

What The SEC Enforcement Stats Really Tell Us

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Each year, the U.S. Securities and Exchange Commission undertakes a familiar exercise. At the close of the fiscal year, senior officials proudly proclaim that the SEC has broken (or nearly broken) previous records for the number of enforcement actions filed by the Division of Enforcement, while simultaneously clarifying that the number of new actions tells only part of the story.

2014 saw the SEC again heralding that it had filed more enforcement actions than ever before. And, as always, the story is not quite so simple. However, other statistical data released by the agency at the beginning of 2015 provides much greater insight into where the enforcement division is focusing its attention and where it may be heading.

Another Record Year (Not That We're Counting)

Shortly after the close of the fiscal year ended Sept. 30, 2014, the SEC issued a press release announcing that “the SEC filed a record 755 enforcement actions.”[1] (This tally of new case filings is known slightly less than affectionately within the division as “stats,” so that term will be used herein as well.) Enforcement division Director Andrew Ceresney reiterated these impressive stats in a November speech, noting that “we filed 755 actions last year — the most ever filed in the history of the Commission.”[2]

This is not to single out Ceresney for taking pride in the program’s stats; the SEC has been making similar announcements for some time. Consider such landmarks as 2011 (“the agency filed a record 735 enforcement actions”)[3] and 2008 (“the second-highest number of enforcement actions in agency history”).[4]

At the same time, the SEC typically follows its announcement of record-breaking numbers with a disclaimer not to focus too much on the numbers. As Ceresney continued in that same November speech, “But as I always say, numbers only tell a small part of the story.”[5]

Indeed, it is no great secret that the SEC’s stats are a poor indicator of the division’s actual productivity or accomplishments. For example, in 2014, the 755 enforcement actions included 107 cases against issuers for delinquent filings — nearly 15 percent of the total.[6] And 80 of last year’s stats arose from



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five targeted industry sweeps, in which large numbers of individuals and entities were simultaneously charged for various nonscienter, nonfraud violations.

More broadly, stats count all SEC case filings exactly the same, regardless of the scope or significance of a particular action. A complaint charging multiple defendants for perpetrating a complex financial accounting fraud or conducting an international insider trading scheme is counted as a single stat — the same as a routine filing to delist an inactive shell company for failing to timely file quarterly reports, or a follow-on action to revoke the registration of a broker previously found liable for violating the federal securities laws.

Likewise, a single investigation may result in multiple separate case filings, further skewing the data. For example, 20 of the 755 actions were filed in a single day to stop trading in the securities of multiple purported mining companies controlled by a stock promoter.[7]

None of this, I should add, should be read to minimize the importance of these various matters to the SEC's mission. The enforcement sweeps, beyond generating numerous stats for the division, focus industry attention on issues and regulations that may not otherwise be on the radar screen; publicly-trading companies without current financial reports may become ripe for future frauds.

And there is no denying that, by any measure, 2014 was an unusually busy year for the division — even after stripping out delinquent filing cases, the SEC filed 648 actions in 2014, versus 544 in 2013[8] — a nearly 20 percent climb. The point is simply that the SEC's pronouncements about record-setting numbers of cases tell us little about what the Division of Enforcement is really doing. The question, then, is what metrics should we be watching?

Subject Matter Trends

The SEC's breakdown of cases by subject matter, illustrated in its Select SEC and Market Data report (supra note 6), helps illustrate the relative priorities of the Division of Enforcement. Cases against brokers represented the largest component of the SEC docket, with 26 percent of new cases (as compared to 22 percent in 2013).[9] Cases against investment advisers, a high priority in recent years, were a close second, with 20 percent of the new filings (a decline from the 2013 high of 26 percent).

Meanwhile, cases involving insider trading (8 percent), market manipulation (10 percent), and securities offerings (12 percent, typically Ponzi schemes) contribute a relatively consistent proportion of the enforcement docket from year to year.

