

Strategic Perspectives

Banner enforcement year sets up SEC and CFTC for continued strength in 2023

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Historic high penalties and a hot trial streak, big actions on crypto assets, and a focus on enforcement sweeps were high points for the SEC and CFTC in FY 2022.

2022 also saw a renewed focus on individual accountability, with DOJ calling it a “first priority.”

Here’s a look at top enforcement trends this year and what they might mean for 2023.

BIG PENALTIES

It was a banner year for SEC enforcement, and the CFTC also turned in a strong performance.

The SEC saw [eyepopping new records](#) in total money ordered (\$6.4 billion, up from \$3.9 billion) and civil penalties (\$4.2 billion, up from \$1.5 billion).

Several hefty penalties boosted the SEC total:

- Aggregate penalties of \$1.2 billion in a sweep against 15 broker-dealers and an investment adviser for [pervasive records violations](#);
- Over \$1 billion in penalties against investment adviser Allianz Global U.S. LLC for a [massive fraudulent scheme](#) that concealed immense downside risks of a complex options trading strategy. The case also involved a parallel criminal action and integrated global resolution.
- A \$200 million penalty against Barclays

for the [sale of \\$17.7 billion of unregistered securities](#). An additional \$161 million in disgorgement and interest was ordered but deemed satisfied by rescission.

The number of SEC cases filed increased 9 percent from last year, for a total of 760 cases.

The SEC also saw notable litigation success. The Trial Unit won favorable verdicts in 12 of 15 trials—the most conducted by the Division in a single year within the past decade. Staff also obtained complete wins on liability at the summary judgment stage in nine matters and partial summary judgment in many others.

The CFTC also had an impressive year. The agency obtained orders [imposing \\$2.5 billion](#) in restitution, disgorgement, and civil penalties. This was up from \$1.3 billion in 2020. The 82 cases filed was down from a record 113 cases in 2020 but higher than the five-year average of 76. The CFTC also won two jury trials, settled one case mid-trial, and won summary judgment in another.

Will 2023 continue to see strong enforcement?

By all indications, the SEC looks to continue its aggressive stance on enforcement in 2023.

The dynamic duo of SEC Enforcement Director Gurbir Grewal and Deputy Director Sanjay Wadhwa are on a roll and have

made recent statements indicating a strong outlook for next year, including an expectation of compliance and more use of sweeps.

A strong stance does not necessarily mean the SEC will continue to break records in terms of numbers. Statistically that is unlikely, given yearly ebb and flow. In announcing the SEC’s eye-popping results, SEC Chair Gary Gensler and Grewal appeared to manage expectations for 2023.

“These numbers ... tell only part of the story,” said Gensler. “Enforcement results change from year to year. What stays the same is the staff’s commitment to follow the facts wherever they lead.”

***“We expect compliance,”
said SEC Enforcement
Director Grewal.***

“While we set a Commission record this past fiscal year for total money ordered at \$6.4 billion, including a record \$4.2 billion in penalties, we don’t expect to break these records and set new ones each year because we expect behaviors to change,” said Grewal. “We expect compliance.”

The outlook is strong at the CFTC as well. Notably, the Division of Enforcement has been operating with only an Acting Director

for over two years. Acting Director Gretchen Lowe has been in the role since April, having taken over from Acting Director Vince McGonagle, who had served in that capacity since October 2020. Yet despite the lack of a full Director, the Division still came out with strong numbers, trial wins, and major settlements in 2022, portending strength for 2023.

A top enforcement for both the SEC and CFTC was crypto assets, which looks to continue into next year.

CRYPTO CRACKDOWN

The crypto “rocket to the moon” is looking more like the Hindenburg lately.

In May, the TerraUSD stablecoin [lost its dollar peg](#), causing its companion coin LUNA to crash from an April high of \$119 to just a few cents. Crypto confidence cratered, triggering customer withdrawals, which in turn led to platforms “pausing” withdrawals, including at crypto lender Celsius Network and crypto-asset broker Voyager Digital. “Pauses” then turned into bankruptcies.

In November, with the crypto space still floundering, the FTX crypto empire collapsed. Once flying at a \$32 billion valuation with an appearance of mainstream legitimacy, FTX filed for bankruptcy on November 11 following a massive liquidity crisis.

Details are still emerging. On December 12, former FTX CEO Sam Bankman-Fried was [arrested](#) in the Bahamas. The next day, an [8-count indictment](#) was unsealed in the Southern District of New York alleging that Bankman-Fried defrauded FTX customers and investors, as well as lenders to Alameda Research, his proprietary crypto hedge fund. He was also charged with violating campaign finance laws.

