SEC UPDATE

2024 YEAR-TO-DATE

Mark Schonfeld, David Woodcock, Tina Samanta

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MCLE CERTIFICATE INFORMATION

MCLE Certificate Information

- Approved for 1.0 hour General PP credit.
- CLE credit form must be submitted by **Thursday, October 31st.**
- Form Link: https://gibsondunn.qualtrics.com/jfe/form/SV_6wWtTIiqzBZYvAO
  - Most participants should anticipate receiving their certificate of attendance in four to eight weeks following the webcast.

- **Please direct all questions regarding MCLE to CLE@gibsondunn.com.**

AGENDA

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Overview

U.S. Securities and Exchange Commission

- Key Leadership Changes in 2024
- Impact of the Election on SEC Rulemaking and Enforcement
- Reflections on the Commission Under Gensler

SEC Leadership Changes in 2024

SEC Division of Enforcement has a new leader as of October 11, 2024, which could have implications for the direction of the agency.

- **Gurbir S. Grewal,** Director of the Division of Enforcement who led the SEC's crackdown on cryptocurrency industry and Wall Street's use of off-channel communications, stepped down effective **October 11, 2024.**
- **Sanjay Wadhwa**, who has been with the SEC for more than two decades, was named as **Acting Director.**

Gurbir S. Grewal

"We have been incredibly fortunate that such an accomplished public servant, Gurbir Grewal, came to the SEC to lead the Division of Enforcement for the last three years…Every day, he has thought about how to best protect investors and help ensure market participants comply with our time-tested securities laws. He has led a Division that has acted without fear or favor, following the facts and the law wherever they may lead. I greatly enjoyed working with him and wish him well."

- SEC Chair Gensler

The Gensler Commission: Key Takeaways

Under Gary Gensler's leadership, the SEC has pursued an aggressive agenda touching on all corners of the U.S. securities markets, including:

- robust rulemaking agenda, including on market structure, climate policy, and private funds
- an active and aggressive enforcement program, with a continued focus on high-impact cases and large penalties
- focus on expanding SEC regulatory authority to address the role of crypto assets and AI in the capital markets

Impact of Significant Litigation on the Commission

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Key Litigation Updates:

Overview

There have been several notable recent cases that potentially limit the scope of the SEC's enforcement authority in consequential ways.

- ***SEC v. Jarkesy*** **(SCOTUS) (June 2024)**
- ***SEC v. SolarWinds Corp.*** **(SDNY) (July 2024)**
- ***SEC v. Govil (2d Cir.) (November 2023)***
- ***National Association of Private Funds Managers v. SEC*** **(5th Cir.) (June 2024)**

SEC v. Jarkesy et al.

U.S. Supreme Court

On June 27, 2024, the U.S. Supreme Court ruled that **when the SEC seeks civil penalties** against a defendant for securities fraud, the **Seventh Amendment entitles the defendant to a jury trial** before an Article III court.

The Supreme Court concluded:

- The SEC's antifraud provisions "replicate common law fraud," thereby requiring that a jury hear such claims.
- The public rights exception to a defendant's jury trial right did not apply to SEC antifraud claims because such claims did not fall within "any of the distinctive areas involving governmental prerogatives where the Supreme Court has previously concluded that a matter may be resolved outside of an Article III Court, without a jury."

On July 18, 2024, the District Court for the SDNY **dismissed many of the SEC's claims** against the company and its former CISO relating to the Company's disclosures, but did sustain claim alleging that a website "Security Statement" in 2017 was misleading. Notable points include:

- Alleged cybersecurity deficiencies are not actionable under internal accounting and disclosure controls rules
- Isolated disclosure failures do not equate to inadequate disclosure controls and procedures
- Statements concerning the incident in press releases, blog posts and podcasts were "too general to cause a reasonable investor to rely upon them"
- The incident did not require amendment of risk disclosures that already warned investors of risks "in sobering terms."
- Omission of details of incident was not misleading where the disclosure, "read as a whole, captured the big picture"

SEC v. SolarWinds Corp. and T. Brown

S.D.N.Y.

