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The SEC and CFTC in 2020: Pandemic hangs over Clayton's and Tarbert's regulatory curtain call

By *Anne Sherry, J.D., Amanda Maine, J.D., Amy Leisinger, J.D., Lene Powell, J.D., Rodney F. Tonkovic, J.D., Brad Rosen, J.D., Jay Fishman, J.D., John M. Jascob, J.D., LL.M.* and *John Filar Atwood*

Introduction

In 2020 the SEC and CFTC pursued aggressive regulatory agendas, often against stiff opposition, despite being hampered by the COVID-19 pandemic. Both agencies spent considerable time addressing COVID-related issues that arose for their constituents while still trying to modernize the federal rulebook and maintain credible enforcement. By sheer numbers, the year was a success, with the SEC issuing 31 final rule releases (compared to 19 last year) and the CFTC finalizing 34 rule changes. Ideologically, however, the year was a mixed bag as many of the rule adoptions were subject to fierce opposition by industry participants and could come under scrutiny as new leaders take over the agencies in 2021.

In many instances, 2020 saw the final chapter of fights that had begun in the proposed-rule stage in 2019 and long before. The rules pertaining to proxy advisors, for example, were subject to a lawsuit immediately after being proposed last year. Upon their passage in July, Commissioner Allison Herren Lee said the agency was merely adding complexity to a system that was not broken. Similarly, the new shareholder proposal thresholds subjected the Commission to accusations that it was pro-business at the time they were proposed, and to claims that the SEC blatantly favored large shareholders over small when they were finalized this year. At the CFTC, the Democratic commissioners strongly opposed the final position limits regime, new capital requirements for swap dealers, and the changed cross-border registration thresholds for swap dealers. As in 2019, many of the year's highly-visible rule changes, particularly at the SEC, passed by partisan split votes subject to sharply-worded dissents.

Despite the vocal opposition, SEC Chairman Jay Clayton and CFTC Chairman Heath Tarbert remained steadfast in their belief that the rule changes implemented on their watch improved the regulatory landscape. The result of the presidential election ensured that both men will be replaced in 2021, and both have officially announced their departures. After the election, both agencies shifted into overdrive to try to get done many of the initiatives still on their agendas. At the SEC, this included, among other things, proposals to address the compensation of gig economy workers, and final rules on fund valuation practices and on the infrastructure surrounding NMS market data. The CFTC held an early December open meeting at which it adopted rules on electronic trading risk principles and Part 190 bankruptcy regulations and finalized six other rules on a seriatim basis.

In the area of enforcement, 2020 was a hectic year for both regulators as they contended with hurdles presented by, and new types of fraud resulting from, the pandemic. The CFTC's Division of Enforcement filed 113 cases, far exceeding the 30-year average of 58 cases. The division also obtained the fourth-highest amount of monetary penalties in agency history ($1.3 billion). The SEC brought 715 enforcement actions and obtained a record $4.68 billion in disgorgement and penalties. The number of SEC enforcement actions represents a significant drop from the 862 actions brought in 2019, partly explainable by the complications caused by COVID-19.

Enforcement is one area where market observers expect changes under the new administration, with Wall Street bracing for a more aggressive approach under the new commissions. Regulatory changes under the new administration may only be incremental since the Senate will likely remain under Republican control. To date, President-Elect Biden has only made broad suggestions such as fashioning a comeback package for Main Street businesses and entrepreneurs, and imposing tax reforms that ensure that the wealthiest Americans pay their fair share. In public remarks after announcing his departure, Chairman Clayton outlined some areas where he believes the new Commission should focus its attention including money market funds, the rules surrounding residential mortgage-backed securities offerings, modernizing the proxy system, remaining Dodd-Frank rulemakings, and improving climate-related disclosures.

The CFTC and SEC performed admirably in 2020 given the unexpected and widespread disruption caused by COVID-19. The agencies quickly provided pandemic-related accommodations to beleaguered entities, then pushed through a number of high-profile, though often controversial, regulatory changes. Late-year proposals set the table for some of the actions that could be taken in 2021, although with new chairpersons at both agencies, the only certainty is that the regulators' paths will be a departure from the past four years. Here is our comprehensive look back at the agencies' efforts over the past year.

I. SEC: COVID accommodations, controversial rules color busy year

COVID-19

COVID-19 changed the way the world operates, and the SEC like everyone else had to adjust quickly. The Commission and its staff moved to telework and remote meetings while continuing to try to meet the SEC's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. As part of its triage efforts after the March 11 official pandemic declaration, the agency extended reporting and filing deadlines and made targeted adjustments to requirements for other registrants as they adjusted to lockdowns and work-from-home mandates. The Commission also issued extensive relief to companies, provided pandemic-specific guidance, pursued COVID-19-related trading issues, and implemented trading pauses.

Examples of the SEC's actions include its issuance of relief for market participants engaged in building the Consolidated Audit Trail (CAT) to allow them to focus key resources on their business continuity plans in light of the pandemic. The agency also modified the way personally identifiable

information would be collected by the CAT for retail investors. The agency also published guidance on the proxy season in connection with issues that made in-person meetings impracticable and could preclude travel by participants, including shareholder proponents. Companies were given more flexibility to reschedule meetings and to conduct virtual or part-virtual meetings. The Commission also encouraged issuers to allow shareholder proponents to present their proposals remotely.

Temporary rules. In March, in addition to delaying final action on proposals with expiring comment periods, the Commission adopted temporary final rules to extend the filing deadlines for specified reports and forms that companies must file under Regulation A and Regulation Crowdfunding and lifted the notarization requirement for new EDGAR filers. In a separate order, the SEC provided municipal advisers with an additional 45 days to file their annual updates on Form MA. In May, the SEC announced temporary rules to allow eligible companies quicker access to capital via crowdfunding.

