ankura

Securities Enforcement Forum West:

2023 Highlights

May 23, 2023

The annual Securities Docket “Securities Enforcement Forum West” conference was held on Tuesday, May 23, 2023, at the Four Seasons San Francisco. Consistent with prior conferences, the event featured many current and former senior Securities and Exchange Commission (SEC) officials, as well as leading securities enforcement and white-collar attorneys, in-house counsel, and compliance executives. The subject matter focused nearly exclusively on SEC Enforcement trends, topics, and recent activity.

In addition to the Directors’ Panel -- which was comprised of current and former directors of the San Francisco and Los Angeles Regional Offices -- conference highlights this year included a luncheon Q&A discussion featuring SEC Enforcement Director Gurbir Grewal, as well as significant panel coverage of other topics including cryptocurrency, financial accounting and disclosure fraud, cooperation credit, insider trading, litigation issues, and recent SEC enforcement cases.

Directors’ Panel:

The Directors’ Panel was moderated by Craig Martin (Partner, Morrison & Foerster). The panel was comprised of Jina Choi (Partner, Morrison & Foerster), Michele Wein Layne, Regional Director, US SEC), Randall Lee (Partner, Cooley LLP), and Monique Winkler (Regional Director, US SEC).

The panel discussion began with comments from Michele Wein Layne and Monique Winkler regarding activity and priorities within the Los Angeles and San Francisco Regional Offices. Activity levels for both offices were higher than the prior year and “covered the waterfront” with respect to a wide range of cases, including cryptocurrency, FCPA, market abuse, investment advisor, and financial fraud.

In terms of priorities for the Regional Offices, “speed” of investigation continues to be a primary goal. In terms of managing staff, while a hybrid approach is still in place, efforts are underway to move individuals into the offices on a more regular basis. “In person” meetings are being pursued more frequently. Both current Directors expressed a view that in-person meetings are most effective, although virtual meetings are still frequently used to keep the investigative process moving forward with some urgency. From his perspective, Randall Lee offered that while he agrees that in-person meetings are most effective, they are still sometimes difficult to get scheduled.

The discussion turned to the criminal landscape and the recent installation of Ismail Ramsey as the United States Attorney for the Northern District of California, and whether the appointment may impact the interest of the DOJ to pursue criminal referrals from the SEC. Wein Layne expressed her view that the Central and Southern Districts of California are the offices most frequently encountered in matters involving the SEC, and that white collar and securities matters have been – and continue to be -- a high

priority for those Districts. Winkler agreed, adding that similarly, there has not been any significant difference in matters involving the Eastern or Northern Districts. As a result, no meaningful changes regarding SEC referrals are expected with the new United States Attorney appointment.

Cooperation and settlement issues were the next topics covered. Craig Martin mentioned that the new DOJ guidance issued regarding self-reporting, cooperation, and remediation includes a presumption of declination, and questioned whether the Commission might consider a similar policy. Wein Layne said she presumed not, since bringing a civil action against a corporation is significantly different than a criminal action, and with dramatically different consequences. She said since there are “no secrets” as to what the elements of cooperation are, the main benefit for companies who follow the guidance of Seaboard is that they get substantial credit for the penalty assessment. Winkler mentioned cases issued regarding Granite Construction and a Silicon Valley private company named HeadSpin as two examples where significant cooperation credit was given based on the actions of the respondents. Wein Layne followed on by highlighting another area worth emphasizing, which is when the staff considers requiring the use of an independent compliance consultant. If the elements of Seaboard have been followed, Wein Layne said the requirement of an independent consultant or monitor may not be required.

Randall Lee said the SEC has done a better job of calling out cooperation but that defining the tangible benefits has been much more of a “black box.” He also stated the DOJ’s guidance is more defined than the SEC’s, with “more concrete markers” of what the benefit may be. Jina Choi added that in the SEC orders now, the SEC has added a section regarding cooperation, which gives some context to defense counsel. At the same time, registrants continue to be skeptical of what the ultimate benefits are. The penalty element is one consideration, but whether an entity or individual took sufficient steps to avoid being charged is a separate consideration. As an example, Choi cited the “bad actor” provisions of matters involving raising of capital, where the fact of a case brought -- even where there is no penalty -- can create particularly difficult circumstances for issuers, and whether the staff could use “other tools” within its menu of remedies to exercise discretion based on the facts and circumstances.

Craig Martin returned to the subject of settlements, stating that in the prior year, the SEC required admissions of misconduct in 19 matters, the majority of which were in the broker dealer recordkeeping sweep, but there were others as well. Wein Layne responded that the criteria that was laid out by Mary Jo White in the SEC’s original admissions policy continue to be the basis for that element. Consequently, the admission decision is difficult to influence by cooperation because it is largely driven by the underlying conduct evaluated by the criteria. In Wein Layne’s view, it is similar in character to disgorgement and is therefore not subject to meaningful cooperation consideration.

