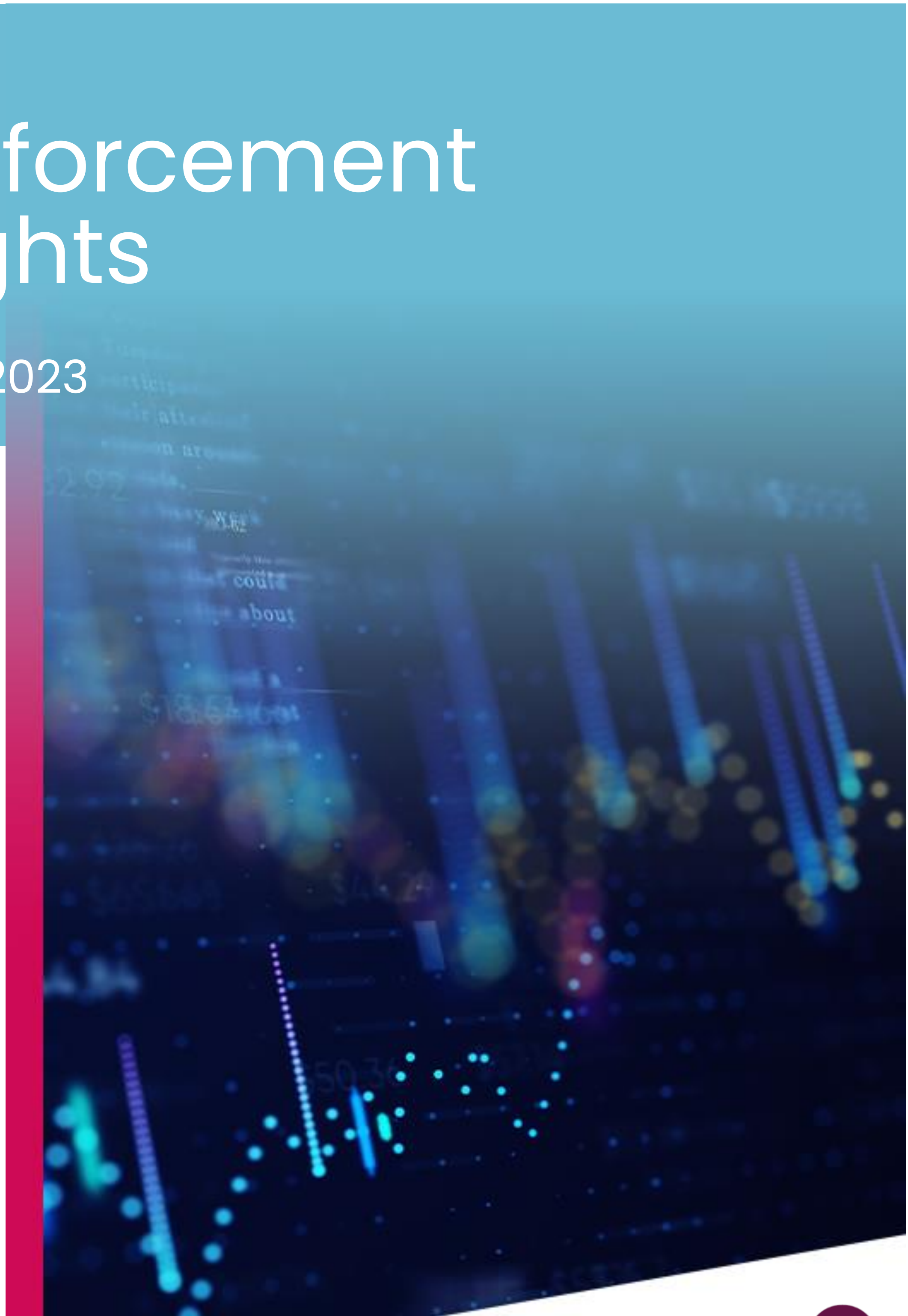
HAYNES BOONE

SEC Enforcement Highlights

FISCAL YEAR 2023



CONTENTS

Fiscal Year 2023 Enforcement Highlights 3
I. Accounting 4
II. Environmental, Social, and Governance 6
III. Public Company Disclosure 8
IV. Cybersecurity 9
V. Insider Trading 9
VI. Investment Advisers 11
VII. Cryptocurrency and NFTs 13
VIII. Off-Channel Communications 16
IX. SPACs 17
X. Foreign Corrupt Practices Act 19
XI. Anti-Money Laundering 20
XII. Whistleblowers 21
XIII. Enforcement Policy: Cooperation and SOX 304 Clawbacks 22
XIV. SEC Rulemaking and Challenges to the Agency's Administrative Forum 23
Looking Ahead 25

Under the leadership of SEC Chair Gary Gensler and the Director of the SEC's Division of Enforcement Gurbir Grewal, the SEC's enforcement program remained demonstrably aggressive in FY 2023. Among other highlights, the SEC filed 784 enforcement actions, imposed the second-highest total of $4.94 billion in aggregate monetary relief (surpassed only by FY 22), brought a multitude of actions for violations that arguably did not involve investor harm, and continued its crackdown on the cryptocurrency industry. In a departure from decades of precedent, Enforcement's senior leadership also sharply curtailed *Wells* meetings, thus reducing the opportunities for defense counsel to present exculpatory evidence and legal arguments before the SEC files enforcement actions.

In this article, we highlight what we view as the SEC's most significant enforcement actions during FY 2023 – which spanned from October 2022 through September 2023 – with a particular focus on actions against public companies and investment advisers. These actions provide insights on the SEC's current and projected enforcement priorities and areas where companies and advisers should examine and potentially tighten compliance to avoid becoming a future target of the SEC's enforcement efforts.

This paper is for informational purposes only. *It is not intended to be legal advice. Transmission is not intended to create and receipt does not establish an attorney-client relationship. Legal advice of any nature should be sought from legal counsel.*

FISCAL YEAR 2023 ENFORCEMENT HIGHLIGHTS

The 784 enforcement actions filed by the SEC in FY 23 constituted a 3% increase from the prior year.[1] Of those enforcement actions, 501 were new or "stand alone" cases in FY 2023, an increase of 8% compared to FY 22.[2]

In summarizing FY 23 results, the Enforcement Division emphasized obtaining $4.94 billion in total monetary relief ordered. Although $1.58 billion in aggregate civil penalties in FY 23 was more in line with historic norms and reflected a significant decrease (62%) compared to last year's record of $4.19 billion, total disgorgement and prejudgment interest of $3.36 billion increased 50% from the prior year.[3] The significant total monetary relief ordered by the SEC in FY 23 indicates a continuation of the Division's FY 22 plan to "re-calibrate penalties to more effectively promote deterrence."[4]

The types of cases filed by the SEC during FY 23 generally tracked recent years.[5] Cases involving securities offerings comprised the most significant year-over-year percentage increase (+10%), which we believe was driven at least in part by the SEC's crackdown on allegedly fraudulent and unregistered crypto offerings.[6] Due to the agency's focus on off-channel communications and other recordkeeping requirements, the agency also filed more cases against broker-dealers (+3%).[7] On a relative basis, the SEC brought fewer cases involving investment advisers and investment companies (-9%) and saw a modest reduction in actions alleging insider trading (-3%).[8]

The SEC brought several first-of-their-kind cases in FY 23, including actions alleging that four prominent crypto trading platforms were operating as unregistered exchanges, broker-dealers, and clearing firms; a sweep against nine investment advisers alleging that website advertisements describing hypothetical performance violated the Marketing Rule; an action alleging that a public company failed to maintain disclosure controls and procedures to collect and analyze employee complaints of workplace misconduct; an action alleging that a public company victimized in a ransomware victim made misleading public disclosures regarding the extent of the attack; and an action against an investment adviser alleging that it caused mutual funds it managed to fail to adopt and implement anti-money laundering policies and procedures as required by the Investment Company Act.

FY 2023 was a record-breaking year for the SEC's whistleblower program, with whistleblower awards totaling nearly $600 million, including the highest-ever single award of $279 million.[9] The whistleblower program has become an increasingly important source for enforcement investigations, and in FY 2023, the SEC received an all-time high of more than 18,000 whistleblower tips, which represented a remarkable 50% increase from the prior year.[10]

---

[1] https://www.sec.gov/news/press-release/2023-234
[2] Id.
[3] Id.
[4] https://www.sec.gov/news/speech/grewal-speech-securities-enforcement-forum-111522
[5] https://www.sec.gov/files/fy23-enforcement-statistics.pdf
[6] Id.
[7] Id.
[8] Id.
[9] https://www.sec.gov/news/press-release/2023-234
[10] Id.

The SEC's interest in protecting this pipeline likely factored in to the agency's continued, exceedingly strict interpretation of conduct by entities that *may impede* potential whistleblowers. In FY 2023, the SEC imposed a record $10 million civil penalty against an investment adviser for a stand-alone alleged violation of the whistleblower impeding provision, and imposed a $35 million civil penalty against a public company for alleged whistleblower impeding and disclosure controls and procedures violations.[11] The SEC imposed these onerous penalties despite evidence that the investment adviser may have impeded a single potential whistleblower and no evidence that the public company's conduct impeded any potential whistleblowers.[12]

As in past years, the SEC continued to tout the purported rewards of self-reporting, proactive cooperation, and remediation, without providing much quantitative guidance regarding the benefits of such actions. In the agency's extensive efforts to combat off-channel communications, Enforcement senior leadership repeatedly encouraged registrants to investigate and self-report violations and touted lower civil penalties against two broker-dealers that did so.[13] Citing self-reporting and extraordinary cooperation during investigations, the SEC also declined to impose penalties in a handful of actions against public companies involving financial misstatements and failure to disclose executive perquisites.[14]

With respect to operations, the Enforcement Division added staff, particularly in its Crypto Assets and Cyber Unit, presumably to keep up with a busy and high-profile litigation docket.[15] Following difficult negotiations with the NTEU (the union which represents line SEC staff), SEC management agreed to a liberal telework policy which requires in-person attendance by the Staff only one day per week.[16] While SEC Staff may voluntarily come into the office as often as they wish, it appears that most enforcement Staff maintained a modest in-office presence during FY 23, continuing to do many interviews and testimony sessions via videoconference.

