

The image features the K&L GATES logo in white text on an orange rectangular background in the top left corner. The background of the entire slide is a composite image: a dark blue cityscape at night with bokeh light effects, overlaid with a semi-transparent world map made of small white dots. A white line graph with several data points is overlaid on the map and cityscape. The data points are labeled with numbers and percentage increases: 334 +7.09%, 56 +1.13%, 178 +3.28%, 206 +1.17%, 281 +1.07%, and 566 +2.08%.

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# SEC Exams and Enforcement 2022

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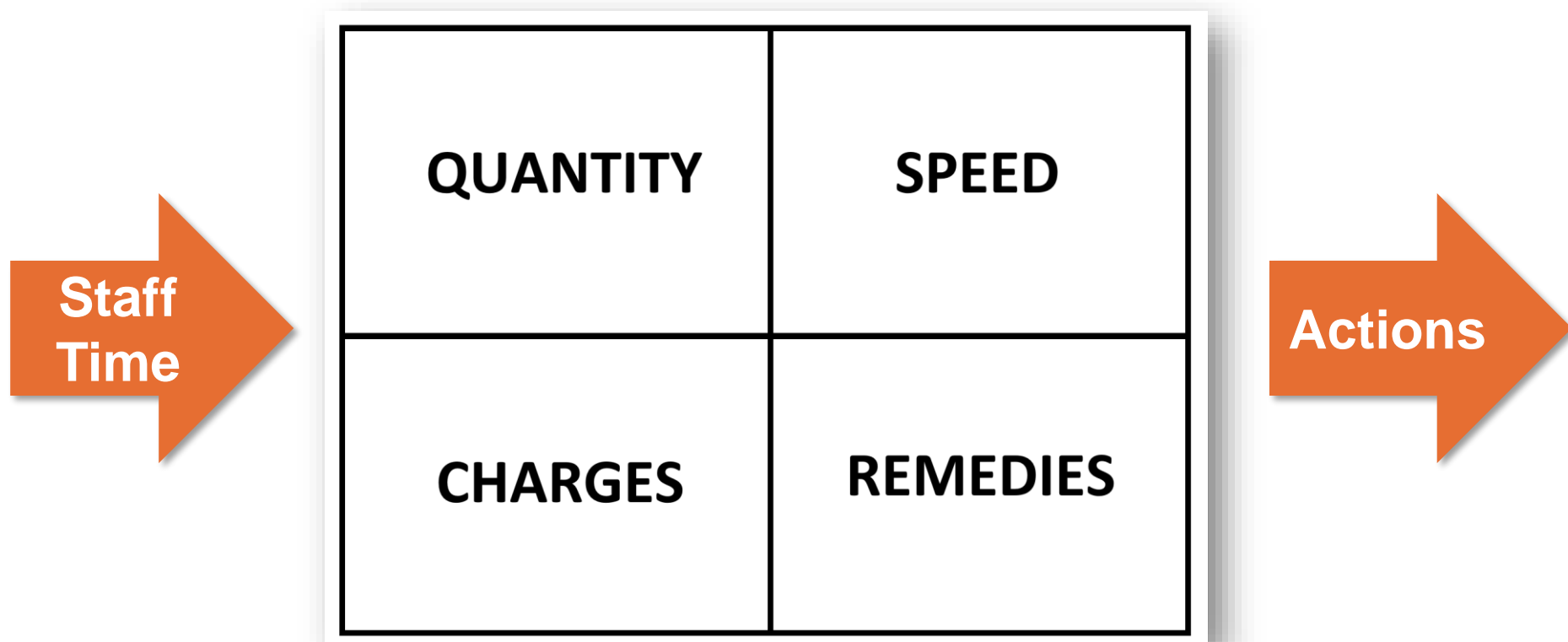
Matt Jacques, *Managing Director*, Alix Partners

# OVERVIEW

- Examination and Sweep-Examination Trends
  - ESG Investing – Greenwashing Concerns
  - AML Issues
- Enforcement Trends
  - Crypto Enforcement and Litigation
  - Data-Driven Enforcement Actions
- Broker-Dealer and RIA Conduct – Reg BI, Fiduciary Duty and Form CRS