Perhaps most interesting is the data concerning financial reporting cases. Since 2013, as the resource-intensive financial crisis investigations began to wind down, the SEC has emphasized its renewed focus on public company accounting, disclosures and internal controls. Among other things, the division has established a financial fraud task force to bring additional resources to proactively ferreting out potential frauds. The SEC has claimed that these efforts began bearing fruit in 2014, with the number of financial reporting cases rising dramatically.[10]

The data, however, are a little murkier. While there was a slight increase in such cases in 2014 (15 percent of new filings, as compared to 12.5 percent in 2013), the 99 financial reporting cases initiated in 2014 included the 20 mining company stop-order actions referenced above. Without that investigation, financial reporting would have constituted only 12 percent of the cases — a slight decline as a proportion of the docket (albeit a slight uptick in the total number of actions filed). The stats, in other

words, are still a long way off from 2005, the high-water mark of the Enron/Worldcom accounting fraud era, when issuer reporting matters constituted a third of the SEC enforcement docket.[11]

Similarly telling is the precipitous decline in officer and director bars sought by the SEC. The SEC sought 57 orders barring defendants from serving as public company officers or directors in 2014, a big drop from the 81 orders sought in 2013 (much less the 150 sought in 2005). As the Division of Enforcement is certainly not pulling back from seeking bar orders to the full extent possible, the logical inference is that the SEC is simply filing fewer cases involving public company executives than it had in the past.

Of course, it could hardly be expected for an initiative begun in mid-2013 to have a noticeable impact so soon. Financial fraud investigations are notoriously complex and protracted. There is no question that the SEC is proactively looking for new cases, and has reported to the press an increase in the number of new accounting fraud investigations being opened by the enforcement staff.[12] The rise in new investigations is presumably aided by the SEC's whistleblower program, which in 2014 continued to experience a growth in the number of tips, with financial reporting cases continuing to be the largest category of complaints.[13]

So public company executives and directors, as well as gatekeepers such as auditors, should take little comfort in these numbers; the SEC is clearly stepping up activity in this area. The real question is whether or not they will uncover the sort of misconduct they seem to think is present, or if the slowdown in financial fraud actions will continue. Based on the statistics, the jury is still out.

The Era of Administrative Proceedings

One of the most significant enforcement trends in recent years is the SEC's growing use of administrative proceedings (APs) in lieu of federal court actions. The change was facilitated in part by legal provisions of Dodd-Frank, which broadened the sanctions that the SEC could recover in APs. Critics of the practice have observed that APs may be disadvantageous to respondents, who have limited discovery rights (including the absence of depositions), no right to a jury trial, and a more onerous path to appeal.[14] Indeed, one report found that the SEC prevailed in 100 percent of its litigated APs in fiscal 2013, as compared to 61 percent of its federal court trials.[15]

SEC stats confirm this shift. In fiscal 2014 (again excluding delinquent filing matters), the SEC filed 78 percent of its cases administratively and only 22 percent in court. The prior year, 62 percent of enforcement actions were filed as APs, while in 2010 — the last year before Dodd-Frank became effective — only 56 percent of enforcement actions were filed as APs.

To be sure, many of these cases are filed as settled actions. However, while the SEC's annual report does not differentiate between litigated and settled actions, Ceresney has confirmed that there has been a deliberate increase in the number of litigated APs; according to Ceresney, the agency filed 43 percent of its litigated cases in 2014 administratively, and had no intention of changing course.[16]

The substantial increase in the likelihood that the SEC enforcement division will proceed administratively rather than filing a civil lawsuit — a decision, incidentally, which lies entirely with the SEC — has important implications for parties who find themselves in the staff's crosshairs. Even beyond the appearance of much steeper odds of prevailing, parties need to carefully consider the much quicker pace of APs (which can come to trial within months, rather than years) and the limited discovery, ensuring they are taking steps to prepare for a potential litigated proceeding far in advance of the initiating of the proceedings.