Bankman-Fried was also [charged by the SEC](#) with defrauding investors of more than \$1.8 billion.

All told, the crypto space has seen a massive reversal of fortune in 2022. According to some estimates, cryptocurrencies lost over \$2 trillion in value this year.

From the year’s roaring start through the wheezing finish, the SEC and CFTC maintained a strong focus on crypto enforcement. The SEC and CFTC laid groundwork for a crypto reckoning in 2023.

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SEC crypto highlights include:

- [BlockFi](#) — The SEC ordered a \$50 million civil penalty in a first-of-its-kind action against a crypto lending platform for failure to register the offers and sales of its retail crypto lending product. BlockFi also agreed to pay an additional \$50 million in fines to 32 states to settle similar charges, cease unregistered offers and sales of a lending product, and attempt to come into compliance with the Investment Company Act within 60 days. The platform ended up [filing for bankruptcy](#) in late November.
- [Kim Kardashian](#) —The SEC settled charges against the famous reality TV star for touting EMAX tokens, a crypto asset security sold by EthereumMax, on social media without disclosing that she had been paid to do so. Kardashian did use the hashtag “#Ad” but this did not satisfy federal securities disclosure requirements. Kardashian agreed to pay \$1.26 million in penalties, disgorgement, and interest, and

cooperate with the SEC’s ongoing investigation.

- [Forsage](#) — The SEC charged 11 individuals in a \$300 million pyramid scheme spanning multiple countries including Russia and Indonesia. Forsage.io was a website that allowed millions of retail investors to enter into transactions via smart contracts that operated on the Ethereum, Tron, and Binance blockchains. However, Forsage has allegedly operated as a pyramid scheme for more than two years.
- [Wahi](#) — Crypto met insider trading when the SEC charged a former Coinbase product manager, his brother, and his friend with perpetrating a scheme to trade ahead of announcements about 25 crypto assets that would be made available for trading on the Coinbase platform. The scheme allegedly generated illicit profits of more than \$1.1 million.
- [LBRY, Inc.](#) — In a ruling with implications for whether “utility coins” may be deemed securities, a federal district court in the District of New Hampshire ruled that a certain digital token was a security. LBRY, Inc. used blockchain technology to allow users to share digital content, such as videos or images, without a centralized host. The blockchain’s LBRY uses a native digital token called LBRY Credits (LBC) to compensate miners, but LBC can also be spent to publish or purchase content or create channels within the LBRY Network. Although LBRY has consumptive in addition to speculative uses, the court agreed with the SEC that LBRY cultivated an expectation of profitability for the token, contributing to the conclusion that it was a security.

The CFTC also had a strong year in crypto enforcement. The CFTC brought 18 actions involving digital assets—more than 20 percent of all CFTC actions filed in FY 2022.

Highlights include:

- **Tether** — The CFTC settled charges against Tether Holdings and related entities for falsely representing that Tether maintained sufficient U.S. dollar reserves to back all U.S. dollar tether token (USDT) stablecoins in circulation, when in fact it could only cover 27 percent. Tether also made other related misrepresentations. Tether agreed to pay a \$41 million civil penalty and cease and desist order.
- **Bitfinex** — The CFTC settled charges against the Bitfinex cryptocurrency trading platform. Bitfinex engaged in illegal, off-exchange retail commodity transactions in digital assets with U.S. persons on the Bitfinex trading platform and operated as a futures commission merchant (FCM) without registering as required. Bitfinex also violated a [2016 order](#) relating to similar violations. Bitfinex agreed to a \$1.5 million civil penalty and cease and desist order, and to implement and maintain additional systems reasonably designed to prevent unlawful retail commodity transactions.
- **bZeroX and Ooki DAO** — The CFTC charged two individuals and a decentralized blockchain-based software protocol that functioned similarly to a trading platform with illegally offering leveraged and margined retail commodity transactions in digital assets and operating as a registered futures commission merchant (FCM). The CFTC imposed a \$250,000 civil penalty and is seeking an injunction against Ooki Dao, to which control of the bZeroX software protocol was allegedly illegally transferred. Commissioner Summer Mersinger [dissented](#) to the filing of the complaint, saying the CFTC did not have the authority to bring the action.

For 2023, expect crypto enforcement to stay strong. The loss of public confidence in crypto and declining Congressional support

will strengthen the position of SEC and CFTC for potential broad crackdowns next year.

The SEC in particular has set the stage for reining in crypto next year.

First, the SEC renamed its Cyber Unit to the [Crypto Assets and Cyber Unit](#) and nearly doubled its staffing, adding 20 positions for a total of 50 dedicated positions.

