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SEC Enforcement Numbers Show Shift To High-Impact Cases

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On Nov. 15, the U.S. Securities and Exchange Commission announced the results of its enforcement efforts in the fiscal year that ended in September.[1] As reflected in the SEC's report and our own analysis, fiscal year 2022 saw an uptick of enforcement activity.

The gains were in nearly every aspect of the SEC's enforcement program, but largely came at the expense of reduced focus on securities offering cases — the largest category of cases affecting retail investors directly.

At the Securities Enforcement Forum in November 2021, SEC Chair Gary Gensler emphasized that the SEC would seek to balance cases against "everyday fraudsters" with ones that "change behavior" and "send a message."[2]

Fiscal year 2022 enforcement results suggest that Gensler was true to his word, as the SEC made a decided shift away from its previous focus on retail fraud cases under Chair Jay Clayton.[3]

2022 Enforcement Results

In the past year, the SEC brought 462 stand-alone cases — defined as civil actions filed or administrative proceedings instituted, excluding Section 12(j) proceedings against delinquent filers and follow-on administrative proceedings to obtain suspensions and bars based on prior enforcement actions by the SEC or other agencies.

Much of the increase between fiscal year 2021 and fiscal year 2022 came in the middle of the year; cases in the second and third quarters of fiscal year 2022 were 38% higher than they had been in fiscal year 2021. However, as in previous years, nearly half of the cases in fiscal year 2022 (44%) came in the fourth quarter.

Following the convention used by the Division of Enforcement, these cases are tracked in nine different categories. Here's a breakdown:

Category	FY 22 Cases	FY 22 % of Total	FY 21 Cases	FY 21 % of Total	% Change between FY 21 and FY 22	FY 20 Cases	FY 20 % of Total	% Change between FY 20 and FY 21
Investment Advisers / Investment Cos.	119	26%	120	28%	-1%	87	21%	+38%
Securities Offering	106	23%	142	33%	-25%	130	32%	+9%
Issuer Reporting / Audit & Accounting	76	17%	53	12%	+43%	62	15%	-15%
Broker Dealer	46	10%	36	8%	+28%	40	10%	-10%
Insider Trading	43	9%	28	6%	+54%	33	8%	-15%
Market Manipulation	32	7%	26	6%	+23%	22	5%	-18%
Public Finance Abuse	19	4%	12	3%	+58%	12	3%	+18%
FCPA	6	1%	5	1%	+20%	10	2%	-50%
Other (Exchanges, NSROs, Transfer Agents, Misc.)	15	3%	12	3%	+25%	9	1%	+33%
Category Total	462	100%	434	100%	+6.5%	405	100%	+7%
Follow-On Administrative Proceedings	169		143		+18%	180		-21%
Delinquent Filings	129		120		+8%	130		-8%

Notable Trends

Investment Advisers

After rebounding from 87 investment adviser cases in fiscal year 2020 to 120 cases in fiscal year 2021, the number of cases in fiscal year 2022 remained about the same at 119. Although total cases did not change much between fiscal year 2021 and fiscal year 2022, there were large fluctuations within the category.

Misappropriation and misrepresentations cases increased by nearly 50% from fiscal year 2021 to fiscal year 2022.

Most notably, in May, the SEC charged Allianz Global Investors U.S. LLC and three former senior portfolio managers for allegedly concealing the substantial downside risks of a complex options trading strategy called Structured Alpha.[4] AGI had marketed Structured Alpha as a "relatively safe investment with strict risk controls."[5]

However, according to the SEC, in March, when the COVID-19 pandemic caused the market to crash, Structured Alpha lost billions of dollars belonging to its approximately 114 institutional investors, including pension funds for teachers, clergy, bus drivers and engineers.[6]

AGI agreed to pay more than $1 billion to settle the SEC's charges and, together with its parent, Allianz SE, over $5 billion in restitution to victims.[7] Additionally, AGI is disqualified from providing advisory services to U.S.-registered investment funds for the next 10 years and will exit the business.[8]

Form CRS cases trended in the opposite direction, dropping 48%, from 21 cases in fiscal year 2021 to 11 cases in fiscal year 2022. In fiscal year 2021, the SEC began charging investment advisers and broker-dealers for failing to file or deliver their Form CRS by the respective deadlines.[9]

The SEC continued this task in fiscal year 2022, settling charges with 11 investment advisers. The significant drop in Form CRS cases indicates that most investment advisers have come into compliance, and Form CRS cases will likely continue to decrease and eventually level out.

Share class selection disclosure cases also decreased significantly, from 19 cases in fiscal year 2021 to seven cases in fiscal year 2022.[10] Despite bringing 63% fewer share class selection disclosure cases in fiscal year 2022 than in fiscal year 2021, the SEC recovered only 29% less in disgorgement plus prejudgment interest and only 19% less in civil penalties from share class selection disclosure cases.