The SEC also issued a temporary order in June granting a conditional exemption from broker registration for municipal advisors to address issues associated with COVID-19 concerns. The temporary order permitted registered municipal advisors to solicit banks, certain wholly owned subsidiaries, and credit unions in connection with direct placements of municipal securities. Business development companies were granted temporary conditional relief to help enable them to make investments in small and medium-sized businesses. Under the exemptive relief, BDCs could issue and sell senior securities in order to provide capital to these companies.

No-action relief. In light of COVID-19 challenges, the Commission also issued several pieces of no-action relief. Specifically, the agency allowed FINRA to issue temporary guidance and other relief to its members who have been affected by the pandemic. In addition, the Division of Investment Management (IM) reaffirmed certain no-action relief for registered investment companies made over a decade ago in connection with the financial crisis. In 2009, the IM division informed Franklin Templeton Investments that it would not recommend enforcement if a family of funds participated in the Term-Asset Backed Securities Loan Facility (TALF) (created in 2008 to provide financing to facilitate purchases of collateralized asset-backed securities) without treating the borrowings as senior securities representing indebtedness. In response to T. Rowe Price, the Division also explained that it would not object if a group of affiliated funds pooled their assets for the purpose of obtaining loans under TALF 2008. In the IM staff's view, the terms and conditions of TALF 2020 were substantially similar to those of TALF 2008. The staff did, however, expand the T. Rowe Price letter, making the relief available to third parties for BDCs.

Together with the IM division, the Divisions of Trading and Markets and Corporation Finance addressed the authentication and document retention requirements under Regulation S-T in light of logistical issues raised by the spread of COVID-19. The staff stated that it would not object if a signatory retained a manually signed document authenticating an electronic signature indicating the date and time the signature was executed and if the filer maintains policies and procedures governing the process.

Staff guidance. In March, CorpFin issued Disclosure Guidance Topic No. 9 providing the Division's views on the securities law obligations companies should consider with respect to the coronavirus

outbreak and related business and market disruptions. The guidance encouraged timely reporting while recognizing that it may be difficult to assess with precision the effects of COVID-19 on industries or individual companies.

The staff also issued guidance on operations, liquidity, and capital resources disclosures that companies should consider with respect to business and market disruptions related to COVID-19. In supplementing CF Disclosure Guidance Topic No. 9, CF Disclosure Guidance Topic No. 9A noted that companies have made a range of operational adjustments in response to the pandemic and, among other things, directed companies' attention to supply chain financing issues that may arise in the context of the COVID-19 pandemic and the need to suspend or modify certain operations to comply with health and safety guidelines.

CorpFin also issued new Compliance & Disclosure Interpretations (C&DIs) to address questions involving the inability of reporting companies to timely file certain reports due to the pandemic and explain how filing extensions related to the COVID-19 crisis apply in certain instances.

OCIE. Early on in the pandemic, the SEC's Office of Compliance Inspections and Examinations (OCIE) moved to conducting examinations off-site through correspondence, unless it was absolutely necessary to be on-site. In those examinations, OCIE observed a number of operational, technological, and other challenges brought on by the pandemic and issued a risk alert. OCIE stressed that each firm must ensure the safety of its investors' assets and recommended that firms review their practices and make adjustments where appropriate. It also encouraged firms to make changes to their procedures around disbursements to investors, including where investors are taking unusual withdrawals. OCIE noted that the market volatility may have increased financial pressures on firms to compensate for lost revenue and increased the potential for misconduct and urged firms to be aware of financial conflicts of interest.

Enforcement. COVID-19 opened up new areas for fraud, and the SEC's Division of Enforcement pursued investigations into potential misconduct. For example, the Division obtained relief against microcap traders cashing in on the pandemic and control persons allegedly concealing their identities to dump stock into the market. It also suspended trading in the securities of numerous issuers where there were questions regarding the accuracy and adequacy of information related to COVID-19, including claims about potential treatments, the manufacture and sale of personal protection equipment, and disaster-response capabilities. From mid-March through the end of September the Division opened more than 150 COVID-related inquiries and investigations.

2020 rulemaking highlights

Despite the disruption caused by the pandemic, the SEC continued to advance its rulemaking agenda. In the middle of the year, the SEC adopted final rules imposing new requirements on proxy advisors and stricter thresholds for shareholder proposals. Both rules passed along party lines, with Democratic Commissioners Allison Herren Lee and, after she joined the Commission, Caroline Crenshaw dissenting. The heightened eligibility requirements for shareholder proposals were

particularly controversial for the purported effect they could have on environmental, social, and governance (ESG) matters. As for the proxy advisor amendments, the industry is pushing back with a lawsuit challenging whether there is justification for the rule.

Proxy advisors and shareholder proposals

The Commission voted 3-2 to propose both rules at the same meeting in November 2019. As proposed, the proxy advisory amendments would have allowed issuers a chance to review proxy voting advice and provide feedback before the advisor could release the advice to its clients. The advisor would also have to disclose material conflicts of interest. As for shareholder proposals, the SEC proposed to require continuous ownership of a certain dollar value of a company's stock for between one and three years (depending on the ownership amount) before a shareholder could submit a proposal for inclusion in the issuer's proxy materials. Effectively, larger investors would be able to make proposals sooner than smaller investors. The proposal also sought to condition resubmission upon a certain level of shareholder support.

Chairman Clayton praised the proposals as exemplifying the principles of modernization and retrospective review. He observed that proxy advice as a business was nearly nonexistent 20 years ago, but now provides a service comparable to that of auditors, rating agencies, and research analysts. Similarly, he said that the shareholder proposal thresholds had not been updated for decades and that the resubmission thresholds were last amended in 1954. In his statement on the proposals, Clayton cited letters "from long-term Main Street investors, including an Army veteran and a Marine veteran, a police officer, a retired teacher, a public servant, a single Mom, a couple of retirees who saved for retirement, all of whom expressed concerns about the current proxy process."