Unless otherwise specified, all settled enforcement orders discussed below were agreed to on a no-admit no-deny basis.

I. Accounting

In accounting enforcement in FY 23, the SEC maintained its perennial focus on revenue recognition, continued its Earnings Per Share (EPS) Initiative, and brought cases alleging that issuers had improperly deferred expenses and made misleading disclosures concerning non-GAAP financial metrics.

In June 2023, the SEC settled charges against a manufacturer and distributor of cashless payment devices for alleged improper revenue recognition practices during the company's 2017

[11] https://www.sec.gov/news/press-release/2023-213; https://www.sec.gov/news/press-release/2023-22
[12] Id.
[13] https://www.sec.gov/news/press-release/2023-91
[14] https://www.sec.gov/news/press-release/2023-195; https://www.sec.gov/news/press-release/2023-126; https://www.sec.gov/news/press-release/2023-111
[15] https://www.sec.gov/files/inspector-generals-statement-sec-mgmt-and-perf-challenges-october-2023.pdf
[16] Id.

and 2018 fiscal years.[17] The settled order alleged that the company improperly recognized more than $4 million in revenue over four quarters from "bill and hold" sales transactions that were not in conformity with GAAP. Specifically, when some customers indicated that they would not take possession of devices until after quarter end, the **manufacturer recognized revenue after shipping some devices to a third party and storing other devices in its own warehouse, while extending customer payment terms until the date of delivery**. The SEC alleged that in other instances when the manufacturer lacked sufficient inventory to meet customer demand for certain devices, and in order to meet sales targets, **the company shipped other unwanted devices to customers, with the intention of exchanging them in future periods for the desired devices**.

The company agreed to a cease-and-desist order and the payment of a $1.5 million civil penalty. The Commission also charged the company's former Chief Services Officer and former Vice President of Sales and Marketing with violating the antifraud and books and records provisions, and with causing the company's violations of the reporting and internal accounting controls provisions of the securities laws.[18] Both former executives consented to cease-and-desist orders and to pay civil penalties of $15,000 and $75,000, respectively.

In FY 23, the SEC brought numerous cases alleging improper deferral of expenses on long-term projects. For example, in September 2023, the SEC settled charges against a global construction company and five of its former and current employees related to the company's alleged improper accounting and failure to maintain internal controls related to two fixed-price construction projects that experienced cost overruns.[19] **According to the SEC, as project delays and cost overruns worsened, the company excluded added costs that were known or should have been known**. **In using the percentage of completion method, the SEC also alleged that the company improperly recorded revenue from unrealistic change order estimates that had not been approved by the customer**. On another project, the Commission alleged that the company failed to adjust its books and financial statements to reflect significantly higher costs stemming from a renegotiated contract with a subcontractor. Upon discovery of these accounting discrepancies, the company restated its financials for FY 2016-2018 and the first three quarters of 2019 and disclosed material weaknesses in its internal accounting controls. The company consented to a cease-and-desist order and to pay a civil penalty of $14.5 million. The five former and current employees agreed to cease-and-desist orders and agreed to pay penalties between $15,000 and $25,000.

In another case involving accounting for cost overruns, in March 2023, the SEC charged three executives of a shipbuilding company for **allegedly causing the company to artificially reduce cost estimates to complete certain shipbuilding projects by tens of millions of dollars despite their knowledge that costs were higher than planned and rising**.[20] Among other things, the SEC alleged that in response to management pressure to meet key financial metrics, the three accounting executives concealed materials cost growth with phony offsets called "challenges" and deliberately underestimated labor costs by applying an arbitrary "learning curve" that assumed a 10% reduction in hours needed to complete future ships. All three executives were indicted by the

[17] https://www.sec.gov/enforce/33-11202-s

[18] https://www.sec.gov/files/litigation/admin/2023/33-11201.pdf; https://www.sec.gov/files/litigation/admin/2023/33-11200.pdf

[19] https://www.sec.gov/news/press-release/2023-170

[20] https://www.sec.gov/news/press-release/2023-69

U.S. Department of Justice ("DOJ") for conspiracy to commit wire fraud, wire fraud, and wire fraud affecting a financial institution.[21] The SEC's civil case is stayed pending resolution of the criminal proceedings.

The Division of Enforcement continues to use unspecified data analytics tools to proactively detect instances in which public companies may have made improper (and often last-minute) accounting adjustments to meet analysts' consensus EPS estimates.

In one of several EPS Initiative cases, in February 2023, the SEC settled charges against a manufacturing company and its current CFO for alleged financial reporting, books-and-records, and internal accounting controls violations related to bonus compensation programs.[22] According to the SEC, the CFO (who was the company's then-Chief Accounting Officer) did not follow the company's process for estimating bonus compensation, failed to undertake the required accounting analysis, and did not document the basis for the release of certain bonus program accruals. In one quarter, the SEC alleged that the CFO reserved a set accrual for the bonus program, but later modified the accrual in an amount sufficient to ensure the company met consensus EPS estimates. To settle the charges, the company and the CFO agreed to cease-and-desist orders and to pay civil penalties of $4 million and $75,000, respectively.

In March 2023, **the SEC announced settled charges against an information technology company related to alleged misleading disclosures regarding non-GAAP financial disclosures**.[23] According to the SEC, following a significant merger, the company misclassified transaction, separation, and integration-related costs, which it excluded from its non-GAAP earnings, resulting in a material overstatement of the company's net income. To settle the matter, the company agreed to a cease-and-desist order, payment of an $8 million civil penalty, and undertakings to develop and implement policies and disclosure controls for its non-GAAP financial performance measures.

The SEC also emphasized the importance of remediation of alleged internal accounting and disclosure controls deficiencies by ordering a novel "springing penalty" in an enforcement action.[24] In August 2023, the Commission charged a green energy company with reporting and internal accounting and disclosure controls failures that required a multi-year restatement of the company's financial statements. The settled order required the company to pay a $1.25 million penalty and to fully remediate the internal accounting and disclosure controls deficiencies within one year. If the company fails to satisfy these undertakings, the company was ordered to pay an additional "springing" civil penalty of $5 million.

II. Environmental, Social, and Governance

While the SEC did not finalize its long-awaited climate change disclosure rules in FY 23, the Commission brought two notable ESG cases relating to human capital disclosures and another against an asset manager for alleged misleading disclosures regarding its evaluation of portfolio companies in its ESG strategies.

In February 2023, the SEC announced settled charges against a video game developer for alleged violations of the disclosure controls and procedures provisions of the securities laws.[25]

[21] https://www.justice.gov/criminal/criminal-vns/case/united-states-v-craig-d-perciavalle-et-al
[22] https://www.sec.gov/enforce/34-96819-s
[23] https://www.sec.gov/news/press-release/2023-49
[24] https://www.sec.gov/enforce/34-98243-s
[25] https://www.sec.gov/news/press-release/2023-22

The SEC did not allege that the company made any false statements or that any affirmative disclosures were rendered misleading by the omission of information. Instead, using what previously had been a seldom-applied provision -- Rule 13a-15(a) of the Exchange Act -- **the Commission contended that over a four-year period, the company failed to maintain appropriate disclosure controls to assess whether it should disclose risks relating to the frequency of employee complaints of workplace misconduct**. According to the SEC, the company also entered into separation agreements with departing employees that required notification to the company if former employees received requests from government agencies in connection with a report or complaint. The SEC asserted that these provisions could have impeded potential whistleblowers from directly communicating with the SEC about possible securities law violations. In settling the action, the company agreed to a cease-and-desist order, a $35 million civil penalty, and to remediate the alleged deficiencies with the company's disclosure procedures and the removal of the notification provision from its separation agreements.

In January 2023, the SEC announced charges against a restaurant company and its former CEO for making false and misleading statements to investors about the circumstances leading to the former CEO's termination.[26] Following the CEO's termination, the company's continuing internal investigation revealed that he had misled the company regarding the *extent* of his misconduct (which involved inappropriate personal relationships with subordinates). The SEC charged the former CEO with scienter-based fraud, alleging that he knew or was reckless in not knowing that his concealment of the extent of his misconduct would impact the company's disclosures to investors and the terms of his separation, which included retention of significant equity compensation. **In a novel theory for proxy disclosure violations, the Commission charged the company with failing to disclose all material elements of the former CEO's compensation – specifically, that the company used discretion in treating the separation as "without cause" after determining that he had violated the company's ethics policies**. The company and the former CEO both agreed to cease-and-desist orders and the former CEO agreed to a civil penalty of $400,000 and a five-year officer and director bar. The SEC did not impose a civil penalty against the company in light of its extraordinary cooperation during the investigation.