This is largely due to the SEC's over $30 million settlement with investment adviser City National Rochdale LLC,[11] nearly $7.5 million more than the highest amount recovered from a share class selection disclosure case in fiscal year 2021.[12]

Securities Offering and Cryptocurrency

Securities offering cases decreased from 142 in fiscal year 2021 to 106 in fiscal year 2022. Actions against alleged fraud in securities offerings dipped from 110 in fiscal year 2021 to 83 in fiscal year 2022, likely due to the SEC's increased focus on high-impact cases.[13] Affected by this shift in focus, the number of run-of-the-mill securities offering fraud and investment adviser cases dipped but, nonetheless, still account for over 44% of all enforcement cases brought by the SEC.

Cryptocurrency cases increased from 14 in fiscal year 2021 to 18 in fiscal year 2022. All signs indicate that the SEC is gearing up to combat perceived securities violations in the crypto markets this coming year.

In February, the SEC brought a first-of-its-kind action against BlockFi Lending LLC for allegedly failing to register the offers and sales of its retail cryptocurrency lending product and for allegedly violating the registration requirements of the Investment Company Act.[14] BlockFi agreed to pay a $50 million penalty to settle the matter.[15]

Additionally, in May, the SEC announced it was adding 20 positions to its Crypto Assets and Cyber Unit, nearly doubling the size of the unit.[16] According to Gensler: "By nearly doubling the size of this key unit, the SEC will be better equipped to police wrongdoing in the crypto markets while continuing to identify disclosure and controls issues with respect to cybersecurity."[17]

The SEC also is reportedly dedicating trial attorneys to the Cyber Unit for the first time, suggesting that it anticipates substantial litigation arising from increased enforcement in the crypto space.[18]

Gensler stated at SEC Speaks 2022, "I've asked the SEC staff to work directly with entrepreneurs to get their tokens registered and regulated, where appropriate, as securities" but acknowledged that "it may be appropriate to be flexible in applying existing disclosure requirements."[19]

Gensler added that cryptocurrency intermediaries are also transacting in securities and would have to register with the SEC.[20] Following Gensler, Division of Enforcement Director Gurbir Grewal pointed out the potentially outsized impact of problems in the cryptocurrency market on nonwhite and lower-income investors and asserted that the SEC would not give cryptocurrency a pass on enforcement action.[21]

Issuer Reporting, Audit and Accounting

Issuer reporting and audit and accounting cases were up 43%, rising from 53 in fiscal year 2021 to 76 in fiscal year 2022. The largest increase came from accounting cases, which jumped from 15 in fiscal year 2021 to 37 in fiscal year 2022.

Auditor misconduct cases more than doubled from fiscal year 2021 to fiscal year 2022, increasing from seven cases to 16. In June, Ernst & Young agreed to pay a $100 million penalty — the largest penalty ever imposed by the SEC against an audit firm — to settle charges for alleged cheating by the company's audit professionals on certified public accountant exams.[22]

In contrast, corporate disclosure cases decreased to 22 in fiscal year 2022, down from 30 in fiscal year 2021.

Despite the dip in corporate disclosure cases, the SEC settled charges in a significant case against The Boeing Co. for its alleged materially misleading public statements following the crashes of Boeing's 737 MAX airplanes.[23] Boeing agreed to pay $200 million to settle the charges.[24]

Broker-Dealer

Broker-dealer cases increased 34%, from the 36 cases in fiscal year 2021 to 46 in fiscal year 2022. In addition to settling charges against 11 investment advisers for not fulfilling their Form CRS obligations, the SEC settled similar charges with six broker-dealers.[25] Combined with the six in fiscal year 2021, the SEC has settled with a total of 12 broker-dealers over delinquent Form CRS filings.

This September, the SEC announced that it had settled charges against 15 broker-dealers and one affiliated investment adviser for failures to maintain and preserve electronic communications.[26] The firms have agreed to pay combined penalties of more than $1.1 billion, ranging from $10 million to $125 million each.[27]

The scale of the penalties levied by the SEC are surprising given the firms' conduct implicated a prophylactic rule and thus, did not result in any identifiable harm to investors.

One month later, the SEC adopted rule amendments to modernize how broker-dealers preserve electronic records and enhance the electronic record-keeping requirements for security-based swap entities.[28] The rule currently requires broker-dealers to exclusively preserve electronic records in a nonrewriteable, nonerasable format.

The amendments add an audit-trail alternative that provides broker-dealers with greater flexibility in configuring their electronic record-keeping systems so they more closely align with current practices.[29]

In June, the SEC also brought its first action enforcing Regulation Best Interest against a broker-dealer when it charged Western International Securities Inc. and five of its brokers for recommending and selling an unrated, high-risk debt security, L Bonds, to retirees and other retail investors who had moderate risk tolerances.[30]

The SEC alleges that defendants "did not exercise reasonable diligence, care, and skill to understand the risks, rewards, and costs associated with the L bonds" and thus, failed to act in their customers' best interests.[31]

Insider Trading

Insider trading cases are rising steadily after a two-plus decade low during the Trump administration.[32] Following an uptick in the second half of fiscal year 2021, the SEC has been ramping up insider trading cases, bringing 43 in fiscal year 2022, compared to 28 in fiscal year 2021.