The proposals garnered significant comments in opposition and even caused a micro-scandal about those Main Street comment letters. When Clayton appeared before the Senate Banking Committee to testify on SEC oversight, Sen. Chris Van Hollen (D-Md) was incredulous that the proposal reflected Main Street concerns. Van Hollen cited media reports that some of the comment letters Clayton relied upon were either not written by the individuals whose signatures they carried or were authored by relatives of the chairman of 60 Plus Association, a "dark money" group that seeks to advance corporate interests.

In a preliminary comment letter asking for an extended comment period, New York City Comptroller Scott Stringer said the proposals "seek to remedy problems that do not exist"; he added that the proxy advisor proposal would create rather than mitigate conflicts by allowing the issuers that are the subject of proxy advice to review and provide feedback on that advice. One of the Commission's advisory committees recommended that the agency revise and reissue the proposals; the recommendation of a subcommittee of the Investor Advisory Committee particularly criticized the lack of analysis in the proposals. Even before the comment period expired, Commissioner Elad Roisman, the commissioner who had been charged with leading the proxy reforms, addressed and attempted to dispel criticism of the rules in prepared remarks. Specifically, he said the proposals were not the product of corporate lobbying and did not enshrine a supposed SEC goal of marginalizing smaller shareholders.

Although proposed in tandem, the final rules came several months apart. In July 2020, the Commission adopted, 3-1, a final rule on proxy advisors that pared back some of the more prescriptive requirements of the proposal. In September the SEC adopted, 3-2, the new shareholder proponent thresholds with substantially the same terms as proposed.

Proxy advisor rule. The final rule regulating proxy advisors scaled back some of the requirements of the proposal. Notably, rather than give issuers a first look at any draft voting advice, proxy advisory firms may provide its advice to the issuer and advisory clients at the same time. The proxy advisory firm must also put in place a mechanism to notify clients of any available written statements by the registrants pertaining to the proxy voting advice prior to the stockholder meeting. The proxy advisor must also provide specified conflicts-of-interest disclosures. If they do not satisfy these conditions, proxy advisory firms will not be able to rely on the exemptions from the information and filing requirements of the proxy rules.

The above requirements are effective December 31, 2021. The transition period is to allow proxy advisory businesses to establish the required policies and procedures and to create other systems for compliance before the start of 2022 proxy season.

The SEC also codified its longstanding view that proxy voting advice generally constitutes a solicitation under the Exchange Act. Furnishing voting advice only in response to an unprompted request does not constitute a solicitation, however. The Commission adopted guidance urging investment advisers to consider disclosing when and how they use automated voting (robo-voting) and how their policies and procedures address automated voting in a situation where the adviser learns (before the submission deadline for voting proxies) that an issuer has or will file additional solicitation materials with the Commission.

Roisman said that the standardized conflicts-of-interest disclosure and the mechanism for engagement with registrants "should improve the information available to investment advisers and other investors." Clayton emphasized that the rule resulted from a "rigorous and well-functioning rulemaking process," and Commissioner Hester Peirce specifically noted that the comments on the proposal made it clear that the SEC could meet its objectives with a less prescriptive approach. But Lee, the lone dissenter, reiterated concerns that the Commission had not adequately justified the need for the rule. "The final rules will still add significant complexity and cost into a system that just isn't broken," she said, adding that "making the final rules less objectionable than the proposal does not relieve the Commission of its fundamental obligation to identify the need for this rulemaking and to explain how the rules we are adopting will meet this need."

A pending lawsuit against the SEC by one of the largest advisory services, Institutional Shareholder Services, challenges the validity of the rules and guidance under the Administrative Procedure Act. According to ISS, the rules and guidance are contrary to law; are arbitrary and capricious; and violate the First Amendment. The Council of Institutional Investors filed an amicus brief in support of ISS's position, while the U.S. Chamber of Commerce filed a brief defending the proxy advisor rule. The

Chamber's Center for Capital Markets Competitiveness issued a white paper concluding that the SEC has statutory authority to promulgate the rule and that the rulemaking satisfied the APA.

Shareholder proposals. Unlike the proxy advisor rule, the SEC's final rule on shareholder proposals hewed closely to the original. The final amendments replaced the existing ownership threshold, which required holding at least $2,000 or 1 percent of a company's securities for at least one year, with three alternative thresholds. A shareholder is now required to demonstrate continuous ownership of at least:

- $2,000 of the company's securities for at least three years;
- $15,000 of the company's securities for at least two years; or
- $25,000 of the company's securities for at least one year.

Shareholders can no longer aggregate their holdings for purposes of satisfying the amended ownership thresholds. Furthermore, the one-proposal rule now applies to each person rather than to each shareholder, meaning that a proponent may no longer submit multiple proposals on behalf of multiple shareholders. Shareholder proponents must state that they are able to meet with the company (in person or via teleconference) between 10 and 30 days after submitting the proposal.

The SEC also revised the levels of shareholder support a proposal must receive to be eligible for resubmission at a future shareholder meeting. A proposal now needs the support of at least 5 percent of the voting shareholders in its first submission in order to be eligible for resubmission in the following three years; previously, that figure was 3 percent. Proposals submitted two and three times in the prior five years would need to achieve 15 percent and 25 percent support, respectively, in order to be eligible for resubmission in the following three years. Those thresholds were previously 6 and 10 percent.

Lee dissented from this action, saying that the amendments "will be most keenly felt in connection with ESG issues, which comprise the main subject matter of shareholder proposals, at a time when such proposals are garnering increasing levels of support." Specifically on climate change, Lee noted that climate-related proposals garnered 31 percent support on average in the prior proxy season, and four of the proposals passed. Commissioner Caroline Crenshaw also dissented, noting that many corporate governance advancements, and annual and majority votes for director elections, have come from investor-led proposals. But Clayton said that the requirements are agnostic as to a proposal's subject matter and will not allow the SEC to regulate or make judgments with respect to the merits of any particular topic.

In remarks the day after the Commission voted, Corporation Finance Director William Hinman explained some of the thinking behind the amendments. Hinman said that the submission thresholds had not been addressed for decades and that a transition period would allow shareholders who were already eligible to submit a proposal under the prior rules to do so for meetings through 2022. As for the resubmission thresholds, Hinman suggested that social media has perhaps made it easier to get votes, but the SEC wanted to balance the costs and administrative issues for companies.

