

# FCA and SEC Enforcement Trends: 2020

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# FCA in 2020

- Annual Report and Accounts 2019/2020 (as at 31 March 2020)
  - Fine levels and enforcement activity
  - Increased delays and costs
- Enforcement amidst the pandemic:
  - *“... will continue to use our range of powers to monitor, make enquiries, investigate, and if necessary take enforcement action to protect the integrity and orderly functioning of the market.”* (FCA Market Watch Newsletter, May 2020)
  - *“We will not compromise on our expectations of firms, particularly that they make consumers’ interests the foundation of their business models and behave accordingly.”* (FCA Business Plan 2020/2021)
- Financial Penalties:
  - Commerzbank: £37,805,400
  - Goldman Sachs: £48,308,400
  - Lloyds Bank Plc and others: £64,046,800
- Whistleblowers

# Areas of Focus for 2020 and Beyond

- Financial crime and AML
- Market abuse:
  - Insider dealing
  - Market Manipulation
  - Misleading Statements
- Operational resilience
- Culture and governance and non-financial misconduct
- Principles for Businesses
- Crypto assets

# Prevention of Financial Crime/AML

- Remains a key priority
- Evaluation and assessment of systems and controls to detect, disrupt and reduce risk
- *“It is important that firms remain vigilant to new types of fraud and amend their control environment where necessary to respond to new threats. This should include the timely reporting of Suspicious Activity Reports (SARs) of any new threats”* (FCA, May 2020)
- **Commerzbank London** (Final Notice, June 2020)
  - £37,805,400 financial penalty
  - Failure to carry out timely client due diligence
  - Weaknesses in monitoring automation tool
  - Failure to address previously identified weaknesses
  - Inadequate policies and procedures

# Market Abuse

- Largest category of FCA cases
  - Insider dealing
  - Market manipulation
  - Misleading statements
- **July 2020: Mr Abbattista, CIO of Fenician Capital Management LLP (pending appeal)**
  - FCA's first market abuse outcome under the EU Market Abuse Regulation
  - Large misleading orders for CFDs affecting the supply and demand of shares
- **July 2020: Mr Conor Foley, CEO of WorldSpreads Limited**
  - AIM admission documents contained misleading information
  - FCA ordered Mr. Foley pay a £658.9k fine and banned him from performing any roles linked to a regulated activity
- **June 2020: Redcentric plc**
  - Redcentric issued unaudited interim results and audited final year results
  - False and misleading information

# Operational Resilience

- 16% of reported operational incidents in 2019/20 due to the use of third party service providers
- **Raphael & Sons Plc (2019)**
  - Outsourced card processor services to a third party
  - Technology incident on Christmas Eve 2015 – customers unable to use cards
  - *“The absence of any adequate processes for capturing and assessing information about the Card Processor’s business continuity and disaster recovery arrangements exposed the Firm and its customers to a serious risk of harm”*. (Final Notice, May 2019)
- *“We expect all firms to have contingency plans to deal with major events and that these plans have been properly tested”* so as to ensure firms are able *“to supply their most important services with minimal interruption, even during severe operational events such as coronavirus”* (Executive Director of Supervision, FCA June 2020)

# Culture and Governance

- *“Culture within firms is the foundation on which their customer outcomes are built”* (Christopher Woolard, Interim Chief Executive, FCA, 2020)
- FCA’s assessment of:
  - Leadership
  - Purpose
  - Governance
  - Approach to managing and rewarding employees
- *“A failure to embed a culture of compliance with regulatory requirements throughout the firm”*
- Senior Managers and Certification Regime
- Non-financial misconduct
  - *“The FCA expects high standards of character, probity and fitness and properness from those who operate in the financial services industry and will take action to ensure these standards are maintained.”* (Mark Steward, Executive Director of Enforcement and Market Oversight, November 2020)

# Crackdown on Smaller Firms and Financial Advisers

- Enhanced scrutiny of smaller firms
- Enhanced focus on financial advisers
- Two year investigation into the financial advisory sector
- “[w]e are seeing an increasing number of cases where the actions of firms are resulting in significant harm to consumers’ financial wellbeing. Preventing harm . . . is therefore a key priority.” (Debbie Gupta, FCA Director of Life Insurance & Financial Advice)



