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Client Alert

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Navigating Regulatory Tides: A Deep Dive into Fiscal Year-End SEC and CFTC Enforcement Strategies

The last thirty days in September, the end of the U.S. federal government's fiscal year, is generally an important time to analyze enforcement activity by the U.S. Securities and Exchange Commission ("SEC") and the US Commodity Futures Trading Commission ("CFTC").

Because all enforcement cases must be reviewed and approved by the SEC and CFTC Commissioners, the end of the fiscal year often poses a logjam in processing enforcement recommendations. As a result, enforcement staff and leaders at the SEC and the CFTC must prioritize enforcement recommendations that they want to have approved by the Commissioners before the end of the fiscal year. Thus, in our experience, enforcement cases filed at the end of the fiscal year (and for the SEC, particularly ones accompanied by a press release as opposed to a typical administrative or litigation release), are strong indicators of issues currently in the regulators' crosshairs and set the tone for enforcement hotspots and priorities for the next fiscal year.

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In this short video, Baker McKenzie Partner Peter Chan, a former SEC Assistant Director of Enforcement, provides his "inside baseball" insights regarding the importance of the timing of some of these enforcement actions.

I. Key Takeaways from the 30 Days Period in September

Below are our key observations regarding the enforcement matters filed in this critical 30 day period in September:

A. Overall SEC Enforcement Trends and Policy Messages

- A number of SEC cases reflect the enforcement message that self-reporting of misconduct by both public companies and financial firms as part of proactive cooperation will be rewarded, including potentially with settlements involving no civil penalties.
- The SEC will be aggressive in going after both companies and financial firms that include contract terms in employee agreements that are perceived to deter whistleblower complaints.
- The SEC is willing to pursue enforcement cases against financial firms and public companies based on strict liability violations that do not require intentional or even negligent misconduct.
- The SEC continues to scrutinize statements touting ESG capabilities and activities.

B. Financial Industry Enforcement Actions

- A significant number of the SEC financial industry actions during fiscal year-end involve investment advisers, particularly those that are private fund managers, and allegations of violations of the marketing rules, custody rules, and breach of fiduciary duty relating to conflicts of interest and overcharging of fees.
- Both the SEC and CFTC continue to focus on "off-channel" communications, reflecting a concern that broker-dealer and investment adviser supervision, as well as SEC and CFTC investigations and

examinations of financial institutions, can be circumvented by communications that are not maintained as part of required corporate books and records.

- The SEC continues to expand its enforcement of Regulation Best Interest against broker-dealers.
- Cases involving cryptocurrency and digital assets remain a priority for both the SEC and the CFTC.

C. SEC Corporate Enforcement

- In addition to traditional accounting and FCPA cases and the focus on ESG, the SEC continues to take action against public companies for non-accounting issues and topics. But the SEC also files significant actions involving arguably technical reporting violations. In other words, even when there is no fraudulent conduct alleged, the SEC continues to take action against companies and individuals that fail to comply with required reporting and filing obligations. Notably, as part of its corporate enforcement, the SEC continues to police auditors, bringing actions against one audit firm and the national quality control partner of another firm.

D. CFTC Enforcement

- Also, the CFTC's enforcement actions in September reflect its ongoing efforts to address deficient supervisions. The CFTC cases during this period also reflect a focus on trading of precious metals.

Below is a more detailed summary of enforcement cases by the SEC and the CFTC that are particularly relevant to financial firms and public companies.

II. Overall SEC Enforcement Trends

A. Incentives to Self-Report: It Pays to Cooperate, or At Least Costs Less

Both the SEC and the CFTC have cooperation policies that encourage self-reporting of potential misconduct, but that fall short of proscribing detailed benefits to self-reporting entities as under the 2023 DOJ Voluntary Self-Disclosure Program. In the last 30 days in September, the SEC announced enforcement settlements that appear designed to highlight the potential financial benefits of self-reporting.

On September 7, 2023, the SEC announced settled charges against a financial services firm for failing to register the offers and sales of its retail crypto lending product. Despite the aggressive crackdown on the crypto industry, the SEC determined not to impose civil penalties due to the firm's cooperation and prompt remedial actions. In particular, following the SEC's February 2022 enforcement action against BlockFi, the firm voluntarily ceased offering its similar interest-bearing crypto lending product and returned all funds to its investors.