New whistleblower program rules

In another major rule change, the Commission in September adopted by a 3-2 vote amendments to the rules governing the whistleblower program. At the time, Chairman Clayton said that the amendments would get more money into the hands of whistleblowers and that the added clarity, efficiency and transparency would further incentivize whistleblowers to come forward.

The whistleblower program was established in 2011 and allows the Commission to pay whistleblowers monetary rewards ranging from 10 percent to 30 percent of the money collected when the monetary sanctions from a successful enforcement action exceed $1 million. Since the program began, information from whistleblowers has led to enforcement actions in which the SEC has obtained over $2.5 billion in financial remedies, and, since the first award in 2012, the Commission has awarded approximately $728 million to 118 individuals. In 2020, despite the obstacles presented by the COVID-19 pandemic, the Commission processed more claims than ever before.

The proposed amendments addressed, among other things, the Supreme Court's 2018 decision in *Digital Realty Trust, Inc. v. Somers*, which held that reporting to the SEC is a prerequisite to protection from employment retaliation and that Rule 21F-2, the Commission's rule interpreting the anti-retaliation protections, was not entitled to deference. To match the Court's construction of Section 21F, Rule 21F-2 would be amended to establish a uniform definition of "whistleblower" that would apply to all aspects of Section 21F and to require an individual to report information to the Commission "in writing."

A meeting was scheduled in early September 2020 to consider the proposal but was postponed. Following the postponement, six senators wrote to Chairman Clayton urging that the Commission not adopt proposed amendments that would potentially lower awards to whistleblowers. The letter called on Clayton to stand by his December 2019 testimony before the Senate Banking Committee 2019 that whistleblower awards would not be capped.

Program rules amended. Finally, on September 23, 2020, a divided Commission voted by party lines to adopt several amendments to the rules governing the whistleblower program. The rules became effective on December 7, 2020.

Among the highlights, the amendments give the Commission additional tools in determining awards. First, for awards where the statutory maximum award amount for the covered action and any related actions is in the aggregate $5 million or less, a new provision in Rule 21F-6 creates a presumption that the SEC will pay a meritorious claimant the statutory maximum amount where none of the specified negative criteria are present. These types of awards make up the vast majority given out in the whistleblower program to date, the Commission noted, and the presumption should increase efficiency in the review process. For awards over $5 million, the Commission will continue to issue awards based on the factors in Rule 21F-6, but if none of the negative criteria are present, the award amount would be expected to be in the top third of the range.

The Commission adopted the rules substantially as proposed, with the exception of proposed Rule 21F-6(d)(2). This rule would have set forth a formal process for the Commission to exercise its discretion to review awards exceeding $30 million to an individual whistleblower. According to the Commission, commenters viewed the proposed rule as a potential restriction on award amounts. Based on these comments and on the adoption of other amendments, the Commission ultimately determined that the proposed rule was not necessary.

In response to the Supreme Court's *Digital Realty Trust* decision, Rule 21F-2 was amended to establish a uniform definition of "whistleblower" applicable to all aspects of Section 21F (i.e., the award program, heightened confidentiality requirements, and employment anti-retaliation protections). The Commission also issued interpretive guidance defining the scope of prohibited retaliatory conduct. In addition, the definition of "related action" in Rule 21F-3(b) was amended to clarify that a law enforcement or non-SEC regulatory action is not related if there is a separate and more appropriate whistleblower award scheme that applies.

Dissenting Commissioners take issue with discretion. In their dissents, Commissioners Caroline Crenshaw and Allison Herren Lee shared serious concerns about the discretion granted to consider dollar amounts. Commissioner Lee, in particular, took issue with what she said is a broad new discretion to consider dollar amount in the setting of award amounts. There is no transparency in its usage, she said, and whistleblowers have no way to contest its application. Commissioner Crenshaw also remarked that the amended rules protect whistleblowers who submit information *in writing*, but whistleblowers providing information through interviews or testimony will not necessarily receive the benefits of the anti-retaliation provision.

Guidance on independent analysis. The Commission also adopted interpretive guidance to help clarify the meaning of "independent analysis" under Rule 21F-4 as that term is used in award applications. In order to qualify as "independent analysis," a whistleblower's submission must provide evaluation, assessment, or insight beyond what would be reasonably apparent to the Commission from publicly available information. To make this determination, the Commission will consider whether the whistleblower's conclusion that there is a possible violation derives from multiple sources that collectively provide a strong inference of a potential securities law violation that would not be reasonably inferred from any of the sources individually. The Commission emphasized that there is no bright-line test and whether any particular submission rises to the level of "original information" will depend on all of the facts and circumstances of the case.

Other notable rulemaking

The SEC's 31 final rules in 2020 included several other important initiatives such as the harmonization of the exempt offering framework, changes to the auditor independence rules, and the adoption of a new definition of "accredited investor." The exempt offering amendments, among other things, set forth in one rule the ability of issuers to move from one exemption to another, increased the offering limits for Regulation A, Regulation Crowdfunding, and Rule 504 offerings, and set consistent rules governing certain offering communications, including permitting certain "test-the-waters" and "demo day" activities.

The rules to update the definition of "accredited investor" included a new definition of "qualified institutional buyer" in Securities Act Rule 144A. The amendments added new categories of qualifying natural persons and entities and made certain other modifications to the existing definition. The amendments to the qualified institutional buyer definition similarly expanded the list of eligible entities under that definition. The auditor independence rules were adjusted to be tailored more toward relationships and services that are more likely to jeopardize the objectivity and impartiality of auditors.

