Baker McKenzie.

Looking Back & Looking Ahead

Financial Regulation and Enforcement 2019/2020

A Series of Analyses of the Past Year in Financial Regulation and Enforcement and What to Expect in the Coming Year.

First, The Numbers.

Introduction

Welcome to the first of our series of year-end analyses of the year in securities regulation and enforcement.

First, we will consider the past year "by the numbers," the statistics that the Securities and Exchange Commission (SEC), or more specifically, its component Divisions and Offices, release annually. Later parts of the series will consider some of the specific areas of focus for the SEC Enforcement Division in bringing enforcement actions in the past year, and how that informs our future expectations.

This analysis will take a look at enforcement actions, penalties and disgorgement, examination statistics, as well as the data issued by the Office of Whistleblower. As you will see, the SEC is canny in how these numbers are released and any careful review will generally require resort to several SEC reports, issued over months, in several documents, to make actual sense of what the statistics mean for considering the past conduct and for the evaluating the future. Some of that material is not yet available, but we will update this document as the data is released. Further, the Commission routinely changes whether and how certain data is released from year to year, so comparing performance is complicated.

In addition, although the SEC's fiscal year runs from October 1 through September 30, we have reviewed material released following the end of the fiscal year and enforcement actions reviewed through the calendar year end. Finally, FINRA's fiscal year is the calendar year and we are awaiting the release of FINRA's statistics. We anticipate a review of those numbers and will share those in a later analysis.

SOURCES: Much of the data is taken from the SEC Division of Enforcement Annual Report (ENF Annual Report), supplemented, as noted, by the 2019 Annual Report to Congress Whistleblower Program; the Fiscal Year 2020 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2018 Annual Performance Report, as well as the Budget Justification documents for prior years and the just released Fiscal Year 2021 Budget Justification; 2020 Examination Priorities, Office of Compliance Inspections and Examinations (2020 Exam Priorities).

Fiscal Year	Total Number of Enforcement Actions	Number of "Standalone" Actions	Total Penalties and Disgorgement Collected
2015	807	508	$4.19 billion
2016	868	548 (96 MCDC)	$4.08 billion
2017	754	446	$3.79 billion
2018	821	490	$3.945 billion
2019	862	526 (95 SCSD)	$4.349 billion

As you can see, the number of cases brought in fiscal year 2016 was improved by MCDC, the Municipalities Continuing Disclosure Cooperation self-reporting initiative, which encouraged municipal bond underwriters and issuers to self-report misstatements and omissions in municipal bond offering documents. Similarly, in 2019, the enforcement action tally was improved by the SCSD, the Share Class Selection Disclosure Initiative, which invited investment advisers to self-report, if they had failed to make the required disclosures related to the selection for customers of mutual fund share classes that paid the adviser or an affiliated broker-dealer a 12(b)-1 fee, when a lower cost share class was available.

Following, you will find a chart of the Enforcement Division's "standalone" cases for fiscal year 2019, broken down according to the Staff's subject matter categories, together with the 2018 numbers for comparison. Date for "standalone" cases exclude from the total enforcement actions those administrative proceedings which follow criminal or civil injunctive actions for the purpose of imposing associational bars based largely on the relief obtained in the prior matter, as well as the deregistration matters filed against companies delinquent in making required periodic filings.

Of particular interest on the following chart is the continuing decline in the number of enforcement actions against broker-dealers. As the financial services industry has shifted toward fee-based, investment advisory programs, and the SEC largely has ceded the "hands on" retail broker-dealer regulatory space to FINRA to focus on examinations of registered investment advisers, these shifts, together, have culminated in fewer broker-dealer matters, an SEC focus on market structure issues in the broker-dealer space, and steady, consistent increases in the enforcement actions against investment advisers. We anticipate that this trend will continue, since it also well suits the Commission's continued focus on "retail" investors.

Given the fiduciary standard applicable to investment advisers, the fact that the Commission has seemed to constantly move the target on what constitutes an adequate disclosure for conflicts of interest, and the reality that enforcement cases against investment advisers generally result in actual remediation payments back to the retail investors that the SEC have made central to all initiatives, we can expect that the numbers of cases involving investment advisers will continue to climb.

