

SEC Enforcement By The Numbers

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Fans of Steve Martin's classic 1979 comedy "The Jerk" undoubtedly recall his character's delight at learning his number had been listed in the phone book. "I'm somebody now! Millions of people look at this book every day!" As an SEC nerd, I derive similarly embarrassing excitement from the annual publication of the U.S. Securities and Exchange Commission's enforcement statistics. While the agency announces an overview of its results in October, following the close of the government's Sept. 30 fiscal year, the more detailed report always takes a few additional months, but provides an abundance of insights into the Enforcement Division's priorities.[1]



Marc J. Fagel

The SEC filed a record number of enforcement actions in fiscal 2015 — 807 total filings vs. 755 in 2014 and 676 in 2013.[2] As I wrote in an article here a year ago, the SEC's annual statistics (or "stats" in agency parlance) are notoriously flexible, and are not necessarily a reliable indicator of the SEC's productivity.[3] To its credit, the SEC this year took criticism of its tallies to heart and provided far greater transparency into its calculation methodology. The SEC expressly noted that a significant number of actions (132) were comprised of relatively straightforward proceedings for delinquent SEC filings, and, for the first time, broke out the number of enforcement actions that constituted "follow-on" administrative proceedings sanctioning industry personnel already found culpable for federal securities law violations (168).

Notably, even after carving out these more routine filings, 2015 proved to be a record-breaking year for the agency, with 507 stand-alone, substantive enforcement actions as compared to 413 in 2014, representing a 23 percent increase. While some years have seen the agency leadership touting record-breaking or near-record-breaking results arguably inflated by routine proceedings or large multiparty "sweeps," there can be little doubt that the Enforcement Division was firing on all cylinders in 2015. (But, to be fair, we need to consider the muni caveat, described below.)

The recently published report confirms another important development: The SEC's increasing focus on financial reporting fraud, highlighted as a priority over the past few years, is finally starting to manifest in new case filings. Meanwhile, cases against investment advisers and broker-dealers, a major focus in recent years, have dropped off slightly, as has the number of insider trading cases. Finally, the SEC's growing use of in-house administrative proceedings rather than federal court actions, a topic of extensive debate, appears to have leveled off, though administrative proceedings remain far more prevalent than in the past.

The Return of Financial Reporting Fraud

Since the public company scandals of the 2000s, when accounting fraud and other public company disclosure cases routinely represented a quarter or more of the Enforcement Division's caseload, there has been a precipitous decline in the number of such cases.[4] By 2013, issuer reporting and disclosure represented only about 13 percent of enforcement actions. The current SEC leadership has been touting a renewed focus on financial reporting over the past few years, but until recently (perhaps unsurprisingly given the complexity and length of most investigations) this had not been reflected in a noticeable uptick in financial fraud cases. That changed in 2015. According to the SEC's annual report, issuer reporting and disclosure cases represented 20 percent of the SEC's 2015 enforcement actions — the largest proportion in many years, and the single largest component of the agency's 2015 docket. All told, the SEC brought 135 such cases against 213 individuals and companies.[5]

Of course, the raw numbers don't tell the whole story. SEC "stats" count all enforcement actions the same, from complex, multidefendant cases that took years to investigate to minor, routine filings. In addition, a single matter can have multiple associated filings, inflating the count. For example, the 96 issuer reporting cases initiated in 2014 included 20 separate proceedings filed the same day against various entities affiliated with a single stock promoter.[6] Similarly, of the 135 new issuer reporting cases in 2015, 10 stemmed from an enforcement sweep against small companies for alleged failures to make disclosures regarding financing arrangements, while eight were filed as part of a sweep against small accounting firms for violations of auditor independence rules in connection with brokerage firm audits.[7] Nonetheless, there can be no doubt that the number of cases in this area has risen dramatically.

One further indicator of increased activity in the financial reporting space is the rebound in officer and director bars. Although the SEC may seek to bar corporate executives for other violations of the federal securities laws, such as insider trading, these bars are typically sought in financial reporting and disclosure actions. In 2014, the SEC sought bars against 57 officers and directors; in 2015, this nearly doubled to 111. (By comparison, at the height of the SEC's crackdown on accounting fraud in 2004, there were 161 officer and director bars sought.)

Other Case Trends

At the same time that financial reporting cases were declining in recent years, the SEC significantly increased its focus on investment advisers (including private investment funds) and brokers. Perhaps predictably, as the decline in financial fraud cases reversed course in 2015, these other matters started to drop off somewhat. Actions against investment advisers comprised about 19 percent of the 2015 caseload, as compared to 26 percent two years earlier; likewise, broker-dealer cases dropped from 22 percent to 18 percent over the same period. Notably, over two-thirds of the cases against brokers were follow-on administrative proceedings, and the number of new stand-alone cases against brokers is actually much lower than the number of cases against advisers. (As this is the first year the SEC has broken out follow-on proceedings from new actions, it is unknown whether this represents a change from prior years.) The relative dearth of new cases against brokers is consistent with recent agency pronouncements that it would be de-emphasizing its scrutiny of brokers, reallocating a number of its broker-dealer examination staff members to exams of investment advisers.[8]

One other noticeable trend in 2015 was the relative decline in insider trading cases. The agency filed a total of 39 insider trading actions in 2015 versus 52 a year earlier. However, the number of individuals sued was essentially unchanged, suggesting that 2015's trading cases involved larger groups of tippers

and/or traders named in each matter.