# Crypto Assets

- FCA as “*AML supervisor*” of crypto assets providers
- “*We apply the same AML standards we expect of businesses operating in traditional financial services to the crypto asset economy*” (Therese Chambers, Director of Retail and Regulatory Investigations, March 2020)
- FCA’s powers:
  - To request information from a crypto-asset firm
  - To place a voluntary/involuntary requirement on crypto-asset firms to cease doing business
  - To conduct fit and proper tests of persons

# 2020 Enforcement Overview

- SEC Enforcement adjusted quickly to impact of COVID-19
  - Transitioned to mandatory teleworking: virtual testimony, depositions, Wells meetings
  - Addressed emerging threats to markets including suspending ongoing fraud
- Division of Enforcement Annual Report (Nov. 2020)
  - Brought more than 700 enforcement actions in diverse areas including financial fraud and disclosure, cryptocurrency offerings and fraud, investment adviser and broker-dealer regulatory cases
  - Continued reliance on Big Data to identify and prove cases
  - Continued focus on retail investors
- Obtained record \$4.68 billion in disgorgement and penalties
- Active whistleblower program

# SEC Response to COVID-19

- The SEC has taken a number of significant steps to deal with COVID-19 and its consequences
  - The SEC was the first U.S. federal agency to adopt work from home approach for all but essential personnel
  - Significant instances of regulatory relief provided by
    - Each of the SEC's regulatory divisions (Trading & Markets, Investment Management, and Corporation Finance) provided significant instances of regulatory relief to market participants relating to products and services and supervisory responsibilities
    - The agency's regulatory divisions coordinated with self-regulatory organizations (*e.g.*, FINRA, NYSE) on relief related to the regulatory programs they administer
  - Examination program conducted by the Office of Compliance Inspections and Examinations recalibrated to evaluate the efficacy of business continuity plans, as well as evaluate integrity and resiliency of core systems, and supervisory regimes of various registrants

# COVID-Related Cases

- The SEC's most recent Annual Report from the Division of Enforcement highlights work in the COVID area
  - According to Chairman Jay Clayton, "Enforcement took action at the onset of the global pandemic against wrongdoers who sought to take advantage of the [resultant] uncertainty and volatility in the markets."
  - Steps to prevent potential fraud related to the pandemic
  - Actions against wrongdoers who attempted to capitalize on it
- The SEC worked quickly to identify and recommend trading suspensions – including two dozen issuers suspended in March and April regarding accuracy and adequacy of COVID-related information

## COVID-Related Cases (cont'd)

- Over 150 COVID-related inquiries and investigations resulted in a number of fraud actions
- Examples of COVID-related enforcement actions include:
  - Emergency action and asset freeze in an alleged scheme that generated over \$25 million from microcap stock sales
    - The alleged scheme involved promotional campaigns with false and misleading information designed to fraudulently capitalize on the COVID-19 pandemic, such as claims that a company could produce medical quality facemasks and that another company had automated kiosks for retailers to use in response to the COVID-19 pandemic
  - California-based penny stock trader for alleged pump-and-dump scheme involving misleading statements, including approval of a blood test for COVID-19
  - Applied Biosciences Corp and officers at Arrayi Corporation for allegedly false claims regarding COVID-19 tests
  - Praxsyn Corp for allegedly false releases related to N95 mask acquisitions

# Cryptocurrency and Cybersecurity

- Cryptocurrency was a significant focus in 2020:
  - Unregistered offering cases due to failure to comply with registration requirement for offering of assets deemed to be securities
  - Telegram and Kiks cases – Significant victories for SEC
    - Commissioner Peirce dissenting views
  - Fraud
    - Several cases related to fraud
    - May overlap with registration issues
      - June 25<sup>th</sup> action for conducting a fraudulent unregistered offering of AML BitCoin, a “new and improved version” of bitcoin
      - Celebrity Cases: Failure to disclose compensation for endorsement
- We expect cryptocurrency and cybersecurity to be a continued focus in the next Administration

# Financial Disclosure and Accounting Fraud

- Proactive, risk-based analytic approach to identifying potential violations
  - Use of Big Data in DERA and within Enforcement Division
- Earnings Per Share (EPS) Initiative
  - Used risk-based data analytics to uncover potential accounting and disclosure violations caused by earnings management practices to mask unexpectedly weak performances
  - Investigations under the EPS Initiatives resulted in settled enforcement actions:
    - Interface Inc. and two of its former executives
    - Fulton Financial Corporation for improper accounting practices that resulted in the reporting of quarterly EPS that met or exceeded analyst consensus estimates
- Data analytics also uncovered potential violations related to corporate perquisites
  - Hilton Worldwide Holdings Inc. – failure to disclose perquisites and personal benefits provided to executive officers