In September 2023, the SEC charged an investment adviser with making misleading statements regarding its controls for incorporating ESG factors into its investment recommendations for certain mutual funds and separately managed accounts.[27] Among other things, **the SEC alleged that contrary to ESG disclosures on its website, the adviser did not always require the inclusion of financial and reputational ESG factors into valuation models and investment decision-making**. The Commission also charged the firm with failing to adopt effective procedures to ensure its public statements about ESG integration were accurate. In settling the matter, the adviser consented to a

[26] https://www.sec.gov/news/press-release/2023-4
[27] https://www.sec.gov/news/press-release/2023-194

cease-and-desist order, payment of a $19 million civil penalty, and a censure. The SEC imposed this significant penalty despite noting the adviser's proactive remediation of its policies and procedures, and its cooperation during the investigation, which included providing detailed factual summaries and making substantive presentations on key topics.

III. Public Company Disclosure

In FY 23, SEC public company disclosure enforcement reflected strict enforcement of reporting violations, including related party transactions and perquisite disclosures, and sweeps for untimely insider transaction reporting and notifications of late periodic filings.

In September 2023, the SEC charged a ride-sharing company for failing to disclose the role that one of its directors played in a shareholder's pre-IPO sale of approximately 7.7 million private shares in the company.[28] According to the SEC, the director, who had been placed on the board by the shareholder, negotiated and structured the sale of the shares to a special purpose vehicle organized by an investment adviser with which he was affiliated, and was compensated millions of dollars by the investment adviser for doing so. The company allegedly approved the sale, which took place in the weeks before its IPO, and secured several terms in the contract. However, the Commission alleged that the company failed to disclose the pre-IPO sale of the shareholder's stake in the company and the material interest of the director in that sale as a related party transaction in the company's 2019 Form 10-K. The company agreed to a cease-and-desist order and to pay a $10 million penalty.

The SEC continued its close scrutiny of executive perquisite disclosures in FY 23, with a particular emphasis on private aircraft travel.[29] In June 2023**, the SEC brought a settled action against a tool manufacturer for the company's alleged failure to disclose at least $1.3 million worth of benefits that it provided to four executives between 2017 and 2020, including personal use of the company's aircraft**.[30] The SEC also charged one of the company's former executives with causing the company's violations of proxy solicitation and books and records provisions by failing to report $280,000 in personal expenses that he charged to the company. The company and former executive each agreed to a cease-and-desist order and the former executive also agreed to pay a $75,000 civil penalty. Based upon the company's self-reporting, cooperation, and remediation, the SEC did not impose a civil penalty for any of the perquisite disclosure violations and declined to bring charges against the company related to the failure to report personal expenses paid on behalf of the former executive.

In September 2023, **as part of a continuing SEC enforcement initiative regarding untimely filings on Form 4, Schedule 13D, and Schedule 13G, the SEC announced charges against five publicly traded companies and six officers, directors, and major shareholders of publicly**

[28] https://www.sec.gov/news/press-release/2023-182
[29] https://www.sec.gov/news/press-release/2023-43
[30] https://www.sec.gov/news/press-release/2023-111

traded companies.[31] The SEC alleged that the individuals failed to timely report their holdings and transactions in company stock and that the companies contributed to or failed to report the late filings. To settle charges, the individuals and companies in the sweep agreed to cease-and-desist orders and to pay civil penalties ranging from $66,000 to $200,000. According to the SEC, the investigation initiative, entitled in the Matter of Certain Deficient Security Ownership Filings, is continuing.

In August 2023, **the SEC settled charges with several public companies that allegedly filed Forms 12b-25 Notification of Late Filing (aka "Form NT") without disclosing that the late filing was caused by an anticipated restatement or correction of prior financial reporting**.[32] In bringing these actions, the SEC emphasized that the companies' subsequent disclosures on Forms 8-K and 10-Q that their previous financial statements should not be relied upon did not mitigate the failure to disclose that information on Form NT. The companies agreed to cease-and-desist orders and to pay civil penalties ranging from $35,000 to $60,000.

IV. Cybersecurity

In March 2023, **the SEC charged a public company with failure to maintain appropriate disclosure controls and procedures and violations of the non-scienter anti-fraud provisions of the Securities Act following a ransomware attack that resulted in unauthorized access to the company's systems.**[33] The company had disclosed the incident and notified impacted customers, but according to the SEC, those disclosures were misleading. Specifically, the company allegedly omitted the fact that certain personal information had been accessed in the attack and framed the

risk of such access as a mere hypothetical, when in fact such access had already occurred. The SEC's order found that senior management responsible for investor disclosures had not been told the full nature of the breach, and the company allegedly did not have procedures in place to ensure that complete information was communicated to management and ultimately to investors, leading to the allegedly deficient disclosures. The company agreed to pay a $3 million civil penalty and to cease and desist from committing or causing any future violations.

V. Insider Trading

For insider trading enforcement in FY 23, the SEC focused on alleged abuses of Rule 10b5-1 plans and the continued use of data analytics to identify highly successful traders, which then prompted investigations of those traders' potential access to material nonpublic information.

In March 2023, the **SEC charged the Executive Chairman of the board of directors of a healthcare company with insider trading for trading pursuant to Rule 10b5-1 plans that were established while he was allegedly in possession of material nonpublic information**.[34] According to the SEC, over a three-month period,

[31] https://www.sec.gov/news/press-release/2023-201
[32] https://www.sec.gov/enforce/34-98192-s
[33] https://www.sec.gov/news/press-release/2023-48
[34] https://www.sec.gov/news/press-release/2023-42

the executive established two Rule 10b5-1 trading plans to sell more than $21 million of the healthcare company's stock after he learned that the company's relationship with its largest customer was in danger of being terminated. The SEC further alleged that when the company subsequently announced that its largest customer had in fact terminated its contract, the company's stock price fell more than 44 percent, and as a result, the executive avoided more than $12.7 million in losses by having previously executed the two trading plans. On the same day, the DOJ announced criminal charges against the executive.[35] The SEC and DOJ cases remain pending.

In June 2023, the SEC again touted its unspecified "data analytics initiatives" in announcing charges against 13 defendants in four separate alleged insider trading schemes. Notably, on the same day that the SEC announced its sweep, the DOJ unveiled parallel criminal actions in each of the matters, with two of the defendants pleading guilty pursuant to cooperation agreements, while cases against the other defendants remain pending.[36]

It's no secret that **the SEC, DOJ, and FINRA conduct routine reviews of aggressive options and equity trading prior to significant corporate announcements, and then use various investigative techniques to attempt to connect that trading to corporate insiders that may have been privy to material nonpublic information**. In the June 2023 sweep, the SEC charged a former pharmaceutical company employee and his friend with insider trading for purchasing short-expiration out-of-the-money call options based on the former employee's alleged knowledge of positive, nonpublic drug trial results for the company's COVID-19 antiviral treatment.[37]

The SEC and other financial regulators also conduct periodic reviews of trading by corporate employees and outside directors in advance of market moving events. In the June 2023 sweep, the SEC filed insider trading charges against a former SPAC board member as well as two individuals and a venture capital firm, for trading on material nonpublic information ahead of the SPAC's announcement of a merger with a media company.[38] The complaint alleges that the former SPAC board member provided repeated updates regarding the status of merger negotiations to his venture capital contact, and that individual, his firm, and other downstream tippees all purchased SPAC shares and then liquidated them for total illicit profits of over $22.9 million.

Additionally, the SEC uses data analytics to identify possible insider trading based on the misappropriation of information from corporate insiders. In one such case in the June 2023 sweep, the SEC alleges that the Chief Compliance Officer of an international payment processing company misappropriated material nonpublic information regarding possible upcoming mergers and acquisitions from his then-girlfriend's laptop while she was working from home during the COVID-19 pandemic.[39] According to the SEC, the CCO used this material nonpublic information to purchase call options on several issuers, and tipped a friend who worked as a registered representative, who then also traded on the inside information and recommended trades to his brokerage customers, resulting in millions of dollars of illicit profits for the customers and hundreds of

---

[35] https://www.justice.gov/criminal/criminal-vns/case/united-states-v-terren-s-peizer

[36] https://www.justice.gov/usao-sdny/pr/us-attorney-announces-charges-four-separate-insider-trading-cases-against-10

[37] https://www.sec.gov/news/press-release/2023-123

[38] https://www.sec.gov/news/press-release/2023-121

[39] https://www.sec.gov/news/press-release/2023-124

thousands of dollars of commissions for the registered representative.

In the June 2023 sweep, the SEC also charged five individuals with insider trading, including the former vice president of a pharmaceutical company, for trading on nonpublic information regarding his company's plans to acquire a competitor. The Commission alleges that after misappropriating material nonpublic information from his employer, the pharmaceutical vice president started a chain of tipping among their group of childhood friends, with various tippees buying options or stock in the acquisition target company, garnering more than $2.2 million in illegal profits.

VI. Investment Advisers

SEC enforcement against investment advisers in FY 23 featured the first actions under the Marketing Rule, a steady stream of cases on perennial priorities of conflicts of interest and fees, the continuation of the Division's cherry-picking initiative, and actions concerning the Custody Rule and other technical violations.

Following the mandatory implementation date for the Marketing Rule in early November 2022, SEC Enforcement focused on advisers' hypothetical performance advertising claims made on public-facing internet websites. **In August 2023, in the first action brought under the Marketing Rule, the Commission charged a fintech adviser with claiming annualized performance results as high as 2700 percent for a crypto strategy, while failing to disclose that these performance results assumed the strategy's performance over three weeks would continue for the full year**.[40] Among other violations, the Commission alleged that the adviser also violated the Marketing Rule by failing to make sufficient disclosure of assumptions used to calculate the hypothetical returns and improperly used embedded links to describe the risks of relying on hypothetical performance. The adviser consented to a cease-and-desist order, the payment of more than $1 million in disgorgement and penalties, and a censure.