State administrators adopt model whistleblower act

In addition to the SEC's changes to the whistleblower program, whistleblower concerns were addressed at the state level in 2020. Drawing upon provisions contained in Section 922 of the Dodd-Frank Act as well as those found in state laws in Indiana and Utah, the North American Securities Administrators Association (NASAA) adopted a Model Whistleblower Award and Protection Act that will provide state securities administrators in adopting jurisdictions with the authority to make monetary awards of up to 30 percent of the monetary sanctions recovered in any related administrative or judicial action. The model act also includes provisions to protect whistleblower confidentiality, prohibit retaliation by a whistleblower's employer, and create a cause of action and provide relief for whistleblowers who have been subject to employer retaliation.

The model act may be adopted either as legislation or implemented by regulation. Among other things, the model act's prefatory note encourages states to keep procedural requirements for making a whistleblower complaint simple and accessible. The prefatory note also provides that it is within the discretion of the securities administrator whether to make an award based on an order of restitution and suggests that adopting states should consider keeping the source of funds out of which whistleblower awards will be paid segregated from the operational funds of the state regulatory agency. Interpretation of the model act may be guided by reference to the whistleblower rules adopted by the SEC in Rule 21F where those rules are not inconsistent.

The model act defines a whistleblower as "an individual who, alone or jointly with others, provides the state or other law enforcement agency with information pursuant to the provisions set forth in this act, and the information relates to a possible violation of state or federal securities laws, including any rules or regulations thereunder, that has occurred, is ongoing, or is about to occur." The requirement that an individual must report to the regulator to be deemed a whistleblower under the model act tracks the definition in the Dodd-Frank Act but not the SEC's implementing rules, which had purported also to protect internal whistleblowers before the Supreme Court rejected this interpretation of the statute in *Digital Realty Trust*.

As with the federal provisions that inspired it, the NASAA model act awards whistleblowers between 10 and 30 percent of the recovery in a successful state administrative or judicial enforcement action. The model act's list of factors in setting the award amount is similar to the SEC's rules, but the factors are described in much less detail. In determining the amount of an award, the securities administrator must consider: (1) the significance of the original information provided by the whistleblower to the action's success; (2) the degree of assistance provided by the whistleblower in connection with

the action; (3) the programmatic interest of the administrator in deterring violations of the securities laws by making whistleblower awards; and (4) any other factors the administrator considers relevant.

The model law also bars employers from retaliating against a whistleblower who: (1) lawfully provided information to the state or other law enforcement agency; (2) assisted in an investigation or action; (3) made disclosures protected under the Sarbanes-Oxley Act or other securities laws or regulations subject to the jurisdiction of the SEC or the state's securities statutes; or (4) made disclosures to a person with supervisory authority over the employee who had authority to investigate or terminate misconduct regarding matters subject to the jurisdiction of the state administrator or the SEC. An individual may sue for retaliation, and the court may award reinstatement, double back pay, legal fees and costs, actual damages, an injunction to restrain a violation, or any combination of these remedies.

Compliance with Regulation Best Interest

2020 saw Regulation Best Interest, which created a new standard of conduct for broker-dealers when making recommendations to retail customers and a requirement for brokers and advisers to disclose relationship summaries to retail investors, go into effect. The regulation states that, when making a recommendation of a securities transaction or an investment strategy involving securities, a broker-dealer must act in the retail customer's best interest and cannot place its own interests ahead of the customer's interests. Regulation BI includes specific obligations in the areas of disclosure, care, conflicts of interest, and compliance.

Prior to its implementation, Better Markets and the Consumer Federation of America filed an amicus brief in support of legal challenges to Regulation BI by a group of financial planners and states. The organizations contended that the regulation was not designed to comport with the letter and spirit of the Dodd-Frank Act's grant of authority to the Commission to adopt a uniform fiduciary standard for those providing investment advice. The organizations also argued that the SEC acted arbitrarily and capriciously in accepting the brokerage industry's claims that a uniform standard would deprive investors of choice. The organizations urged the court to invalidate the rule and stressed the need to ensure that the SEC does not enforce a less-protective standard for broker-dealers that is at odds with Congress' plan.

Legislators also weighed in supporting the challenges, noting that Congress required the SEC to study the distinction between the standards of care applicable to financial advisors and directed that any rule addressing that problem harmonize the standard of care for broker-dealers and investment advisers.

In an opinion issued in *XY Planning Network, LLC v. SEC* in June 2020, a Second Circuit panel held that the Dodd-Frank Act authorized the SEC to promulgate Regulation BI. The court's decision came just days before the rule's June 30 implementation date. The court stated that the petitioners had failed to explain how the SEC's interpretation of the broker-dealer exemption made Regulation BI "arbitrary, capricious, or otherwise not in accordance with law." The court observed that the SEC considered several thousand comment letters and rejected proposed alternatives in concluding that the best interest standard will best achieve its goals.

Guidance. The SEC's Office of Compliance Inspections and Examinations published a Risk Alert to provide broker-dealers and advisers with information about the scope and content of the first examinations to be conducted under the new rules. In a statement, OCIE Director Pete Driscoll said that OCIE staff's "focus will be on firms continuing good faith and reasonable efforts, including taking into account firm-specific effects from disruptions caused by COVID-19."

SEC staff participated in a roundtable discussion regarding initial observations on the implementation of Regulation BI and related Form CRS. Regarding the compliance obligation, John Polise of OCIE said that the staff had found that firms generally made good faith efforts to implement written policies and procedures. Trading and Markets Senior Special Counsel Alicia Goldin emphasized the importance of using plain language in creating a concise document that avoids technical and legal terms. She also praised firms' use of layered disclosure in Form CRS.

Overall, the staff explained, firms were generally compliant with Form CRS's requirements, but staff recommended that firms put themselves in the shoes of retail investors when assessing the form's readability and usefulness.

Regulation BI: The state response

While the SEC was preparing Regulation BI for its June 19, 2020 effective date, some of the states began promulgating broker-dealer fiduciary standards of their own. Nevada was the first state to do so, followed by New Jersey's more fleshed out version. Because New Jersey received so much pushback from the securities industry, State Commissioner Christopher Gerold extended the comment deadline, resulting in the state's fiduciary standard remaining proposed, along with Nevada's rule. Additionally, Maryland and Oklahoma both withdrew proposed fiduciary rules earlier in the year.

