6 Top Priorities For SEC Enforcement In 2023

By **Paul Kisslinger and Rebecca Stoddard** (January 26, 2023)


Paul Kisslinger


Rebecca Stoddard

Senior U.S. Securities and Exchange Commission officials have made it quite clear in recent public statements that they are determined to be very aggressive in enforcing securities regulations in 2023.

As SEC Enforcement Director Gurbir Grewal testified to the House Oversight Committee in July 2022, "Robust enforcement requires the division to be the cop on the beat and cover the entire securities waterfront, investigating and litigating every type of case within our remit with a sense of urgency."[1]

The SEC's aggressive stance will not only lead to the filing of more cutting-edge enforcement actions in 2023, but also in all actions going forward the SEC has pledged to seek maximum, or "robust," disgorgement, sanctions and civil penalties against violators against whom it obtains judgments. As Grewal stated, "[i]n addition to punishing wrongdoers for violations of the securities laws, our remedies must deter those violations from happening in the first place. They must be viewed as more than the cost of doing business."[2]

The SEC's promises of "robust enforcement" are not mere words. The agency has put its money where its mouth is by beefing up staffing in areas of attention, including by adding 20 new positions to its Cyber and Crypto Unit, and by its recent filings of district court and administrative actions in these priority areas — all of which foreshadow a flood of new enforcement activity in the coming year.[3]

Following are the top areas of SEC enforcement for 2023. Some of these priority areas relate to existing, age-old enforcement concerns, such as preventing insider trading. But by and large, the SEC's 2023 priorities arise in the wake of front-page, news-grabbing topics in envelope-pushing areas such as crypto-assets, cybersecurity and climate change, or environmental, social and governance reporting.

1. Cryptocurrencies

It is no secret that the SEC and its sister agency regulating commodities, the Commodity Futures Trading Commission, place the regulation of crypto-assets at the top of their enforcement agendas.

In the wake of the TerraUSD stablecoin collapse in the spring of 2022, and the FTX exchange failure a few months later, the SEC is hell-bent on roping and wrangling these illusive, constantly adapting assets — the cyber tokens or coins sold, and the platforms and exchanges that sell them — into its regulatory corral.

As SEC Chairman Gary Gensler told Yahoo Finance in a Dec. 7, 2022, interview, "You might think of them as the casinos wherein the investing public is looking for a better future, and because most of these tokens are securities, that means that the ... casinos need to come into compliance with our time-tested laws."[4]

CFTC Chairman Rostin Behnam likewise testified before the Senate Committee on Agriculture, Nutrition, and Forestry on Dec. 1, 2022, stating, "I strongly believe that we need to move quickly on a thoughtful regulatory approach to establish guardrails in these fast-growing markets of evolving risk, or they will remain an unsafe venture for customers and could present a growing risk to the broader financial system."[5]

Before the SEC and the CFTC are able to police cryptocurrencies fully, however, the courts, or Congress, must first determine that crypto-assets are, indeed, securities or commodities covered by federal law, as the agencies contend.

The SEC is making progress in this regard. Several district courts have found that the particular crypto-assets at issue in those cases are securities subject to SEC regulation. In late 2020, the U.S. District Court for the Southern District of New York in SEC v. Kik Interactive Inc. granted summary judgment in favor of the SEC, finding that the Kin tokens that Kik sold should have been registered as securities.[6]

And recently, the U.S. District Court for the District of New Hampshire in SEC v. LBRY Inc. found that LBRY Inc. improperly offered and sold its crypto LBC tokens as unregistered securities.[7] The appellate courts have yet to offer a substantive decision tackling this issue, however.

The new year promises to offer a wave of new investigations and actions brought by federal, state and international financial regulators aggressively asserting that cryptocurrencies and exchanges are subject to their respective financial regulatory schemes, and if so, testing the limits of the regulators' jurisdiction and authority in this space.

The SEC, armed with its new Crypto Assets and Cyber Unit recruits, will be a prime mover on this front. On Jan. 4, 2023, the SEC kicked off the new year by charging the creator of CoinDeal and seven other individuals with engaging in a fraudulent investment scheme that raised more than $45 million from sales of unregistered securities.[8]

Not to be outdone, the CFTC in coordination with the U.S. Department of Justice just filed a market manipulation complaint in the U.S. District Court for the Southern District of New York against the founder of Mango Markets, a decentralized crypto exchange that provides margin trading and futures and operates as a lender. The SEC piled on in a complaint in the Southern District of New York filed last week. The question remains what the appellate courts, and eventually, the U.S. Supreme Court will do when these cases begin to appear on their dockets.

2. Private Funds and Fund Advisers

In recent years, the SEC has vowed to increase regulatory scrutiny for private funds and has taken steps to do so in the form of proposed rules and enforcement actions.