In September 2023, the **SEC charged 9 investment advisers with violating the Marketing Rule by including hypothetical performance in advertisements to the general public on websites without having first adopted policies and procedures reasonably designed to ensure that such hypothetical performance was relevant to the likely financial situation and investment objectives of the intended audience**.[41] In nearly identical orders, the SEC alleged that the respective advisers generally would not be able to include hypothetical performance in advertisements directed to a mass audience because the advisers generally could not form expectations about all ad recipients' financial situation or investment objectives. Each of the charged advisers settled to cease-and-desist orders, undertakings to remove or develop appropriate hypothetical performance policies and procedures within 30 days, and the payment of civil penalties ranging from $50,000 to $175,000.

In August 2023, the **SEC charged an investment adviser with violating the Marketing Rule by failing to provide clients with requisite disclosures that it had paid more than 200 social media influencers and publishers of online newsletters to solicit prospective clients**.[42]

---

[40] https://www.sec.gov/news/press-release/2023-153

[41] https://www.sec.gov/news/press-release/2023-173

[42] https://www.sec.gov/enforce/ia-6381-s

The adviser consented to a cease-and-desist order, the payment of a civil penalty of $250,000, and a censure.

In FY 23, alleged undisclosed conflicts of interest continued to make up a significant portion of SEC enforcement actions against investment advisers. In September 2023, **the Commission charged a real estate private equity adviser with failing to adequately disclose to its fund clients that millions of dollars of real estate brokerage fees were paid to a firm owned by the adviser's CEO**.[43] The adviser agreed to a cease-and-desist order and to pay a $6.5 million penalty and more than $14 million in disgorgement.

Also in September 2023, **the SEC charged an adviser with failing to disclose that it helped set the fee that its affiliate custodian received for operating a cash sweep program for advisory clients, thereby reducing interest paid to clients**. The Commission also charged the adviser with failing to disclose conflicts stemming from its receipt of millions of custodial support payments from third party custodians for client assets held in no-transaction-fee mutual funds, when in some cases, lower-fee mutual fund share classes were available that would not have resulted in payments to the adviser. The firm settled to a cease-and-desist order, the payment of a civil penalty of $9.5 million, and disgorgement and prejudgment interest of more than $8.5 million.

In FY 23, the SEC maintained its focus on advisers that collected improper advisory fees or misallocated expenses. In June 2023, **the Commission charged a private equity fund adviser with inaccurately calculating management fees based on aggregated invested capital at the portfolio company level rather than at the individual portfolio investment security level, as required by fund documents**.[44] The SEC also alleged that the adviser failed to disclose conflicts posed by its "narrow and subjective" permanent impairment criteria for portfolio companies, which granted the adviser significant latitude to avoid write-downs that would reduce its management fees. **In other notable fees cases during FY 23, the SEC charged advisers for systemic errors in assessing advisory fees to retail clients,[45] imposing undisclosed fees such as foreign**

[43] https://www.sec.gov/news/press-release/2023-167
[44] https://www.sec.gov/news/press-release/2023-112
[45] https://www.sec.gov/news/press-release/2023-159

exchange fees,[46] **and failing to implement contractually-required fee waivers for a private fund of funds.**[47]
Pursuant to an ongoing initiative to proactively identify cherry-picking, the SEC charged multiple investment advisers in FY 23. In litigated actions filed in February and August 2023, **the Commission charged investment advisers and investment advisory representatives with placing trade orders in block accounts, and then allegedly allocating end-of-day profitable trades to personal accounts, while allocating unprofitable trades to client accounts**.[48] The SEC further alleged that one of the investment advisers also made false and misleading statements to clients regarding trade allocations and the reasons for switching clients' accounts to a new custodian (after being terminated by a prior custodian for suspicious trading).

Throughout FY 23, the Commission also demonstrated a willingness to bring enforcement actions against advisers for relatively technical violations that in past years may have only resulted in examination deficiency letters. In September 2023, the SEC brought its second tranche of enforcement actions for violations of the Custody Rule against five investment advisers. Mirroring similar actions brought in FY 22, **the Commission alleged that advisers failed to obtain audited financials for private funds they managed; failed to deliver audited financials to fund investors in a timely manner; or failed to ensure a qualified custodian maintained client assets**.[49] The SEC further alleged that two of the firms failed to promptly file amended Forms ADV to reflect that they had received audited financial statements for private funds after initially checking the Form ADV box indicating "Report Not Yet Received." To settle the actions, each of the firms agreed to cease-and-desist orders and the payment of civil penalties ranging from $50,000 to $225,000.

In February 2023, **the SEC also charged a church and a non-profit entity operated by the church to manage the church's investments with failing to file Forms 13F that would have disclosed the church's equity investments**. Instead, the SEC alleged, that as directed by the church, the affiliated non-profit entity filed Forms 13F for shell companies that obscured the church's overall investment portfolio and the non-profit's control over investment decision-making.[50] The non-profit and church agreed to cease-and-desist orders, and to pay civil penalties of $4 million and $1 million, respectively.

VII. Cryptocurrency and NFTs

In the wake of the so-called "crypto winter," which saw the collapse of numerous high-profile cryptocurrencies, crypto strategies, and trading platforms, the SEC devoted significant resources to crypto enforcement in FY 23.

In December 2022, the **SEC charged the former CEO and former Chief Technology Officer (CTO) of a leading crypto trading platform, along with**

[46] https://www.sec.gov/news/press-release/2023-73
[47] https://www.sec.gov/news/press-release/2023-109
[48] https://www.sec.gov/litigation/litreleases/lr-25710; https://www.sec.gov/litigation/litreleases/lr-25629
[49] https://www.sec.gov/news/press-release/2023-168
[50] https://www.sec.gov/news/press-release/2023-35

the former CEO of an affiliated, privately-held crypto hedge fund, with defrauding the platform's *equity investors* by, among other things, failing to disclose the alleged diversion of more than $8 billion in customer funds to meet obligations to lenders following massive investment losses at the hedge fund.[51] The SEC further alleged that the executives also manipulated the price of a crypto token issued by the platform by using the hedge fund to purchase large quantities of the token, and then pledging those tokens as collateral for loans from the platform. The former CTO and hedge fund CEO agreed to cooperate and accepted bifurcated settlements with the SEC with immediate injunctive relief and officer and director bars, with the court to later determine civil penalties, disgorgement, and the length of the former CTO's officer and director bar. In parallel actions, the DOJ charged all three former executives,[52] and in November 2023, the former CEO was convicted on all counts.[53] The SEC and DOJ cases against all three defendants remain pending.

In June 2023, **the SEC brought a first-of-its-kind enforcement action against a U.S.-based affiliate of a leading international crypto exchange platform, alleging that by trading thousands of tokens and other crypto assets the agency alleges are securities, the firm was operating as an unregistered securities exchange, broker-dealer, and clearing agency**.[54] The Commission also alleged that the platform's crypto lending and staking programs constituted unregistered securities offerings. According to the SEC's complaint, the platform misled U.S. customers and equity investors that it had adequate market surveillance and controls to detect and prevent manipulative trading, when in reality, platform affiliates engaged in undisclosed market making activities that artificially inflated trading volumes. The SEC additionally charged the platform's CEO as a control person. In November 2023, the platform agreed to pay $4.3 billion to the DOJ, the U.S. Department of the Treasury, and the CFTC for a wide range of anti-money laundering, bank fraud, sanctions, and registration violations.[55] The platform's CEO also pled guilty to anti-money laundering violations, agreed to step down from the company, and paid $150 million in penalties.[56] However, the SEC was not part of this multi-regulator settlement, and the agency's case against the platform and the CEO remain pending.

Also in June 2023, the SEC charged the leading U.S. crypto exchange platform with failing to register as an exchange, broker, or clearing agency.[57] In pleadings and an extensive media campaign, the U.S. exchange has defended its decision not to register on the grounds that, among other things, the crypto and other digital assets traded on its platform are not securities, and that the SEC in effect approved the platform's business model when the agency approved the company's equity securities offering. This litigation also remains pending.

In January and February of 2023, the SEC brought its first enforcement actions alleging that certain types of crypto lending and staking as a service products constituted unregistered

---

[51] https://www.sec.gov/news/press-release/2022-219; https://www.sec.gov/news/press-release/2022-234

[52] https://www.justice.gov/usao-sdny/pr/united-states-attorney-announces-charges-against-ftx-founder-samuel-bankman-fried; https://www.justice.gov/usao-sdny/pr/united-states-attorney-announces-extradition-ftx-founder-samuel-bankman-fried-united

[53] https://www.justice.gov/usao-sdny/pr/statement-us-attorney-damian-williams-conviction-samuel-bankman-fried

[54] https://www.sec.gov/news/press-release/2023-101

[55] https://www.justice.gov/opa/pr/binance-and-ceo-plead-guilty-federal-charges-4b-resolution; https://home.treasury.gov/news/press-releases/jy1925; https://www.cftc.gov/PressRoom/PressReleases/8825-23

[56] Id.

[57] https://www.sec.gov/news/press-release/2023-102; https://www.sec.gov/news/press-release/2023-7;

securities offerings.[58] With respect to crypto lending, the Commission alleged that agreements offering customers the opportunity to loan their crypto assets in exchange for the promise to pay interest met the definition of a security as a "note" under the *Reves* test.[59] This litigation remains pending. In a separate action, the SEC alleged that a crypto asset staking-as-a-service program offered by a crypto platform -- whereby investors transfer crypto assets to a crypto platform for staking in exchange for advertised annual investment returns – constituted an unregistered securities offering under the *Howey* test.[60] The crypto platform settled the matter by agreeing to cease-and-desist from offering the staking-as-a-service product and to pay a $30 million civil penalty.

