
HIGHLIGHTS FROM THE SEC DIVISION OF ENFORCEMENT FY 2020 ANNUAL REPORT

On November 2, 2020, the SEC's Division of Enforcement (Division) published its Annual Report for Fiscal Year 2020 (October 1, 2019 to September 30, 2020), available [here](#) (Annual Report).¹ The Division began FY20 with the same focus as in previous years—protect retail investors and preserve market integrity. But the Division faced unique challenges in FY20, including the departure of Steven Peikin, former Division Co-Director, and the imposition of mandatory telework for the second half of the fiscal year caused by the COVID-19 pandemic. Despite these and other challenges, the Division remained firm in its commitment to protect investors and maintain market integrity by enforcing federal securities laws.

Our own experience handling investigations and enforcement actions filed by the Division reveals that the Division, like the rest of the world, had to adjust to conducting its work remotely. With nimbleness top of mind, the Division's staff tacked into pandemic-caused headwinds quickly and adjusted resources and methods to continue actively investigating and filing actions.

When compared to FY19, the Division in FY20 received higher numbers of tips, complaints, and referrals; filed fewer enforcement actions but with higher total financial remedies ordered; and yet distributed lower total funds to harmed investors.

The following summarizes our key takeaways from the Annual Report, trends in FY20, and what we expect moving into FY21.²

ENFORCEMENT ACTIVITY

The Division brought 715 enforcement actions in FY20—405 “standalone,”³ 180 “follow-on,” and 130 to deregister public companies for filing delinquencies—typically failures to file required periodic and annual reporting. Although the SEC brought 492 of its 715 enforcement actions *after* the staff began teleworking in mid-March, the actions in FY20 marked the lowest in five years, and the third lowest in 10 years, fewer actions filed only in FY10 and FY13 when the Division brought 681⁴ and 686⁵ enforcement actions, respectively.

A breakdown of the Division's 405 standalone actions reveals the following:

¹ U.S. Sec. & Exch. Comm'n, *Division of Enforcement 2020 Annual Report* (Nov. 2, 2020).

² To read more about the SEC's FY20 COVID-19-accommodations to market participants, please see our previous Client Alert, available [here](#). For more information on the Division's COVID-19-tailored enforcement activity, please see our previous Client Alert, available [here](#).

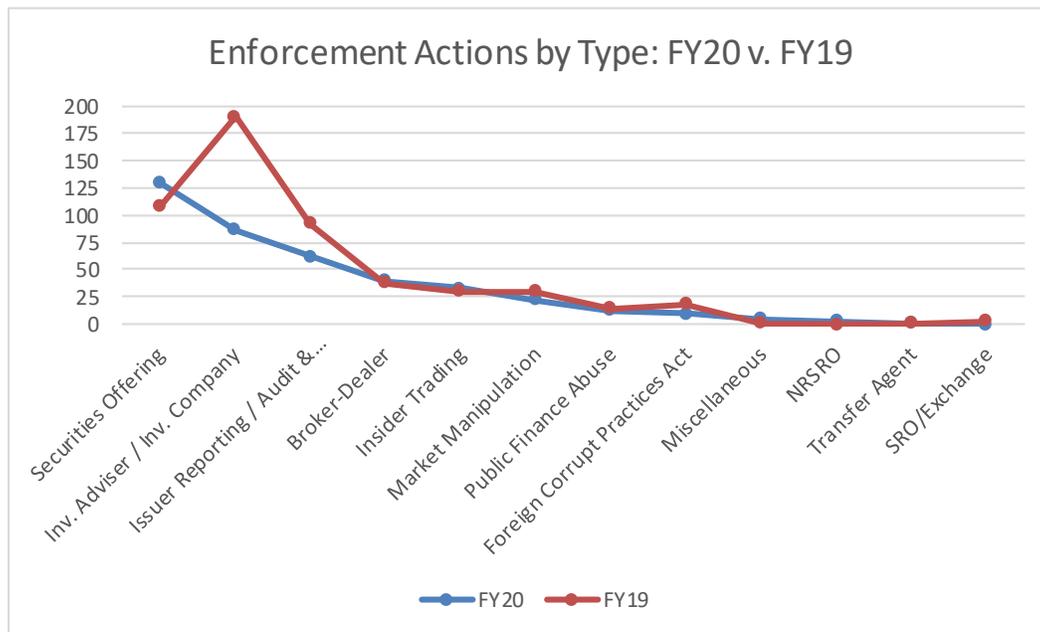
³ “Standalone” actions are cases filed in federal court or as administrative proceedings alleging any number of violations of the federal securities laws, versus “follow-on” actions, which are administrative proceedings that follow as a result of standalone action outcomes and seek, for example, to suspend gatekeepers whom the SEC alleges failed to follow the law or lack the professional qualifications required to appear and practice before the agency.