# BALANCING ENFORCEMENT PRIORITIES



## SEC RULE-MAKING AGENDA

- Chairman Gensler has been front-loading his term with proposed rules
  - The SEC proposed 26 new rules in the first 8 months of 2022, more than in each of the previous 5 years
- New rules are focused on ESG disclosures, transparency from private-equity and hedge funds, and stock trading



## 2023 PREDICTED FOCUS AREAS

- Disclosures and conflicts of interest of private funds
  - Non-traditional IPOs by special purpose acquisition companies (SPACs)
  - Crypto-assets and compliance with securities laws
  - Use of data analytics
  - Regulatory and enforcement activity involving fintech start-ups
- *Takeaway: SEC sought a budget increase of \$240 million. The increased focus in these areas will likely come from the increase of 125 positions in the Enforcement Division and 90 positions in the Examinations Division*







# EXAMINATION TRENDS



# 2023 EXPECTED EXAMINATION PRIORITIES

- Crypto regulation
  - Crypto industry will not have immunity “from the application of well-established regulations and precedents”
  - SEC maintains “vast majority” of crypto tokens are securities that fall within federal securities regulations
- Cybersecurity disclosures—material incidents and policies and procedures
- Emerging risk disclosures—Russia-Ukraine war, supply chain issues, and inflation
- New Investment Adviser Marketing Rule compliance date is November 4, 2022.
  - Initial sweeps will likely focus on ensuring that examined registrants are aware of the rule and engaging in good faith efforts to comply



## ESG—GREENWASHING

- SEC Priority: SEC Asset Management Unit to focus on ESG and climate-related disclosures to determine whether they contain accurate representation
- Challenges: Third-party rating organizations assess companies on ESG compliance, but there is no single, unified standard or methodology behind ESG ratings
- Vale S.A. – April 2022 – SEC charged Vale with violating antifraud and reporting provisions as a result of false and misleading claims about the safety of its dams prior to the collapse of one dam. SEC alleged Vale concealed environmental and economic risks in annual Sustainability Reports and other public filings.





# ESG—SEC ACTIONS TO COMBAT GREENWASHING

- SEC Priority: Proposed rule to require public companies to disclose climate-related risks, how likely risks are to impact financial performance and strategy, and how companies identify and manage risks
    - Comments were due June 17, 2022
  - ESG Task Force – increasing enforcement actions, including two settled actions and two other announced charges within the last 6 months
    - Compass Minerals International Inc. – \$12 million penalty for failing to disclose the financial risks of the company’s excessive discharge of mercury
    - BNY Mellon Investment Adviser, Inc.– \$1.5 million penalty for representing or implying that all investments in the funds had undergone an ESG quality review, which was not always true
- *Takeaway: Likely that the extent of required ESG-related disclosures will increase*



## AML ISSUES

- **October 11, 2022, Bittrex**—First parallel enforcement effort between OFAC and FinCEN for AML violations for failing to screen for transactions involving sanctioned jurisdictions in cryptocurrency
- Expected examination focus for broker-dealers on customer identification programs, SAR filing obligations, beneficial ownership requirements, and on conducting robust and timely independent tests of their AML programs



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# ENFORCEMENT TRENDS





## 2023 EXPECTED ENFORCEMENT AGENDA

- Cryptocurrency
- Broker-dealers and gatekeeping role: Regulation BI, Form CRS, and safeguarding customer records
- Increased focus on individual accountability, including:
  - Director and officer bars in any settlement, not only scienter-based violations
  - D&O bars against individuals not currently serving as directors
  - Use of executive compensation claw back provision under Sarbanes-Oxley Act of 2002 following the filing of an accounting restatement
- SEC continues to seek broad disgorgement following *Liu v. SEC*.
  - Enforcement staff will seek disgorgement even where funds would not be returned to investors and will seek disgorgement of trading profits and losses avoided in addition to prejudgment interest and penalties