In FY 23, the SEC brought the first actions alleging that in some circumstances, non-fungible tokens (NFTs) were securities such that their offer and sale required registration or an applicable exemption. In enforcement actions in August and September 2023, the SEC alleged that the NFT issuers used their sale to fund operations and touted the NFTs as investments. To settle the action, one issuer consented to a cease-and-desist order, paid disgorgement and prejudgment interest totaling $5.58 million, bought back $7.7 million worth of NFTs, and paid a penalty of $500k.[61] The other issuer agreed to a cease-and-desist order, paid a $1 million penalty, and agreed to return approximately $8 million to investors.[62] Both issuers also were required to publish the SEC order on their websites and social media channels and revise smart contracts associated with the NFTs to eliminate royalties paid on secondary market transactions in the NFTs.

Given the prevalence of trading in crypto assets by their sponsors and the marketing of crypto assets on social media, in FY 23, **the SEC also remained active in bringing cases against sponsors for alleged manipulative trading in their tokens, and touting cases against celebrities and other high-profile individuals**. For example, in March 2023, the Commission charged the owner of a crypto sponsor with manipulating the secondary market of crypto tokens through wash trading and orchestrating an illicit promotional scheme with celebrities.[63] In related actions, the SEC charged eight celebrities for promoting crypto tokens on social media without disclosing to their followers that they had been paid to promote the tokens. For additional insights regarding celebrity touting cases, please see our published takeaways from a similar touting case involving a former NBA star.[64]

SEC enforcement actions in FY 23 arguably posed existential threats for crypto platforms and some crypto token sponsors, resulting in high-profile and high stakes litigation. Not surprisingly, the crypto exchanges charged by the Commission offered vigorous and nearly identical defenses, arguing that crypto tokens they offered were not securities, and that their functions substantially differed from those that Congress contemplated when drafting the registration requirements for securities exchanges, broker-dealers, and clearing agencies. Both exchanges further asserted that SEC regulation of crypto falls under the major questions doctrine, which requires express authorization by Congress before the agency can assert jurisdiction over such assets.

---

https://www.sec.gov/news/press-release/2023-25

[59] *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

[60] *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946).

[61] https://www.sec.gov/news/press-release/2023-163

[62] https://www.sec.gov/news/press-release/2023-178

[63] https://www.sec.gov/news/press-release/2023-59

[64] https://www.law360.com/articles/1581010/why-celebrities-are-ensnared-in-sec-crypto-touting-actions

The resolution of all of these questions of first impression will have massive implications for the crypto industry.

During FY 23, the SEC and crypto market participants also grappled with the implications of seemingly inconsistent rulings – issued just two days apart by different U.S. District Courts – as to whether crypto tokens constituted securities. At the end of 2022, the SEC prevailed on summary judgment against one digital token issuer in the District of New Hampshire, where the court found the company's digital token was a security because purchasers could have reasonably expected profits from management's efforts under the *Howey* test.[65] In July 2023, the Court granted the SEC's motion to permanently enjoin the crypto sponsor, but refused to enjoin its subsidiaries and declined to rule on whether the registration of token transactions *on the secondary market* required registration.[66]

However, just two days later, a judge in the Southern District of New York ruled that a crypto sponsor's sales of its tokens to institutional investors was a security subject to registration requirements, but that the sale to retailer investors was *not* a security.[67] Specifically, the court found that the retail purchasers of "programmatic sales," which involved a blind bid/ask transaction on the token sponsor's platform, "stood in the same shoes as a secondary market purchaser who did not know to whom or what it was paying its money." In October 2023, the SEC dropped aiding and abetting claims against the token sponsor's executives in an effort viewed by many as narrowing the case to speed up the appeal process.

VIII. Off-Channel Communications

After imposing eye-popping civil penalties in FY 22 against some of Wall Street's largest firms for failing to preserve business-related text messages and other "off-channel" electronic communications, in FY 23, the SEC encouraged self-reporting of such violations while broadenings its sweeps in this area to include financial services firms of all sizes.

In May 2023, the SEC attempted to illustrate the benefits of self-reporting by imposing smaller civil penalties against two large broker-dealers that self-reported violations, cooperated in the SEC's investigation, and took prompt remedial measures.[68] In these two settled actions, the SEC imposed relief for the firms that self-reported that was identical to other off-channel communications cases, including admissions, cease-and-desist orders, independent compliance consultants, and remediation, but imposed lower civil penalties (as compared to civil penalties imposed against other large broker-dealers) of $15 million and $7.5 million, respectively. In the press release announcing these actions, Enforcement Director Grewal stated that "the reduced penalties in these cases reflect their efforts and cooperation."

[65] https://www.sec.gov/litigation/litreleases/lr-25573
[66] https://www.sec.gov/litigation/litreleases/lr-25775
[67] https://www.nysd.uscourts.gov/sites/default/files/2023-07/SEC%20vs%20Ripple%207-13-23.pdf
[68] https://www.sec.gov/news/press-release/2023-91

In August and September 2023, the SEC instituted settled actions against 21 additional firms, including 15 broker-dealers, 4 dually registered broker-dealer and investment advisers, and 2 affiliated investment advisers for failing to preserve and monitor off-channel communications.[69] Each of the orders were nearly identical to the FY 22 sweeps in that the firms admitted that since 2019 firm employees at various levels of seniority sent "off-channel communications" on their personal devices, such as iMessage, WhatsApp, and Signal, regarding their employer's business. Because these communications were not subject to the firms' record retention systems, the firms did not preserve most of these communications and the SEC alleged they failed to reasonably supervise their employees as required by the Exchange Act and the Advisers Act. To settle the charges, the firms agreed to cease and desist orders, the payment of a total of $368 million in civil penalties, the retention of an independent compliance consultant, and broad remedial measures relating to the retention of electronic communications on employees' personal devices.

In FY 23, the SEC expanded enforcement involving alleged recordkeeping violations by bringing settled charges against two credit rating agencies for failing to preserve electronic records regarding ratings decisions, which encompassed off-channel communications.[70] The firms admitted violations of the recordkeeping provisions, and agreed to cease-and-desist orders, the payment of a total of $12 million in civil penalties, and remedial undertakings.

Additionally this year, **the SEC brought recordkeeping charges against a broker-dealer in its capacity as an underwriter, alleging that the firm failed to maintain records related to indirect expenses incurred in connection with their underwriting operations**.[71] According to the SEC, the underwriter calculated an indirect expense amount based on a fixed percentage of the underwriting fee for each deal where it was engaged as a lead underwriter, and then used fixed allocation grids to divide that amount into specific categories of expenses. In settling the matter, the underwriter consented to a cease-and-desist order, a $2.9 million civil penalty, and a censure.

IX. SPACs

Although the number of SPAC transactions in FY 23 continued to decline from their peak in FY 21, the SEC remained active in this space, with numerous cases alleging that investment advisers sponsoring SPACs failed to disclose conflicts of interest, that SPAC and SPAC merger targets made misleading disclosures, and that the leading SPAC audit firm had systemic audit deficiencies.

In April, May, and July 2023, the SEC announced settlements with three investment advisers who were charged with failing to disclose conflicts of interest arising from advisory personnel having ownership interests in SPAC sponsors.[72] The ownership interests entitled the personnel to a portion of the compensation the SPAC sponsors received upon completion of the SPACs' business combinations. **The SEC alleged that the advisers did not inform their clients of their ownership-related conflicts of interest before using client funds in a variety of ways to help effectuate the completion of SPAC transactions,** such as PIPE investments, open market purchases of SPAC stock, providing bridge financing to SPAC merger targets, and the

[69] https://www.sec.gov/news/press-release/2023-149; https://www.sec.gov/news/press-release/2023-212
[70] https://www.sec.gov/news/press-release/2023-211
[71] https://www.sec.gov/news/press-release/2023-165
[72] https://www.sec.gov/enforce/ia-6284-s; https://www.sec.gov/enforce/34-97622-s; https://www.sec.gov/enforce/34-97957-s.

cancellation of warrants obtained in previous private placements. To settle the charges, the advisers agreed to cease-and-desist orders and censures. Two advisers each agreed to $1 million civil money penalties, while the third adviser agreed to a $1.4 million civil money penalty.

The SEC pursued numerous SPACs for making alleged misstatements regarding their merger plans or financial prospects. In July 2023, the **SEC announced settled charges against a SPAC for misleading investors by failing to disclose that it had formulated a plan to acquire and was actively pursuing acquisition of a specific company prior to its IPO**.[73] The SEC also alleged that the SPAC failed to disclose that its chairman had a potential conflict of interest because he had agreed to pay a $1 million breakup fee if the SPAC did not complete an acquisition. To settle the charges, the SPAC agreed to a cease-and-desist order and to pay an $18 million civil money penalty by January 1, 2025 (or earlier if it closes a merger transaction). Perhaps implicitly recognizing that the civil penalty against the SPAC could harm its innocent shareholders, the SEC agreed to forgo the penalty if the SPAC dissolved and returned the money in trust to its shareholders before January 1, 2025.

In September 2023, the SEC announced settled charges against a company formed by the merger between a SPAC and a company providing electrification systems for commercial vehicles for misleading investors about sales and revenue projections.[74] Specifically, the SEC alleged that **after announcing their anticipated merger, the SPAC and target company made misleading public statements falsely claiming a sales pipeline of over $220 million and projecting revenue of over $1 billion by 2024**. To settle the charges, the company agreed to a cease-and-desist order and an $11 million civil penalty.