On Feb. 9, 2022, the SEC proposed changes to the Investment Advisers Act of 1940, or the Advisers Act, that would "enhance the regulation of private fund advisers and [] protect private fund investors by increasing transparency, competition, and efficiency," which Chairman Gensler believes "would help investors in private funds on the one hand, and companies raising capital from these funds on the other."[9]

On Aug. 10, 2022, the SEC proposed amendments to Form PF, which is a confidential reporting form for certain SEC-registered investment advisers of private funds, that would enhance private fund reporting and the Financial Stability Oversight Council's "ability to assess systemic risk" as well as "bolster the SEC's regulatory oversight of private fund advisers and its investor protection efforts in light of the growth of the private fund industry."[10] Gensler hopes that these amendments will improve the quality of information provided by Form PF filers.

Through its enforcement arm, over the course of 2021 and 2022, the SEC brought numerous enforcement actions against private fund advisers, and that trend will surely continue into 2023 and beyond.

For example, in the summer of 2021, the SEC filed a complaint in the Southern District of New York and obtained an emergency asset freeze and other injunctive relief against fund manager Ofer Abarbanel and his investment advising company, New York Alaska ETF, alleging that they orchestrated a $200 million fraud through domestic and offshore mutual funds that they managed.[11]

In March 2022, fund manager Alumni Ventures Group LLC and its CEO were charged with violations of the Investment Advisers Act of 1940 for making misleading statements about the fund's management fees and engaging in inter-fund transactions in breach of its operating agreements.[12] In September, the SEC brought an action against registration-exempt reporting adviser Energy Innovation Capital Management LLC for charging excess management fees from two venture capital funds.[13] In her press release, the chief of the SEC Enforcement Division's Asset Management Unit stated that "[v]enture capital fund advisers, even if exempt from registering with the SEC, are not exempt from the anti-fraud provisions of the Investment Advisers Act."[14]

2023 will undoubtedly bring many more actions against private funds and their advisers.

3. Executive Compensation Clawbacks

On Oct. 26, 2022, the commission adopted final rules mandated by the Dodd-Frank Act regarding clawbacks of erroneously awarded incentive-based compensation.[15]

Corporate executives are often paid based on the performance of the companies they lead, with factors that may include revenue and business profits.

If the company makes a material error in preparing the financial statements required under the securities laws, an executive may receive compensation for reaching a milestone that in reality was never hit. Whether such inaccuracies are due to fraud, error, or any other factor, the new rules would implement procedures that require issuers to recover erroneously rewarded pay, a process known as a clawback.

Grewal touted the division's successes in this area in 2022, and its efforts will certainly expand into 2023.

As Grewal stated,

> More is required to ensure accountability from senior executives at public companies and incentivize them to prevent misconduct at their firms. That's why the commission employed another tool in fiscal year 2022 and used Sarbanes-Oxley 304 to require several executives to return bonuses and compensation following misconduct at their firms, even though the executives were not personally charged with the underlying misconduct.[16]

4. ESG Disclosures and Compliance

Another rapidly emerging focus point for the SEC involves disclosures and compliance in the much-publicized area of environmental, social and governance, or ESG, exposure.

As part of its rulemaking agenda, in March 2022 the SEC proposed expansive rule changes that would require registrants to include climate-related disclosures in their registration statements and periodic reports, and climate-related financial statement metrics — including greenhouse gas emissions — in a note to their audited financial statements.[17]

Depending on how far upstream and downstream a company needs to extend its analysis when reporting climate exposure, the new rules could impose significant compliance challenges on issuers. In May 2022, the SEC proposed additional rule changes requiring certain funds and advisers to provide more specific disclosures in fund prospectuses, annual reports and adviser brochures based on the ESG strategies they pursue.[18]

In the enforcement arena, since forming the Climate and ESG Task Force in March 2021, the Division of Enforcement has increased its efforts to investigate disclosure and compliance issues relating to ESG strategies, and to root out so-called greenwashing by issuers.[19]

Although the SEC has yet to file a contested action squarely alleging SEC disclosure violations, there is little doubt that ESG-related cases will increase exponentially in 2023 and beyond, especially after the new ESG rules are adopted. This headline-grabbing area spurs the need for companies to get in front of their ESG compliance issues so as not to be caught on the wrong side of an SEC examination or enforcement investigation charging inadequate or improper ESG disclosures.

5. Cybersecurity Risk Disclosures and Compliance

In response to much-publicized cybersecurity breaches in the past few years, such as those at SolarWinds,[20] Twitter and Uber, in March 2022 the SEC proposed new Cybersecurity Risk Management Rules, scheduled for a final vote in April 2023.[21]

If adopted, which is likely, the proposed rules would require advisers and funds to adopt and implement written cybersecurity policies and procedures designed to address cybersecurity risks. The proposed rules also would require advisers to report significant cybersecurity incidents to the commission, and would impose record-keeping requirements to improve the availability of cybersecurity-related information.

