

SEC Touts Successes in Wake of Shutdown

At this year's PLI "SEC Speaks" conference held April 8-9, 2019, in Washington, D.C., the U.S. Securities and Exchange Commission's leadership and staff showcased its 2018 successes and outlined initiatives that the SEC intends to pursue in 2019 and beyond. With the conference being delayed due to the federal government shutdown earlier this year, the SEC was able to speak to more developments in 2019 affecting the federal securities laws.

"Main Street" Remains the Focus

As he did [last year](#), Chairman Jay Clayton emphasized his philosophy of protecting "Main Street" and "retail" investors, using those terms dozens of times in his remarks and connecting the accomplishments of each of the SEC's divisions by the impact on these investors.

Borrowing from common disclosure phrases in the industry, Chairman Clayton discussed the SEC's operations through the "eyes of management," similar to what a public company does in the "Management Discussion and Analysis" portion of its SEC filings. Chairman Clayton noted that the SEC's work over the past year had been, and likely would continue to be, affected by a number of factors that caused "actual results to differ" from what the SEC intended to do. These factors included: budget constraints (the SEC is short 400 authorized positions compared to fiscal year 2016); the ability to invest in technology to combat attempts to disrupt systems critical to market function; and ongoing changes in the regulatory landscape.

Chairman Clayton highlighted the SEC's coordinated efforts this year to protect retail investors by targeting disingenuous or conflicted actions and disclosures by investment advisors and other financial professionals and setting expectations and standards for personal data protection and financial data analysis, disclosure and security. On rulemaking, Chairman Clayton noted that the SEC advanced 23 of the 26 rules on its near-term agenda in fiscal year 2018 and responded to events and regulatory changes by advancing initiatives not in the original agenda.

Below are the highlights of the SEC's recent and current efforts.

Enforcement

In addition to substantive actions, Enforcement Division co-directors Stephanie Avakian and Steven Peikin and their colleagues discussed practical guidance for practitioners before the SEC.

Key Enforcement Actions, Decisions and Trends

False Statement Dissemination. Top of mind for the Enforcement Division was the U.S. Supreme Court's recent decision in [Lorenzo v. SEC](#), which extended Rule 10b-5 liability to those who knowingly [disseminate false or misleading statements](#) made *by others*. The defense bar was urged to exercise care in trying to frame this holding as applying only to the narrow act of dissemination. Those attempting to argue that the Court's reasoning does not also extend to other types of deceptive conduct will face a "fair bit of skepticism" from Enforcement leadership, who predict broad application of the ruling. For those concerned with the impact on private actions,

litigants are still required to show deceptive conduct, reliance and scienter under the PSLRA.

Insider Trading. Enforcement leadership noted the ongoing debate regarding the government's burden of proof in insider trading cases. Courts have continued to grapple with the Supreme Court's 2016 decision in *Salman v. United States*, which held that the "personal benefit test"—as detailed in the Court's decision in *United States v. Newman*—is met where an insider "gifts" confidential information to a trading relative or friend. Following *Salman*, the U.S. Court of Appeals for the Second Circuit ruled in *United States v. Martoma* that the government need not prove a "meaningfully close personal relationship" to satisfy the personal benefit test, so long as the evidence established that the tip was given with the intent that the recipient would trade on it, akin to a "gift" of profits.

However, in July 2018, the Second Circuit panel walked back this expansion of the gift theory. In *Martoma II*, an *en banc* panel decided it need not decide whether *Salman* implicitly abrogated *Newman's* "meaningfully close personal relationship" test, and instead held that the test can be satisfied by a showing either (1) that the tip was part of a quid pro quo, or (2) that the tipper intended the tip to benefit the tippee. The *Martoma II* decision was interpreted by many as ratcheting back the government's burden of proof against tippers.

Disgorgement & Penalties. The SEC is still feeling the effects of last year's Supreme Court decision in *Kokesh v. SEC*, holding that disgorgement is a "penalty" subject to a five-year statute of limitations. The SEC estimates that "hundreds of millions of dollars have been left on the table" because of *Kokesh*, and noted that over the last year, defendants have used *Kokesh* to argue that other remedies should also be treated as penalties subject to the same statute of limitations.

Enforcement leadership noted that a [bipartisan bill](#) recently introduced by Senators Mark Warner (VA) and John Kennedy (LA) may help the SEC by authorizing a separate remedy of restitution and establishing new limitations periods for those remedies. However, the bill appears to have little traction at this early stage. Not to be discouraged, Director Avakian harkened back to the SEC's "oldie but goodie" case against Galleon Hedge fund manager Raj Rajaratnam. In March 2019, the Second Circuit affirmed a \$93 million fine levied against Rajaratnam, upholding the maximum penalty of three times Rajaratnam's total insider trading profits, plus the illicit profits Rajaratnam generated for his clients.

Data Protection. The Chief Counsel's Office discussed the first enforcement action brought under Regulation S-ID, [In the Matter of Voya Fin. Advisors, Inc., \(IA-5048; September 26, 2018\)](#). There, the SEC alleged that broker-dealer and investment adviser Voya Financial Advisors Inc. failed to develop and implement a written Identity Theft Prevention Program. That failure in part allowed cyber intruders to impersonate Voya's contractors to access the personal information of thousands of Voya customers. Overall, it seems clear practitioners can expect further actions related to data protection and the enforcement of Regulation S-ID.