⁴ U.S. Sec. & Exch. Comm'n, *Fiscal Year 2010 Performance and Accountability Report* (Nov. 15, 2010).

⁵ U.S. Sec. & Exch. Comm'n, *Fiscal Year 2013 Agency Financial Report* (Dec. 12, 2013).

- 130 Securities Offerings (32%);
- 87 Investment Advisory and Investment Company Issues (21%);
- 62 Issuer Reporting/Accounting and Auditing (15%);
- 40 Broker-Dealers (10%);
- 33 Insider Trading (8%);
- 22 Market Manipulation (5%);
- 12 Public Finance Abuse (3%);
- 10 Foreign Corrupt Practices Act (2%);
- 5 Miscellaneous (1%);
- 3 NRSRO (1%);
- 1 Transfer Agent (~0%); and
- 0 SRO/Exchange (0%).

Notably, the Division experienced a significant drop in investment advisory and investment company actions—from 191 in FY19 to 87 in FY20. This reduction was likely caused by the Division concluding its Share Class Selection Disclosure Initiative in April 2020, which led to nearly 100 investment firms self-reporting to the Division and the return of more than \$139 million to investors since its inception in 2018.



Source: U.S. Securities and Exchange Commission

In FY19, the Division set a goal to accelerate the pace of its investigations because of a belief that “cases have the greatest impact when they are filed as close in time to the conduct as possible.”⁶ On average, it took the Division slightly less than two years to open an investigation and file a typical

⁶ U.S. Sec. & Exch. Comm’n, *Division of Enforcement 2019 Annual Report* (Nov. 6, 2019) at 7.

enforcement action in FY19.⁷ But its complex actions, such as financial fraud and issuer disclosure cases, took an average 37 months from opening to filing.⁸ Although the number of total enforcement actions was lower in FY20 than FY19, the Division did shorten the length of investigations and brought cases sooner by increasing staffing, making more targeted informational requests, and leveraging cooperation at the start of an investigation. In the Annual Report, Division Director Stephanie Avakian announced a reduction in the average amount of time it took to complete investigations for financial fraud and issuer disclosure cases of 37 months to 34 months.⁹ Ms. Avakian also highlighted a median time to file an action of 24.1 months, the second-fastest in the last five years and second to the 21.6-month median in FY19.¹⁰ To highlight its improved pacing, the Division points to charges it brought within just five weeks of the alleged misconduct by the co-chair of the unsecured creditors committee in the Neiman Marcus Group Ltd. LLC Chapter 11 bankruptcy proceeding.¹¹

Targeted requests were also integral to the Division reducing the time it took to move from investigation opening to first-filed action. We reason that the COVID-19 pandemic forced the Division to consider novel and more narrowly focused approaches in some investigations, including making tailored requests aimed at the core of a potential violation rather than typically broader informational requests and subpoenas. This tailored approach allowed the Division to be more agile in preparing for interviews and making charging and settlement decisions.

Early cooperation was another major factor allowing the Division to investigate and file actions more promptly. Thus, the Division remains committed to rewarding meaningful cooperation. For example, the Division imposed a reduced civil penalty against BMW for its cooperation in connection with the Division's investigation into disclosing inaccurate and misleading information about BMW's retail sales volume in the United States.¹² Likewise, the Division did not impose a penalty against Transamerica Asset Management, Inc., a registered investment adviser, because Transamerica self-reported the unlawful conduct, remediated the violations, and cooperated with the Division's investigation.¹³ These examples show that, in the right circumstances, there are increased benefits to self-reporting and providing meaningful cooperation early in an investigation. Even so, individuals or entities

⁷ *Id.*

⁸ *Id.*

⁹ Annual Report at 6.

