

SEC Has Been Busy In FY 2019

By **Gerald Hodgkins, Blake Hulnick and Catherine McGrath**

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Despite enduring the longest government shutdown in U.S. history, the U.S. Securities and Exchange Commission's Division of Enforcement filed more cases in the first six months of this fiscal year than in the same period last year. From October 2018 through the end of March, the division filed 216 new "stand-alone" actions,[1] compared to just 149 during the first six months of FY 2018.

This increase was largely due to 79 cases filed on a single day in March against investment advisers for alleged disclosure failures relating to conflicts of interests associated with certain mutual fund fees. With the addition of these cases, enforcement actions against investment advisers made up nearly 50% of all cases filed so far this fiscal year.

Excluding the 79 March settlements from the half-year results, the division filed only 137 stand-alone enforcement actions — 12 fewer than at the same point last year, though perhaps more in line with our expectations, considering the time lost during the shutdown.

Overview of FY 2019 Enforcement

Despite bringing fewer cases involving broker dealer misconduct, insider trading and public finance abuse, the division is outpacing its FY 2018 results in the areas of issuer reporting/audit and accounting, Foreign Corrupt Practices Act and, as mentioned above, investment adviser misconduct.

The division is also close to where it was in FY 2018 with respect to market manipulation cases, just 10% off last year's pace. Below is a chart comparing this year's performance to FY 2018. For a comprehensive analysis of FY 2018, see our earlier article [here](#).



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	<i># of Cases Filed in the First Half of FY 2019</i>	<i>% of Total Cases Filed in the First Half of FY 2019</i>	<i># of Cases Filed in the First Half of FY 2018</i>	<i>Change in First Half of FY 2019 vs. First Half of FY 2018</i>
Investment Advisers / Investment Cos.	106	49%	28	+279%
Securities Offering	35	16%	39	-10%
Issuer Reporting / Audit & Accounting	30	14%	25	+20%
Broker Dealer	17	8%	23	-26%
Insider Trading	8	4%	13	-38%
Market Manipulation	9	4%	10	-10%
Public Finance	3	1%	5	-40%
FCPA	8	4%	2	+300%
Other (Exchanges, NSROs, Transfer Agents, Misc.)	0	0%	4	-100%
Total	216	100%	149	+45%

As the chart above shows, the government shutdown assuredly had a negative impact on several program areas. Every enforcement area but investment adviser misconduct, FCPA and issuer reporting/audit and accounting has seen a decline relative to the same period last year. Most notable is the decline in securities offering cases, which had increased each of the past two years.

Nevertheless, some enforcement activity continued during the shutdown and even a few enforcement actions were brought. According to Chairman Clayton,[2] during the shutdown, the SEC “focused on monitoring the functioning of our markets and, as necessary to prevent imminent threats to property, taking action.” That action involved filing only 10 new cases during the lull.

Notably, during the shutdown, the division sued nine individuals and entities accused of hacking into the SEC’s EDGAR system — the electronic portal used by the public to make SEC filings — in 2016. The defendants purportedly accessed the system to extract nonpublic information for use in illegal trading.

Before the shutdown, the SEC brought several significant cases against public companies for disclosure violations and fraudulent or otherwise deficient financial statements or internal controls. Once the shutdown ended, the agency picked up where it left off, ending with 20% more cases in these areas than during the same period last year.

In addition to significant cases against the Hertz Corporation,[3] Lumber Liquidators Holdings Inc.[4] and Volkswagen Aktiengesellschaft,[5] the SEC punctuated those efforts with two mini-sweeps — one addressing alleged longstanding but unaddressed internal controls failures and another focused on

alleged failures to disclose that required quarterly reviews by external auditors had not occurred.

Share Class Selection Disclosure Initiative

Largely due to the government shutdown, there would have been a slight decline in SEC enforcement activity this year over last, but for the culmination of the division's Share Class Selection Disclosure Initiative, or SCSDI,[6] which resulted in the simultaneous filing on March 11 of 79 settled administrative cases against investment advisers.[7]

The initiative, first launched in February 2018, targets investment advisers that have failed to adequately disclose conflicts of interest related to the sale of higher-cost mutual fund share classes when a lower-cost share class was available.

The 79 settlements announced on March 11 involve some of the nation's largest investment advisers and will, according to the division, "return more than \$125 million to clients, with a substantial majority of the funds going to retail investors." Although the bulk of those cases were filed in March, we anticipate one or more mini-sweeps and a number of one-off Share Class Selection Disclosure Initiative, or SCSDI, cases to be brought later this year.

In addition to these SCSDI cases, the division brought an additional 27 investment adviser cases in the first half of the year, bringing the total to 106 — a notable increase from the 28 such cases brought in the first half of FY 2018.

Continuing Emphasis on Cryptocurrency

The SEC announced the creation of the enforcement division's new Cyber Unit in September 2017.[8] As explained at the time, the new interdisciplinary enforcement unit would focus on a range of "cyber-related misconduct," including electronic and social media-driven market manipulation, hacking, the "dark web," as well as "[v]iolations involving distributed ledger technology and initial coin offerings."