In June 2023, the SEC announced settled charges against an accounting firm that allegedly had systemic quality control failures and violated audit standards in connection with auditing hundreds of SPAC clients.[75] Among other things, the SEC alleged the firm audited more than 400 SPAC IPOs in 2020 and 2021, and more than tripled its audit practice over a three-year period without adding sufficient staffing capacity at multiple levels. According to the SEC, this exponential growth exposed widespread deficiencies in the firm's underlying quality control procedures and caused failures to comply with audit standards related to documentation, engagement quality reviews, risk assessments, committee communications, engagement partner supervision and review, and due professional care. To settle the charges, the firm agreed to a cease-and-desist order, payment of a $10 million civil penalty, the retention of an independent compliance consultant, and extensive remediation of its alleged quality control deficiencies.

In August 2023, the SEC announced settled charges against a London-based public accounting firm that allegedly conducted a deficient audit of a music streaming company's 2016–2018 financial statements.[76] The company went public in 2019 via merger with a SPAC. But it was later discovered the company's 2018 financial statements falsely claimed over $120 million in revenue, when in reality the company actually had only negligible revenue and operations. To give the appearance of revenue, the company had presented the accounting firm with agreements that were facially problematic and lacked a commercial purpose as well as fabricated confirmation letters. **The SEC alleged the firm did not design audit procedures to respond to such red flags and did not attempt to investigate the suspicious documents before**

[73] https://www.sec.gov/news/press-release/2023-135
[74] https://www.sec.gov/news/press-release/2023-208
[75] https://www.sec.gov/news/press-release/2023-114
[76] https://www.sec.gov/news/press-release/2023-152

completing its audits. The accounting firm paid $11.5 million to the streaming company's defrauded investors, and to settle the SEC's charges, the firm agreed to a cease-and-desist order, payment of a $750,000 civil penalty, the retention of an independent compliance consultant, and the remediation of its allegedly deficient audit policies and procedures.

X. Foreign Corrupt Practices Act

The SEC's FCPA enforcement in FY 2023 demonstrated a new focus on violations by third parties and intermediaries.

The SEC announced settled charges in December 2022 against an electrification and technology company for allegedly channeling bribes in South Africa in exchange for a lucrative contract to make alterations to a state-owned power station.[77] **The SEC alleged that company executives used complicit third-party service providers to pay bribes to a high-ranking government official over a three-and-a-half year period**. In the alleged scheme, the company invoked phony "variation orders" to negotiate new prices for various services at inflated rates, and then contractors siphoned off portions of the increased rates to pay the South African officials.[78] In settling parallel FCPA actions by the SEC and DOJ, the company agreed to pay penalties of $75 million and $315 million, respectively, with $73-million in disgorgement deemed satisfied by the company's prior $107-million civil settlement with the South African government. **Regulators also appear to have factored in the company's two prior alleged FCPA violations in requiring an undertaking for a three-year independent FCPA monitor**.

In March 2023, the SEC charged a global mining company with violating the FCPA stemming from an agent's bribery of a senior government official in Guinea.[79] The Commission alleged that after losing mineral rights to half of its operations in Guinea, the company hired a French investment banker who claimed to be a close, personal friend

[77] https://www.sec.gov/news/press-release/2022-214

[78] See also, https://www.sec.gov/news/press-release/2023-209 (SEC charged a specialty chemicals company with FCPA violations, alleging that its agents' paid bribes to obtain contracts to sell refinery catalysts to public-sector oil refineries in Vietnam, India and Indonesia without listing contractually-required explanations for the payments at issue).

[79] https://www.sec.gov/news/press-release/2023-46

of a senior government mining official. **The SEC alleged that the company never verified the legitimacy of the investment banker's activities, inaccurately recorded payments to the banker in its books, and failed to maintain sufficient accounting controls to detect over $800,000 in improper payments to the senior government official**. While the company did not have a formal agreement with the investment banker, the company paid him $10.5 million only after the banker obtained the restoration of its remaining mineral rights.

To settle the matter, the company agreed to a cease-and-desist order and the payment of a $15 million civil penalty. No disgorgement was ordered because the relevant mineral rights have not been developed. In accepting the company's offer of settlement, the Commission noted the company's cooperation, including identifying and providing key facts and documents uncovered in the company's internal investigation. The Commission also noted the company's remedial efforts, such as the termination of employees responsible for the misconduct, enhancements to its internal accounting controls, code of ethics, and whistleblower programs, as well as improved transaction testing and employee training.

In September 2023, the SEC charged an advertising company with violating the FCPA by bribing Chinese government officials over a five-year period in exchange for contracts to display advertisements in public spaces.[80] **According to the SEC, personnel at the company's Chinese subsidiary paid bribes in the form of gift cards, gifts, and invitations to entertainment venues, then obscured the payments in internal records** by creating false invoices for "customer development" or entertainment expenditures arising from "the negotiation process with clients for a renewal." The SEC alleged that improper expenditures or misappropriation surfaced as early as 2018, yet internal auditors and an external accounting firm were not granted full access to the records for the "customer development" entries until 2019. The company agreed to a cease-and-desist order, and the payment $20 million in disgorgement and a $6 million civil penalty.

XI. Anti-Money Laundering

In AML enforcement in FY 2023, the SEC brought numerous groundbreaking actions, including first-of-their-kind cases alleging that: an investment adviser to a mutual fund caused AML violations at the fund; a multinational financial services firm failed to disclose AML deficiencies to investors; and a broker-dealer failed to file Suspicious Activity Reports (SARs) for transactions on its alternative trading system (ATS).

In September 2023, the SEC brought a first-of-its-kind enforcement action against an investment adviser for allegedly causing the mutual funds it advised to fail to adopt and implement a reasonably designed AML program to comply with the Bank Secrecy Act and applicable regulations promulgated by the Financial Crimes Enforcement Network.[81] As a result, the SEC alleged that the investment adviser caused the mutual funds' violations of Rule 38a-1 of the Investment Company Act. The Commission alleged that over a five-year period, the board of the adviser's proprietary mutual funds reviewed an "umbrella" AML program for all of its U.S. subsidiaries, however, that program did not address the specific compliance requirements for the firm's mutual fund business. Among other things, the SEC alleged that the mutual funds improperly relied on a vendor-provided software system for transaction monitoring without adequately testing the system, reviewing alerts it generated, or training its staff in AML compliance specific to mutual funds. Although the Commission noted the adviser's remediation of the AML compliance

[80] https://www.sec.gov/news/press-release/2023-206
[81] https://www.sec.gov/news/press-release/2023-194

deficiencies and cooperation during the investigation, the adviser consented to a cease-and-desist order and the payment of a $6 million penalty.

In December 2022, the SEC charged a multinational financial services firm with making fraudulent disclosures concerning its AML compliance program at its Estonian branch and failing to disclose the risks posed by the program's significant deficiencies.[82] The SEC alleged that the firm knew or should have known that a substantial portion of the branch's customers were engaging in high-risk transactions. According to the SEC, over an eight-year period, the firm provided banking services to high-risk, non-Estonian customers, who facilitated more than $200 billion in suspicious transactions through the U.S. and other countries, generating as much as 99% of the branch's profits. The SEC noted that upon disclosing the significant deficiencies in its AML controls and governance, the firm's share price dropped by approximately 49%. The firm agreed to an integrated global resolution with the SEC, DOJ, and other regulators which included the payment of more than $2 billion in sanctions, including $413 million in civil penalties, disgorgement and prejudgment interest paid to the SEC.

In August 2023, the SEC charged a broker-dealer that operated an ATS for failing to file at least 461 SARs over an eight-year period.[83] According to the SEC, the ATS traded exclusively in over-the-counter securities, including higher risk microcap and penny stock securities. Notwithstanding these risks, the SEC alleged that the broker-dealer operating the ATS failed to establish an AML surveillance program to detect suspicious manipulative trading activity such as possible spoofing, layering and wash trading. As a result, the broker-dealer failed to detect, investigate, or file SARs on numerous transactions that it reasonably should have known were possible red flags of fraudulent activity. To settle the enforcement action, the broker-dealer consented to a cease-and-desist order and to pay a civil penalty of $1.5 million.

In July 2023, the SEC brought an enforcement action against a dually-registered broker-dealer and investment adviser and the firm's parent company for its alleged failure to file hundreds of SARs over an eleven-year period.[84] The Commission alleged that after the parent company assumed responsibility for creating and implementing the broker-dealer's SARs policies and procedures, **the parent company used an inappropriate quantitative threshold of $25,000, rather than the $5,000 threshold applicable to broker-dealers, causing the failure to file hundreds of SARs**. To settle the SEC matter, the firm agreed to a cease-and-desist order and to pay a $6 million civil penalty. In a parallel action, the company agreed to pay a separate $6 million fine to settle charges brought against it by FINRA.

XII. Whistleblowers

In September 2023, the SEC announced settled charges against an investment adviser for alleged violations of the whistleblower impeding

[82] https://www.sec.gov/news/press-release/2022-220
[83] https://www.sec.gov/news/press-release/2023-164
[84] https://www.sec.gov/news/press-release/2023-128

provisions of the Exchange Act.[85] Among other things, the **SEC alleged that the adviser required employees to sign agreements that prohibited the disclosure of confidential corporate information to third parties unless required by law or an order of a court, regulatory body, or governmental body, without an exception for voluntary communications with the Commission**. The SEC also alleged that the advisor required approximately 400 departing employees to sign releases affirming they had not filed any complaints with any government agency as a condition for them to receive deferred compensation and other benefits. To settle the matter, the adviser consented to cease-and-desist order, to pay a $10 million civil penalty, and a censure.