For the final topic, Craig Martin and the panel turned to the SEC litigating a subpoena against an American multi-national law firm, seeking names of clients who received notification that their information may have been compromised by a cyberattack. Regarding the question of whether the SEC was coming at defense counsel for client lists, Choi said she "hoped not," but said the idea that a law firm could be subpoenaed is "breathtaking." Randall Lee added that from a policy standpoint, he "shares the concern that the SEC has picked this particular fight," but from a legal standpoint, "it's a really tough case." Martin asked Wein Layne if a law firm had relevant information on an investigation, and the SEC was interested in obtaining that information, what general process the SEC would take. She responded that such a situation would generate "a great deal of deliberation, consideration and consultation," but that there have been instances where the SEC has sought relevant information – voluntarily or by subpoena – where a good resolution was able to be reached without compromising the attorney client privilege.

Luncheon Q&A Session:

SEC Enforcement Director Gurbir Grewal covered a range of topics during the luncheon session, where he was interviewed by Kristin Snyder (Partner, Debevoise & Plimpton). Grewal emphasized some common themes and positions taken during his tenure and provided additional context regarding cooperation credit, sweeps, and the enforcement process.

Grewal began his comments by discussing the overall objectives that he has prioritized during his tenure, stating that one has been to pursue an investigative environment where both SEC Enforcement staff and outside counsel can "be straightforward, … (and) engage in robust discussions throughout the investigative process." He said the SEC staff "want to get to the right answer as quickly as possible" because timely resolution benefits the market, as well as the registrants and individuals involved in the matters under examination.

When asked about other priorities, Grewal cited prior speeches he has given regarding "protecting and rebuilding (of) public trust," and how that remains particularly important today. He cited crypto markets and the banking sector as two areas of current relevance and emphasized how critical it is for the SEC to act with "urgency" to ensure that bad actors are held accountable in a timely manner.

While discussing penalties, Grewal returned to a continuing theme that he has previously expressed regarding the need for the SEC to pursue remedies and civil penalties sufficiently high to yield a "deterrent effect." He noted that in the last fiscal year ended September 2022, "the Commission delivered on that (initiative)" citing "remedies in excess of $6.4 billion dollars, $4.3 (billion) of which went to corporate penalties," a

record and a sharp increase from prior years. He reiterated that to be successful in ensuring fair markets, the SEC “needs to have the help of the gatekeepers, the compliance professionals, (and) all those people who are on the front lines.”

Regarding substantive priority areas, Grewal stated that one objective was to “be where the risks and investor interest are,” citing unregistered crypto offerings and potential conflicts of interest within the expanding private fund space as recent examples. He also mentioned a continuing focus on holding “insiders who abuse their positions” accountable – including gatekeepers -- in instances where violations occur.

Grewal also remarked that sweeps would continue to be used by SEC enforcement, citing the unauthorized “off-channel” communications sweep as an example. By identifying, examining, and addressing pervasive risks in this area, Grewal noted the SEC was able to efficiently focus attention, communicate results and improve compliance. The SEC bundled the cases in this sweep to increase attention on the practice, assess over $1 billion in penalties and impose undertakings on affected parties.

Regarding self-reporting and policing, Grewal mentioned the Seaboard guidance, and how it continues to be a relevant summary of measures for registrants to be aware of. In the unauthorized communications sweep, for example, Grewal pointed to self-reporting and remediation done by HSBC and Scotiabank as examples where registrants were able to mitigate fines by cooperating and remediating in a positive, constructive way and by doing “the right thing.”

In response to a question about whether there was merit to self-reporting issues arising from multi-jurisdictional or multi-agency investigations to the SEC, Grewal said that “any report is better than no report,” suggesting that the sooner all areas of concern can be identified and addressed, the more favorably the self-reporting process would be viewed in granting cooperation credit.

As for the subject of civil fines and negotiating settlements in SEC actions, Grewal emphasized prior public statements he had made that historic fines for similar violations would not be a persuasive argument to advance in a settlement context, since in his view, civil penalties would need to increase to discourage similar violations. Grewal mentioned, however, that defense observations or arguments challenging “novel” rule interpretations or charges and facts being considered by the SEC that hadn’t been pursued in the past could be an area that would be helpful for the staff to evaluate. Regarding Wells meetings and negotiations, Grewal said that “this should be a collaborative process” between the SEC staff and counsel. He reiterated that discussions regarding substantive issues should occur earlier and in real time during the investigation, so as not to delay any ultimate resolution. When alternative positions are raised earlier in the process, Grewal stated, there are instances when the SEC may be persuaded to not pursue or charge a particular component of an investigation.