# LITIGATION

- Wells process: SEC is empowering front-line enforcement staff, including limiting meetings with senior officials in the Wells process
- Resolutions
  - 15 cases tried in federal court in 2022 — the most since 2015
  - Aggressive litigation timelines and postures
  - Early self-reporting and remediation efforts considered when determining penalties
  - \$3.852 million total ordered to be paid in enforcement actions in FY 2021
    - Increase in penalties imposed from FY 2020, totaling \$1.456 billion
    - Decrease in disgorgement ordered from FY 2020, totaling \$2.396 billion





# CRYPTO ENFORCEMENT AND LITIGATION



# CRYPTO ENFORCEMENT

- Staffing increases – In May 2022, 20 additional positions were added to the Crypto Assets and Cyber Unit
- Investigatory focus on:
  - Digital asset offerings, digital asset exchanges, digital asset lending and staking products
  - Decentralized finance platforms, non-fungible tokens (“NFTs”), and stablecoins





# CRYPTO LITIGATION

- *BlockFi Lending LLC*
  - February 2022, SEC charged BlockFi with failing to register the offers and sales of its crypto retail lending product
  - BlockFi agreed to pay largest penalty in crypto enforcement history-- \$50 million + \$50 million to state regulators; agreed to bring business in compliance within 60 days
- *Takeaway: SEC actively enforcing securities laws in crypto markets, requiring compliance for crypto products*





# REG BI, FIDUCIARY DUTY, AND FORM CRS ENFORCEMENT



## EMPHASIS ON REG-BI

- June 2022 – *SEC v. W. International Securities, Inc.*  
SEC’s first substantive enforcement action involving Reg BI
  - Claimed broker dealer failed to comply with “Care Obligation” by selling high-risk bonds to retail customers. Did not conduct adequate diligence or advise its customers of the risks
  - Claimed breach of “Compliance Obligation” by failing to maintain adequate policies and procedures for compliance with Reg BI





# FORM CRS AND ELECTRONIC RECORD KEEPING

- SEC brought approximately 40 Form CRS compliance cases within the last 15 months
- Increased Enforcement focus on electronic record-keeping obligations for broker-dealers and investment advisers, including communications on personal devices
  - September 15, 2022 DOJ Memorandum expanded the DOJ's focus into how companies manage employee communications platforms
  - Prosecutors are considering whether and how companies preserve business-related communications in determining the effectiveness of a company's compliance program and cooperation credit





## EPHEMERAL MESSAGING

- September 27, 2022 – SEC announced charges against 15 broker-dealers for failures to properly monitor and retain business-related communication conducted over “off-channel” mediums—i.e., personal text messaging, personal email accounts, and applications such as WhatsApp and Signal
  - The firms have agreed to pay combined penalties of more than \$1.1 billion
- *Takeaway: Crucial to evaluate policies pertaining to electronic records preservation and the use of unauthorized communication channels and implement measures to preserve and/or flag off-channel communications*





# DATA-DRIVEN ENFORCEMENT ACTIONS



# TREND TOWARDS DATA-DRIVEN ENFORCEMENT ACTIONS

- SEC seeking a FY 2023 budget \$240 million more than FY 2022. Increased due to data analytics and machine learning to enhance enforcement
  - DOJ may also trend towards data-driven enforcement, led by new DOJ Fraud Section compliance counsel, Matt Galvin, Former global vice president of ethics and compliance at InBev
    - System at InBev allows compliance personnel, senior management, and key stakeholders to have real-time view of company's global transactions and operations and monitor the qualities of these transactions
- *Takeaway: SEC likely to bring more enforcement actions as a result of issues identified using data analytics*





# TREND TOWARDS DATA-DRIVEN ENFORCEMENT ACTIONS

- *April 18, 2022, Rollins Inc.:* \$8 million penalty—largest EPS Initiative civil penalty to date. Analytics were used to detect patterns of meeting or slightly exceeding consensus EPS estimates for multiple consecutive quarters, often followed by significant drops in EPS
- *August 24, 2021, Healthcare Services Group, Inc.:* \$6 million penalty—SEC claimed HCSG failed to timely accrue for and disclose material loss contingencies related to the settlement of private litigation against the company. Third action to result from the EPS Initiative.
- *September 30, 2020, Hilton Worldwide Holdings:* \$600,000 penalty – SEC used data analytics to uncover violations for failing to fully disclose perquisites and personal benefits provided to executive officers.