In a separate action involving a more traditional corporate accounting case, the SEC charged a public company with failing to disclose material information about unsupported adjustments the company made in several SEC filings, which increased the company's reported operating income by at least 15% in three quarters from 2019 through 2020. Again, the SEC determined not to impose civil penalties because the company promptly self-reported, undertook remedial measures and provided substantial cooperation to the Staff.

B. Whistleblower Protection: Boilerplate Disclaimers in Employment Agreements May Not Be Sufficient

The SEC continues to aggressively enforce Rule 21F-17 under the Exchange Act against employment and other contracts with provisions that arguably chill whistleblower complaints to the SEC, regardless of whether the provisions were intended to deter such complaints. In the end of the fiscal year, the SEC highlighted its priority in this area by bringing cases against a privately-held company and an investment adviser.

On September 8, 2023, the SEC announced it settled with a privately held energy and technology company for using employee separation agreements that violated the SEC's whistleblower protection rules by requiring certain departing employees to waive their rights to monetary whistleblower awards in connection with the filing of claims with or participating in investigations by government agencies. These provisions were determined to have raised

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clear impediments to participation in the SEC's whistleblower program. Jason J. Burt, Regional Director of the SEC's Denver Office, explained that "both private and public companies must understand that they cannot take actions or use separation agreements that in any way disincentive employees from communicating with SEC staff about potential violations of the federal securities laws," and "any attempt to stifle or discourage this type of communication undermines [the SEC's] regulatory oversight and will be dealt with appropriately." The company agreed to pay a civil penalty of USD 225,000.

On September 19, 2023, the SEC announced settled charges against a Dallas-based commercial real estate services and investment firm subsidiary of a publicly traded company for using an employee release that violated the SEC's whistleblower protection rule. According to the SEC's order, between 2011 and 2022, as a condition of receiving separation pay, the company required its employees to sign a release in which employees attested that they had not filed a complaint against the company with any federal agency. The SEC's order finds that by conditioning separation pay on employees' signing the release, the company took action to impede potential whistleblowers from reporting complaints to the Commission. Importantly, the SEC order found that a generic carve-out provision to allow for reporting to the SEC and other agencies was insufficient to remedy the impeding and chilling effect of the other provision. Noting the company's extensive remedial actions, the SEC imposed a civil penalty of USD 375,000.

On September 29, 2023, the SEC announced settled charges against a New York-based registered investment adviser for USD 10 million based on the adviser having raised impediments to whistleblowing by requiring employees to sign agreements prohibiting the disclosure of confidential corporate information to third parties (without an exception for potential SEC whistleblowers), and by requiring departing employees to sign releases affirming that they had not filed any complaints with any government agency in order for the employees to receive deferred compensation.

C. ESG: Do What is Promised

With the rise of Environmental, Social, and Governance (ESG) discourse, it is no surprise that the SEC is targeting companies that improperly promote ESG initiatives.

On September 25, 2023, the SEC announced charges against a registered investment adviser for misstatements regarding its ESG investment process. To settle those charges and others, the investment adviser agreed to pay a total of USD 25 million in penalties. The SEC's order found that the investment adviser made materially misleading statements about its controls for incorporating ESG factors into research and investment recommendations for ESG-integrated products, including certain actively managed mutual funds and separately managed accounts. The order also found that the investment adviser marketed itself as a leader in ESG that adhered to specific policies for integrating ESG considerations into its investments. However, from August 2018 until late 2021, the investment adviser failed to adequately implement certain provisions of its global ESG integration policy as it had led clients and investors to believe it would. Additionally, the investment adviser failed to adopt and implement policies and procedures reasonably designed to ensure that its public statements about the ESG-integrated products were accurate.

We expect the SEC to continue its enforcement approach including, monitoring public statements by market participants and issuers regarding ESG topics. Given the lack of agreed upon definitions for each of the ESG categories, it will be important for both market participants and issuers to ensure that statements on ESG can be substantiated and that investors receive clear and full disclosure about how a statement on ESG was derived.