Cross-Border, Cross-Agency and Cross-Division Coordination. A panel of Enforcement Division attorneys focused significant attention on cooperation across agencies and divisions. More parallel civil and criminal actions were predicted for the coming year. The Office of International Affairs' preparation for the May 2018 implementation of the European Union General Data Protection Regulation (GDPR) and Brexit have been two of its biggest projects in 2018-2019, requiring significant updates to the memoranda of understanding under which the SEC has traditionally obtained and shared information internationally. Accordingly, regulated entities with international operations can still expect cooperation between the SEC and international regulators in the enforcement of federal securities laws.

Practice Tips

Cooperation Credit. Director Avakian said cooperation was "as important to the program now as it has ever been." Avakian initially referenced three of the four [Seaboard](#) factors for cooperation credit (self-policing,

cooperation and remediation), and then joked that she forgot to mention self-reporting (the fourth factor) because "no one does it." On self-reporting, Director Peikin acknowledged a lack of uniformity in awarding cooperation credit, to which he referred as an "imperfect science." Even though the overall quality of "forthrightness" and early/thorough remediation were emphasized as being key to maximum cooperation credit, the general tone of the discussion suggested that uneven application and results of cooperation credit continues to be a risk to self-disclosure.

The Wells Process. When making a *Wells* submission, the Enforcement panel advised practitioners to: (1) tailor arguments to the most salient issues rather than challenging *every* alleged violation; (2) set realistic and credible goals (e.g., the resolution cannot *always* be declination); and (3) understand that citing an individual commissioner's past public statements (as opposed to, say, expert reports that would be admissible at trial) as persuasive authority was generally ineffective. One technique Director Peikin found effective was defense counsel walking through how the case would proceed at trial and discussing why certain evidentiary elements could not be met if the SEC brought an enforcement action.

Policy Priorities Reflected in Rule-Making and Program Initiatives

The SEC's 2018 rule-making activity focused on the long-standing missions of protecting investors and encouraging capital formation, with the goal of making the securities markets more attractive and accessible to "Wall Street" and "Main Street" investors alike.

Regulation Best Interest. The SEC remains focused on establishing standards of conduct and disclosures for broker-dealers and investment advisers who interface with retail investors. The proposed "Regulation Best Interest" in part obliges these professionals to think about factors that influence their recommendations and potential conflicts influencing such recommendations. Although differing views on the rule are still prevalent, making it unlikely Regulation Best Interest will become effective in 2019, the proposal in some form is expected to reframe financial professionals' duty to subordinate their own interests in favor of their clients' interests.

Cryptocurrency and Fintech Questions. The Trading and Markets Division highlighted cryptocurrency issues, including: (1) whether a particular cryptocurrency asset is a security; (2) whether someone is acting as a broker-dealer; (3) whether a trading platform is an exchange; and (4) custody issues. Such questions were front and center in the SEC's February 2019 action against [Gladius Network](#) for conducting an unregistered initial coin offering (ICO). Ultimately, in what the SEC touted as a successful invocation of cooperation credit principles, Gladius self-reported, and agreed to return funds to investors and register its tokens as securities, and therefore received no penalty for its failure. In October 2018, the SEC launched the Strategic Hub for Innovation and Financial Technology (FinHub), a resource for information about the SEC's views and actions in the fintech space and a forum for market participants to engage with the SEC. Companies were advised to continually assess their alternative trading systems to determine if they meet the definition of an "exchange," and referred to FinHub's [newly published framework](#) for analyzing whether a digital asset is offered and sold as a security under the federal securities laws.

Data Reliability and Disclosure Standards. Reliable disclosure of "big data" and examination of that data is also a top objective for the SEC. The Chief Accountant's Office cautioned that the SEC has been, and intends to continue, prioritizing the importance of high-quality, reliable, useful financial information to allow investors to make important decisions about their capital.

- The Research and Data Services Office is collaborating with Enforcement and the Compliance Inspections and Examinations Office to use big data and machine learning to look for outliers and train data sets towards internal information about past bad actors.

- The Investment Management Division is exploring modernization of the design, delivery and content of disclosures, and in June 2018, issued a Request for Comment on disclosure enhancements. The Division is also considering moving beyond the paper-based disclosure regime that has been in place for decades.
- The Investment Management Division is also attempting to modernize regulations under the Investment Advisor Act by reviewing advertising and solicitation rules to account for recent growth of institutional and high net worth investors and development of new mediums (e.g., social media) for disseminating information on service providers.

Comments and guidance by the SEC commissioners and leadership demonstrated that, although the SEC's work was temporarily slowed by the government shutdown, it continues to evolve and adapt to changing markets and technologies. It is all but certain that the SEC will continue to target actors who employ technology to take advantage of investors and the markets. And although the SEC intends to leave nothing on the table making harmed investors whole again, these goals are still aspirational as evidenced by the chairman's caveats and the acknowledgement that individual counsel involved and strategies they employ may cause results to vary.

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