Type of Case	Number of Actions	Percentage of Total Actions	Number/Percentage in 2018
Investment Advisers/Investment Companies	191	36	108 cases/22%
Securities Offering	108	21%	121 cases/25%
Issuer Reporting/Audit & Accounting	92	17%	79 cases/16%
Broker-Dealer	38	7%	63 cases/13%
Market Manipulation	30	6%	32 cases/7%
Insider Trading	30	6%	51 cases/10%
FCPA	18	3%	13 cases/3%
Public Finance Abuse	14	3%	15 cases/3%
SRO or Exchange	3	1%	1 case/0%
Miscellaneous	1	0%	3 cases/1%
Transfer Agent	1	0%	2 cases/0%
National Recognized Statistical Ratings Organization (NRSRO)	0	0%	2 cases/0%
TOTAL	**526**	**100%**	**490 cases/100%**

Since fiscal year 2012, the Commission has ordered the payment of at least $3 billion in penalties and disgorgement in connection with enforcement proceedings concluded during that year; and in the course of those eight fiscal years, including 2019, the amounts ordered have exceeded $4 billion half of the time.

These seemingly ever-increasing numbers cannot be taken at face-value, however. More recently, the Enforcement Division has offered a closer analysis of what these numbers actually mean, including providing this year a breakdown of sums distributed to harmed investors during the fiscal year.

Monetary Sanctions Ordered, Collected and Distributed

*All amounts in millions

Fiscal Year	Penalties Ordered	Disgorgement Ordered	TOTAL	Amounts Collected[1]	Amounts Distributed to Harmed Investors
2015	$1,175	$3,019	$4,194	$2,444	$158
2016	$1,273	$2,809	$4,083	$2,655	$140
2017	$832	$2,957	$3,789	$2,194	$1,073
2018	$1,439	$2,506	$3,945	$1,095	$794
2019	$1,101	$3,248	$4,349	not avail	$1,197

For each of the five most recent five fiscal years, the top 5% largest cases accounted for between 67% and 77% of all monetary relief ordered by the Commission, with the remaining 95% of the matters accounting for the bulk of the Enforcement Division's work and the remaining 23%-33% of the of the ordered relief. Further, as demonstrated in the chart above, these larger amounts, while ordered, are often neither collected nor collectable. This was the case, for example, with last year's Petrobras matter, an FCPA case responsible for 45% of the total monetary sanctions ordered for the entire year, but the eye-popping monetary sanctions ordered in that matter were subject to significant off-sets due to other regulatory and civil actions concurrently resolved.

In addition, while the Commission often talks about the importance of distributions to harmed investors, the amounts actually distributed during the fiscal year represent a very small amount of the sums ordered. Even in those years when the figure for distributed amounts appears to be significant, a closer look at the sources of the funds distributed to harmed investors reveals that, while the distributions may have actually occurred during the identified fiscal year, these funds derive from cases and conduct dating back several, even many, years. See ENF Annual Report at p. 17. See also, e.g., In the Matter of Citigroup Alternative Investment LLC, AP File No. 3-16757 (noting that the settled Commission Order was entered in August 2015, relating to conduct that occurred between 2002 and 2008, but the Order directing distribution of almost $185 million to "harmed investors" issued in September 2019).

[1] These figures are taken from the US Securities and Exchange Commission Fiscal Year 2020 Congressional Budget Justification Annual Performance Plan, Fiscal Year 2018 Annual Performance Report ("2019 Budget Report"), issued March 18, 2019, available at https://www.sec.gov/cj. According to the 2019 Budget Report, these are the amounts actually ordered during each of the identified fiscal year and "the amounts collected in those actions as of the end of FY 2018." Id. at p. 127. Thus, for each year, this is a cumulative tally and, for example, sums ordered in 2015 and not collected until 2018, will be reflected here.