Absent novel issues or substantive areas of dispute, Grewal stated the SEC Enforcement staff may manage the Wells meeting process to accelerate the resolution of matters, rather than to "go through the motions" and create delays. For example, Grewal cited the limited benefits to both parties of meetings with Enforcement leadership in certain instances to cover routine fact patterns not in dispute, or to request time extensions for intermediate steps -- such as pre-Wells "white papers."

Digital Assets and Cryptocurrency

Throughout the conference, digital assets and cryptocurrency actions were raised on a variety of panels. The principal panel handling this subject was moderated by Kenneth Herzinger (Partner, Paul Hastings), and featured Steven Buchholz, (Assistant Regional Director of the SEC), Teresa Goody-Guillen (Partner, Baker Hostetler), Abe Chernin (VP, Cornerstone Research), and Scott Walker (Chief Compliance Officer, Andreessen Horowitz).

The panel covered topics ranging from recent SEC enforcement activity and outlook to stablecoins, NFTs, decentralized finance protocols, and regulatory concerns for crypto industry participants. Steven Buchholz began by discussing the expansion of the SEC's Crypto Assets and Cyber Unit to handle the ongoing influx of enforcement actions and investigations, recent bank and company failures that involved crypto assets, and recent and relevant SEC activity in the space. Buchholz also reinforced the message that the SEC's activities are focused on protecting American investors in the crypto asset space.

Scott Walker then went into a discussion of the recent SEC enforcement action involving Kraken and their staking product, detailing what "staking" means and what factors the SEC believed differentiated Kraken's product from other forms of crypto asset staking. Walker also covered how those differences may have been factors contributing to the SEC's action alleging that the product is a security.

Abe Chernin then presented information regarding the market and pricing impact on crypto asset tokens after being targeted by an action from the SEC. He indicated that to date, his analysis is that the negative impact on token pricing following an SEC press release has been relatively limited. Chernin also indicated that the pricing and market appear to be more in tune with overall market sentiments that are more broadly focused on changes in regulatory policy and political policy, citing China's ban on bitcoin mining as an example.

Teresa Goody Guillen discussed stablecoins and the topic of whether crypto assets fall into the category of a "commodity" or "security" for the purposes of regulatory oversight and jurisdiction. Goody Guillen pointed out that judgments all require consideration of "facts and circumstances," saying the underlying asset needs to be considered along

with the complete contractual relationship of the entire transaction. She also noted that jurisdiction positions over different assets have evolved and overlapped somewhat over the past few years and that in substance, the area is still unclear. To accentuate the complexities, Goody Guillen also discussed and contrasted recent SEC and CFTC matters asserting positions that stablecoins were securities in some instances and commodities in others.

Financial Disclosure and Accounting Fraud Panel

Financial disclosure and accounting fraud were other topics that were discussed or referenced on various panels throughout the day. The primary panel handling this subject was moderated and led by Lorraine Echavarria (Partner, WilmerHale) and included panelists Jennifer Calabrese (Attorney, CPA, Securities and Exchange Commission), Rebecca Lubens, (Associate General Counsel, Ernst & Young), and Martin Wilczynski, (Senior Managing Director, Ankura Consulting).

Lori Echavarria began the discussion with an observation of the underlying theme of "cooperation" that had arisen multiple times during the conference, and how cooperation is particularly relevant for parties undergoing accounting and disclosure fraud investigations. Jennifer Calabrese then followed by discussing a selection of recent SEC accounting actions brought against both registrants and individuals. Examples included materially misleading disclosure and reporting matters, revenue recognition issues, and Sarbanes-Oxley Section 304 actions in fraud cases where registrant officers were required to return various amounts of bonuses and compensation for improper financial reporting, even though no individual misconduct was ascribed to them. Calabrese commented that these types of SOX 304 clawback actions provided an incentive to executives to prevent this type of misconduct, and an example of holding them accountable when misstatements occur.

Echavarria raised the subject of changes in the litigation environment, and the evolving factors necessarily evaluated by individuals considering whether to litigate or settle financial reporting actions being recommended by the SEC. Martin Wilczynski forecasted that given the increasingly tough negotiation positions taken by the SEC in resolving matters, an uptick in the willingness of respondents to litigate may be on the horizon. He commented that typical areas considered by individuals in deciding whether to litigate financial fraud cases include the nature and severity of charging recommendations, the amounts of proposed civil money and disgorgement penalties, and the reputational or business disruption risks presented in resolving the matter.