SEC v. Govil

2d Circuit

In November 2023, the Court of Appeals for the Second Circuit held that the SEC is **not entitled to disgorgement unless it can show that the allegedly defrauded investors suffered pecuniary harm**, reversing a disgorgement judgment against an executive who misappropriated funds from his company.

The Court followed the Supreme Court's decision in *Liu v. SEC* and concluded:

- Liu "emphasized" that disgorgement as "an equitable remedy is about 'returning the funds to victims,'" which necessarily "presupposes pecuniary harm" as funds "cannot be returned if there was no deprivation in the first place."
- The decision potentially puts in question the SEC's ability to seek disgorgement in a wide range of enforcement actions in the absence identifiable victims who incurred a financial loss.

National Association of Private Fund Managers v. SEC

5th Circuit

On June 5, 2024, the Fifth Circuit **vacated in full the SEC's 2023 final rule to enhance the regulation of private fund advisers** (the "Private Funds Rule"), which imposed substantial new disclosure requirements and restricted a broad range of activities within the private funds industry.

The Court ruled that the SEC **exceeded its statutory authority** under Sections 211(h) and 206(4) of the Advisers Act in adopting the Private Funds Rule.

Importantly, in reaching its decision the Fifth Circuit held that the SEC's authority under Section 211(h) is **limited to "retail investors"** and that to promulgate rules under Section 206(4) the SEC is required to articulate a "rational connection" to fraud and explain how such rules are designed to prevent fraud.

Notable Enforcement Sweeps

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Recordkeeping Sweep

The SEC has continued its **aggressive, years-long sweep** of off-channel recordkeeping violations. There are now **more than 100 individuals and entities charged** as part of this ongoing sweep, with total **penalties of over $3 billion** to date. Recent actions in the last 6 months include:

- In April 2024, the SEC announced settled charges against a registered investment adviser for alleged recordkeeping and ethics code violations.
- In August 2024, the SEC announced settled charges **against twenty-six** broker-dealers, investment advisers, and dually-registered broker-dealers and investment advisers.
- In September 2024, the SEC announced **four rounds** of settled charges against credit ratings agencies, municipal advisors, broker-dealers, and investment advisers.

NOTE: The firms that self-reported their violations paid significantly less in penalties.

Whistleblower Protection Sweep

- On September 9, 2024, the SEC announced settled enforcement actions against seven companies for violating the SEC's whistleblower protection rule, alleging that the companies had provisions in various kinds of agreements with employees, including employment, separation, and settlement agreements, that **purport to restrict, and thereby could potentially discourage, employees and other signatories from reporting information to government investigators** or participating in a whistleblower award.
- In its sweep, the SEC included companies from various industries, including fashion, healthcare, software, manufacturing, and consumer credit reporting. Penalties ranged from $19,500 (against a company with a going concern opinion and $8,890 in cash) to $1,386,000 and totaled **more than $3 million**.

NOTE: The SEC assessed penalties notwithstanding the companies' remedial efforts once approached by the SEC and the fact that the provisions had never been invoked to prevent a party from making a claim or seeking compensation as a whistleblower.

Section 16 Reporting Sweep

- On September 25, 2024, the SEC announced a sweep of enforcement actions against twenty-three entities and individuals for **failing to timely file reports on their holdings and transactions** in violation of Section 13 and Section 16 of the Securities Exchange Act of 1934 (Exchange Act).
- Additionally, two public companies settled claims for contributing to their officers' and directors' filing failures and for not disclosing their insiders' filing delinquencies as required by SEC rules.
- The penalties ranged from $10,000 to $200,000 for individuals and $40,000 to $750,000 for public companies.
- This sweep is **part of an ongoing enforcement initiative**, launched in 2014, that focuses on these reporting requirements and particularly on the habitual late filers.
- The latest sweep is **one of the largest to date** in terms of the number of individuals and entities.

NOTE: In announcing the settlements, the SEC once again highlighted its use of data analytics to identify individuals and entities who filed late reports.