Although SEC enforcement activity in this area began before the new rules were proposed, it is certain to pick up in 2023.[22]

Not only is this issue a highly publicized SEC enforcement priority, but also, to be sure, the numerosity and severity of cyberattacks will only pick up in the coming years due to the increased sophistication of domestic and international cybercriminals.

The SEC's recent subpoena enforcement action filed against Covington & Burling LLP in the U.S. District Court for the District of Columbia — demanding that the firm turn over the names of clients that were victims of the Microsoft Hafnium cyberattack suffered by the firm — emphasizes the aggressive approach the agency intends to take in the cybersecurity arena.[23]

SEC registrants, particularly investment advisers and broker dealers, would be wise to focus serious attention on their cybersecurity defenses — and as relevant here, their cybersecurity compliance and disclosure programs — to avoid inquiries by the SEC and other regulators.

6. Rule 10b5-1 Plans

On Dec. 14, 2022, the SEC adopted new rules amending Rule 10b5-1 of the Securities Exchange Act of 1934 to enhance insider trading compliance.[24] The amendments include updates to Rule 10b5-1(c)(1), which provides an affirmative defense to insider trading liability.

They also restrict the use of multiple overlapping trading plans and limit the ability to rely on the affirmative defense for a single-trade plan to one single-trade plan per 12-month period. Further, the amendments will require more comprehensive disclosures about issuers' policies and procedures related to insider trading.

As we all know, as surely as smoke follows fire and form follows function, enforcement activity will undoubtedly follow this new rulemaking.

In fact, a Nov. 3, 2022, Bloomberg article announced that the SEC, in coordination with the DOJ, will be taking hard looks at whether executives have been "gaming prearranged stock-sale programs designed to thwart the possibility of insider trading."[25]

The article went on to note that the SEC and DOJ will use artificial intelligence and computer algorithms to engage in broad sweeps of preplanned equity sales by company executives to test for illegal trading behavior. Following these sweeps, these regulators likely will initiate a slew of investigations and actions against companies and executives who they believe have engaged in improper trading activities under the guise of Rule 10b5-1 plans.

To avoid facing any civil or criminal inquires in this area, compliance officers would be wise to engage in fresh reviews and retoolings of their companies' executive stock-buying programs to make sure they are compliant with the new SEC rules, and robust enough to detect and deter improper trading by executives.

Paul W. Kisslinger is a partner at Lewis Brisbois Bisgaard & Smith LLP and chairs the firm's SEC enforcement and litigation practice.

Rebecca Stoddard is an associate at the firm.

Disclosure: During his tenure at the SEC, Kisslinger acted as lead attorney in its complaint against fund manager Ofer Abarbanel and the New York Alaska firm.

[1] https://www.sec.gov/news/statement/grewal-statement-house-testimony-071922

[2] https://www.sec.gov/news/statement/grewal-statement-house-testimony-071922

[3] https://www.sec.gov/news/press-release/2022-78

[4] https://www.cnbc.com/2022/12/07/sec-chair-gary-gensler-cryptocurrency-firms-need-to-come-into-compliance-.html

[5] https://www.cftc.gov/About/Commissioners/RostinBehnam.htm

[6] SEC v. Kik Interactive Inc., 1:19-cv-05244 (S.D.N.Y. 2020)

[7] SEC v. LBRY, Inc., No. 1:21-cv-00260 (D.N.H. Nov. 7, 2022)

[8] https://www.sec.gov/litigation/complaints/2023/comp-pr2023-2.pdf

[9] https://www.sec.gov/news/press-release/2022-19

[10] https://www.sec.gov/news/press-release/2022-141

[11] https://www.sec.gov/litigation/litreleases/2022/lr25336.htm

[12] https://www.sec.gov/news/press-release/2022-34

[13] https://www.sec.gov/news/press-release/2022-154

[14] https://www.sec.gov/news/press-release/2022-154

[15] https://www.sec.gov/rules/final/2022/33-11126.pdf

[16] https://www.sec.gov/news/speech/grewal-speech-securities-enforcement-forum-111522

[17] https://www.sec.gov/news/press-release/2022-46

[18] https://www.sec.gov/news/press-release/2022-92

[19] https://www.sec.gov/spotlight/enforcement-task-force-focused-climate-esg-issues

[20] https://www.gao.gov/blog/solarwinds-cyberattack-demands-significant-federal-and-private-sector-response-infographic;

[21] https://www.sec.gov/news/press-release/2022-39

[22] https://www.sec.gov/news/press-release/2021-169

[23] https://storage.courtlistener.com/recap/gov.uscourts.dcd.250898/gov.uscourts.dcd.250898.1.1.pdf

[24] https://www.sec.gov/news/press-release/2022-222

[25] https://www.bloomberg.com/news/articles/2022-11-03/us-probes-insider-trading-in-prearranged-executive-stock-sales