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**SEC ENFORCEMENT
DEVELOPMENTS AND HOT
TOPICS**

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SECURITIES AND EXCHANGE COMMISSION OVERVIEW



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SEC Leadership: Chair and Commissioners



Allison Herren Lee
Commissioner
Since 2019



Jay Clayton
Chair of SEC
Since 2017



Elad L. Roisman
Commissioner
Since 2018



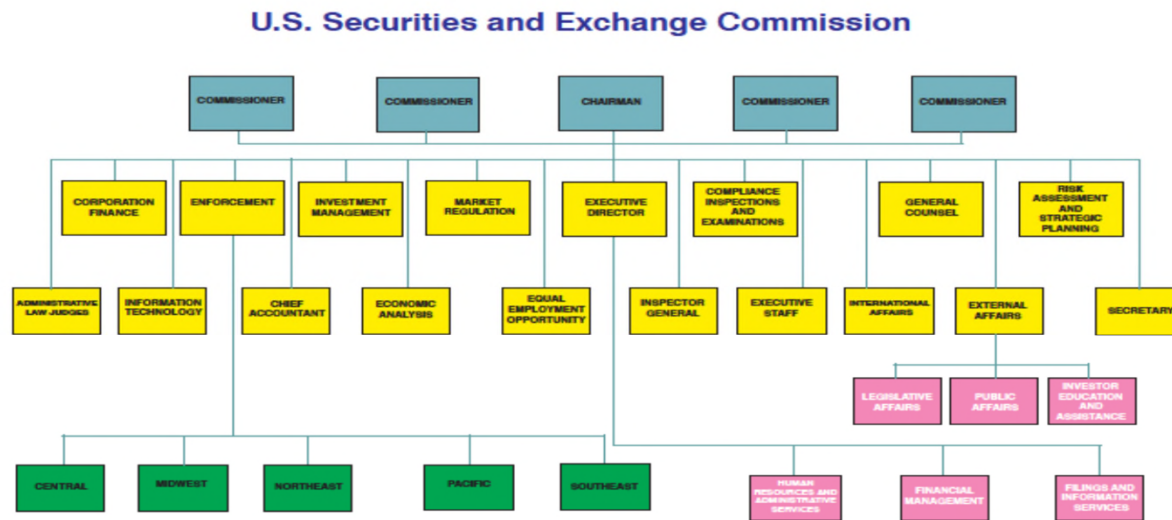
Robert J. Jackson Jr.
Commissioner
Since 2018



Hester M. Peirce
Commissioner
Since 2018

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SEC Organizational Chart



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DIVISION OF ENFORCEMENT



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Types of Enforcement Cases Affecting Public Companies

- Financial Reporting and Internal controls
- Disclosures of material information, including non-accounting related information
- Regulation FD
- Focus on individuals and gatekeepers
- Cybersecurity
- Whistleblowers
- Insider Trading
- FCPA

2018 SEC Enforcement Statistics

- 821 cases brought, a 9% increase from FY 2017.
 - According to the SEC, 490 of these cases were independent actions for securities laws violations, the balance were delinquent filing cases or administrative actions seeking bars based on injunctions or criminal convictions.
- \$3.945 billion in penalties and disgorgement, a 4% total increase from 2017, but disgorgement dropped about 15% from 2017.
 - 45% of the total penalties/d disgorgement were ordered in one case, the *Petrobras* matter.

2018 SEC Enforcement Statistics

Type of Case	Number of Actions	Percentage of Total Actions
Securities Offering	121	25%
Investment Advisers/ Investment Companies	108	22%
Issuer Reporting/Audit & Accounting	79	21%
Broker-Dealer	63	13%
Insider Trading	51	10%
Market Manipulation	32	7%
Public Finance Abuse	15	3%
FCPA	13	3%
Miscellaneous	3	1%
Transfer Agent	2	0%

Tone at the Top: A Tougher Enforcement Approach

- Specialized Units – now entrenched.
- More Former Criminal Prosecutors in Leadership Positions = SEC looking more like DOJ, structurally.
 - Cooperation programs, Non prosecution agreements, Deferred Prosecution Agreements.
 - In practice, these programs are less used.