Looking ahead, the most important pending issue in the area of monetary sanctions is the Liu v. SEC, No. 18-1501 (U.S.) case, currently before the United States Supreme Court. As we noted in a prior publication, in the Liu matter, the Supreme Court is now considering whether the SEC has authority to obtain disgorgement as a remedy in federal court actions. Needless to say, should the Court determine that the SEC does not have the power to seek disgorgement in federal court actions, this would significantly alter how and in which forum the Commission decides to bring unsettled enforcement actions. However, since disgorgement is a remedy available in the administrative forum, and since the overwhelming majority of enforcement matters settle, the overall effect really might be to dampen rather than fully alter Enforcement Division litigation strategy, as the Staff will have to proceed with the knowledge that if they overreach in settlement discussions, they could face a real challenge.

Statistics Related to Investigations

Also of interest each year is the number of investigations that the Enforcement Division Staff has opened and how many remain open at the close of the fiscal year. This information, set forth in the chart below, is not published in the now-annual Division of Enforcement Annual Report but can be found in the agency's Annual Performance Report and budget request, along with related metrics about quickly the Division progresses its investigations, in how many investigations did another regulator seek access to the investigative file, and the percentage of enforcement actions that arose out of what the agency considered to be a "national priority investigation," just to name a few of the performance indicator measures. See 2019 Budget Report at, e.g., pp. 25, 120-129.

Fiscal Year	Investigations Opened	Ongoing Investigations At Close of Fiscal Year
2014	995	1,612
2015	980	1,677
2016	1,063	1,729
2017	965	1,695
2018	869	1,604
2019	827	1,431

Of particular interest among these performance indicators is the fact that the Enforcement Division has routinely failed to meaningfully move the needle on so-called "real time enforcement." The chart below shows the percentage of cases in which the first enforcement action arising from a single investigation was filed within two years from the opening of the investigation - and also shows that figure has declined for each of the last five years for which data is available. Id. at 123.

Fiscal Year	Percentage of first enforcement actions filed within 2 years from the opening of an investigation
2014	64%
2015	58%
2016	53%
2017	52%
2018	49%
2019	Not yet available

According to the ENF Annual Report, when the actual statistics come out, we should see an improvement in these numbers, since the Enforcement Division advises that, on average, its cases took just under two years from case opening to the filing of an enforcement action. But based on the chart above, that would appear to suggest more of the same. See ENF Annual Report at p. 7.

Office of Compliance Inspections and Examinations Statistics

Although full statistics are not yet available for 2019 from the Office of Compliance Inspections and Examinations (OCIE), certain data is available in the OCIE 2020 Examination Priorities document, the balance of the data in the two charts below has been collected from the Commission's annual Congressional Budget Justification and Annual Performance Report and Plan documents.

OCIE notes that the slight reduction in total exams is most certainly a result of the month-long government shut-down that began calendar year 2019. See 2020 Exam Priorities at p. 3. Worth noting, too, is the fact that "total exams" includes a wide variety of "exams," from full actual periodic exams, to smaller limited scope inquiries. One of the more interesting OCIE statistics for 2019 is the fact that, as the result of deficiencies found during exams, firms returned "more than $70 million to investors." Id. Unfortunately, it is unclear from the language of the document whether those remediation payments were made in lieu of a referral to Enforcement, but one would anticipate that was the purpose.

The 2020 Exam Priorities document mentions that OCIE referred "over 150" matters to Enforcement in fiscal year 2019. See id. That said, as the first chart reveals, although the number of total exams has increased, the percentages of those exams where a deficiency was identified, or where a "significant finding" or a referral to the Enforcement Division for further investigation was the result, has pretty steadily declined over time. This is a particularly interesting analysis when you consider that in recent years we have seen a steady rise in targeted exams, seeking to identify specific conduct, based on data the SEC Staff already has, largely for the purpose of developing Enforcement referrals, such as we saw, for example, in the mutual fund share class matters. Again, it is uncertain whether or when we will see the details on the 2019 exam deficiency and referral data, since it was not included in the recently released Fiscal Year 2021 Congressional Budget Request report.