The Administrative Proceedings Plateau

As SEC enforcement practitioners are well aware, one of the most important (and controversial) developments in recent years has been the dramatic rise in administrative proceedings (APs). Ever since the passage of Dodd-Frank essentially enabled the Enforcement Division to obtain the same relief in APs as it could in federal court, the SEC has increasingly relied on such proceedings, held before an in-house administrative law judge rather than a federal judge or jury. In 2012, 55 percent of all enforcement actions were filed administratively; by 2014 this had risen to 78 percent. In 2015, the number leveled off, dropping slightly to 76 percent (but still well in excess of historic levels).

The SEC's reports do not distinguish between litigated and settled actions. Undoubtedly a significant portion of the rise in APs is in the settlement context, where the SEC can avoid the burden of seeking approval from a federal judge (and the risk of a judge challenging the terms of the settlement). However, there is no question that the SEC has also increased the frequency with which it has filed litigated actions as APs. This has met with some controversy, given the procedural restrictions of the administrative forum and perceived benefits of federal court actions by defendants.^[9] While the 2015 data suggest that this trend may have peaked (perhaps due at least in part to extensive criticism of, and court challenges to, APs), defendants should assume that the SEC will continue to use the administrative forum far more frequently than in the pre-Dodd Frank era.

The Muni Caveat^[10]

One final quirk in the 2015 stats should be noted. The SEC filed 80 cases involving municipal securities and public pensions, accounting for 12 percent of its new case filings. This represents quite a leap for the traditionally sleepy segment of the enforcement program (which, by contrast, accounted for fewer than 2 percent of the SEC's cases in 2013). However, the figures are skewed significantly by the SEC's 2014 "Municipalities Continuing Disclosure Cooperation" initiative, under which underwriters are encouraged to self-report misstatements in muni bond offering documents in exchange for lenient settlements. The SEC simultaneously charged 36 firms in June 2015 under the initiative, and another 22 in September (on the last day of the fiscal year).^[11] In addition, the SEC simultaneously charged 13 underwriters in connection with an enforcement sweep involving Puerto Rico junk bonds.^[12] Those three matters alone account for 71 of the 80 muni cases, and represent more than 10 percent of all 2015 enforcement actions, arguably making the leap in overall filings a bit less impressive, albeit still ahead of 2013 and 2014.

At the same time, factoring in the muni caveat (i.e. discounting these filings from the overall total) would make the proportion of financial reporting cases even higher, and somewhat offset the decline in investment adviser and broker-dealer cases. (None of this is intended to diminish the importance of the muni actions. Signing up 71 separate parties to SEC settlements is no small task; but it's certainly less resource-intensive than 71 stand-alone investigations.)

Conclusion

Projecting ahead, one should assume that the frenetic pace of new enforcement filings will continue into 2016, albeit perhaps down slightly. The Enforcement Division opened slightly fewer new investigations in 2015 compared to 2014 (980 vs. 995), and obtained 554 formal orders of investigation (down slightly from 576 the year before). While not every investigation with a formal order results in an

enforcement proceeding, it is at least a signifier of a matter receiving substantial staff resources and attention. In short, while the dramatic leap in new cases seen in 2015 is unlikely to be replicated, the SEC shows no signs of slowing down.

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[1] The statistics discussed herein are drawn from the annual Select SEC and Market Data reports, which can be found on the SEC's website at www.sec.gov/about/secreports.shtml.

[2] SEC Press Release, SEC Announces Enforcement Results for FY 2015 (Oct. 22, 2015), available at www.sec.gov/news/pressrelease/2015-245.html.

[3] See Marc J. Fagel, What The SEC Enforcement Stats Really Tell Us, Law360 (March 3, 2015).

[4] Issuer financial statement and reporting cases represented nearly 30 percent of all enforcement actions in 2004. For purposes of this article, delinquent filing actions are excluded from the calculations used herein.

[5] Note that of these 135 cases, 21 were follow-on administrative proceedings against previously charged defendants. As the SEC has not shared this breakdown previously, it is unclear how this compares to prior years.

[6] SEC Press Release, SEC Seeks Stop Orders Against 20 Purported Mining Companies (Feb. 3, 2014), available at www.sec.gov/News/PressRelease/Detail/PressRelease/1370540716442.

[7] SEC Press Release, SEC Sanctions 10 Companies for Disclosure Failures Surrounding Financing Deals and Stock Dilution (Nov. 5, 2015), available at www.sec.gov/News/PressRelease/Detail/PressRelease/1370543368026; SEC Press Release, SEC Sanctions Eight Audit Firms for Violating Auditor Independence Rules (Dec. 8, 2015), available at www.sec.gov/News/PressRelease/Detail/PressRelease/1370543608588.

[8] See, e.g., L. Lambert, U.S. SEC Says Shift from Examining Brokers to Investment Advisers Necessary, Reuters (Feb. 20, 2016).

[9] The SEC has proposed amendments to its rules of practice governing administrative proceedings in response to this criticism, but these have yet to be approved. See Gibson, Dunn & Crutcher, SEC Moves in the Right Direction ... (Sept. 28, 2015), available at www.gibsondunn.com/publications/Pages/SEC-Proposed-Amendments-to-Rules-Governing-Administrative-Proceedings.aspx.

[10] I made this term up; feel free to use it.

[11] SEC Press Release, SEC Charges 36 Firms for Fraudulent Municipal Bond Offerings (June 18, 2015), available at www.sec.gov/news/pressrelease/2015-125.html; SEC Press Release, SEC Sanctions 22 Underwriting Firms for Fraudulent Municipal Bond Offerings (Sept. 30, 2015), available at www.sec.gov/news/pressrelease/2015-220.html.

[12] SEC Press Release, SEC Sanctions 13 Firms for Improper Sales of Puerto Rico Junk Bonds (Nov. 3, 2014), available at www.sec.gov/News/PressRelease/Detail/PressRelease/1370543350368.

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