Sources of Investigations

- **Self-Reporting—New Developments**
- Referrals from Other SEC Divisions
- Referrals from Other Regulators
 - Other Federal Regulators
 - State Regulators
 - International Regulators
- Self-Regulatory Organizations
 - NASDAQ
 - FINRA
- PCAOB
- Press or Other Reports
- Whistleblowers

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SEC Investigation Process

- Informal v. Formal Investigation
- Investigatory Process
 - Documents
 - Testimony
- Coordination with DOJ
- Wells Process
- Settlement
- Litigation
 - Administrative Proceeding
 - Federal District Court

SEC Investigation Process

- Typical SEC Enforcement Practices When There is an Expected Restatement
 - Initial Document Preservation Notice to be Followed by Document Request.
 - Expectation of Cooperation Including Presentation by Outside Counsel of Internal Investigation Overseen by Audit Committee.
 - Request for Documents and Information from Outside Auditor.
 - After initial collection of information and assessment, testimonies of relevant officers and employees.
- Typical FINRA Market Surveillance Practice After Significant Company News
 - Requests for information: initial data, followed by chronology, identification of persons with knowledge in advance of announcement
 - Blue Sheet review and evaluation of potential trader connections
 - Decision whether to refer any potential insider trading matters to the SEC

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**RELATIONSHIP BETWEEN
CORP FIN AND ENFORCEMENT**



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Corp Fin Overview

- **Division of Corporation Finance (“Corp Fin”)**

- Corp Fin is charged with ensuring that issuers comply with the SEC’s disclosure rules and requirements.
 - Ensure that investors are provided with material information in order to make informed investment decisions, both when a company initially offers its securities to the public and on an ongoing basis as it continues to give information to the marketplace.
 - Corp Fin also has legal policy and accounting offices that provide interpretive assistance with respect to SEC rules and forms and make recommendations to the Commission regarding new rules and revisions to existing rules.
- The Corp Fin population is made up of attorneys and accountants.
 - Division of labor between legal and accounting is much less “siloeed” than it used to be”.
 - Staffers work together to review disclosure documents that are filed with the SEC and, if necessary, issue comment letters to the company seeking clarification or changes to such disclosure.

Structure of Corp Fin

AD Office	Representative Companies
Office of Health Care and Insurance - AD1	Merck, Pfizer, Johnson & Johnson, Chubb
Office of Consumer Products - AD2	Walmart, Amazon
Office of Information Technology and Services - AD3	VMware, Alphabet, Facebook, Adobe
Office of Natural Resources - AD4	ExxonMobil, Chevron, ConocoPhillips
Office of Transportation and Leisure - AD5	McDonalds, UPS, Boeing
Office of Manufacturing and Construction - AD6	Home Depot, Colgate Palmolive, DowDupont
Office of Financial Services - AD7	JPMorgan, PNC, BlackRock, American Express
Office of Real Estate and Commodities - AD8	Crown Castle International, Simon Property, Marriott
Office of Beverages, Apparel and Mining - AD9	CocaCola, CVS, TJX, Constellation Brands
Office of Electronics and Machinery - AD10	GE, Thermo Fisher Scientific, Caterpillar, 3M
Office of Telecommunications - AD11	Verizon, T-Mobile, Comcast

Office of Enforcement Liaison

- The Office of Enforcement Liaison (OEL) coordinates matters between the Corp Fin and the Division of Enforcement.
 - Handles referrals from Corp Fin.
 - Assists in the development of Enforcement cases relating to disclosure matters (e.g., accounting fraud).
- OEL also processes waiver requests for “ineligible issuer” status, or so-called “WKSI waiver” requests, that may arise under Rule 405 of the Securities Act.

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FINANCIAL REPORTING AND ISSUER DISCLOSURE



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They're Back on the Rise: Accounting and Disclosure Cases

- Between 2003-2005, accounting and disclosure cases accounted for 25% of enforcement actions; 2013 accounted for only 11%.
- Renewed Focus Began in 2013 & Continues
 - July 2, 2013: Creation of “Financial Reporting and Audit Task Force” (now referred to as the Financial Reporting and Audit Group or “FRAud Group”).

SEC Enforcement Detection Tool: Big Data

- “Accounting Quality Model”
 - Analyzes financial statements for factors indicating or inducing earnings management
 - Includes textual analysis of MD&A—looks at the words, not just the numbers
 - Compares with peer-level metrics



SEC Enforcement Detection Tool: Big Data

- 1st generation tool: Accounting Quality Model (AQM)
 - Isolate discretionary accruals and identify outliers to peers.
 - Statements are processed and assigned a risk score by AQM within 24 hours of filing with the SEC.
 - Sample risk-indication factors
 - Choice of accounting policy
 - Interactions with/replacement of independent auditors
 - Sample risk-inducement factors
 - Loss of market share
 - Lower profitability