# Coordination With Other Regulators

- The SEC has worked to coordinate its enforcement efforts with those of other regulators
- Examples include:
  - **Interactive Brokers** – \$11.5 million penalty to SEC for failing to file SARs for securities trades executed on behalf of customers
    - Parallel CFTC and FINRA actions (\$38 million in total penalties)
  - **Ponzi scheme targeting African immigrants** – SEC charged two Maryland companies and their principals for defrauding 1,200 investors of more than \$27 million (seeking permanent injunction, disgorgement and civil penalties)
    - Parallel criminal actions by U.S. Attorney’s Office for the District of Maryland and CFTC
  - **Fraud in securities offering in Neiman Marcus bankruptcy (Marble Ridge)** – Co-chair charged with abusing his position on unsecured creditors committee at Neiman Marcus to benefit his management firm (SEC requested permanent injunction and civil penalties)
    - Parallel criminal action by U.S. Attorney’s Office for the S.D.N.Y.



## Powers of Disgorgement – *Liu v. SEC*

- In *Liu*, U.S. Supreme Court upheld SEC authority to seek disgorgement but narrowed its contours compared to current practice
- It remains unclear how future enforcement actions will be affected, but Supreme Court provided guiding principles for determining the availability and scope of SEC disgorgement:
  - Disgorgement should benefit wronged investors, not the general public
  - Similarly, parties can be held liable for their own profits, not others'
  - Disgorgement can't exceed actual gains – only net profits after deducting legitimate expenses
- *Liu* has begun to have an effect on disgorgement
  - **SEC v. Yang** – Ninth Circuit reversed and remanded a judgment that included about \$3 million in disgorgement in light of *Liu*

# Private Fund Adviser Enforcement

- OCIE Risk Alert signaled potential for future enforcement actions
  - Issues with (1) conflicts of interest; (2) fees and expenses; and (3) material non-public information policies and procedures
- Conflicts of interest: Issues with (1) investment allocations; (2) multiple clients; (3) financial relationships between clients/investors and the adviser; (4) preferential liquidity rights; (5) advisers having interests in recommended investments; (6) co-investments; (7) service providers; (8) fund restructurings; and (9) cross-transactions
- Fees and expenses: Issues with (1) fee and expense allocations with sharing of expenses, among other things; (2) fees and expenses for “Operating partners” without adequate disclosure; (3) valuation; and (4) monitoring/board/deal fees and fee offsets
- MNPI: Signaled to private fund managers that they risk enforcement action if they misuse material non-public information
  - Examinations found investment advisers failing to establish, maintain, and enforce written policies and procedures to prevent misuse

## Private Fund Adviser Enforcement (cont'd)

- Consistent with previous years, the SEC has continued to bring enforcement cases against private fund advisers
- **Rialto Capital Management** – Private equity fund adviser expensed third-party tasks performed by in-house employees without proportionately allocating certain expenses to co-investors
  - Rialto fully remediated its funds (approximately \$2.75 million and \$250,000) and agreed to pay a civil penalty of \$350,000
- **Monomy Capital Management** – Private equity fund adviser failed to fully disclose or obtain consent to charge private fund portfolio companies for the costs of certain services
  - Monomy agreed to pay disgorgement of \$1,521,972 and prejudgment interest of \$204,606, and a civil penalty of \$200,000

# ADR Enforcement

- In 2020 the SEC has continued its initiative, commenced in 2018, focusing on ADR practices, in particular pre-release ADRs
- **ABN AMRO** – ANB AMRO settled charges of improper handling of pre-released ADRs. ANB AMRO improperly borrowing pre-released ADRs from other brokers when it should have known that they did not own the foreign shares needed to support the ADRs
  - ABN AMRO agreed to return more than \$326,000 of ill-gotten gains and pay a \$179,353 penalty plus \$80,970 in prejudgment interest

# Broker-Dealer Enforcement

- **Morgan Stanley Smith Barney** – Information provided to clients in retail wrap fee programs regarding trade execution services and transaction costs
  - MSSB agreed to pay a \$5 million penalty
- **Morgan Stanley & Co.** – Regulation SHO netting of positions and marking long and short sales
  - Morgan Stanley agreed to pay a \$5 million penalty
- **Interactive Brokers LLC** – Red flags and SARs for US microcap securities executed on behalf of customers
  - Interactive Brokers agreed to pay an \$11.5 million penalty