Gearing Up For 2015

Even with all the caveats discussed above, there has been an undeniable increase in the SEC's enforcement activities and the number of individuals and companies on the receiving end of an enforcement action. And this pace shows no sign of slowing. In 2014, the Enforcement Division opened 995 new investigations, compared to 908 in 2013; the SEC reported a total of 1612 ongoing investigations in 2014, versus 1444 in 2013 — a 12 percent increase. And the size of the division is growing as well, from 1266 enforcement staff members in 2014 to 1,343 budgeted for 2015.[17]

In short, while the SEC's annual pronouncements about record-setting enforcement actions should be taken with a grain of salt, there can be little question that the Division of Enforcement is unusually busy and productive lately, with every indication that the trajectory will continue for the foreseeable future.

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[1] SEC Press Release, SEC's FY 2014 Enforcement Actions Span Securities Industry to Include First-Ever Cases (Oct. 16, 2014). While the total count of cases was made available at that time, the agency did not post its annual report of other key metrics — including a breakdown of enforcement actions by subject matter — until mid-January 2015.

[2] Andrew Ceresney, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 21, 2014).

[3] SEC Press Release, SEC Enforcement Division Produces Record Results in Safeguarding Investors and Markets (Nov. 9, 2011).

[4] SEC Press Release, SEC Announces Fiscal 2008 Enforcement Results (Oct. 22, 2008).

[5] Prior Enforcement Division directors have made similar observations. See Robert Khuzami, Remarks Before the Consumer Federation of America's Financial Services Conference (Dec. 1, 2011) ("In fiscal year 2011, the SEC filed a record 735 enforcement actions ... While numbers do not tell the whole story, it was nonetheless the most cases we've ever filed in the history of the agency"); Stephen M. Cutler, Second Annual General Counsel Roundtable (Dec. 3, 2004) ("In the last two fiscal years, the SEC has brought more than 1,300 civil cases ... These numbers far exceed those of any other two-year time frame in the Commission's history ... But it's a recitation of the names (and not the numbers) that I think best conveys a sense of the period that we've been through").

[6] Select SEC and Market Data, Fiscal 2014, available at www.sec.gov/about/secstats2014.pdf.

[7] SEC Press Release, SEC Seeks Stop Orders Against 20 Purported Mining Companies with Misleading Registration Statements (Feb. 3, 2014).

[8] Select SEC and Market Data, Fiscal 2013, available at www.sec.gov/about/secstats2013.pdf.

[9] For purposes of this section, delinquent filing cases have been excluded.

[10] See Mary Jo White, Chairman's Address at SEC Speaks 2015 (Feb. 20, 2015) ("We experienced a 40 percent jump in financial reporting cases last year ...").

[11] Select SEC and Market Data, Fiscal 2005, available at www.sec.gov/about/secstats2005.pdf.

[12] Jean Eaglesham and Michael Rapoport, SEC Gets Busy with Accounting Investigations, Wall St. J. (Jan. 20, 2014).

[13] 2014 Annual Report on the Dodd-Frank Whistleblower Program, available at www.sec.gov/about/offices/owb/annual-report-2014.pdf.

[14] See generally Gibson Dunn, 2014 Year-End Securities Enforcement Update (Jan. 12, 2015), available at www.gibsondunn.com/publications/Pages/2014-Year-End-Securities-Enforcement-Update.aspx.

[15] Jean Eaglesham, SEC is Steering More Trials to Judges It Appoints, Wall St. J. (Oct. 21, 2014).

[16] *Supra*, note 2. Moreover, filing more settled cases as APs is not without significance. In recent years, several federal judges — most notably Judge Jed Rakoff in New York — have rejected SEC settlements, demanding more information from the parties regarding the adequacy of the terms. In a settled AP, however, the SEC can institute the proceeding without a need for judicial approval.

[17] FY 16 Congressional Justification, available at www.sec.gov/about/reports/secfy16congbudgjust.shtml.