SEC Enforcement Detection Tool: Big Data

- 2nd generation tool: Corporate Issuer Risk Assessment program (CIRA)
 - “CIRA is essentially the Accounting Quality Model on steroids”
 - SEC Director of the Division of Economic and Risk Analysis, June 2015
 - CIRA dashboard contains over 100 custom metrics to compare firms and look for anomalies.
 - AQM now incorporated in CIRA
 - CIRA enables SEC staff to look, for example, at how inventory at a manufacturing company is moving relative to reported sales.
 - SEC staff who saw increased inventory and declining sales may flag the company as ripe for fraudulent accounting adjustments.
 - Data comes from XBRL filings and commercial databases.

Financial Reporting Hot Buttons

- Improper Revenue and Expense Recognition
- Disclosure of Executive Perks in Proxy
- False or Inadequate Disclosures
- Earnings Management
- Internal Controls
- Valuation (particularly of illiquid assets) and Goodwill write-downs

Examples of SEC Enforcement Actions Involving Accounting Improprieties

Action Against Trucking Company (April 25, 2019)

- SEC alleged that between mid-2016 and April 2017, a publicly-traded trucking and shipping company avoided recognizing at least \$20 million in impairment charges and losses – almost two-thirds of its 2016 pre-tax income – by selling and buying used trucks at inflated prices from third parties.
- As a result of the alleged scheme, the company overstated its pre-tax and net income and earnings per share in its annual report for the period ending June 30, 2016, and in its subsequent public filings for the first two fiscal quarters of 2017.
- \$7 million in disgorgement by the company.
- Investigation “is continuing.” Coordination with U.S. Department of Justice.

Examples of SEC Enforcement Actions Involving Accounting Improprieties

Action Against Real Estate Company (Aug. 1, 2019)

- SEC alleged that a publicly-traded real estate investment trust, and four former senior executives with fraud in connection with a scheme to manipulate a key non-GAAP metric relied on by analysts and investors to evaluate the company's financial performance.
- The SEC's complaint against the individuals alleges that from the third quarter of 2013 to the third quarter of 2015, the company's CEO, CFO, CAO and Senior VP of Accounting improperly adjusted the company's same property net operating income (SP NOI) in order to report quarterly numbers that hit the company's publicly-issued growth targets.
- According to the complaint, certain of the defendants described their manipulation of the non-GAAP measure as "mak[ing] the sausage," using tactics such as selectively recognizing income from a "cookie jar" account.
- \$7 million civil penalty against the company. Ongoing SEC litigation against officers. Parallel criminal charges against individuals.

Examples of SEC Enforcement Actions Involving Accounting Improprieties

SEC v. Armbruster et al. (April 3, 2019)

(former executives of Roadrunner Transportation Systems)

- The SEC alleged that the former CFO and two former employees of a publicly traded transportation company with fraud for manipulating the company's financial results in order to meet earnings targets and projections.
- The SEC alleges, among other things, that the former CFO hid incurred expenses by improperly deferring and spreading them across multiple quarters to minimize their impact on Roadrunner's net earnings and then allegedly manipulated certain reductions to liabilities, creating an income "cushion" that could be accessed in future quarters to offset expenses.
- The SEC also alleged that the defendants misled Roadrunner's outside auditor.
- SEC complaint seeks permanent injunctions, penalties, and officer-and-director bars, disgorgement, and clawback bonuses and other incentive-related compensation. Investigation ongoing. Parallel criminal charges by Fraud Section of U.S. DOJ.

Examples of SEC Enforcement Actions Involving Accounting Improprieties

Action Against CEO of Startup

- The SEC alleged that the company's former founder and CEO of a Silicon Valley mobile payment startup, overstated the company's 2013 and 2014 revenues and then sold shares he held personally to investors in the private, secondary market.
- The company restated its financial results in 2015, wiping out most of its revenue, and the shares became worthless after it filed for bankruptcy in 2016.
- Officer and director bar. Disgorgement of \$16 million and civil penalty of \$640,000.

Examples of SEC Enforcement Actions Involving Accounting Improprieties

In the Matter of GT Advanced Technologies Inc. (May 3, 2019)

- The SEC alleged that, GT Advanced Technologies, a New Hampshire-based company, and its former CEO misled investors about the company's ability to supply "sapphire glass" for Apple's iPhones.
- The SEC also alleged that the company misclassified more than \$300 million in debt to Apple that resulted from its repeated failures to meet performance milestones.
- Cease and desist order against the company and civil penalty against CEO.