The SEC also continued to bring whistleblower impeding claims against *private* companies. In September 2023, the SEC alleged that a privately-held company impeded potential whistleblowers by requiring departing employees to forego monetary whistleblower awards in connection with filing claims with or participating in investigations by governmental agencies.[86] The company settled by consenting to a cease-and-desist order, the payment of a civil penalty of $225,000, and a remedial undertaking to notify employees who had signed the separation agreements that the agreements did not in any way limit their ability to obtain whistleblower incentive awards.

XIII. Enforcement Policy: Cooperation and SOX 304 Clawbacks

The SEC continued to tout the purported benefits of self-reporting and cooperation in FY 23. For example, in July 2023, the SEC announced settled charges against a window manufacturer for materially understating their warranty liability by approximately $28 million.[87] The Commission alleged that the manufacturer estimated their liability strictly on the projected costs to manufacture replacement windows, while neglecting to account for the costs to ship and install the replacement windows. **Based upon the company's self-report of the misstatement, proactive cooperation in the investigation, and prompt remedial measures, the SEC accepted the company's offer to consent to a cease-and-desist order that did not impose a civil penalty**.

In September 2023, **the SEC also touted the benefits of self-reporting and proactive cooperation in declining to impose a penalty against an issuer that allegedly failed to disclose material facts to support certain financial adjustments that resulted in a 15% increase in the company's reported operating income**.[88] According to the SEC, the company was unable to reconcile data discrepancies in two of the company's key operational systems and therefore lacked the information necessary to accurately report and record their expenses over several quarters. The company agreed to a cease-and-desist order, but the SEC did not impose a civil penalty based upon the company's prompt self-report to the Commission, extraordinary cooperation during the investigation, and voluntary remedial measures.

[85] https://www.sec.gov/news/press-release/2023-213; https://www.sec.gov/about/offices/owb/reg-21f.pdf
[86] https://www.sec.gov/news/press-release/2023-172; https://www.sec.gov/about/offices/owb/reg-21f.pdf
[87] https://www.sec.gov/news/press-release/2023-126
[88] https://www.sec.gov/news/press-release/2023-195

In FY 23, the Division of Enforcement also continued to mandate clawbacks of incentive-based compensation from CEOs and CFOs pursuant to Section 304 of the Sarbanes-Oxley Act of 2002. For example, in September 2023, the SEC announced settled fraud charges against a hydrogen fuel cell vehicle manufacturer and the company's former CEO and former managing director.[89] The SEC's complaint alleged the company misrepresented the status of its business dealings with potential customers and suppliers with an intent to create a false appearance that significant sales transactions were imminent. To settle the charges, the company agreed to a permanent injunction and to pay a $25 million civil penalty. The former CEO agreed to a permanent injunction, to pay a $100,000 civil penalty, and a 5-year officer and director bar. The former managing director agreed to a permanent injunction, to pay $200,000 in civil penalties, and a 10-year officer and director bar. **Notably, the SEC did not pursue Section 304 clawback actions against either the former CEO or CFO due to their prior reimbursement to the company of incentive-based bonuses they had received during the twelve months after the materially false representation of the company's financial statements**.

XIV. SEC Rulemaking and Challenges to the Agency's Administrative Forum

The SEC undertook significant rulemaking in FY 23, but continues to face headwinds related to the Constitutionality of its administrative enforcement forum.

Rulemaking

Rule 10b5-1 Trading Plans: On December 14, 2022, the SEC adopted amendments to Rule 10b5-1 under the Exchange Act, which Chair Gensler described as designed to fill "potential gaps" through which "insiders have sought to benefit from the rule's liability protections while trading securities opportunistically on the basis of material nonpublic information ("MNPI")." In light of the enforcement actions in FY 23 around Rule 10b5-1 plans, discussed above, officers and directors can expect this to be a priority area for SEC enforcement.

Amendments to Rule 105b-(1)(c) significantly tightened the availability of an affirmative defense to insider trading liability by imposing (i) mandatory cooling off periods for persons other than issuers; (ii) additional certifications regarding the possession of MNPI at the time of the Rule 10b5-1 plan's adoption or modification; and (iii) a requirement to act in good faith with respect to any Rule 10b5-1 plan. The new amendments also restricted the use of multiple overlapping trading plans and limited the ability to rely on the affirmative defense for a single-trade plan to one single-trade plan per twelve-month period (for all persons other than issuers). Finally, the amendments required more comprehensive disclosures by companies, including quarterly disclosures regarding the use of any Rule 10b5-1 trading plans. The restrictions on the 10b5-1 safe harbor took effect on February 27, 2023, and companies were required to comply with the updated disclosure requirements in Forms 10-Q, 10-K, 20-F and in proxy and information statements in the first filing that covering the first full fiscal period beginning on or after April 1, 2023. For a more detailed analysis, please read our Haynes Boone Client Alert Regarding the Rule 10b5-1 Amendments.

Cybersecurity Risk Management and Disclosures: This year, the SEC also adopted the long-awaited new rules and rule amendments governing cybersecurity risk management, strategy, governance, and incident disclosure by

[89] https://www.sec.gov/news/press-release/2023-200

public companies. These changes were designed to enhance and standardize the cybersecurity-related disclosure required by public companies subject to the reporting requirements of the Exchange Act. While the new rules include amendments to (i) Form 8-K through the addition of Item 1.05, (ii) Form 10-K through the addition of Item 106 to Regulation S-K and (iii) Forms 6-K and 20-F, the SEC scaled back a number of the disclosure requirements that were described in the proposed rules in response to public comments.

Notably, the new rules require registrants to disclose any cybersecurity incident they determine to be material within *four days* of such determination and to describe the material aspects of the incident's nature, scope, and timing, as well as its material impact or reasonably likely material impact on the registrant. The amendments also added Regulation S-K Item 106, requiring registrants to describe their processes, if any, for assessing, identifying, and managing material risks from cybersecurity threats, as well as the material effects or reasonably likely material effects of risks from cybersecurity threats and previous cybersecurity incidents.

In recent years, the SEC has taken an increasingly active interest in enforcement investigations related to cybersecurity concerns, including incident disclosures. This summer's new rules amendments suggest that focus will continue as companies work through the additional specificity provided by the 2023 amendments. For a more detailed analysis, please read our Haynes Boone Client Alert Regarding Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure.

Enhanced Regulation of Private Fund Advisers: On August 23, 2023, the SEC adopted extensive and controversial new rules and amendments under the Investment Advisers Act of 1940 (as amended, the "Advisers Act") governing investment advisers to private funds. The new rules—while marginally less onerous than those originally proposed in 2022—substantially alter the reporting, disclosure, recordkeeping, and other obligations of investment advisers to private funds. Applicable in full to investment advisers registered with the SEC and in part to exempt reporting advisers, state-registered advisers, and other advisers not registered with the SEC, the new rules are ostensibly intended to increase "transparency, competition, and efficiency in the private funds market."

Key changes include:

- Restricting advisers from engaging in certain enumerated activities without notifying clients and in some cases, obtaining clients' previous consent;
- Prohibiting *all* private fund advisers from providing investors with preferential treatment regarding redemptions and information if such treatment would have a material, negative effect on other investors.
- A requirement for registered investment advisers to provide investors with quarterly statements detailing certain information regarding fund fees, expenses, and performance; and
- A requirement for registered investment advisers to obtain and distribute to investors an annual financial statement audit of each private fund it advises and fairness opinions on any adviser-led secondary transaction.

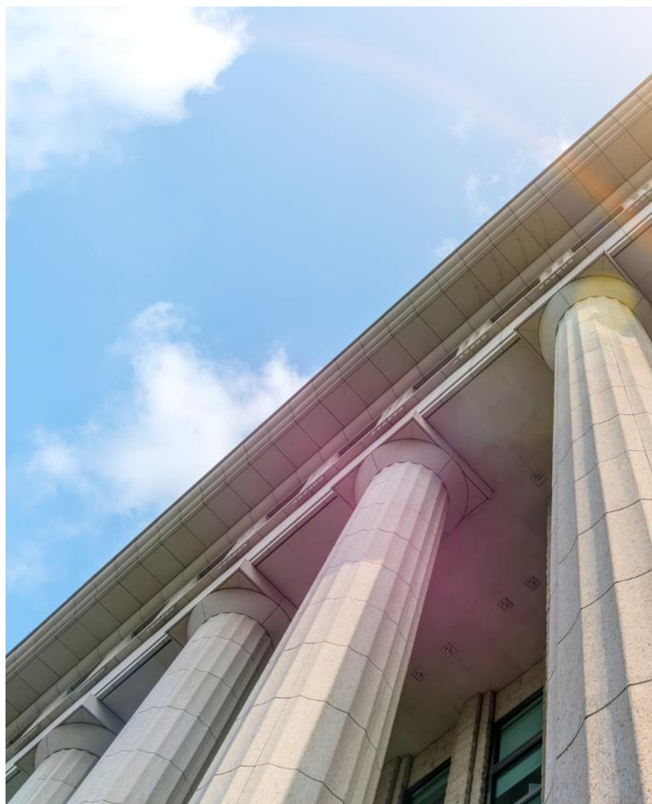
For a more detailed analysis, please read our Haynes Boone Client Alert Regarding Private Fund Adviser Rules.

Constitutionality of the SEC's Administrative Forum

Last year, the Fifth Circuit held that SEC administrative proceedings were unconstitutional on three grounds: (i) the SEC's use of the forum to pursue fraud claims and seek civil penalties violated the respondent's 7th Amendment right to a jury trial; (ii) under Article I of the

Constitution, Congress unconstitutionally delegated legislative power to the executive branch when it gave the SEC the power to choose between district courts and its administrative forum without providing an intelligible principle to guide the SEC's decision; and (iii) the two-layered for-cause removal protections applicable to SEC administrative law judges unconstitutionally restricted the President's removal powers under Article II of the Constitution.[90] The Supreme Court granted the SEC's petition for a writ of certiorari on June 30, 2023 to resolve the three constitutional challenges to the SEC's administrative proceedings noted above. In oral argument on November 29, 2023, numerous Justices appeared receptive to arguments that the SEC's administrative proceedings violated the 7th Amendment right to a jury trial.