## Broker-Dealer Enforcement (cont'd)

- **Bluefin Trading LLC and Critical Trading LLC** – Short tender rule in a partial tender offer
  - Bluefin has agreed to pay disgorgement and prejudgment interest totaling \$253,638 and a \$50,000 penalty, while Critical agreed to pay disgorgement and prejudgment interest totaling \$169,092 and a \$50,000 penalty
- **SG Americas Securities LLC** – Blue sheet trading data
  - SGAS agreed to pay a \$1.55 million penalty
- **JonesTrading Institutional Services** – Preservation of business-related text messages exchanged on PDAs of several registered reps
  - JonesTrading agreed to pay a \$100,000 penalty

## Broker-Dealer Enforcement (cont'd)

- Another topic we are closely monitoring, and one where we have been called on to advise clients and defend certain others, is in the area of unregistered broker-dealer activity
- The SEC has taken an increasingly aggressive approach to looking to the activities of certain market participants (whether issuers, investment advisers, or persons who thought of themselves merely as traders) and saying that those activities constitute unregistered broker-dealer activity
  - Firms or individuals engaged in making loans to small or microcap companies convertible to equity securities in those companies
  - Finders and Placement Agents
  - Non-US persons and entities that engage in broker-dealer activity in the US and that fail to meet the requirements of Rule 15a-6 under the Exchange Act

# Insider Trading

- Enforcement regarding insider trading has declined during the current administration—32 actions in 2019, the lowest since 1996
- **Ares** – Compliance policies failed to implement and enforce policies and procedures set forth in the Investment Advisers Act
- **Sagent Pharmaceuticals** – Husband and wife involved in alleged multi-million dollar insider trading regime involving trading ahead of announcement of company's acquisition
- **PetMed Express** – Alleged trading ahead of market-moving announcements from 2014 to 2018
- **Aceto Corporation** – Alleged trading ahead of poor sales and pending impairment charge
- **Rite Aid** – Two employees alleged to have traded ahead of negative announcement regarding merger talks with Walgreens
- **Investor Relations** – An IR consultant allegedly trading ahead of earnings announcements in various public companies between 2016 and 2018



## Prevention of Financial Crime – FCPA Enforcement

- **Herbalife** – Herbalife agreed to pay at least \$67 million to settle charges that it violated the FCPA books and records and internal accounting controls provisions
  - Parallel action: DOJ and U.S. Attorney’s Office for the S.D.N.Y. announced a \$55+ million criminal fine
- **Alexion Pharmaceuticals** – \$21+ million to settle charges that it violated the FCPA books and records and internal accounting controls provisions
- **Novartis AG** – Global pharmaceutical and healthcare company and its former Alcon subsidiary agreed to pay over \$340 million to resolve SEC and DOJ charges arising out of conduct in multiple jurisdictions

## FCPA Enforcement (cont'd)

- **ENI S.p.A.** – Italian multinational oil and gas company agreed to resolve charges that it violated the books and records and internal accounting controls provisions of the FCPA in connection with an improper payment scheme in Algeria
- **Asante Berko** – SEC charged a former executive of a financial services company with orchestrating a bribery scheme to help a client to win a government contract to build and operate an electrical power plant in the Republic of Ghana
- **Cardinal Health** – Ohio-based pharmaceutical company Cardinal Health, Inc. agreed to pay more than \$8 million to resolve charges that it violated the books and records and internal accounting controls provisions of the FCPA in connection with its operations in China

# Looking Ahead to 2021

- Biden Administration is likely to lead to more aggressive enforcement and regulations
- Chairman Clayton announced he will resign at end of 2020
  - Leaves Commission with two Democrats and two Republicans until new chair is appointed by Biden
- Likely areas of Enforcement focus
  - EPS Initiatives Phase II, Cryptocurrency offerings and fraud, Implementation of Regulation BI including suitability, Supervision, Insider Trading, Cybersecurity
  - Additional areas of focus: Innovative use of disclosure focused, e.g., political contributions, socially responsible investments, sustainable development
- Potential increase in penalties versus disgorgement in light of *Liu*

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Elizabeth P. Gray is a partner in the Litigation Department and Co-Chair of the Securities Enforcement Practice Group. Elizabeth represents investment advisers, investment companies and their boards, accounting firms, broker-dealers, self-regulatory organizations, public companies and senior executives facing examination, investigation and litigation by financial regulators. She counsels clients on cybersecurity regulation and breach response, and conducts investigations on behalf of audit committees and other committees of the board.