Over the ensuing 18 months, SEC leadership has repeatedly touted this area as a priority, with a particular emphasis on cryptocurrency-related enforcement. For instance, SEC Enforcement Division Co-Director Stephanie Avakian commented last year that, "[g]iven the potential of [initial coin offerings] to fundamentally alter the process by which issuers raise money, they have a significance to our markets that far outweighs strict notional dollar amounts. So, matters related to ICOs and crypto-assets must be a focus for the Division of Enforcement." [9]

Consistent with this message, the number of enforcement actions involving cryptocurrency is on the rise. The SEC has brought eight cryptocurrency cases so far in FY 2019, compared to nine cases in all of FY 2018.

However, with more than 600 ICOs in 2018[10], it is a fair question to ask whether the SEC is effectively covering this regulatory landscape. The SEC's cryptocurrency-related actions span a range of violations, and include the first cryptocurrency "anti-touting" cases — against the social-media influencers Floyd Mayweather, a boxer, and DJ Khaled, a music producer[11], as well as another, in the matter of Zachary Coburn,[12] addressing the thorny issue of regulating cryptocurrency exchanges.

In November, the SEC's Divisions of Corporation Finance, Investment Management, and Trading and Markets issued a joint statement in which they gave a roadmap for how the SEC intends to regulate the

cryptocurrency markets.[13] The Coburn action is another step in that direction.

Given the enormous media coverage surrounding initial coin offerings and blockchain technology more generally — not to mention the SEC Division of Corporation Finance’s announcement of a new “Framework for ‘Investment Contract’ Analysis of Digital Assets” on April 3, 2019[14] — we expect that the number of enforcement cases involving increasingly complex blockchain- and crypto-related issues will continue to increase as market participants grapple with this emerging technology and its many regulatory challenges.

Declines in Broker-Dealer and Insider Trading Cases

Enforcement actions against broker-dealers are down 26% compared to the first half of FY 2018, though the numbers are not significant — 17 cases versus 23 by this time last year. This minor decline in activity, however, does not necessarily signal the wind-down of the Broker-Dealer Task Force, which has coordinated several broker-dealer initiatives over the past few years.

Rather, the decline, if it continues, could reflect a drop in broker-dealer enforcement activity in the SEC’s regional offices as result of the shift away from broker-dealers and toward investment advisers in the agency’s exam program, which historically has been an important source of enforcement matters for the SEC’s regional offices.

As we pointed out at the end of FY 2018,[15] the division’s 2017 Annual Report[16] boasted that its investment adviser examination coverage had nearly doubled over the preceding five years. Along with this shift in emphasis was a conscious decision to reduce the number of broker-dealer exams conducted by the SEC, which likely reduced the number of referrals to Enforcement involving broker-dealers.

This year, enforcement actions involving charges of anti-money laundering violations (UBS Financial Services Inc.,[17] Central States Capital Markets LLC,[18] and Vision Financial Markets LLC[19]), faulty trading data provided to the SEC in the form of “blue sheets” (Natixis Securities Americas LLC,[20] Citadel Securities LLC[21] and MUFG Securities Americas Inc.[22]) and violations associated with the lending of pre-release ADRs (Citibank, N.A.,[23] The Bank of New York Mellon,[24] JPMorgan Chase Bank, N.A.,[25] and Merrill Lynch[26]) have dominated the broker-dealer docket.

The division’s insider trading program also has declined down from 13 enforcement actions in the first half of FY 2018 to only eight so far this fiscal year. Given the small number of cases in this category overall, we doubt the decline portends any greater shift in enforcement emphasis.

We did note that at least two of the division’s FY 2019 insider-trading cases involved the use of sensitive regulatory information. In one case, the division “charged a former employee of a biotech company with insider trading on confidential information regarding the company’s withdrawal of certain products from consideration by the U.S. Food and Drug Administration.”[27]

In another, noted above, the division charged nine different individuals and entities with a “scheme to hack into the SEC’s EDGAR system and extract nonpublic information to use for illegal trading,” from which they “generated at least \$4.1 million in illegal profits.”[28]

Two other insider trading cases, SEC v. Cho[29] and SEC v. Gannamaneni, et al.,[30] involved leaks at investment banks, always a focus of the SEC.

Individual Accountability

As it did in its 2017 Annual Report,[31] the Enforcement Division's 2018 Annual Report[32] once again emphasized "individual accountability" as a "a key pillar of any strong enforcement program." On this, the division gave itself high marks, noting that "the Commission charged individuals in more than 70% of the stand-alone enforcement actions it brought."

At first glance, there appears to be a precipitous decline in individual accountability so far this fiscal year: by our count, only 38% of the cases brought by the division in the first half of this fiscal year included individuals.

However, this result is skewed by the share class selection disclosure initiative noted above, which so far has resulted in 79 investment adviser cases this fiscal year, none of which included individuals. Excluding those cases from our computation, about 61% of the SEC's enforcement actions this fiscal year included individuals, which is much closer to last year's rate.