The Supreme Court will decide the matter prior to the conclusion of its current term in June 2024.



[90] *Jarkesy v. SEC*, 34 F.4th 446 (5th Cir. 2022).
[91] https://www.sec.gov/news/press-release/2023-234

LOOKING AHEAD

Based upon the track record of the Division of Enforcement's leadership team during FY 22 and FY 23, we expect aggressive enforcement to continue in FY 24.

The SEC's senior leadership often use press releases to telegraph priorities. In announcing the Division of Enforcement's FY 23 results, **Enforcement Director Grewal emphasized "leveraging risk-based initiatives, seeking robust remedies, rewarding cooperation, [and] protecting whistleblowers."[91]**

Given Director Grewal's allusion to the growing importance of the SEC's whistleblower program, we recommend that all SEC registrants be vigilant regarding the wording of employment agreements, separation agreements, and training materials that could be read to *potentially impede* prospective SEC whistleblowers. And based upon the high number of enforcement cases in FY 23 stemming from the Division of Enforcement's proactive initiatives, we expect the continuation of most, if not all of those initiatives in FY 24, including:

- For public companies: EPS; untimely filings on Form 4, Schedule 13D, and Schedule 13G; Form NT filings without adequate disclosure of anticipated restatements; and close scrutiny of perquisite disclosures, particularly regarding executives' use of aircraft for personal travel
- For investment advisers: publicly-disseminated hypothetical performance advertising; Custody Rule violations and related Form ADV disclosures, including the failure to timely disseminate audited financials to private fund investors; and inaccurate Form 13F filings

- For broker-dealers (and dual registrants): off-channel communications recordkeeping; Reg. BI's duty of care obligations; and AML programs and SARs filings.

We anticipate that the SEC will continue to seek higher civil penalties in FY 24, with less deference to past comparable penalties for similar conduct. The aggregate monetary relief obtained by the SEC in FY 23 ($4.94 billion) was surpassed only by the record-setting monetary relief obtained in FY 22 ($6.43 billion). Despite periodic dissents from Commissioners Peirce and Uyeda, the majority of the Commissioners have shown no inclination to ease up on civil penalties.

The SEC's avalanche of rulemaking under Chair Gensler will provide fertile grounds for enforcement actions in FY 24 and beyond. In finalizing the Amendments to Rule 10b5-1 trading plans, the Chair and other Commissioners expressed concerns with what they perceived as past abuses. Therefore we believe that there is a strong likelihood that Staff will closely scrutinize trading pursuant to the revised Rule 10b5-1. In FY 23, SEC Examination Staff focused heavily on compliance with the Marketing Rule, and we expect a robust pipeline of referrals to Enforcement this year. With the proliferation of global cybersecurity attacks and breaches, we also anticipate that the Commission will be aggressive in bringing cases against public companies and their executives for violations of the new cybersecurity risk management and disclosure rules, which became effective beginning in December 2023.

It should be no surprise that in FY 24, the SEC will continue to devote significant resources to cryptocurrency and digital assets enforcement. Here, we will keep a close eye on the SEC's high-stakes litigation alleging that numerous crypto platforms are operating as unregistered exchanges, broker-dealers, and clearing agencies. The outcome of these cases will greatly expand or restrict the SEC's ability to regulate crypto. In addition, we believe that the SEC will continue to pursue platforms that offer crypto lending and staking-as-a-service products.

Finally, in the coming year, we anticipate that the SEC will continue to seek creative remedies based upon the agency's assertion of authority to obtain broad, equitable relief. Similar to the past two FYs, in settlement negotiations, we think the Commission will insist on very specific conduct-based injunctions, extensive undertakings, and the expansive application of officer and director and securities industry bars. In FY 23, the Commission imposed what we believe was the first "springing penalty," if a registrant failed to make promised enhancements to its internal accounting and disclosure controls procedures. This may be relief that the SEC seeks more often against registrants it deems recidivists in FY 24.

MEET THE AUTHORS

KIT ADDLEMAN chairs the firm's national Securities Enforcement Defense group and is a member of the Investment Funds Practice group. Kit defends companies, executives and directors against government charges of misconduct, particularly investigations and litigation by the SEC and DOJ. Many of her matters involve allegations of accounting and financial fraud, insider trading, hedge fund and advisor fraud, and Foreign Corrupt Practices Act violations. Prior to joining Haynes Boone, Kit was the Regional Director of the SEC's Atlanta Regional Office and spent more than 20 years prosecuting matters in four SEC offices around the country.

RON BREAUX is a veteran trial lawyer, who has represented companies in mission-critical litigation and investigations for more than three decades. Ron has detailed knowledge of complex commercial litigation; products liability; internal and governmental investigations; securities, healthcare and environmental fraud; antitrust; and data security. He has tried bench and jury trials and argued critical motions in venues across the country, including state, federal and bankruptcy courts.

NICK BUNCH is an experienced trial lawyer, appellate advocate, and former federal prosecutor, who brings an insider's perspective on how the government investigates and prosecutes white-collar criminal and civil matters. Nick gained that unique insider's perspective over nearly 11 years at the U.S. Attorney's Office for the Northern District of Texas where he served as an Assistant United States Attorney, Deputy Criminal Chief, and Deputy Section Chief, investigating, prosecuting, and supervising healthcare, corruption, national security, cybercrime, and economic crime offenses.

KURT GOTTSCHALL focuses on representing public companies and their officers and directors, auditors, investment advisers, broker-dealers and individuals in investigations by the U.S. Securities and Exchange Commission (SEC) and other government agencies, as well as internal investigations and regulatory compliance. Prior to joining Haynes Boone, Kurt was the Regional Director of the SEC's Denver Regional Office, where he managed more than 100 staff and oversaw all of the office's enforcement investigations, litigation and examinations of SEC registrants in an eight-state region.

TIM NEWMAN represents clients in government enforcement actions, cybersecurity investigations, and complex litigation. He has extensive experience representing organizations and executives under investigation by the SEC, DOJ, FINRA, and state regulators and conducting internal investigations related to suspected accounting fraud, offering fraud, insider trading, and other securities law violations. Tim has been recognized in *The Best Lawyers in America*, Woodward/White, Inc., for Criminal Defense: White Collar and was recently featured in D Magazine's "Best Lawyers in Dallas" List.

CARRINGTON GIAMMITTORIO focuses on securities law defense including both investigations and litigation. Her experience with both government enforcement and private securities litigation makes her uniquely suited to guide companies and individuals though parallel proceedings—helping her clients build a solid defense on all fronts. Carrington has been recognized in "Ones to Watch" by Best Lawyers in America.

NEIL ISSAR focuses his practice on healthcare litigation, securities enforcement defense, and government investigations, with particular expertise in fraud and abuse laws (including the False Claims Act, the Anti Kickback Statute, and the Stark Law), navigation of regulatory and compliance issues involving the healthcare industry, representing securities market participants before the SEC, and defending and pursuing antitrust claims. Neil has been recognized in "Ones to Watch" by Best Lawyers in America.

TAMMIE BANKO defends clients in both civil and criminal government investigations and litigation including SEC and DOJ matters. Before joining Haynes Boone, Tammie clerked for the Honorable Sidney A. Fitzwater in U.S. District Court for the Northern District of Texas. In addition, before law school Tammie served as a Teach for America corps member.

BEN BRECKLER focuses on government investigations, securities litigation, white collar defense, and antitrust matters. Ben is a Teach For America, Dallas-Fort Worth corps alumni. He is a member of the State Bar of Texas, the Dallas Bar Association, and the Dallas Association of Young Lawyers.

ASHLEY KOOS focuses her practice on government investigations and white-collar defense. She was a judicial clerk for the Honorable Fernando Rodriguez, Jr. in the U.S. District Court for the Southern District of Texas before joining Haynes Boone. Additionally, prior to law school, Ashley served as a Teach for America corps member in Houston, Texas, where she taught middle school mathematics and English Language Arts.

PAYTON ROBERTS is a litigator representing clients in criminal and civil government matters including white collar defense, antitrust allegations, and securities law claims. He also works on internal and government investigations and advises clients in matters related to digital assets.

GRETA GIESEKE focuses on securities litigation, government investigations, antitrust, and white-collar defense. Before practicing at Haynes Boone, Greta clerked for the Honorable Michael J. Truncale on the United States District Court for the Eastern District of Texas.

JUSTIN MANCHESTER focuses on securities litigation, government investigations, and white-collar defense. Justin previously clerked for the Honorable Jeremy D. Kernodle on the U.S. District Court for the Eastern District of Texas. Also prior to joining Haynes Boone, Justin completed a prestigious Coleman Fellowship with the Office of the Solicitor General of Texas.

SAMARA TAPER focuses on securities litigation, government investigations, and white collar defense. Before practicing at Haynes Boone, Samara was an extern for the Honorable Catharina Haynes of the U.S. Court of Appeals for the Fifth Circuit.

HAYNES BOONE

Austin
Charlotte
Chicago
Dallas
Dallas - North
Denver
Fort Worth
Houston
London
Mexico City
New York
Northern Virginia
Orange County
Palo Alto
San Antonio
San Francisco
Shanghai
The Woodlands
Washington, D.C.

© 2024 Haynes and Boone, LLP