In ranking Elizabeth among the leaders in Securities and Financial Services Enforcement, Chambers USA highlighted that she is “the much needed type of attorney who doesn’t just identify problems but works to solve them,” commending her “practical approach to client representation and to adversarial negotiations with the government.” Elizabeth is recognized nationally among the leading individuals practicing in the area of Securities Regulation: Enforcement in *Chambers USA* (2010-2020); Financial Services Regulation: Broker Dealer (Enforcement) in *Chambers USA* (2014-2020); Securities Litigation and Securities Regulation in *The Best Lawyers in America* (2010-2021); and Securities Litigation in *Super Lawyers* (2018-2020).



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James R. Burns is a partner in the firm’s Asset Management Group, focusing on counseling investment managers, broker-dealers, self-regulatory organizations, and other registered entities on regulatory, compliance and enforcement matters. Prior to joining Willkie, Jim served as Deputy Director of the SEC’s Division of Trading and Markets.

Jim has significant experience in both the trading and markets and investment management areas. He provides clients with insights into current issues in SEC examination and enforcement contexts as well as strategic advice on the effects of SEC initiatives on the business operations and compliance programs of registrants overseen by the Division of Trading and Markets and the Division of Investment Management. He advises clients on cybersecurity and business continuity issues – ranging from broker-dealer and investment adviser regulatory obligations to expectations established by the SEC, FINRA and other federal and state authorities in connection with breaches and technology failures.

Jim brings well-respected knowledge and understanding of the equity, fixed income, and derivatives markets, having played an integral role in the development of current SEC positions and regulatory initiatives affecting those markets, their intermediaries and sell-side and buy-side participants. This includes trading, cybersecurity issues and the use of complex financial products. He played a central role in the development and execution of significant rules under the Dodd-Frank Act, including the Volcker Rule and the SEC’s security-based swap regulatory regime.

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Peter Burrell is a partner and heads Willkie's Litigation, Compliance and Enforcement and White Collar Defence Practices in the London office.

Peter is recognised as one of the U.K.'s leading specialists in corporate crime and compliance matters. His practice includes advising on compliance issues relating to money laundering, bribery and corruption, sanctions and fraud; conducting complex internal corporate investigations; and defending companies and individuals in investigations and enforcement actions by the U.K.'s Serious Fraud Office, Financial Conduct Authority, HM Revenue and Customs, and other law enforcement and regulatory agencies. He also handles complex High Court litigation and arbitration proceedings in London, with a particular focus on financial fraud, securities disputes and financial reporting issues.

*Chambers* and *Legal 500* cite Peter as a leading practitioner in his areas of practice in the U.K. His recent representations include acting for Afren Plc in connection with an investigation concerning alleged breaches of Listing Rules and Improper Payments, acting in relation to the SFO's failed prosecution of 6 brokers concerning LIBOR manipulation, and representing Tony Allen in connection with a US prosecution for alleged incorrect LIBOR submissions.



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Simon Osborn-King is a partner in Willkie's Litigation and Compliance, Investigations & Enforcement Practices in London. Simon has a broad-ranging domestic and cross-border investigations, commercial litigation and arbitration practice. Simon has significant experience in complex regulatory, criminal, and internal investigations and enforcement proceedings facing multinational corporations, financial institutions and individuals across a wide spectrum of business sectors including before the U.K. Financial Conduct Authority and Serious Fraud Office, U.S. Department of Justice, European Commission, Italy Public Prosecutors' Office, Japan Financial Services Agency and Korea Fair Trade Commission.

Simon also represents a range of clients, including financial institutions, funds, major corporates, shareholders, and high-net worth individuals in high value and complex commercial litigation and arbitration proceedings, often with parallel U.K. and U.S. dimensions. He has particular experience in relation to disputes where allegations of fraud, conspiracy or misconduct are central issues. Simon is frequently called upon to provide urgent advice on compliance issues relating to anti-corruption, sanctions, whistle-blowing, money-laundering and data protection.

Simon was recognized in the 2020 edition of **Global Investigations Review's** '40 under 40', which celebrates the next generation of leading investigations specialists from around the world. He is also recognized by *The Legal 500 UK* (2021) for 'Commercial Litigation', 'Regulatory Investigations and Corporate Crime (advice to corporates)' and 'Fraud: Civil'.