Chairman Jay Clayton's and the industry's belief is that Regulation BI is a strong enough rule to obviate the need for state regulations on the subject. But while Regulation BI has been effective only a short while and regulators and practitioners wait for enough data, including enforcement actions, to give a "yay" or "nay" to the rule, two state regulators have already weighed in—Massachusetts and the North American Securities Administrators Association (NASAA).

Massachusetts broker-dealer/agent fiduciary duty rule. Massachusetts became the first and only state so far to adopt a fiduciary duty rule for broker-dealers and agents. The rule was adopted on March 6, 2020, and went into effect September 1, 2020.

After reviewing nearly 700 written comments and hearing oral testimony from 23 individuals, the Massachusetts Securities Division decided to drop the following three proposed provisions from the final rule:

1. The proposed rule applied the fiduciary duty to broker-dealers, agents, investment advisers and investment adviser representatives. Commenters suggested that the fiduciary duty apply to only broker-dealers and agents that provide investment advice and not also to federal covered investment advisers. The Securities Division went a step further by removing all investment advisers

and investment adviser representatives from the final rule since advisers and their representatives already have a fiduciary duty.

2. The proposed rule applied to purchases, sales and exchanges of securities, commodities and insurance products such as annuities. Commenters requested removing commodities and insurance products from fiduciary duty application since these instruments are excluded from the definition of "security." The Securities Division agreed and removed them from the final rule.
3. The proposed rule imposed a fiduciary duty during any time a broker-dealer or agent receives ongoing compensation or provides investment advice to a customer in connection with non-brokerage financial advice. Many commenters wrote that this extended duty might run contrary to the "incidental" exemption from the Advisers Act (mentioned in the final rule). The commenters specifically stated that: (1) requiring broker-dealers and agents to conduct ongoing monitoring under these circumstances would be outside the scope of the "incidental" exemption, and (2) requiring broker-dealers and agents to conduct ongoing monitoring under these circumstances would impose additional costs onto broker-dealers and their agents that would ultimately be passed on to their customers.

Thus, the final rule applies solely to broker-dealers and agents, and states that they are deemed to act unethically and dishonestly when they fail to act as fiduciaries for their customers during any period the broker-dealers or agents: (1) have or exercise discretion over a customer's account (unless the discretion relates solely to the time and/or price of the order's execution); (2) have a contractual fiduciary duty, or (3) have a contractual obligation to regularly or periodically monitor a customer's account as determined by a customer agreement.

The Securities Division also particularized the mandated fiduciary duty into two types—a duty of care and a duty of loyalty. To exercise the fiduciary duty of care, a broker-dealer or agent must reasonably inquire about: (1) the risks, costs and conflicts of interest pertaining to all recommendations made and investment advice given; (2) the customer's investment objectives, risk tolerance, financial situation and needs; and (3) any other relevant information. To exercise the fiduciary duty of loyalty, a broker-dealer or agent must: (1) disclose all material conflicts of interest; (2) make all reasonably practicable efforts to avoid conflicts of interest, eliminate reasonably unavoidable conflicts, and mitigate reasonably unavoidable or uneliminated conflicts; and (3) make recommendations and give investment advice by considering only their customers' interests (without considering any other party's financial or other interests).

The Securities Division, to avoid confusion over who is owed a fiduciary duty, defines a "customer" as a current or prospective customer but excludes:

- financial institutions such as banks, savings and loan associations, insurance companies, trust companies, or registered investment companies;
- broker-dealers registered with a state securities commission (or agency or office performing like functions);
- investment advisers registered with the SEC or with a state securities commission (or agency or office performing like functions); or
- any other institutional buyers defined in the Massachusetts securities rules.

The fiduciary duty does not apply to persons acting as Employment Retirement Income Security Act (ERISA)-defined fiduciaries for an employee benefit plan, its participants, or its beneficiaries. Also, the fiduciary duty does not create any capital, custody, margin, financial responsibility, recordkeeping, bonding, financial, or operational reporting for broker-dealers or agents that differs from, or is in addition to, Exchange Act Section 15(i) requirements.

Barbara Roper, Investor Protection Director for the Consumer Federation of America, expressed her disappointment with the final rule, calling it a watered-down version of the proposal that other states should not use to craft their own fiduciary duty rules. Roper was particularly disappointed with the final rule's not applying to commodities or annuities, along with the elimination of the ongoing duty to monitor during any time a broker-dealer or agent receives ongoing compensation or when an investor has a reasonable expectation that the investor's broker will be providing ongoing services, based on how the broker holds out and markets the broker's services.

NASAA reports on Regulation BI effects. While federal and state securities practitioners and regulators wait to see how the Massachusetts fiduciary duty plays out against the SEC's Regulation BI, along with whether Nevada and/or New Jersey adopt their respective fiduciary proposed rules and if other states propose one of their own, NASAA published a report in September 2020 benchmarking the initial effects of Regulation BI on broker-dealers and investment advisers. The chair of the Implementation Committee, Ohio Securities Commissioner Andrea Seidt, said the results revealed that "both broker-dealers and investment advisers have a significant opportunity to improve under Regulation Best Interest in order to better serve the interests of their retail clients."

The report came from 34 state examiners coordinating a cumulative examination in first quarter 2020 of 2,000 broker-dealer and investment adviser firms representing more than 360,000 investment professionals and 68 million retail investment accounts. This benchmarking initiative found the following notable differences between broker-dealers operating under the current suitability standard and investment advisers operating under a fiduciary duty standard:

- Investment advisers generally took more conservative investment approaches overall, avoiding higher cost, riskier, and complex products. Investment advisers also reported more robust due diligence, disclosure, and conflict management practices.
- Broker-dealers offered a more diverse set of product offerings than investment advisers.
- Few firms offered complex, risky products like private offerings, variable annuities, non-traded real estate investment trusts (REITs), and leveraged- or inverse- exchange-traded funds (ETFs). In fact, two-thirds of the firms surveyed did not make any of these products available to their customers.
- When complex products were sold, broker-dealers were twice as likely as investment advisers to recommend the purchase of leveraged and inverse ETFs, seven times as likely to recommend private placements, eight times as likely to recommend variable annuities, and nine times as likely to recommend non-traded REITs.