III. SEC Financial Industry Enforcement

In a break from the typical Spring-time announcement, the SEC released its 2024 SEC Exam Priorities on October 16th, 2023 with the "hope that aligning the publication of our examination priorities with the beginning of the SEC's fiscal year will provide earlier insight to registrants, investors, and the marketplace of adjustments in our areas of focus year-to-year."

A. Investment Adviser Compliance with Core Obligations with Particular Focus on Fund Managers

The SEC's fiscal year-end actions involving investment advisers, broker-dealers and clearing agencies reflected a focus on compliance with registrants' daily obligations.

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1. Marketing Rule and Custody Rule Compliance

The SEC has been examining investment advisers for Marketing Rule compliance since the Rule went into effect last November and made clear a priority early on would be examining whether advisers adopted and implemented policies and procedures reasonably designed to achieve compliance with the Rule. On September 11, 2023, the SEC announced charges against nine investment advisers for violating the Rule by failing to do just that: focusing on the firms' failure to adopt and/or implement policies and procedures to address advertising hypothetical performance on their websites. In settling the charges, Gurbir S. Grewal, Director of the SEC's Division of Enforcement, made clear that the SEC would be continuing its Marketing Rule sweep efforts with a focus on the adequacy of policies and procedures, including hypothetical performance advertising.

On September 5, 2023, the SEC announced charges against, and settlements with, five investment advisers for failing to comply with core requirements under the Custody Rule, including performing audits, delivering audited financials to investors in a timely manner and ensuring a qualified custodian maintains client assets.

Undoubtedly, more enforcement actions related to the Marketing Rule will be forthcoming this fiscal year as the SEC's compliance sweep continues, and as noted its 2024 Exam Priorities regarding Marketing Rule compliance, the SEC staff will continue to make this an exam focus. While not a focus in the 2024 Exam Priorities, compliance with the Custody Rule is also a core investment adviser obligation and noncompliance can present significant risks. Moreover, the SEC proposed amendments to the Custody Rule early this year and is continuing to assess the proposal for enhancements.

2. Fiduciary Duty, Conflicts and Disclosure

Investment advisers should be aware that the SEC is focused on affiliate party conflicts of interest, and is closely monitoring adviser duties to clients.

On September 5, 2023, the SEC announced an enforcement action against, and settlement with, a private equity firm focused on alternative real estate assets classes for failing to adequately disclose millions of dollars of real estate brokerage fees that were paid to a real estate brokerage firm owned by the CEO of the private equity firm. Osman Nawaz, Chief of the SEC's Enforcement Division's Complex Financial Instrument Unit, made clear that "information related to payments made to affiliates, and the potential conflicts of interest embedded in such arrangements, is critical to investors' decisions." The private equity firm agreed to pay the USD20.5 million in penalties.

On September 12, 2023, the SEC announced a settled action against a company and its registered investment adviser subsidiary for failing to disclose critical information to investors in a USD14.5 million asset-backed securities offering. Specifically, the company failed to disclose a heightened risk that it would be unable to seize assets in the event of a default and prior to the offering, the company had information showing that assets securing other loans that affiliates had made to the same borrowing group were reported as deconstructed without any notice or repayment or could not be located. Still, the company proceeded with the offering without disclosing this material information to investors.

On September 14, 2023, the SEC announced an enforcement action against, and settlement with, a Connecticut-based investment advisory firm and its owner for allocating profitable securities trades to favored accounts, including the firm's own accounts and client accounts that paid the firm a higher percentage of positive returns in fees. Andrew Dean, Co-Chief of the SEC Enforcement Division's Asset Management Unit, explained that "the SEC has the means to identify investment advisers that abuse their position through cherry-picking, as [the firm and its owner] did." The firm and its owner agreed to pay USD 3 million in civil penalties.

On September 22, 2023, the SEC announced charges against, and settlement with, a California-based registered adviser to private funds resulting from acceleration of portfolio company monitoring fees, transferring a private fund asset from funds nearing the end of their term to a new fund and for loaning money from one private fund to another private fund advised by an affiliate.

Additionally, on September 26, 2023, the SEC announced settled charges against a New York-based advisory firm and its principal for failing to implement reasonably designed written policies and procedures concerning the disclosure of conflicts of interest. The advisory firm and its principal advised

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at least 13 clients to invest USD 6.1 million in three companies in which the principal had decision-making authority and significant ownership interests.

