommendations of complex products.

The Exchange-Traded Product Initiative, which resulted in **five simultaneous actions** and a subsequent sixth, used trading data analytics to uncover potentially unsuitable sales of volatility-linked ETPs to retail customers or clients.

Now that the SEC has significantly more market data available to it through the consolidated audit trail, which tracks all customer orders and broker-dealer proprietary trades throughout their life cycle, as well as through the swaps reporting requirements that went into effect this month, the Enforcement Division may seek to bring its data analytics capabilities to more areas of the market.

According to press reports, the last 12 months have also seen a marked uptick in sweeps. With reports of sweeps launched focusing on cybersecurity breaches, SPACs and offline communications at broker-dealers, the Enforcement Division appears to be taking a more proactive approach to identifying problems relating to prominent issues in today's markets.

While it is too early to predict how effective these sweeps — which by definition target broad swaths of a market or industry — will be in translating to enforcement actions, it is already apparent that market participants engaged in what the SEC considers to be hot-button areas will be subject to heightened regulatory scrutiny.

The Year Ahead

When Gensler served as chair of the U.S. Commodity Futures Trading Commission, that agency engaged in prodigious rulemaking efforts.

At the SEC, he similarly has staked out an ambitious agenda by announcing proposed rules on gamification; SPACs; environmental, social and governance issues; security-based swap holdings; short sale disclosures; and market structure modernization, among other areas.

Even if only some of these efforts result in final rules, as a whole they could comprise one of the most significant regulatory developments in recent memory.

Grewal has stated he will introduce far-reaching changes to the division's work. In two speeches given shortly after the close of the fiscal year, he discussed a willingness to discount precedent in determining penalties, indicated that defense counsel meetings with Enforcement Division leadership may occur less often, and reintroduced the possibility that the SEC would require that defendants **admit to misconduct** as a condition of settlement.[4]

While the recently closed fiscal year provides strong indications that the Enforcement Division has already pivoted to new priority areas, its first full fiscal year under Gensler and Grewal should be particularly informative in light of the ambitious and far-reaching goals they have set.

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[1] The SEC's 2021 results did not contain information on the length of investigations; however, the 2020 annual report states that the median time to file enforcement actions for that year was 21.6 months. 2020 SEC Division of Enforcement Annual Report, at 6 (Nov. 2, 2020), available at <https://www.sec.gov/files/enforcement-annual-report-2020.pdf>.

[2] See "Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding Certain Cyber-Related Frauds Perpetrated Against Public Companies and Related Internal Accounting Controls Requirements," Exch. Act Rel. No. 84429 (Oct. 16, 2018), available at <https://www.sec.gov/litigation/investreport/34-84429.pdf>; In re Alta Inc. f/d/b/a Yahoo! Inc., Exch. Act Rel. No. 83096 (Apr. 24, 2018), available at <https://www.sec.gov/litigation/admin/2018/33-10485.pdf>; Press Release, "Facebook to Pay \$100 Million for Misleading Investors About the Risks It Faced from Misuse of User Data" (July 24, 2019), available at <https://www.sec.gov/news/press-release/2019-140>.

[3] See In re First American Fin. Corp., Exch. Act Rel. No. 92176 (June 14, 2021), available at <https://www.sec.gov/litigation/admin/2021/34-92176.pdf>; In re Pearson plc, Exch. Act Rel. No. 92676 (Aug. 16, 2021), <https://www.sec.gov/litigation/admin/2021/33-10963.pdf>; Press Release, "SEC Announces Three Actions Charging Deficient Cybersecurity Procedures," (Aug. 30, 2021), available at <https://www.sec.gov/news/press-release/2021-169>.

[4] See Gurbir Grewal, "Remarks at SEC Speaks 2021" (Oct. 13, 2021), <https://www.sec.gov/news/speech/grewal-sec-speaks-10132>; Gurbir Grewal, "PLI Broker / Dealer Regulation and Enforcement 2021" (Oct. 6, 2021), <https://www.sec.gov/news/speech/grewal-pli-broker-dealer-regulation-and-enforcement-100621>.