Lisa Hopkins, NASAA's current president and West Virginia's Senior Deputy Securities Commissioner said that "the examinations identified compliance challenges for industry" and that state securities regulators will conduct follow-up examinations next year [2021] to assess the effectiveness of Reg BI.

SEC enforcement in 2020

The SEC's enforcement program in 2020 was marked by challenges related to the COVID-19 pandemic. The Enforcement Division moved to a remote working environment, so instead of sitting across the table from defense counsel and witnesses, SEC attorneys took depositions, conducted testimony, and shared documents in a virtual environment. Despite the challenges of working in a virtual world, the enforcement staff adjusted quickly and maintained its focus on both COVID-related and non-COVID-related enforcement issues, assured Enforcement Director Stephanie Avakian in her message introducing the SEC's annual enforcement report for fiscal year 2020.

Operational challenges were not the only issue confronting the Commission in the face of COVID-19. Amidst the pandemic, the SEC jumped in to halt trading in securities of companies that made questionable representations about their products and services. The SEC suspended trading in the securities of over 30 issuers who made various COVID-related representations, such as claims about testing kits, personnel protection equipment, disaster-response capabilities, and potential treatments. In addition to trading suspensions, the Division opened over 150 COVID-related investigations. In one such action, the SEC settled charges with The Cheesecake Factory, which agreed to pay a $125,000 civil penalty for making misleading disclosures about the impact of the COVID-19 pandemic on its business operations and financial condition.

High-profile issuers. Beyond COVID-related actions, the Division brought enforcement actions against several high-profile issuers. General Motors agreed to pay a $200 million penalty to settle charges for disclosure failures in its power and insurance businesses. As part of a combined $3 billion settlement with the SEC and the Department of Justice, Wells Fargo was sanctioned for misleading investors about the success of its core business strategy at a time when it was opening fake accounts for unknowing customers and selling unnecessary products that went unused. The SEC will distribute $500 million of the penalty to Wells Fargo's harmed investors.

The Division charged Fiat-Chrysler with making misleading disclosures about an internal audit of its emissions control systems, for which the company agreed to pay a $9.5 million penalty. In the Division's latest charges against a financial services firm for municipal bond offering "flipping" and retail order period abuses, UBS settled for $10 million charges that it improperly allocated bonds intended for retail customers to parties who then immediately resold or "flipped" the bonds to other broker-dealers at a profit in violation of SEC rules that priority be given to retail investors.

Two companies, Telegram and Kik Interactive, settled enforcement actions involving the selling of unregistered securities in the form of initial coin offerings (ICOs). In Kik's case, the company raised over $100 million from investors in tokens called Kin. The court-approved settlement required Kik to pay a $5 million civil penalty and for three years to provide 45 days' notice to the SEC before it participates in any issuance, offer, sale, or transfer of any new cryptocurrency, digital coin, digital token, or similar digital asset using distributed ledger technology. Telegram, which had been preliminarily enjoined from delivering its Gram tokens to investors from whom it raised $1.2 billion, agreed to return the money raised from Grams to investors and to pay a $18.5 million penalty. Like Kik, Telegram is also subject to a notice period before participating in any issuance of digital assets for three years.

In a case highlighting the SEC's focus on rewarding cooperation with its enforcement staff's investigations, BMW AG and two of its U.S. subsidiaries agreed to pay a joint $18 million penalty to settle charges related to inflating its U.S. retail sales by maintaining a reserve of unreported retail vehicle sales that it used to meet internal monthly sales targets without regard to when the underlying sales occurred. The penalty was reduced due to BMW's cooperation with the SEC, which saw the company overcome considerable constraints on its ability to gather information under circumstances imposed by the COVID-19 pandemic, including travel restrictions, work-from-home orders, and office closures. BMW gathered and made available a large volume of information in response to the staff's document, information, and data requests despite these challenges and merited a reduced penalty.

Holding individuals accountable. The SEC also brought a number of enforcement actions against executives, illustrating the Commission's stated goal of holding individuals accountable for wrongdoing. The former chairman and CEO of Hertz was charged with aiding and abetting the company's misleading financial disclosures. He allegedly pressured subordinates to "find money" in order to meet Hertz's earnings targets. In addition to paying a $200,000 civil penalty, the former chairman and CEO agreed to reimburse the company almost $2 million in incentive-based compensation.

The SEC charged Super Micro Computer and its former CFO with engaging in a scheme to prematurely recognize revenue and understate expenses. The company agreed to pay a $17.5 million penalty, while the former CFO agreed to pay over $350,000 in disgorgement and penalties. While not charged with misconduct, Super Micro's CEO agreed to reimburse the company $2.1 million in stock sales profits under the Sarbanes-Oxley Act's clawback provision.

On the pandemic front, the SEC sued not only Turbo Global Partners, Inc. and Praxsyn Corp. for misstatements related to COVID-19 supplies, but also the companies' CEOs. Both companies were early targets of the SEC's efforts to clamp down on COVID-related disclosures by suspending trading in the companies' securities.

Other individuals charged by the SEC in 2020 included gatekeepers such as accountants and auditors. Three former audit partners at KPMG entered into settlements with the SEC for improperly sharing answers to internal training exams and for subsequent wrongdoing during an investigation of exam-sharing misconduct at the firm. The SEC also charged PLS CPA and three of its individual auditors for back-dating audit documents and then attempting to conceal their misconduct from the SEC and the PCAOB.