In July, the SEC charged former U.S. Rep. Stephen Buyer, R-Ind., for improperly using information from a T-Mobile executive to purchase Sprint securities a month prior to the two companies' merger announcement in April 2018.[33]

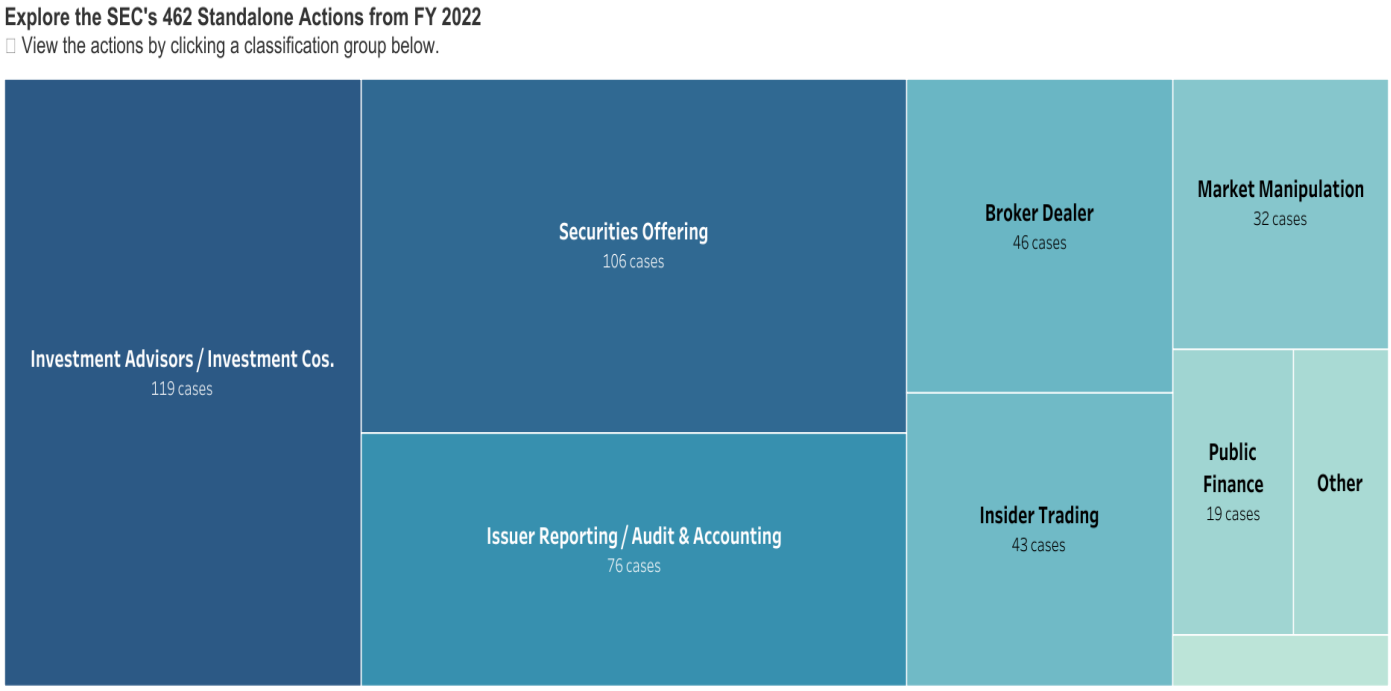
Individual Accountability

At this year's Securities Enforcement Forum, Grewal emphasized, as in previous years, that holding individuals accountable is "critical to [the SEC's] trust building efforts."[34] In fiscal year 2021, the SEC charged individuals in 66% of stand-alone cases, and in fiscal year 2022, the SEC charged individuals in 68% of stand-alone cases.

Thus, the proportion of cases involving actions against individuals appears to have stabilized, after rebounding in fiscal year 2020.[35]

The slight increase from fiscal year 2021 to fiscal year 2022 resulted from increases in the proportion of cases against individuals in the issuer reporting and audit and accounting (32%); investment advisers and investment companies (20%); market manipulation (7%); and securities offering (3%) categories.

In contrast, the proportion of cases against individuals decreased in the public finance abuse (60%) and in the Foreign Corrupt Practices Act (100%) categories.



Conclusion

While the increase in enforcement activity from fiscal year 2021 to fiscal year 2022 was modest, the SEC's enforcement actions in fiscal year 2022 were, nonetheless, high-impact actions on account of the high-profile defendants and large penalties. It seems likely that this trend will continue.

At the Securities Enforcement Forum this month, Grewal highlighted the SEC's continued emphasis on substantial penalties to meaningfully deter violations and "to get away from the idea that penalties are just another business expense."[36]

Additionally, the SEC undertook an "aggressive agenda" of rulemaking in fiscal year 2022 — proposing 26 new rules from January to August[37] — which seems likely to impact the intensity of its enforcement activity in the upcoming fiscal year.

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