B. Regulation Best Interest Cases against Broker-Dealers

After bringing only a single enforcement action in all of 2023 involving Regulation Best Interest ("Reg BI"), the SEC squeezed in three new enforcement actions just under the fiscal year-end wire. Interestingly, the SEC chose not to announce these three cases in press releases, but in the more muted and less noticed form of administrative releases. It appears that the SEC wants to start treating Reg BI enforcement actions as routine, thus signalling additional cases are on the horizon. Therefore, we highlight these cases as they reflect the SEC's willingness to enforce less egregious Reg BI violations.

In line with its January 2023 Reg BI Risk Alert and 2023 Exam Priorities, each of the three actions dealt with one or more of the four core Reg BI obligations: Disclosure, Care, Conflict of Interest, and Compliance.

- **Disclosure Obligation**: In one action, the SEC cited a broker-dealer for failing to make effective delivery of required Reg BI disclosures when attempting to deliver the disclosures electronically without meeting the SEC's requirements for electronic delivery: notice, access, and evidence of delivery (or informed consent). Of the three actions, it is notable that this one led to the largest fine. The action also is a reminder that the SEC has yet to adapt its electronic delivery guidance to the 21st Century.
- **Care and Compliance Obligations**: In another action, the SEC charged a broker-dealer with violating the Care Obligation (as well as antifraud provisions of the federal securities laws) for excessive trading in customer accounts without regard for the associated transaction costs. The SEC also cited the firm for violating the Compliance Obligation by failing to establish, maintain and enforce policies and procedures reasonably designed to achieve compliance with the Care Obligation concerning excessive trading. The SEC also is litigating the same conduct in federal court against five of the firm's registered representatives. It is notable that the underlying conduct here could just have easily been brought under FINRA's prior suitability rule, and FINRA historically brought numerous cases involving similar facts under the prior suitability rule.
- **Conflict of Interest and Compliance Obligations**: In a third action, the SEC focused entirely on the inadequacy of the broker-dealer's written policies and procedures with respect to Reg BI. Both the Conflict of Interest and Compliance Obligations explicitly require broker-dealers to establish, maintain and enforce written policies and procedures reasonably designed to achieve compliance with each of the Reg BI obligations, and, in particular, address conflicts of interest. While the firm had some written policies, they lacked guidance or actual procedures on how its associated persons could achieve compliance with the policies.

The string of actions are likely only a preview of SEC enforcement activity related to Reg BI that should be expected in the coming year. Coupled with Reg BI highlights in the 2024 SEC Exam Priorities, SEC enforcement will clearly be trending towards compliance with the substantive Reg BI obligations. As noted above, the SEC has yet to locate the distinguishable delta between the Care Obligation and the prior suitability rule in an enforcement action, but written policies and procedures will continue to be an area ripe for potential issues.

C. No Slowdown in the Crypto Crackdown

The SEC has placed an emphasis on the crypto marketplace and participants, seeking to ensure that entities are regulated under existing marketplace structures and frameworks while still deliberating new rules and regulations. As we discussed in a recent post, on September 13, 2023, the SEC charged an entity with conducting an unregistered offering of crypto assets securities in the form of purported non-fungible tokens (NFTs) that raised approximately USD8 million from investors to finance an animated web series.

We have frequently commented on the SEC's crypto crackdown since the fall of FTX late last year. Despite recent litigation losses, the SEC clearly will continue to test the bounds of its enforcement jurisdiction when it comes to crypto. As indicated recently by David Hirsch, Chief of the SEC's Crypto Asset and Cyber Unit, and reflected in the 2024 SEC Exam Priorities, the SEC will continue to be active when it comes to crypto investigations and enforcement.

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D. Practices Inhibiting SEC Investigations and Surveillance Remain in Focus

In contrast with lack of civil penalties for cooperating, the SEC imposed some of its stiffest penalties for practices that inhibit the SEC from conducting investigations and carrying out its market surveillance role.

1. Off-Channel Communications

On September 29, 2023, the SEC issued the latest actions in its ongoing crusade on recordkeeping violations related to off-channel communications, targeting broker-dealers and investment advisers, as well as credit rating agencies. In some instances, the off-channel communications were discovered because firms could not produce communications to the SEC during investigations. The combined penalties from all of these actions exceeded USD90 million across 12 firms. Notably, the SEC credited one firm in the recent sweep for self-reporting following an internal investigation initiated after firm staff identified business-related off-channel communications. The fine against that firm was millions less than the other firms included in the sweep, affirming the SEC's favorable view of self-reporting.

