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The SEC stays active in 2018 with continued action from its enforcement division

By Stephen M. LaRose

The U.S. Securities and Exchange Commission's (the "SEC" or the "Commission") Division of Enforcement recently issued its Annual Report for Fiscal Year 2018. First initiated last year, the report is the Enforcement Division's summary of its accomplishments for the past year. In this brief client alert, we offer our review and comments on the report and recent SEC activity. We find the SEC's report instructive for our clients (and how we advise them), as it provides insight into the Commission's current and future priorities.

First, the Enforcement Division's co-directors, Stephanie Avakian and Steven Peikin, explain the five main principles that guide the division's efforts: (1) focus on main street, or retail, investors; (2) focus on individual persons' accountability; (3) keep pace with technological changes; (4) impose remedies that most effectively further the Commission's goals; and (5) assess their own allocation of resources. According to the co-directors, these principles are reflected in all of the Division's main initiatives, a fact that is a key guidepost for those in the securities industry.

More emphasis on brokers and advisors dealing with retail investors, as well as individual responsibility

In our view, the Division's first principle—focus on main street, retail investors—is a bit of a shift in priorities by the current administration, away from attention on the Wall Street institutions and the practices that many blamed for the 2008 financial crisis. These matters affecting retail investors often involve placing curbs on the aggressive selling practices, conflict of interests and other misconduct alleged against brokers and advisors. We also note the report's particular emphasis on the Commission's initiative to hold individuals accountable for alleged wrongdoing. Per the report, in 70% of its new cases brought in FY 2018, the SEC charged an individual. It should be noted that often, in such cases, the SEC will charge an institution, as well as an individual working at the institution.

Technology: The emerging world of cybercrime and blockchain

The SEC describes in its report its attention toward keeping up with technological advances to reduce the harm that technology can cause to investors, particularly by holding investment firms accountable for failure to protect customers against cybercrimes like identity theft. Additionally, the SEC reported on its efforts to counter misconduct associated with digital assets and initial coin offerings, including the use of blockchain technology, a new and emerging area that saw dramatic change in the market in just the past year. The SEC's focus in the digital asset space included the Commission's call for caution against celebrity promotions of risky initial coin offerings, and to put in place court-ordered receivers to rectify fraudulent digital offerings. The SEC was a leader in the regulation of blockchain's use in securities, forming a task force to try to stay informed on this ever-changing technology.

Remedies fit for celebrity CEOs

When discussing its use of the particular legal remedies at its disposal, the SEC highlights in the report its traditional efforts to obtain substantial fines and the disgorgement of ill-gotten gains, but also to seek more creative remedies, highlighted by the SEC's celebrity prosecutions against Tesla's CEO and Chairman, Elon Musk, and Theranos' CEO, Elizabeth Holmes. In each of those media focused prosecutions, the SEC obtained resolutions that included tough, remedial measures removing certain control and powers of these well-known executives. While these high profile cases involved outcomes different than the typical approach, we expect that the SEC will continue to pursue its usual remedies—statutory fines, disgorgement of gains and either suspensions or permanent bars from the securities industry.

Courts weigh-in on SEC practices

The Enforcement Division further commented on the fact that its headcount is down 10% from its staffing high point in 2016, which factors into the Division's ability to prosecute cases. Further, the Division acknowledged that two significant landmark court decisions changed the way the SEC does business and allocates its resources. First, in *Kokesh v. SEC*, the Supreme Court limited to only five (5) years the SEC's ability to look back and force disgorgement of funds from a defendant. Previously, the SEC sought disgorgement back to a date when the alleged misconduct began, no matter how far back, thereby exponentially increasing the dollars sought by the SEC. Second, the SEC's practice of filing many of its cases in the much friendlier Administrative Proceedings forum, in front of an SEC-appointed Administrative Law Judge (instead of in federal court before an Article III judge), took a significant hit in *Lucia v. SEC*, with the Supreme Court finding that the appointment of these administrative judges was not constitutional.

By the numbers

From a review of the statistics offered by the Enforcement Division, it appears that the SEC had another active year and its overall approach to enforcement was largely unchanged from prior years. Some of the notable statistics point to certain priorities from 2018:

- 821 total cases vs. 754 total cases in 2017 (as a further comparison, the SEC brought 868 total cases in 2016).
- 108 cases against investment advisors and investment companies vs. 82 similar actions in 2017. This reflects the SEC's stated priority to protect retail investors.
- 121 cases involving securities offerings vs. 94 securities offering cases last year. Although the report is not specific, we believe this category is largely made up of actions against issuers or advisors of securities offerings, including corporate and municipal bonds, for insufficient disclosures or conflicts of interest.
- 79 cases involving securities issuer disclosure and reporting issues, including insufficient disclosures, revenue and expense recognition problems, faulty valuation decisions and inadequate internal controls. This figure compares to 95 cases in this area a year ago.
- 51 cases involving insider trading vs. 41 insider trading cases in 2017.

- 13 cases for violations of the Foreign Corrupt Practices Act ("FCPA")—the exact same number of FCPA cases as a year ago.

From our perspective, the SEC's enforcement division had another active year, marked by a focus on protecting small, retail investors from bad actors and highly risky practices; policing of disclosures in municipal bond issuances with a focus on municipal financial advisors; and significant efforts to stay ahead of the curve on emerging trends in the market, like initial coin offerings and other digital assets. We will continue to review the SEC's enforcement cases for new trends and practices, as well as important judicial decisions that govern the SEC's regulatory authority affecting your business.

For more information on the content of this alert, please reach out to a member of Nixon Peabody's Securities Litigation team, your regular Nixon Peabody attorney or:

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