Fiscal Year	Total Exams	Percentage Identifying a Deficiency	Percentage Resulting in "Significant Finding:	Percentage Resulting in Enforcement Referral
2014	1,878	76%	30%	12%
2015	1,992	77%	31%	11%
2016	2,427	72%	27%	9%
2017	2,873	72%	20%	7%
2018	3,175	69%	20%	6%
2019	3,089	not yet available	not yet available	not yet available

As the bookend to the comments above related to the decrease in broker-dealer related enforcement actions, as you can see from the chart that follows, the numbers of broker-dealer examinations undertaken by the SEC continues to fall. However, as the last line of the chart shows, the SEC's SRO partners, like FINRA, have made up for that, to ensure that broker-dealers largely continue to experience a two-year exam cycle. By contrast, the Commission has really struggled to surpass the 15% mark in its examinations of investment advisers, with the result that risk ranking continues to play an important role in selection. See 2020 Exam Priorities at p. 8.

Exam Type	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Investment Adviser total	1,150	1,221	1,447	2,114	2,312	2,188
% of all Investment Advisers	10%	10%	11%	15%	17%	15%
Investment Company total	87	137	184	95	132	102
% of all Investment Companies	10%	15%	17%	11%	15%	not avail
SEC Broker-Dealer total	493	484	543	325	329	352
% of all Broker-Dealers (includes SEC/SRO)	49%	51%	50%	48%	48%	43%

Office of the Whistleblower Statistics

For the first time since the Office of the Whistleblower was established, the number of tips, complaints and referrals declined in fiscal year 2019. This is not really a surprise, since last year's figure was significantly higher likely as the result of the United States Supreme Court's decision in the Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767 (2018), matter, in which the court held that a whistleblower must report concerns to the Commission in order to qualify for the non-retaliation protections afforded under Section 21F(h) of the Dodd-Frank Act.

Fiscal Year	Total Number of Tips	Percentage Increase of Tips	Total Investigations Arising from Tips	Percentage of Investigations Arising from Tips
2015	3,923	8.4%	325	8.3%
2016	4,218	7.5%	336	8.0%
2017	4,484	6.3%	307	6.8%
2018	5,282	17.8%	315	6.0%
2019	5,212	-1.3%	not yet available	not yet available

In terms of the types of conduct that is the subject of whistleblowers' tips, complaints and referrals, the category "Other," always the largest group, simply means that the person submitting the information did not believe that it fit into one of the other categories. As a result, drawing conclusions from this data is complicated, since, for example, none of the other categories would appear to contemplate whistleblowing activity at a regulated entity for most types of non-compliance that the SEC or FINRA would examine for or consider a securities law violation.

Finally, the number of tips that result in Enforcement investigations continues to fall; and one can only presume that the number of actual cases that results from these tips is a fraction of that already small number. These are not figures that can be found in the 2019 Annual Report to Congress of the Whistleblower Program, where the rest of this data comes from; rather, the 2020 Budget Justification document includes this information as part of the performance metrics.

Unfortunately, we do not anticipate the number of tips to diminish, or the work required by and with our clients to manage whistleblower issues, many of which appear to stem more from employment-related difficulties than they do from actual securities laws violations.

Allegation Type	Total Allegations				
	2019	2018	2017	2016	2015
Other	1,614	1,210	1,162	996	956
Corporate Disclosure and Financials	1,107	983	954	938	687
Offering Fraud	692	1,054	758	646	613
Manipulation	535	624	468	472	482
Cryptocurrency	289	*	*	*	*
Insider Trading	222	262	231	262	273
FCPA	200	202	210	238	186
Unregistered Offerings	138	252	144	143	150
Not Reported	131	109	94	97	114
Municipal Securities and Public Pension	35	57	58	57	67

Conclusion

We hope that you have found this quick review of the SEC's statistics to be interesting. We will follow this analysis with our reviews of some of the most interesting cases and areas of focus of the past year, along with our takes on what that means, and what we are seeing, in the current year.

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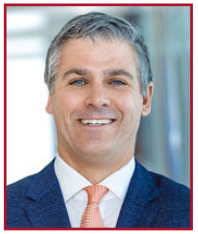

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