Registrants must establish strong protocols to ensure employees communicate via approved mediums in the first instance, and if the company finds there are off-channel communications, they must be preserved. With respect to broker-dealers and investment advisers, the SEC noted the off-channel communication violations were pervasive and longstanding, an indication that the SEC will be digging deep into firms' handling of unapproved communication channels.

2. Market Data Reporting Violations

In a similar vein to the off-channel violations, the SEC continues to monitor companies' other reporting requirements and in particular, blue sheet reporting. Blue sheet data is relied upon daily by the SEC and FINRA for market surveillance to detect insider trading and other market abuse practices. The SEC's latest action involving blue sheet data reporting compliance is a simple reminder of the importance that the SEC places on trade reporting generally. Given the various other trade reporting obligations of broker-dealers (CAT, OATs, TRACE, etc.), firms should be reviewing their reporting controls and processes periodically to ensure they are providing complete and accurate data. The firm received a USD6 million civil penalty.

3. Incorrect Marking of Short and Long Sales

On September 22, 2023, the SEC announced settled charges against a broker-dealer for violating a provision of Regulation SHO, the regulatory framework designed to address abusive short selling practices, which requires broker-dealers to mark sale orders as long, short, or short exempt. These records are routinely used by regulators in policing prohibited short selling activity. To settle the SEC's charges, the broker-dealer agreed to pay a USD7 million penalty.

According to the SEC's order, for a five-year period, it is estimated that the broker-dealer incorrectly marked millions of orders, inaccurately denoting that certain short sales were long sales and vice versa. The SEC's order finds that the inaccurate marks resulted from a coding error in the broker-dealer's automated trading system and that the firm provided the inaccurate data to regulators, including the SEC during this period.

IV. SEC Corporate Enforcement

A. Corporate Enforcement involving Non-Accounting Disclosure and Misstatements

The SEC continues to bring enforcement cases against corporate misstatements affecting a company's business that do not directly involve traditional accounting issues.

On September 26, 2023, the SEC settled fraud charges against an upstate New York-based company that builds hydrogen fuel cell electric vehicles (FCEVs), for misleading investors about its business relationships and vehicle sales before and after a July 2021 merger with a publicly-traded special purpose acquisition company, or SPAC.

On September 28, 2023, the SEC charged a corporation, its subsidiary, and the subsidiary's former CEO with fraud in connection with a multi-year scheme to corruptly influence and reward then-Speaker of the Illinois House of Representatives, Michael Madigan.

B. Traditional Corporate Accounting and Financial Cases

That said, the SEC continues to focus on corporate accounting and financial misstatements with an emphasis on holding individual executives liable.

On September 6, 2023, the SEC announced that a Irving, Texas-based company will pay USD14.5 million to settle charges stemming from the company's improper accounting on two large-scale, fixed-price construction projects. Five former and current officers and employees also agreed to settle related charges for causing the company's violations.

On September 28, 2023. the SEC announced charges against the former Chief Financial Officer and the former Chief Commercial Officer of a New York-based telecommunications company for engaging in fraudulent revenue recognition practices. The SEC also announced settled charges against the company's former Controller, for his role in the scheme. The company previously settled to accounting and disclosure fraud charges filed by the SEC in 2021 and filed for bankruptcy in 2022.

On September 28, 2023, the SEC charged a Denver-based company involved in hybrid electrical vehicle systems for commercial fleet, for misleading investors about revenue projections that topped USD 1 billion within three years of going public. The company previously went public through a 2020 merger with a SPAC. The SEC alleged that the company violated certain antifraud, proxy and reporting provisions of the federal securities laws. The company consented to a cease-and-desist order and a civil penalty of USD 11 million, which took into consideration the company's cooperation and remedial efforts.

On September 29, 2023, the SEC charged a Georgia-based consumer products company and its former CEO with misleading investors about the company's core sales growth, a non-GAAP (Generally Accepted Accounting Principles) financial measure the company used to explain its underlying sales trends. The company and the executive agreed to cease-and-desist from violating certain provisions of the securities laws and to pay civil penalties of USD12.5 million and USD 110,000, respectively.