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**ENFORCEMENT FOCUS ON
DISCLOSURE OF NON-
ACCOUNTING DEVELOPMENTS**



Non-Accounting Disclosure: Cybersecurity

- Altaba (formerly Yahoo!)
 - \$35 million civil penalty
 - Alleged failure to have controls and procedures in place to assess cyber-disclosure obligations
 - Allegations included amount of time between breach and ultimate disclosure

Non-Accounting Disclosure: Cybersecurity

- SEC Issued Statement and Guidance on Public Company Cybersecurity Disclosures
<https://www.sec.gov/rules/interp/2018/33-10459.pdf>
- SEC is focused on several issues for public companies
 - Internal controls to prevent breaches and protect the integrity of the financial reporting process.
 - Disclosure in periodic filings of risks to the issuer’s business of a breach, and what controls exist to prevent.
 - Disclosure of threats and incidents.
 - *Question is when and how to disclose*
 - *Materiality*
- What you should do now:
 - Board of Directors must proactively oversee cyber policies and procedures.
 - Create (or update) rapid response team to deal with breaches. Include expert in SEC disclosure and dealing with SEC enforcement inquiries.
 - Internal investigation protected by attorney-client privilege

Non-Accounting Disclosure: Privacy/Risk of Misuse of User Data

- According to the SEC, for more than two years, a major social media company's public disclosures presented the risk of misuse of user data as merely hypothetical when the social media company knew that a third-party developer had actually misused user data. The SEC stated that public companies must identify and consider the material risks to their business and have procedures designed to make disclosures that are accurate in all material respects, including not continuing to describe a risk as hypothetical when it has in fact happened.
- The social media company agreed to pay \$100 million to settle the charges.

Non-Accounting Disclosure: Liability Involving Other Regulatory Agencies

- According to the SEC's complaint, from April 2014 to May 2015, a European auto manufacturer issued more than \$13 billion in bonds and asset-backed securities in the U.S. markets at a time when senior executives knew that more than 500,000 vehicles in the United States grossly exceeded legal vehicle emissions limits, exposing the company to massive financial and reputational harm. The complaint alleges that the manufacturer made false and misleading statements to investors and underwriters about vehicle quality, environmental compliance, and financial standing.

Non-Accounting Disclosure: Viability of Technology

- **Theranos Inc et al. (March 14, 2018)**
 - SEC alleged that charged Silicon Valley-based private company Theranos Inc., its founder and CEO Elizabeth Holmes, and its former President Ramesh “Sunny” Balwani with raising more than \$700 million from investors through an elaborate, years-long fraud in which they exaggerated or made false statements about the company’s technology, business, and financial performance.
 - Holmes agreed to pay a \$500,000 penalty, be barred from serving as an officer or director of a public company for 10 years, return the remaining 18.9 million shares that she obtained during the fraud, and relinquish her voting control of Theranos by converting her super-majority Theranos Class B Common shares to Class A Common shares.

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INCREASED EMPHASIS ON INTERNAL CONTROLS



Increased Emphasis on Issuer Compliance and Controls

- Cases brought which indicate that
 - Issues were not discovered
 - Issues were not escalated
 - Management ignored pushback from the compliance staff
 - Internal controls or accounting resources were insufficient for size of company's risk
 - Accounting personnel not sufficiently knowledgeable
 - Management leaves impression that issues not important

Increased Emphasis on Issuer Compliance and Controls

- Cybersecurity and Internal Controls
 - On Oct. 16, 2018, the SEC issued an investigative report cautioning that public companies should consider cyber threats when implementing internal accounting controls. The report is based on the SEC Enforcement Division's investigations of nine public companies that fell victim to cyber fraud, losing millions of dollars in the process.
 - The SEC's investigations focused on "business email compromises" (BECs) in which perpetrators posed as company executives or vendors and used emails to dupe company personnel into sending large sums to bank accounts controlled by the perpetrators.

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**RENEWED FOCUS ON SELECTIVE
DISCLOSURE**



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Regulation FD

- On Aug. 20, 2019, the SEC charged TherapeuticsMD Inc., a pharmaceutical company headquartered in Boca Raton, Florida, with violations of Regulation FD based on its sharing of material, nonpublic information with sell-side research analysts without also disclosing the same information to the public.
- The SEC alleged that one day after a publicly-announced meeting with the FDA about a new drug approval, TherapeuticsMD sent private messages to sell-side analysts describing the meeting as “very positive and productive.” TherapeuticsMD’s stock price closed up 19.4 percent on heavy trading volume the next day. At that time, the company had not issued a press release or made any other market-wide disclosure about the meeting.
- The company agreed to a civil penalty of \$200,000.

