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2015 was a record year for the SEC

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Last year, the Securities and Exchange Commission bolstered its already strong enforcement record under Chair Mary Jo White. It filed a record 807 enforcement actions in FY2015 and obtained orders totaling $4.2 billion in disgorgement and penalties. These numbers mark the third successive year that the SEC has increased its enforcement results under White's leadership. White, a former U.S. attorney, continued her "broken windows" approach to enforcement, under which the SEC pursues "all types of violations of our federal securities laws, big and small." The 2015 results reflect these priorities; here are a few new developments leading into 2016.

Administrative Proceedings

In 2014, on the heels of several high-profile jury trial losses, Andrew Ceresney, director of the SEC's Enforcement Division, announced that the SEC would bring more actions before its own administrative law judges, where the SEC wins nearly all of its cases. This policy drew criticism from federal judges, defense counsel, former senior SEC officials, and even sitting SEC commissioners, among others. And at least three district court judges, two in Georgia and one in New York, have found that the SEC's procedures for hiring its ALJs likely were unconstitutional and issued preliminary injunctions halting the underlying administrative proceedings.

The torrent of criticism led to revisions, proposed by the SEC last September, to the rules governing administrative proceedings. One noteworthy proposed change involves allowing each side to conduct limited depositions (current rules do not allow depositions). Critics argue these revisions do not go far enough, and Congress is considering a bill to restrict administrative proceedings.

Insider Trading

The 2nd U.S. Circuit Court of Appeals' 2014 decision in *U.S. v. Newman* continues to reverberate within the SEC. Under *Newman*, to prove insider trading, the government must demonstrate that a tippee knew the tipper violated a fiduciary duty in passing on inside information, and that the tipper received a tangible personal benefit in exchange. Even though *Newman* is a criminal case, it still impacts enforcement actions. For example, an ALJ dismissed claims against a former Wells Fargo Securities trader who allegedly traded on tips he received from an analyst. The ALJ, applying *Newman*, said the SEC did not prove that the analyst gave the tips in exchange for a personal benefit (alleged benefits of career mentorship and positive feedback were not sufficient).

Thus far, the 9th U.S. Circuit Court of Appeals has declined to follow *Newman*. Specifically, in *U.S. v. Salman*, decided in July, it rejected the 2nd Circuit's narrow view of tipping liability. Despite the split, the Supreme Court has declined to review *Newman*.

Whistleblower Program

The SEC's Whistleblower program continues to be robust, resulting in increased enforcement activity arising from whistleblower tips. In FY2015, the SEC received over 4,000 tips, expanded protection against whistleblower retaliation, and awarded a total of $38 million to eight whistleblowers. In addition, in April, the SEC filed a controversial, first-of-its-kind action against KBR Inc. for using restrictive language in confidentiality agreements that allegedly violated the whistleblower protection rules of the Dodd-Frank Act. KBR required employees who were interviewed during internal investigations to sign confidentiality agreements that prohibited them from discussing the investigations without authorization. Although the SEC acknowledged that it was unaware of any instances in which KBR employees were prevented from speaking about violations (placing in question whether the alleged conduct actually violated the Dodd-Frank Act), the SEC said the confidentiality agreements "potentially discouraged employees from reporting securities violations."

Individual Liability

The SEC continued to emphasize its intent to focus on individual liability in its investigations, leading to increased enforcement actions against individuals. The SEC's goals align with those of the U.S. Department of Justice as articulated by Deputy Attorney General Sally Quillian Yates in her memorandum to federal prosecutors. The "Yates memo" makes clear that the DOJ intends to combat corporate misconduct "by seeking accountability from the individuals who perpetrated the misconduct" and focusing on individuals from the inception of an investigation. Among other things, the memo highlighted a requirement that corporations, to be eligible for any cooperation credit, must provide prosecutors with all relevant facts concerning individuals responsible for misconduct.

Financial Reporting and Accounting Fraud

2015 saw renewed focus on financial reporting and accounting fraud enforcement, with the SEC bringing numerous enforcement actions against issuers in a variety of industries, including computer sciences, financial services, pharmaceutical and energy. Most of the cases involved charges against issuers as well as executives, and resulted in payment of disgorgement, penalties and clawback of executive compensation. In one case, the SEC required the clawback of $2.5 million in bonuses and stock profits received by the CEO even though he was not charged with any wrongdoing. The SEC also charged the issuers' auditing firms in certain cases and, in one case, the audit committee chair.

FCPA

Vigorous enforcement of the Foreign Corrupt Practices Act continues to be a priority. The SEC charged several issuers and obtained hundreds of millions in disgorgement and penalties last year. It also brought its first FCPA action against a financial institution arising out of its hiring practices, charging BNY Mellon with providing internships to family members of foreign officials affiliated with a Middle East sovereign wealth fund.

Admissions

A variety of defendants admitted to misconduct — rather than settling enforcement actions without admitting or denying any wrongdoing — under the admissions policy previously outlined by White and Ceresney. In another first-of-its-kind case, the SEC obtained admissions from an auditing firm for ignoring red flags and issuing false and misleading unqualified audit opinions about the financial statements of one of its clients. The SEC highlighted the firm's failure to train its professionals to "have the resolve to refuse signing off on an audit even if there are unresolved material issues," even though the issues were known by "the highest levels of the audit practice."

Gatekeepers

The SEC maintained its focus on gatekeepers, such as attorneys and accountants, for failing to comply with professional standards. For example, in September, the SEC charged MusclePharm's former audit committee chair for substituting his wrong interpretation of SEC rules for those of an outside expert, resulting in an inaccurate disclosure. The SEC also charged a total of 14 accountants and 10 attorneys for aiding the perpetrators of various fraudulent microcap offerings.

Cybersecurity

This past year also saw a heightened emphasis on cybersecurity. In September, for example, the SEC charged an investment advisor for failing to establish required cybersecurity policies in advance of a cyberattack traced to China that compromised thousands clients' information. Ceresney has said other cases will follow. This action followed on the heels of the announcement by the SEC's examination program that it will continue to focus on cybersecurity by conducting examinations of registered broker-dealers and investment advisers to test their implementation of cybersecurity procedures and controls.

Liability for Chief Compliance Officers

In recent years, the SEC has increased its scrutiny of the compliance function of broker-dealers and investment advisers. In November, Ceresney gave a speech to the National Society of Compliance Professionals that addressed, among other things, circumstances in which the SEC would charge CCOs. He placed CCO cases into three categories: (1) cases in which CCOs are directly involved in misconduct unrelated to the compliance function, such as a CFO who commits accounting fraud while also wearing the CCO hat, (2) cases where CCOs engage in efforts to obstruct or mislead SEC staff and (3) cases where CCOs have "exhibited a wholesale failure to carry out [their] responsibilities." As an example, he highlighted an enforcement action the SEC brought against the CCO of BlackRock for causing the firm's failure to adopt written policies regarding outside business activities, despite his knowledge and approval of such activities by BlackRock employees.

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Conclusion

The SEC's enforcement record in 2015 remained strong, reflecting the street-cop mentalities of White and Ceresney. Similar results should be expected for 2016, particularly given the growing strength of the SEC's highly successful whistleblower program, as long as the SEC does not lose focus due to the growing administrative proceedings controversy or any further adverse impact from the *Newman* decision.

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