C. FCPA

On September 28, 2023 the SEC announced that a US-based company in the out-of-home advertising industry agreed to pay more than USD26 million to resolve charges that it bribed Chinese government officials to obtain outdoor advertising contracts in violation of the FCPA.

The SEC's order finds that the company violated the FCPA in connection with the actions of its agent which, at the relevant time, was the company's majority-owned subsidiary in China. Specifically, the order finds that, from at least 2012 through 2017, the subsidiary bribed Chinese government officials to obtain contracts required to sell advertising services to public and private sector clients for display on public bus shelters and other outdoor displays. In addition, the order finds that the subsidiary used sham intermediaries and false invoices to generate cash for off-book "customer development" consultants engaged to win advertising business from government and private customers. According to the order, the subsidiary's improper payments were falsely characterized as legitimate entertainment, cleaning and maintenance, and "customer development" expenses in the company's consolidated books and records. The order further finds that, from at least 2012 through 2019, the company failed to ensure that sufficient internal accounting controls were in place at the subsidiary.

On September 29, 2023, the SEC announced it had settled with a global specialty chemicals company which agreed to pay more than USD103.6 million to settle the SEC's charges that it violated the anti-bribery, recordkeeping, and internal accounting controls provisions of the FCPA. According to the order, despite significant red flags, the company used agents from at least 2009 through 2017 that paid bribes to obtain sales of refinery catalysts to public-sector oil refineries in Vietnam, India and Indonesia and to private-sector oil refineries in India. In addition, the order finds that the company violated the FCPA's recordkeeping requirements and failed to devise and maintain a sufficient system of internal accounting controls to provide reasonable assurances that payments made to agents in Vietnam, Indonesia, India, China and the United Arab Emirates were for legitimate services.

D. Non-Fraud Reporting and Filings Violations involving Company and Insiders

The September cases also reflect the SEC's willingness to go after companies and executives for violations that do not involve intent or even negligence.

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On September 18, 2023 the SEC charged a company for failing to disclose a company board director's role in a shareholder's sale of approximately USD424 million worth of private shares of Lyft's stock prior to the company's initial public offering. According to the SEC's order, the company, which approved the sale and secured a number of terms in the contract, was a participant in the transaction, and the director was a related person by virtue of his position because he received millions of dollars in compensation from the investment adviser for his role in structuring and negotiating the deal. The company failed to disclose this information regarding the sale in its Form 10-K for 2019. The SEC alleged that the company violated Section 13(a) of the Exchange Act and Rule 13a-1 thereunder. Without admitting or denying the SEC's findings, the company agreed to a cease-and-desist order and to pay a USD10 million civil penalty.

On September 27, 2023 the SEC announced charges against six officers, directors, and major shareholders of public companies for failing to timely report information about their holdings and transactions in company stock. Five publicly-traded companies were also charged for contributing to the filing failures by insiders or failing to report their insiders' filing delinquencies.

The charges stem from an SEC enforcement initiative focused on Form 4 and Schedules 13D and 13G reports that company insiders are required to file regarding their holdings of company stock. SEC enforcement staff used data analytics to identify the charged insiders as repeatedly filing these reports late. Some filings were delayed by weeks, months or even years.

E. Outside Auditors of Reporting Companies

Corporate gatekeepers, particularly auditors, continue to be in the SEC's crosshair.

On September 12, 2023 the SEC charged the former National Assurance Services Leader at a public accounting firm, with failing to sufficiently address and remediate numerous deficiencies in the firm's quality control system. The SEC previously charged the firm for these quality control deficiencies and other violations, many of which were in connection with the company's audit work for hundreds of SPACs.

On September 29, 2023 the SEC announced charges against an accounting firm and its California professional services firm for violating auditor independence rules and for aiding and abetting their clients' violations of federal securities laws. According to the SEC's complaint, between approximately December 2017 and October 2020, the firm improperly included indemnification provisions in engagement letters for more than 200 audits, reviews, and exams. As a result, the complaint alleges, the firm was not independent from its clients for those engagements, as required under the federal securities laws.