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**FOCUS ON INDIVIDUALS AND
GATEKEEPERS**



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Individual Targets: Nature of Evidence

- Financial reporting and certification process provide ample leads for SEC to focus on individuals
 - SOX Certifications (and sub-certifications)
 - Management Representation to Outside Auditors
 - Statements at Board Meetings (including Audit Committee Meetings)
 - Statements at Analysts Calls

Individual Targets – Not Just CEO and CFO

- General Counsel
- Treasurer
- Mid-level Managers
- For regulated entities, CCOs

Focus on Gatekeepers

- Board members including Audit Committee Members
- Outside Auditors
- In the Matter of RSM US LLP (Aug. 27, 2019)
 - SEC alleged RSM violated SEC's auditor independence rules in connection with more than 100 audit reports involving at least 15 audit clients.
 - SEC found that RSM US or its associated entities, including other member firms of the RSM International network, provided non-audit services to, and had an employment relationship with, affiliates of RSM US audit clients, which violated the SEC's auditor independence rules.

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WHISTLEBLOWERS



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Dodd-Frank Act – Whistleblower Bounty Provision Rules

- Person who voluntarily provides SEC with original information that leads to successful enforcement action resulting in sanctions greater than \$1 million may be entitled to 10 – 30% of the funds recovered.
- Effective Date – August 12, 2011
- Covers tips provided to SEC from July 21, 2010 to present
- Office of Whistleblower established
- SEC currently seeking to revise Whistleblower Rules to limit recoveries.

Dodd-Frank Whistleblower Rules

- Persons who may qualify as a “Whistleblower”
 - Employees, consultants, agents, vendors, competitors, customers, etc.
 - Excluded persons: Entities, govt. employees, person knowingly making false statement or convicted of crime related to the action.
 - MAY include, if certain conditions met: Attorneys, auditors, internal compliance staff, officers/directors who learn through compliance.
 - *If report to audit committee, chief legal officer or chief compliance officer and 120 days lapse*
 - *Entity impeding investigation*
 - *Necessary to prevent substantial injury to investors*
 - ***Based on US Supreme Court Decision in Digital Realty Trust, Inc. v. Somers, for purpose of anti-retaliation provisions, an employee is not a whistleblower at time of termination if he or she had not reported to the SEC.***

First SEC Retaliation Cases

- SEC Rule 21F-17(a) Prohibits Employers From Doing Anything that Impedes or Discourages WB From Going to the Government, Specifically **Including “enforcing, or threatening to enforce, a confidentiality agreement....”**
- June 2014: SEC brought first retaliation case against Paradigm Capital Management.
 - SEC alleged that, among other things, employer marginalized whistleblower by modifying responsibilities following report of wrongdoing.
 - 4/28/15: SEC awarded \$600,000 – the maximum payment of 30% of amounts collected as penalties to the employee WB.
- April 2015: SEC charged KBR, Inc. with violating whistleblower rules because it required witnesses to sign confidentiality agreements which warned that a witness could face discipline if he/she discussed the matters with third parties without prior approval.
 - KBR paid a \$130,000 penalty.
 - No evidence that any witness was ever in fact dissuaded from going to SEC – only the potential.

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BIOGRAPHIES



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Biographies



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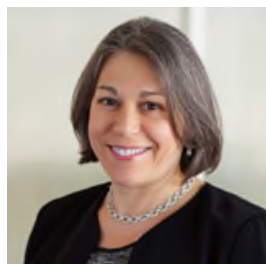
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Peter K.M. Chan brings two decades of experience at the US Securities and Exchange Commission (SEC) to his litigation and counseling work. He represents public companies, financial services firms, and other organizations in litigation, investigations, and regulatory actions by federal agencies. As an Assistant Director at the SEC's Chicago Regional Office, Peter oversaw numerous high-profile investigations, including matters involving financial reporting by public companies.



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Amy J. Greer focuses her practice on securities enforcement and litigation matters. A former regional trial counsel for the US Securities and Exchange Commission's (SEC) Philadelphia office, Amy brings insight from that experience when addressing litigation and investigations by the SEC, the US Department of Justice (DOJ), the US Financial Industry Regulatory Authority (FINRA), and self-regulatory organizations, as well as state attorneys general and securities commissions.

Our Global Reach

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North America

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