Monetary Remedies

Our analysis indicates that the SEC obtained over \$800 million in monetary judgments in the 216 stand-alone actions brought so far this fiscal year. Three cases and the share class disclosure initiative, however, account for over 60% of those recoveries. Eight other matters provided an additional 28% of the monetary judgments recovered so far this year. This pace is far ahead of where the SEC was at this time last year when, according to data from the New York Times, the SEC had recovered approximately \$130 million in monetary remedies in actions filed and settled simultaneously.[33]

The division eventually reported nearly \$4 billion in monetary remedies at the end of FY 2018, though \$1.7 billion of that amount was deemed satisfied by payments to other law enforcement organizations in actions related to a single SEC case — In the matter of *Petroleo Brasileiro SA - Petrobras*. [34] Monetary remedies in FCPA cases increased the most from last year — from approximately \$1.5 million at this time last year to nearly \$300 million this year.

Conclusion

The SEC's Enforcement Division usually resists any attempt by outside observers to judge its success based on the number of cases filed. As the division's co-directors noted in their 2018 Annual Report, "raw numbers and gross totals do little to provide a true picture of whether the Division's efforts have furthered the Commission's three-part mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation." [35]

More recently, Commissioner Hester Peirce echoed that sentiment, stressing that "cases do not neatly stop or start at the turn of the fiscal year." [36] Nevertheless, the Division of Enforcement's busy first half of the fiscal year, notwithstanding the government shutdown, is surely an indication that SEC enforcement activity will remain vigorous throughout 2019.

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[1] “Stand-alone” actions are civil or administrative actions filed by the SEC, excluding actions to deregister securities and so-called “follow-on” actions — administrative cases in which the SEC seeks to place limitations on the activities of regulated persons based on the entries of injunctions against, or the criminal convictions of, those persons. Our count of stand-alone actions is based on a review of SEC’s reported administrative proceedings and litigation releases announcing filed civil actions. To the extent the SEC did not issue a litigation release in connection with a filed civil action, our count may be slightly different than actuals.

[2] <https://www.sec.gov/news/public-statement/statement-regarding-recommencement-normal-operations>

[3] <https://www.sec.gov/litigation/admin/2018/33-10601.pdf>

[4] <https://www.sec.gov/litigation/admin/2019/34-85291.pdf>

[5] <https://www.sec.gov/litigation/litreleases/2019/lr24422.htm>

[6] <https://www.sec.gov/enforce/announcement/scsd-initiative>

[7] <https://www.sec.gov/news/press-release/2019-28>

[8] <https://www.sec.gov/news/press-release/2017-176>

[9] <https://www.sec.gov/news/speech/speech-avakian-092018>

[10] See, CoinDesk, <https://www.coindesk.com/ico-tracker> (last visited April 8, 2019). It is worth noting, however, that the precise number of ICOs in any given year varies by source — ICOData reports over 1,200 ICOs in 2018. ICOData, <https://www.icodata.io/stats/2018> (last visited April 8, 2019)

[11] <https://www.sec.gov/news/press-release/2018-268>

[12] <https://www.sec.gov/news/press-release/2018-258>

[13] <https://www.sec.gov/news/public-statement/digital-asset-securities-issuance-and-trading>

[14] <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>

[15] <https://www.cov.com/en/news-and-insights/insights/2018/11/sec-enforcement-activity-in-2018>

[16] <https://www.sec.gov/files/enforcement-annual-report-2017.pdf>

[17] <https://www.sec.gov/litigation/admin/2018/34-84828.pdf>

[18] <https://www.sec.gov/litigation/admin/2018/34-84851.pdf>

[19] <https://www.sec.gov/litigation/admin/2019/34-85460.pdf>

- [20] <https://www.sec.gov/litigation/admin/2018/34-84760.pdf>
- [21] <https://www.sec.gov/litigation/admin/2018/34-84759.pdf>
- [22] <https://www.sec.gov/litigation/admin/2018/34-84758.pdf>
- [23] <https://www.sec.gov/litigation/admin/2018/33-10571.pdf>
- [24] <https://www.sec.gov/litigation/admin/2018/33-10586.pdf>
- [25] <https://www.sec.gov/litigation/admin/2018/33-10600.pdf>
- [26] <https://www.sec.gov/litigation/admin/2019/34-85395.pdf>
- [27] <https://www.sec.gov/litigation/litreleases/2019/lr24406.htm>
- [28] <https://www.sec.gov/litigation/litreleases/2019/lr24381.htm>
- [29] <https://www.sec.gov/litigation/litreleases/2018/lr24375.htm>
- [30] <https://www.sec.gov/litigation/litreleases/2018/lr24371.htm>
- [31] <https://www.sec.gov/files/enforcement-annual-report-2017.pdf>
- [32] <https://www.sec.gov/files/enforcement-annual-report-2018.pdf>
- [33] <https://github.com/newsdev/SEC>
- [34] <https://www.sec.gov/litigation/admin/2018/33-10561.pdf>
- [35] <https://www.sec.gov/files/enforcement-annual-report-2018.pdf>
- [36] <https://www.sec.gov/news/speech/peirce-speech-lies-statistics-102618>