F. Cases Against Insider Trading and Enforcement Obligations on Insider Trading Prevention

The SEC's September enforcement actions included a traditional insider trading action against a former financial analyst and three others as part of an insider trading ring. The case originated from the SEC Market Abuse Unit's Analysis and Detection Center, which uses data analysis tools to detect suspicious trading patterns. The SEC also charged a corporate finance officer and his two siblings with insider trading. Both matters involved parallel criminal actions.

A September 12, 2023 action reminds broker-dealers of their obligation to (a) establish and implement adequate information barriers, and (b) generally not mislead customers about their existence and adequacy or overstate the controls, barriers and processes that firms have in place to secure its institutional customers trading data.

V. CFTC Enforcement Trends

Like the SEC enforcement actions, the September CFTC enforcement actions announcement helps predict the CFTC's activity in the upcoming year. After our review of these September enforcement actions, the following types of conduct will likely be a priority for the CFTC going forward:

A. Off-Channel Communications

Since December 2021, the CFTC has imposed over USD1 billion in civil monetary penalties on (now) 20 financial institutions for their use of unapproved methods of communication, in violation of CFTC recordkeeping and supervision requirements. That figure is likely to continue to grow in light of the CFTC's end-of-year activity.

In its latest action, on September 29, 2023, the CFTC settled charges against an introducing broker and an affiliated futures commission merchant (FCM), for failing to maintain and preserve records required under CFTC recordkeeping requirements, and failing to diligently supervise matters related to their businesses as CFTC registrants. The CFTC complaint states that employees used WhatsApp and other unapproved communication methods in violation of company policy without remediation. The violations resulted in a USD20 million civil monetary penalty.

As with the SEC, CFTC enforcement actions related to off-channel communications show no sign of slowing down.

B. Crypto – Registration and Fraud

The jurisdictional turf war between the SEC and CFTC in the crypto space is no hidden secret. Thus, it is not surprising to also see the CFTC close the fiscal year with a number of crypto-related enforcement actions.

As we discussed in another recent post, the CFTC sent a clear message in September that DeFi regulation was in its sights. Indeed, in a September 11, 2023 speech, CFTC Director of Enforcement, Ian McGinley, unequivocally stated that "[g]oing forward, I intend for DeFi to be a significant and continuing focus for the Division of Enforcement."

The CFTC separately brought an enforcement action for an individual operating an unregistered commodity pool with respect to trading leveraged bitcoin, and two other actions (here and here) under the CFTC's anti-fraud remit involving the fraudulent solicitation and misappropriation of funds connected to schemes trading bitcoin and "other digital commodities." Finally, to close out the month, the CFTC filed charges against eight entities for (unlawfully) claiming to be CFTC-registered FCMs and retail foreign exchange traders.

Whether involving spot, futures, or leveraged crypto-related products, or TradFi or DeFi, we take Direct McGinley at his word when he states that "the CFTC will keep up with developments in the relatively new market for derivatives on digital assets and will continue to prosecute those who try to avoid the US regulatory regime no matter how esoteric their means of avoiding that regime." Unsurprisingly, any firm, business, DAO, or individual looking to engage in a crypto-related business in the US should be considering the recent actions and trends from both the SEC and CFTC.

C. Registrant Obligations – Supervision, Reporting and Recordkeeping

For all registrants, supervision is the first line of defense to misconduct and investor protection. The CFTC's end-of-year activity serves as a reminder that CFTC registrants must be vigilant in implementing and maintaining their supervisory systems to ensure proper oversight of customer trading activity. Moreover, registrants' reporting obligations serve an important role in market transparency and customer protection. The CFTC's recent enforcement actions reflect a continued focus on these day-to-day obligations of registrants.

On September 20, 2023, the CFTC issued an order against a registered FCM for failing to diligently supervise the handling of commodity interest accounts, which resulted in incomplete and inadequate oversight of its surveillance of customers' trading activity for disruptive trading over a four-year period. The firm failed to ensure that its clients' accounts were monitored correctly, causing over 12.8 million cleared contracts to not be processed or surveilled between July 2018 and June 2022 due to mistakes or inaction by the firm. The firm was charged USD395,000.