¹⁰ *Id.*

¹¹ *Id.* For a more in depth discussion about the Neiman Marcus fraud proceeding, please see our previous Client Alert, available [here](#).

¹² Press Release, U.S. Sec. & Exch. Comm'n, *SEC Charges BMW for Disclosing Inaccurate and Misleading Retail Sales Information to Bond Investors* (Sept. 24, 2020), available at <https://www.sec.gov/news/press-release/2020-223>.

¹³ Press Release, U.S. Sec. & Exch. Comm'n, *Denver Investment Adviser Settles Charges for Disclosure Failures* (Sept. 30, 2020), available at <https://www.sec.gov/enforce/ia-5599-s>.

should carefully consider such a decision and weigh the risks and opportunities for early and extensive cooperation with the SEC.¹⁴

ACCOUNTABILITY FOR INDIVIDUALS AND GATEKEEPERS

The Division continues to stress that “individual accountability is critical to an effective enforcement program,” and 72% of standalone enforcement actions in FY20 involved charges against one or more individuals.¹⁵ For example, the SEC’s New York Regional Office filed a civil action in the District of New Jersey against the former CEO and Chairman of Hertz alleging the executive aided and abetted Hertz in its filing of inaccurate financial statements and disclosures.¹⁶ The former Hertz executive entered a final judgment without admitting or denying the SEC’s allegations and consented to reimburse Hertz for nearly \$2 million in incentive-based compensation and pay a \$200,000 civil penalty.¹⁷ Gatekeepers, including auditors, were also subject to the Division’s scrutiny. Indeed, the Division brought actions against three former KPMG LLP audit partners¹⁸ and three CPAs of a California audit firm¹⁹ for violating the rules of the Public Company Accounting Oversight Board. The Annual Report also notes that along with obtaining monetary remedies, the Division’s enforcement actions led to 477 bars and suspensions.²⁰

MONETARY REMEDIES, WHISTLEBLOWER AWARDS, AND RECOVERIES FOR HARMED INVESTORS

FY20 produced record-breaking numbers for the Whistleblower Program and delivered an 8% increase in total monetary relief ordered compared to FY19.

First, the SEC took concerted action in FY19 to “streamline and substantially accelerate the evaluation of claims for whistleblower awards.”²¹ The SEC’s efforts came to fruition in FY20, a year in which the SEC issued whistleblower awards totaling approximately \$175 million to 39 individuals, surpassing every other year since the Program’s inception in 2011. In September 2020, the SEC adopted new rules to continue improving and evolving its Whistleblower Program. In particular, one new rule creates a presumption that the statutory maximum award will apply when the (1) authorized statutory

¹⁴ For more information on the legal implications of such actions, please contact one of the attorneys listed at the end of this document.

¹⁵ Annual Report at 4.

¹⁶ Press Release, U.S. Sec. & Exch. Comm’n, *SEC Charges Hertz’s Former CEO with Aiding and Abetting Company’s Financial Reporting and Disclosure Violations* (Aug. 13, 2020), available at <https://www.sec.gov/news/press-release/2020-183>.

¹⁷ *Id.*

¹⁸ Press Release, U.S. Sec. & Exch. Comm’n, *SEC Charges Three Former KPMG Audit Partners for Exam Sharing Misconduct* (May 18, 2020), available at <https://www.sec.gov/news/press-release/2020-115>.

