Securities Regulation Daily Wrap Up, ENFORCEMENT—SEC enforcement director gives thoughts on Division priorities, (Jan 25, 2024)

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Director Grewal offered insights on the SolarWinds cybersecurity case, ESG task force, and the importance of not impeding whistleblowers, among other matters.

Strong enforcement is important to maintain confidence in financial institutions and markets, said SEC Director of Enforcement Gurbir Grewal. He gave his thoughts on Division actions and priorities over the past year, including on cybersecurity, whistleblowers, and internal controls.

Grewal made his remarks at a panel of the 2024 Securities Regulation Institute hosted by Northwestern University Pritzker School of Law. The panel was moderated by Dixie Johnson, a partner in securities enforcement and investigations at King & Spaulding.

Strong 2023. The SEC set a new enforcement record in 2023 by bringing 784 enforcement actions, said Johnson. The SEC obtained financial remedies of about $5 billion, which was second only to the record set the year before of $6.44 billion.

It's important to act with urgency so people see results when they report wrongdoing, Grewal said. Sometimes cases can take two to four years to bring accountability. In what Grewal calls "proactive robust enforcement," the Division looks to where risk is and uses all the tools at its disposal to get ahead of issues.

Cybersecurity. Johnson asked how counsel should think about cybersecurity disclosures and protecting their clients while making sure disclosure happens as it should.

Grewal said to look at the complaint in the SolarWinds case. The allegations were that the company said things publicly that were counter to what they knew about the situation. The person's role does not matter, said Grewal, noting that Timothy Brown was not CISO at the time of the breach. What matters is what you did—what you knew, what red flags you saw, what red flags you ignored, what information you provided to people or did not provide to people.

Grewal compared CISO liability to chief compliance officers (CCOs). The same arguments have been made in those cases, that bringing enforcement actions will have a chilling effect and folks will not want to take on those roles. And that these are tough jobs that are underfunded.

Grewal said he thinks SolarWinds is a good preventive enforcement action for CISOs. He saw a CISO quoted in an article who said that SolarWinds is actually a good case for CISOs. Because they can bring it to their organizations and say, "This is why you need to better fund us. This is why you need to listen to us. This is why you need to empower us."

"We don't want to second guess good faith determinations made by individuals with these positions," said Grewal. "After reasonable diligence and analysis, if you're doing that, you have no reason to be concerned about an enforcement action."

ESG task force. Johnson asked if the ESG task force is still going.

Grewal said the SEC continues to look at ESG matters. He thinks there is some confusion that a task force is a

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collection of individuals exclusively looking at a certain set of cases. The taskforce was set up under then-Acting Chair Lee to be a clearinghouse and collect information from other government agencies on ESG issues and support enforcement. The SEC continues to bring enforcement actions in the ESG space, said Grewal.

As a practice point, Johnson said to look at your risk factors. If you say something matters to you, make sure you really follow up internally and have something to back it up.

Impeding whistleblowers. Johnson asked about the recent settlement in which J.P. Morgan Securities agreed to pay $18 million for impeding clients and customers from reporting securities laws violations to the SEC.

Grewal said to think very broadly about cases involving impeding whistleblowers. It's not just about employees, it is also about customers. It is not just one sentence in an agreement, it is the entire agreement. And it is not just about written agreements, it is also what is being said to employees in other contexts, like trainings.

It also does not matter if you're an issuer, registrant, or private company, said Grewal. Provisions that impede reporting violations apply to all.

Self-reporting and cooperation. With the SEC receiving 18,000 tips a year, public companies should assume that someone is talking to the government about you, said Johnson. That factors into the decision of whether to self-report a violation.

Grewal agreed and said to think about the self-reporting decision as gambling that somebody does not tell the SEC about wrongdoing before you self-report. Because if that happens, those cooperation conversations "become a lot different," said Grewal.

Johnson pointed out that while self-reporting will typically lead to an investigation, it will not necessarily lead to an enforcement action. Her firm handled an accounting investigation that went away within one year with no action being brought.

Johnson asked why the SEC does not provide the same explicit cooperation framework as the Department of Justice. Grewal said that model does not fit for the SEC, where it is not as clear cut as a criminal case. The Division investigates and makes recommendations to a five-member commission, which evaluates and decides.

Officer-director bars. 130 officer-director bars were imposed in FY 2023, the highest in a decade. These bars make sure that people who don't deserve to be in those roles because of their conduct cannot be, said Grewal.

Johnson asked how the Division decides whether to seek an officer-director bar.

Grewal said there should be a presumption that if an officer or director of a public company is charged with violating the scienter-based fraud provisions of the securities laws, the Division will seek that penalty.

Grewal explained that the Division also looks to other factors like egregiousness, role in wrongdoing, economic benefit, and other factors as laid out in case law and elsewhere.

Officer-director bars will be an emphasis moving forward, said Grewal.

Charges against individuals. Two-thirds of cases against entities included charges against at least one individual, said Johnson. She asked how the Division decides whether to recommend cases against individuals.

Grewal said the two-thirds statistic is not unique to his time, it has also been true for prior directors. The Division seeks to hold individuals accountable where the facts support it and brings entity-only cases if it makes sense under the facts and circumstances. For example, if there is a long-running practice that later results in a violation, and it is hard to identify one or two individuals who are responsible for the misconduct.

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Records violations. Another factor in charging individuals is the evidence available, said Grewal. That is why the enforcement actions on off-channel communications are so important. He has heard criticism that those cases were low-hanging fruit or a cash cow for the SEC. But that is just nonsense, he said.

“These are some of the most important cases we’ve brought,” said Grewal. “The origin of these cases comes from our inability to investigate, to figure out who was saying what to whom, what was happening in an investigation.”

Records are there to make sure folks are playing within the chalk lines, said Grewal. Not gaming the requirements by telling people to go off-channel using Telegram or Signal or other ephemeral messaging apps.

Johnson advised that while issuers do not have the same recordkeeping requirements as regulated entities, expect questions if communications policies are not being enforced.

Internal controls. Johnson asked about two recent cases involving internal controls, Charter Communications and Activision Blizzard.

On Charter Communications, Grewal said part of Exchange Act Section 13(b)(2)(b) is about making sure you have controls in place to have compliant financials, but other parts speak to having adequate controls to safeguard company assets and obtaining proper authorization. In Charter Communications, these controls were not complied with. 10b5-1 plans authorize use of company assets to buy back shares according to the plan. Charter Communications’ plans had “accordion” provisions that allowed them to buy back more shares and over a longer period.

On Activision Blizzard, Grewal said the company chose to speak on the importance of having a diverse workforce, that retaining a diverse workforce was critical to remaining a viable, ongoing business. Yet the company had “a ton” of governance issues in which internal complaints were not being elevated.

“That was, in my mind, squarely a violation of their disclosure controls,” said Grewal. “You can't communicate to investors that this is important to our ongoing business [yet] have all these violations percolating inside your company. Violations that resulted in enforcement actions, not just from us but from other entities. And that information wasn't getting to the people who are required to make the disclosures.”

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