On September 29, 2023, the CFTC announced an order against another FCM for failure to maintain adequate supervisory systems and controls to ensure its customers' trading was not disruptive and for material omissions in a letter to the CFTC's Division of Enforcement related to the investigation. The FCM received a civil penalty of USD 3 million.

On September 20, 2023, the CFTC issued an order simultaneously filing and settling charges against a registered swap dealer for violations of the CFTC's Business Conduct Standards applicable to swap dealers. Specifically, the CFTC found that the swap dealer failed to disclose thousands of Pre-Trade Mid-Market Marks (PTMMM), in

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violation of CFTC Regulation 23.431, and failed to diligently supervise its PTMMM compliance process, in violation of CFTC Regulation 23.602. The swap dealer received a USD 650,000 civil monetary penalty along with certain reporting and compliance requirements.

On September 29, 2023, the CFTC announced orders against three major financial institutions for a variety of swap dealer activities, including failures related to the disclosurePTMMMs. The settling financial institutions, charges, and civil monetary penalties are:

- Failing to diligently supervise a wide range of its swap dealer activities, and for unprecedented failures regarding swap data reporting and the disclosure of PTMMMs in violation of multiple sections of the CEA and CFTC regulations. The order imposes a USD 30 million civil monetary penalty and includes the financial institution taking steps to develop a written remediation plan and retain a consultant to advise on and assess its remediation plan;
- Violations related to swaps reporting. The order imposes a USD 15 million civil monetary penalty and other undertakings; and
- Failing to diligently supervise swaps reporting and failing to comply with swaps reporting obligations. The order imposes an USD8 million civil monetary penalty and other undertakings.

D. Unregistered Activity (Beyond Crypto)

Beyond crypto, the CFTC historically has focused enforcement of the various registration requirements under the Commodity Exchange Act (CEA) for intermediaries and trading platforms to mitigate and address potentially fraudulent conduct. In September, the CFTC brought actions involving unregistered trades against two forex funds and an individual with fraudulently soliciting customers to trade leveraged, margined, or financed retail foreign exchange (retail forex), and leveraged retail commodity transactions; and a separate action against a foreign-based trading platform for offering leveraged gold, silver and forex without registering as an FCM.

E. Fraud Generally

On September 7, 2023, the CFTC announced that a US federal district judge entered a consent order stemming from CFTC charges against a trading firm and finding the firm liable for fraud in connection with retail forex transactions, fraud by a commodity pool operator (CPO), registration violations, and failure to comply with CPO regulations. The court ordered the firm to pay more than USD1.7 billion in restitution to defrauded victims, permanently enjoined from further violations of the CEA, as charged, imposed permanent trading bans in any CFTC-regulated markets and required a registration ban against the firm.

On September 27, 2023, the CFTC announced that a federal district court entered a preliminary injunction against a CPA, along with four other individuals and five companies, for charges alleging fraud, misappropriation, and registration violations in connection with a fraudulent forex scheme. The complaint alleged from 2019 to 2021, the defendant's companies fraudulently solicited and misappropriated USD58 million from US and international customers for purported trading in forex.

F. Precious Metals

The CFTC also monitored the precious metals market and brought several enforcement actions, partnering with other regulators and agencies. We anticipate increased collaboration and enforcement in the coming year.

On September 26, 2023, the CFTC sought and obtained a restraining order against the defendant precious metals dealer and two other firms, freezing assets and requiring the firms to submit to examination. The CFTC has also brought an action against the companies for (i) fraudulent solicitation of customers to purchase precious metals in self-directed IRAs and (ii) misappropriating customer funds and assets. The CFTC alleged that the defendants received more than USD7 million from more than 100 (mostly elderly) victims, and have misappropriated most of those funds.

On September 28, 2023, the CFTC and California Department of Financial Protection & Innovations announced an action against a precious metal dealer, its CEO, and former president, alleging misappropriation of more than USD21 million in a nationwide fraudulent scheme. Rather than using all of the customers' funds to purchase precious metals, the defendants misappropriated more than USD21 million from more than 120 customers. In doing so, the defendants made knowing or reckless fraudulent misrepresentations and omissions to customers,

including using forged documents, in order to conceal their misappropriation and maintain their fraudulent scheme. Defendants were engaged in Ponzi-like activity, and misappropriated funds to pay off personal and business expenses.

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