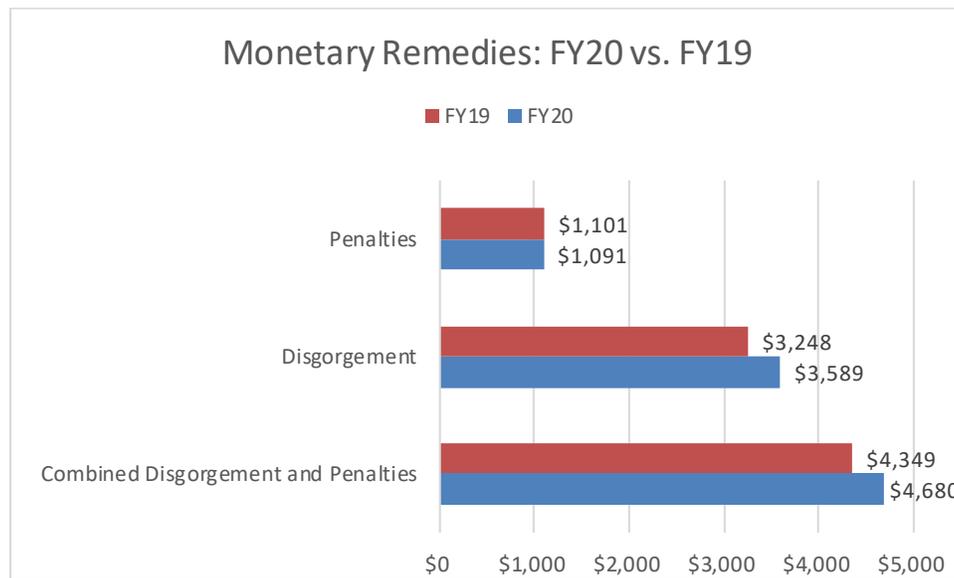
¹⁹ Press Release, U.S. Sec. & Exch. Comm’n, *Audit Firm Charged with Back-Dating Audit Work Papers Provided to SEC and PCOAB* (Apr. 24, 2020), available at <https://www.sec.gov/enforce/34-88739-s>.

²⁰ Annual Report at 22.

²¹ U.S. Sec. & Exch. Comm’n, *Division of Enforcement 2019 Annual Report* (Nov. 6, 2019) at 8.

maximum of 30% from the funds recovered as a result of the whistleblower equals \$5 million or less; and (2) negative award factors are not present.²² Looking ahead to FY21, we expect whistleblower activity to remain high and that whistleblower awards will continue to increase. For example, the SEC issued a \$114 million whistleblower award, the largest ever awarded, less than a month after closing its FY20.²³

Second, the Division ordered monetary relief totaling \$4.68 billion in FY20—\$1.091 billion in civil penalties and \$3.589 billion in disgorgement—which represents an 8% overall increase from the \$4.349 billion ordered in FY19.



Source: U.S. Securities and Exchange Commission

Although FY20 total monetary remedies outpaced FY19 despite fewer filed actions, the Division distributed \$602 million to harmed investors, representing a 50% decline from FY19’s distribution of \$1.19 billion to harmed investors. Not surprisingly considering the U.S. Supreme Court’s June 2020 decision in *Liu v. SEC*,²⁴ the Division’s Annual Report focuses on efforts to return disgorgement proceeds to harmed investors by featuring the *WG Trading Investment Fraud* matter. In *WG Trading Investment Fraud*, the court-appointed receiver returned more than \$1 billion to harmed investors, representing 100% of investors’ net principal investments.²⁵ Touting the achievement, Stephanie Avakian commented, “This final distribution is a demonstration of the SEC’s resolute commitment to protecting investors and

²² Negative award factors include, but are not limited to, culpability, malfeasance, unreasonable delay in reporting, and interference with a company’s internal compliance processes or reporting programs. See 17 C.F.R. § 240.21F-6 (2020). For more information on Whistleblower Program and the negative award factors, please contact one of the attorneys listed at the end of this document.

²³ Press Release, U.S. Sec. & Exch. Comm’n, *SEC Issues Record \$114 Million Whistleblower Award* (Oct. 22, 2020), available at <https://www.sec.gov/news/press-release/2020-266>.

²⁴ *Liu v. SEC*, 140 S. Ct. 1936 (2020). For a more in depth analysis of the *Liu* decision, please see our previous Client Alert, available [here](#).

²⁵ Annual Report at 6.

seeking justice for victims of fraud.”²⁶ The Division continues to focus on streamlining the process to order financial remedies, collect monetary awards, and return money to investors. To advance its goal, the Division created the Office of Bankruptcy, Collections, Distributions, and Receiverships to centralize existing functions in order to allow “additional efficiencies and maximize results for investors.”²⁷

Finally, the Annual Report foreshadows how the balance between penalties and disgorgement may fluctuate, leading to potentially higher penalties in response to the Supreme Court’s *Liu v. SEC* decision.²⁸ Generally, *Liu* affirmed courts authority to order disgorgement in cases brought by the SEC, but set some limitations on disgorgement amounts.²⁹ The Annual Report asserts, however, that the Division’s future recommendations for financial remedies will be both consistent with the *Liu* decision and its mission to protect investors and maintain market integrity.