Rebecca Lubens then covered the topic of matters brought by the SEC involving auditors, gatekeepers, and financial professionals under Rule 102(e), involving appearance and practice before the Commission. Characterizing the current enforcement environment as "demanding," Lubens pointed out the numbers of actions continued to escalate toward pre-pandemic levels, and that those increases were likely to continue based in part on statements by members of the SEC's Office of the Chief Accountant that touched on enforcement themes and on comments by the PCAOB

Chair regarding the intent of the Board to pursue enforcement “with a renewed vigilance.” Lubens remarked that the PCAOB has indeed been active in the enforcement space as expected.

Lubens also predicted “challenging dynamics” ahead for auditors in the coming year. Examples included concurrent jurisdictional considerations where the SEC and PCAOB are both involved in an investigation of an auditor -- rather than one deferring to the other -- as well as the possibility of increased use of prospective remedies in the form of undertakings and monitorships, or even client bans. Calabrese followed by agreeing that activity in the area has been robust.

Lori Echavarria brought the discussion back to the subject of clawbacks, which have become an important part of the cooperation conversation in conducting and resolving enforcement matters. The recently announced DOJ policies identified clawbacks as part of their fine assessment process. While SOX 304 had focused attention on clawbacks for officers, Echavarria noted recent rulemaking efforts that could potentially affect others within the corporate structure as well.

Lubens expanded on the rulemaking discussion by citing Exchange Act Rule 10D-1, (Listing Standards for Recovery of Erroneously Awarded Compensation), which directs the national securities exchanges to establish standards requiring issuers to adopt and comply with clawback policies, including providing disclosure about such policies and how they are being implemented.

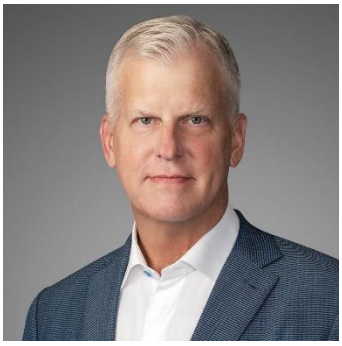
Under the rule amendments, which are not yet effective, a listed issuer is required to develop and implement a clawback policy that provides for the recovery of incentive-based compensation from current or former executive officers in the event the issuer is required to prepare an accounting restatement. The policy must provide for recovery of any erroneously awarded compensation received during the three completed fiscal years immediately preceding the date the issuer is required to prepare the accounting restatement. The rule is significantly broader than SOX 304 in that it is triggered without regard to whether the registrant is undertaking a “Big R” or “Little R” restatement, or whether the restatement involves misconduct and leaves room for a wider range of implicated "current or former executives and officers” than under SOX 304.

Echavarria observed that certain filers, as part of their internal corporate compliance and governance responsibilities, are considering expanding clawback policies to a wider range of employees beyond executive officers, both for accounting restatement type issues as well as for other reputational, ESG, or litigation harm to the registrant. Recent SEC cooperation credit cases show also show that issuers are being incentivized to include clawbacks as part of their compensation compliance program guidelines.

Returning to the subject of civil penalties, Wilczynski stated that based on a review of relevant SEC Enforcement accounting actions for approximately the last 18 months, there appeared to be a higher percentage of Securities Act 17(a)(2) and (3) “non-scienter” based fraud charges than the more consequential 17(a)(1) and Exchange Act 10(b) “scienter” based fraud charges. Wilczynski contrasted the charges with the substantial accompanying civil penalties agreed to in a variety of settlements, which were amounts ranging from $8 to $18 million. While the higher penalties required by the SEC were not unexpected, Wilczynski said, the size and consistency of the remedies were interesting given the “non-scienter” based charges underlying many of the orders, as opposed to 10(b) charges. He also noted that even in the matter of stand-alone Exchange Act Section 13(b) “books and records” charges, recent fines have been substantial as well.

For the last topic of the panel, Echavarria introduced the rise in “disclosure controls” matters. Calabrese summarized that disclosure controls and procedures are covered under Exchange Act Rule 13a-15. The rule mandates the gathering of controls information for the purpose of evaluating whether any changes or risks have occurred during a reporting period that affect the issuer's internal control over financial reporting and to ensure that information required to be disclosed is properly communicated to management. Lubens also summarized recent cases that included references to these disclosure requirements.

--- May 23, 2023 --- San Francisco, CA



Martin Wilczynski
Senior Managing Director

martin.wilczynski@ankura.com
+1.202.481.1326

Andrew Sotak
Managing Director

andrew.sotak@ankura.com
+1.100.123.1234