Second, the SEC has now brought cases involving many different crypto aspects, including stablecoins, crypto lending platforms, celebrity promoters, insider trading on a crypto trading platform, and many others. This has given enforcement staff important experience in applying the federal securities laws to novel and diverse fact patterns in the crypto space, smoothing the way for additional cases along these lines.

An SEC sample letter seeks detailed info on companies' involvement with crypto.

Finally, a [sample letter](#) released by the Division of Corporate Finance indicates they are closely scrutinizing company disclosures on crypto. The pointed questions will likely uncover violations not only by registrants, but also by crypto entities discussed in the responses.

Turning to the CFTC, we can expect that the agency will continue to make full use of its existing enforcement authorities. The big question is whether Congress will expand the CFTC's authority to cover more of the crypto space, particularly over spot crypto trading platforms. CFTC Chair Rostin Behnam has advocated for this expanded authority.

While multiple bills have been proposed, none are likely to pass before the current

Congress expires. Further, some have asked if proposed legislation should be revised in light of the recent crypto market turmoil. With the coming turnover of the House, stark political polarization may cause legislative paralysis, causing crypto reform legislation to languish.

ENFORCEMENT SWEEPS

Enforcement sweeps were big in 2022.

In the same [massive records sweep](#) in which the SEC fined 16 registrants a total of \$1.2 billion, the CFTC also ordered fines of [\\$710 million](#).

The records sweep found extremely widespread use of unapproved communications methods like personal texts and encrypted chat apps to conduct firm business. In a sample of thirty UBS employees, all but one had used unapproved communications methods. And, those employees' communications revealed that hundreds more UBS employees conducted firm business via unapproved methods—including numerous managing directors and senior supervisors.

Records dodging makes it hard for regulators to conduct oversight, and the agencies are placing a new emphasis in this area. In a [\\$125 million settlement](#) last December involving JPMorgan, SEC Deputy Director Sanjay Wadhwa said that JPMorgan's recordkeeping failures had hindered several SEC investigations, and that this factored into the Enforcement Division's decision to obtain an admission in the case.

Similarly, CFTC Enforcement Acting Director Gretchen Lowe said disregard for records rules threatens the CFTC's ability to conduct examinations and investigations. CFTC Commissioner Kristin Johnson also noted that use of unauthorized communications tools creates privacy and cybersecurity risks for customers.

In other sweeps, the SEC targeted private fund advisers and Form CRS violations.

- **Private fund advisers.** The SEC settled charges against nine advisory firms—two for Custody Rule violations, one for Form ADV violations, and six for both. In the custody rule violations, certain advisers failed to have audits performed or to deliver audited financials to investors in certain private funds in a timely manner. In the Form ADV violations, advisers failed to promptly file amended Forms ADV to reflect they had received audited financial statements after having initially reported that they had not yet received the audit reports. The firms agreed to pay combined penalties of over \$1 million.

“Expect more SEC enforcement sweeps,” said Director Grewal.

- **Form CRS violations.** The SEC settled charges against six broker-dealers and six investment advisers for deficiencies relating to Form CRS under Regulation Best Interest. The firms agreed to be censured, cease and desist from violations, and pay civil penalties of \$10,000 to \$97,523. The action followed an [initial Form CRS sweep](#) in 2021 against 27 other financial firms for similar failures to timely file and deliver their Forms CRS to their retail investors.

Heads up for 2023—review Risk Alerts. In a November speech, Grewal [said](#) to expect the SEC to conduct sweeps more frequently moving forward. Take note!

Because sweeps sometimes target deficiencies discussed in Risk Alerts, it is helpful to review Risk Alerts issued in 2022:

- Private funds. [Observations from Examinations of Private Fund Advisers](#), January 27, 2022—relating to conduct inconsistent with disclosures, disclosures regarding performance and marketing, due diligence, and hedge clauses. The alert follows a previous related alert, [Observations from Examinations of Investment Advisers Managing Private Funds](#), June 23, 2022;
- Material non-public information. [Investment Adviser MNPI Compliance Issues](#), April 26, 2022—relating to rules preventing the misuse of material non-public information (MNPI) by the adviser or associated person, under Section 204A of the Investment Advisers Act of 1940 and Rule 204A-1 thereunder (“Code of Ethics Rule”);
- Adviser marketing rule. The SEC adopted significant reforms in December 2020 to modernize rules on investment adviser advertisements and payments to solicitors. In advance of the compliance date of November 4, 2022, the Division of Examinations issued [Examinations Focused on the New Investment Adviser Marketing Rule](#) (September 27, 2022), to inform advisers, including private fund advisers, of areas of upcoming review.
- Payment for order flow. [Observations Related to Regulation NMS Rule 606 Disclosures](#), November 10, 2022. Staff found issues with quantifiable disclosures, material aspects disclosures, and supervision.
- Identity theft. [Observations From Broker-Dealer and Investment Adviser Compliance Examinations Related to Prevention of Identity Theft under Regulation S-ID](#), December 5, 2022. Deficiencies included failure to identify covered accounts, failure to develop and implement a written program, failure to include all necessary program elements, and failures related to program administration.