COVID-19 AND RISING TIPS, COMPLAINTS, AND REFERRALS

As the COVID-19 pandemic swept across the world, it induced mandatory telework for many, including the SEC’s nationwide staff. Despite the challenges this posed (*e.g.*, how to conduct testimony, swear in witnesses, present documentary evidence, and the like), the Division moved forward with its investigations, including conducting witness testimony and Wells presentations by video-conference and, in some instances, engaging with defense counsel to establish reliable means for receiving and reviewing testimony exhibits.

In addition, and likely because an increased number of people are working from home, away from workplace cultures where they may not have felt safe identifying concerns or reporting problems, the Division reported receiving more tips, complaints, and referrals (TCR) in FY20. The Annual Report notes the SEC received over 23,650 TCRs, and of those about 16,000 were received between mid-March and the end of the fiscal year on September 30, 2020. The Division also opened more new inquiries in FY20 than FY19. Indeed, FY20 closed with 1,181 new inquiries and investigations opened across the Division, compared to a lesser 1,082 opened in FY19.

CONCLUSION AND LOOKING AHEAD

Moving into FY21, we expect the Division will continue to navigate extended telework and will continue to see increased TCR and whistleblower activity. Of course, we will remain on the lookout for new trends and priorities that emerge from the Commission, including any stemming from Chairman Jay Clayton’s anticipated departure from the Commission and any potential changes in the future.

We also expect to see the Division continue to chart a new path forward following the Supreme Court’s decision in *Liu* establishing a framework for obtaining disgorgement net of legitimate business expenses and established for the benefit of harmed investors.

²⁶ Press Release, U.S. Sec. & Exch. Comm’n, *SEC Announces Final Distribution in WG Trading Investment Fraud, Totaling Over \$1 Billion Returned to Harmed Investors* (Sept. 11, 2020), available at <https://www.sec.gov/news/press-release/2020-204>.

²⁷ Annual Report at 5.

²⁸ *Liu*, 140 S. Ct. 1936 (2020).

²⁹ *Id.*

Moreover, we anticipate increased actions resulting from the Division's new Earnings Per Share (EPS) Initiative³⁰ and its increasing use of risk-based data analytics to investigate and prosecute harder-to-detect violations involving, for instance, unlawful earnings management³¹ and undisclosed executive perks.³²

Finally, we anticipate the Division will continue its efforts to leverage cooperation and more tailored investigative efforts to continue accelerating the pace of its investigations, including into national priority areas such as the Paycheck Protection Program and COVID-triggered fraud by bad actors, corporate insiders, and others.

If you have any questions about the information contained in this Client Alert, please contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

CONTACTS:

William L. Banowsky

214.969.1231

Bill.Banowsky@tklaw.com

Richard B. Roper

214.969.1210

Richard.Roper@tklaw.com

Jessica B. Magee

214.969.1375

Jessica.Magee@tklaw.com

Michael W. Stockham

214.969.2515

Michael.Stockham@tklaw.com

Sydne K. Collier

214.969.2138

Sydne.Collier@tklaw.com

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³⁰ The EPS Initiative uses risk-based data analytics to uncover possible accounting or disclosure violations caused by, for example, earnings management practices.

³¹ See Order, U.S. Sec. & Exch. Comm'n, *In re Interface, Inc., et al.*, File No. 3-20085 (Sept. 28, 2020), available at <https://www.sec.gov/litigation/admin/2020/33-10854.pdf>; Order, U.S. Sec. & Exch. Comm'n, *In re Fulton Financial Corporation*, File No. 3-20084, (Sept. 28, 2020), available at <https://www.sec.gov/litigation/admin/2020/34-90017.pdf>.

³² See Order, U.S. Sec. & Exch. Comm'n, *In re RCI Hospitality Holdings, Inc., et al.*, File No. 3-20035 (Sept. 21, 2020), available at <https://www.sec.gov/litigation/admin/2020/34-89935.pdf>.