Marketing Rule Sweep

- On September 9, 2024, the SEC settled charges against **nine registered investment advisers** for violations of Rule 206(4)-1 (the "Marketing Rule") by **disseminating advertisements that included untrue or unsubstantiated statements** of material fact or testimonials, endorsements, or third-party ratings that lacked required disclosures.
- The alleged violations were found primarily on the Advisers' **public websites** and, in one instance, third-party public websites and social media sites, among other marketing materials.
- The advisers ranged in size from $191 million to $5.2 billion in regulatory assets under management and paid civil monetary penalties ranging from $60,000 to $325,000.
- The 2024 sweep follows a **similar enforcement sweep in 2023**, which involved nine investment advisers and a total of $850,000 in combined penalties.

Financial Reporting, Disclosure, and Accounting Developments

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S.D.N.Y. Motion to Dismiss SolarWinds Decision

Internal Accounting Controls

- The court found that the SEC's attempt to bring a claim under Section 13(b)(2)(B) of the Exchange Act (relating to internal accounting controls) was **unsupported by legislative intent**, as the surrounding terms that Congress used when drafting Section 13(b)(2)(B), which refer to "transactions," "preparation of financial statements," "generally accepted accounting principles," and "books and records," are uniformly consistent with financial accounting.

Disclosure Controls and Procedures

- The court sided with SolarWinds in rejecting the SEC's claims that the company failed to maintain and adhere to appropriate disclosure controls for cybersecurity incidents. The court was unwilling to accept the SEC's argument that one-off issues—even if the company misapplied its existing disclosure controls in considering cybersecurity incidents—gave rise to a claim that the company failed to maintain such controls. The court implied that **disclosure controls do not have to be perfect**—they should provide reasonable assurance that information is being collected for disclosure consideration.

Commissioner Dissents

Dissenting statements on enforcement actions by Commissioners, most notably Commissioner Peirce, are becoming increasingly more common, especially with respect to the **expansion of the SEC's interpretation of its enforcement authority** under Section 13(B)(2)(b) (internal controls).

E.g. Statement on R.R. Donnelley & Sons, Co. (July 2024): "Identifying a link between the Commission's preferred policies and procedures and accounting controls seems a collateral concern, if it is a concern at all. In today's settled administrative proceeding against R.R. Donnelly & Sons, Co., the Commission finds and uses a novel attachment on its multi-use tool—'a system of cybersecurity-related internal accounting controls.'"

Voluntary Dismissal of 102(e) Proceedings

- Following the Supreme Court's *Jarkesy* decision, the SEC **voluntarily dismissed multiple 102(e) proceedings** against accountants who had been sued in administrative proceedings for allegedly faulty audits.
- This suggests the SEC had **concerns about the constitutionality** of these proceedings.
- Future enforcement uncertain.

Notable Insider Trading Developments

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“Shadow Insider Trading”: Panuwat

- SEC charged Panuwat, a business development executive at Medivation, with insider trading.
- Within minutes of learning Medivation would be acquired by Pfizer at a premium, Panuwat bought short-term out-of-the-money call options in Incyte, a competitor of Medivation, which he anticipated would increase in price when the Medivation deal became public.
- Medivation’s insider trading policy prohibited the use of MNPI to trade in securities of Medivation or “another publicly traded company”
- When the Medivation deal was announced, Incyte stock increased 8%
- Court **denied defense motion to dismiss,** as “the SEC’s theory of liability falls within the general framework of insider trading”
- After 2 hours’ deliberation, **jury found Panuwat liable** for insider trading.

Credit Markets:

Sound Point Capital

- SPC managed CLOs and traded the tranches of CLOs both that it managed and that were managed by third parties.
- SPC **lacked written policies and procedures** aimed at preventing the misuse of MNPI about the underlying loans when trading tranches of CLOs.
- In 2019, SPC sold equity tranches of two CLOs it managed and that included loans to Company A. Before the sale, SPC had received MNPI about Company A through participation in an ad hoc lender committee for Company A.
- MNPI concerned likely failure of an asset sale and need for rescue financing.
- When the MNPI became public the next day, the value of the CLO tranches declined 50%. One of the buyers of the CLOs demanded reimbursement and threatened litigation. SPC agreed to reimburse.
- SEC settlement included **$1.8 million penalty**.