INDIVIDUAL ACCOUNTABILITY

Individual accountability took on new significance in 2022.

The SEC spotlighted individual accountability as a “pillar of the SEC’s enforcement program.”

Highlights include:

- More than two-thirds of the SEC’s stand-alone enforcement actions in FY 2022 involved at least one individual defendant or respondent. This was similar to prior years.
- Former Boeing CEO [Dennis Muilenburg](#) was ordered to pay a \$1 million civil penalty for making misleading statements about safety following two Boeing plane crashes that killed 346 people.
- Former Eagle Bancorp CEO [Ronald Paul](#) agreed to pay a total of \$431,216 for negligently making false and misleading statements about related party loans extended by the bank to Paul’s family trusts. Paul also agreed to a permanent injunction and two-year officer and director bar.
- Infinity Q Capital founder and Former Chief Investment Officer [James Velissaris](#) was charged with a fraudulent scheme to overvalue assets in Infinity Q funds.
- Three former [Granite Construction, Inc.](#) senior executives were ordered to return nearly \$2 billion in bonuses and compensation following misconduct at the firm. In, even though the executives were not personally charged with the misconduct. This was pursuant to Sarbanes-Oxley (SOX) 304.
- Synchronoss Technologies, Inc. founder and former CEO [Stephen Waldis](#) agreed to reimburse the company more than

\$1.3 million in stock sale profits and bonuses as well as return previously granted shares of company stock pursuant to SOX 304.

Turning to DOJ, Deputy Attorney General Lisa Monaco issued a [memo](#) in September 2022 outlining revisions to corporate criminal enforcement policies. The memo identifies individual accountability as a top priority.

“The Department’s first priority in corporate criminal matters is to hold accountable the individuals who commit and profit from corporate crime,” said Monaco.

The memo identifies two policies to reinforce individual accountability:

First, the memo states that to be eligible for any cooperation credit, corporations must swiftly disclose to the Department all relevant, non-privileged facts about individual misconduct. Companies seeking cooperation credit should prioritize production of evidence to the government that is most relevant for assessing individual culpability. Companies ultimately bear the burden of ensuring that documents are produced in a timely manner to prosecutors.

On the DOJ’s part, prosecutors must strive to complete investigations into individuals-and

seek any warranted individual criminal charges- prior to or simultaneously with the entry of a resolution against the corporation.

Second, the memo clarifies policy on coordination of international prosecutions of individuals. According to the memo, prosecution by foreign counterparts of individuals responsible for cross-border corporate crime plays an increasingly important role in holding individuals accountable and deterring future criminal conduct. Yet DOJ rules on coordination can potentially hinder U.S. prosecutions of individuals because the Principles of Federal Prosecution recognize that effective prosecution in another jurisdiction may be grounds to forego federal prosecution.

To ensure that DOJ can continue to pursue forcefully its own individual prosecutions, DOJ policy going forward is that before declining to commence a prosecution in the U.S on that basis, prosecutors must make a case-specific determination as to whether there is a significant likelihood that the individual will be subject to effective prosecution in the other jurisdiction.

In 2023, accountability will likely see increased emphasis from both the SEC and DOJ. The SEC and DOJ have spoken out forcefully on this and the message is clear.

LOOKING AHEAD TO 2023

Looking at the big picture, the SEC and CFTC will continue robust enforcement into next year.

For 2023:

- Expect the SEC and CFTC to step up crypto enforcement even more. Given significant failures in the crypto market and increasing indications of widespread misconduct, the “cops on the beat” will step up to the extent they are able using existing authorities. As cases wend their way through the court system, the picture will become clearer on key questions like what crypto assets are deemed securities. Legislators may move to clarify the division of authority among regulators and possibly enhance authorities as well, particularly for the CFTC. But reform may be stymied by political gridlock in the House.
- Enforcement sweeps are likely to take on an enhanced focus, as stated by SEC Enforcement Director Grewal.
- Individual accountability will take on new importance. To obtain cooperation credit, companies should be ready to provide information on individual culpability including senior officials.

Stay tuned for Wolters Kluwer coverage to come on what is sure to be an exciting year ahead!