Ad Hoc Committees:

Marathon Asset Management

- Marathon joined, and served on coordinating group of, ad hoc committee of creditors of Issuer. Committee retained Adviser.
- October 2020, Adviser entered into NDA with Issuer and received MNPI. Adviser conferred with committee orally and in writing. Written material were based on "publicly available" information. Marathon continued building a position in Issuer bonds and selling CDS.
- November 2020, Marathon entered into NDA with Issuer to negotiate potential restructuring. Marathon received materials from the Adviser that included "Private" or "Restricted" information.
- According to SEC's order, Marathon's **policies and procedures did not sufficiently take into account the special circumstances** presented by participation in committees, which included the retention of, and consultation with, financial advisers who had access to MNPI.
- Marathon had no policies or procedures for conducting due diligence on advisers' handling of MNPI or for obtaining representations from advisers concerning policies and procedures for handling MNPI.

Credit for Cooperation and Self-Reporting

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Former Enforcement Director Gurbir S. Grewal's Comments

May 2024

Director Grewal stated that there are **"real benefits"** to parties that effectively cooperate with SEC investigations, which may include the SEC:

- **Charges** – recommending reduced charges or declining to recommend any charges altogether.
- **Remedies** – recommending reduced or even zero civil penalties, and effective remediation efforts may impact whether the SEC recommends any undertakings (and the scope of any such undertakings).
- **SEC Finding of Cooperation** – stating in the SEC's order that the party provided meaningful cooperation.

Former Enforcement Director Gurbir S. Grewal's Comments

May 2024

Director Grewal also outlined **"five principles of effective cooperation":**

- **Self-policing** – "showing that you had appropriate safeguards in place can also be important in establishing that any misconduct was not the result of an institutional failure or a lax tone at the top"
- **Self-reporting without delay** – signals "effective self-policing," "proactive compliance," and builds credibility with the staff
- **Remediation** – measures include disciplining or dismissing the actors responsible for the violations; strengthening relevant internal controls; conducting training; hiring personnel with relevant expertise; clawing back executive compensation; and repaying harmed investors
- **Going beyond what is legally required** – "more than simply complying with subpoenas without undue delay or gamesmanship"
- **Collaboration** – ***new element*** *described as effective communication with the SEC*

Strategic Considerations When Self-Reporting

There are a **range of potential outcomes to consider** when assessing whether to self-report a potential violation.

Recent examples include:

(1) September 2023 recordkeeping sweep - unreported violations resulted in penalties between $8 million and $35 million, whereas self-reported violation only received penalty of $2.5 million.

(2) September 2024 recordkeeping sweep – unreported violations resulted in penalties between $325,000 and $35 million, whereas self-reported violation did not result in any penalty.

Cooperation Summary

- Seaboard factors have aged well
- Self-reporting decisions are never easy
- Whistleblowers raise the stakes
- Collaboration is hard to define
- Benefits of cooperation are hard to estimate or quantify
- Benefits of cooperation may not be known until the very end

Upcoming Programs – Fall White Collar Webcast Series

Date and Time	Program	Registration Link
Thursday, November 7, 2024 **1:00 PM – 2:30 PM ET** **10:00 AM – 11:30 AM PT**	**False Claims Act Enforcement in the Life Sciences and Health Care Sectors** Presenters: John Partridge, Jonathan Phillips, Katlin McKelvie, Jim Zelenay	Event Details
Wednesday, November 13, 2024 **3:00 PM – 4:00 PM ET** **12:00 PM – 1:00 PM PT**	**Government Investigations into AI Systems** Presenters: Eric Vandevelde, Chris Whittaker, Poonam Kumar	Event Details
Thursday, November 14, 2024 **12:00 PM – 1:00 PM ET** **9:00 AM – 10:00 AM PT**	**Criminal Antitrust Enforcement: A Preview of Priorities for the New Administration and Implications for Corporate Compliance Programs** Presenters: Scott Hammond, Jeremy Robison, Alexandra Buettner	Event Details
Thursday, November 21, 2024 **11:00 AM – 12:00 PM ET** **8:00 AM – 9:00 AM PT** **4:00 PM – 5:00 PM BST**	**Investigations: A UK Perspective** Presenters: Allan Neil, Matthew Nunan, Amy Cooke, Marija Brackovic	Event Details

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