The enforcement staff also sued a number of companies for violations of the Foreign Corrupt Practices Act. In a joint action against Herbalife Nutrition, the company agreed to pay $67 million to the SEC and $55 million to the DOJ for concealing improper payments and meals, gifts, and other benefits to Chinese officials in connection with obtaining sales licenses, curtailing government investigations of Herbalife China, and removing negative coverage of Herbalife China in state-owned media. Alexion Pharmaceuticals agreed to pay $21 million to settle charges that its subsidiaries made improper payments to officials in Turkey, Russia, Colombia, and Brazil. Global pharmaceutical and healthcare company Novartis AG, which allegedly engaged in schemes to make improper payments

or to provide benefits to public and private healthcare providers in South Korea, Vietnam, and Greece in exchange for prescribing or using the company's products, paid over $112 million to settle the SEC's FCPA charges.

Delaware Supreme Court: Forum selection after *Sciabacucchi*

In March 2020 the Delaware Supreme Court issued a decision that could have the side effect of foreclosing litigation in the state's own courts. In *Salzberg v. Sciabacucchi*, the court held that corporate charter provisions requiring that Securities Act claims be brought in federal court are facially valid under Delaware law. While the court had been mindful of concerns that other states may not enforce its decision, several outside courts took on questions adjacent to *Sciabacucchi*, revising the landscape of forum selection for direct and derivative claims.

First, *Sciabacucchi*. The three appellants were Delaware corporations that had, prior to their 2017 IPOs, adopted charters providing that federal district courts are the exclusive forum for Securities Act claims. The U.S. Supreme Court in *Cyan* (U.S. 2018) held that state courts could preside over private lawsuits alleging only Securities Act claims. The response, according to a Cornerstone Research study, was a change in litigation strategy that had plaintiffs filing an increasing number of Securities Act cases in state court, sometimes resulting in parallel actions in both federal and state court.

Initially, the chancery court invalidated the federal-forum provisions based on "first principles," a conclusion that puzzled the academic and former SEC Commissioner Joseph Grundfest, whose relevant paper the Supreme Court cites in a footnote. According to the chancery court, a Securities Act claim relates to external rather than internal affairs of the company. The Supreme Court rejected the dichotomy posited by the Court of Chancery, reasoning instead that federal-forum provisions lie along a continuum between the extremes of pure external and pure internal affairs.

The high court allowed that the chancery court may have grounded its decision in "first principles" out of concern that other states may not be inclined to uphold federal-forum provisions. The high court recognized that it is potentially problematic for Delaware to have a narrower definition of "internal affairs." And it devoted some space in its opinion to assuaging the "powerful concern" over whether other states will respect and enforce Delaware corporations' federal-forum provisions. Nevertheless, the court was swayed by "persuasive arguments that a federal-forum provision does not offend federal policy or principles of horizontal sovereignty."

Next, in June, the federal district court in Chicago upheld a Boeing bylaw that required derivative suits to be brought only in Delaware state court (*Seafarers Pension Plan v. Bradway*). This case specifically disclaimed the application of *Sciabacucchi*, but it represents a milestone in the rapid evolution of forum-selection decisions. The derivative plaintiff sued Boeing directors for violating Exchange Act Section 14(a) by disseminating false and misleading statements. Unlike the Securities Act claims at issue in *Sciabacucchi*, federal courts have exclusive jurisdiction over Section 14(a) suits. Accordingly, the plaintiff argued that the bylaw amounted to an impermissible waiver of his right to file a federal derivative suit. But the district court concluded that the weight of the authority, significantly a case involving an international agreement and its progeny, favored Boeing's argument. *Spenta*

Enterprises v. Coleman (N.D. Ill. 2008) reasoned that *Bonny v. Society of Lloyd's* (7th Cir. 1993) applied to domestic agreements where the availability of Illinois' securities law and common law were available to vindicate shareholders' substantive rights.

In a third decision, the California Superior Court grappled with whether to apply *Sciabacucchi* to a federal-forum provision affecting Securities Act claims (*Wong v. Restoration Robotics, Inc.*). The court undertook a lengthy analysis that suggests a degree of hesitancy about federal-forum provisions, but it ultimately concluded that the plaintiff had failed to carry its burden of showing that the FFP was "unenforceable unconscionable, unjust, or unreasonable."

One of the big questions following *Sciabacucchi* was whether other states would acknowledge Delaware companies' federal-forum provisions or otherwise enforce such provisions. The California court suggested that the answer may ultimately rest on whether 8 Del. C. §102, which the Delaware Supreme Court interpreted as implying a continuum between internal corporate affairs and external corporate affairs, with federal-forum provisions falling in the middle as intracorporate affairs. The California court declined to opine on the constitutionality of Section 102. *Sciabacucchi* also addressed only a facial challenge, leaving open the question of how the decision will function in an applied challenge to federal-forum provision.

II. CFTC: Pandemic, what pandemic? Agency pulls out all the stops in record-breaking year

With a full Commission and an extremely ambitious agenda pursued by Chairman Heath Tarbert, the CFTC ran full tilt this year on both the enforcement and rulemaking fronts. The Division of Enforcement filed a record number of cases, obtained the fourth-highest amount of monetary penalties in agency history, coordinated extensively with criminal authorities and other regulators, and brought novel causes of action involving the Bank Secrecy Act and foreign corrupt practices.

In addition, the Commission kept up a breakneck pace in rulemakings. The CFTC adopted 34 final rules, including major rulesets relating to position limits, capital requirements for swap dealers, electronic trading, and bankruptcy. These rules were years in the making and in some areas were beset by controversy, but are now finally on the books, giving market participants and other stakeholders certainty, if not always satisfaction.

Carrots and sticks: Enforcement on an upswing

Despite the pandemic, the CFTC Division of Enforcement still managed to knock it out of the park. The Division achieved new records for the number of actions filed as well as the number of coordinated actions brought with criminal authorities and other regulators. The Division also brought brand new types of actions involving foreign corrupt practices and anti-money laundering provisions under CFTC Regulation §42.2.

Recognizing the benefits of partnership with the entities it oversees and the importance of clear expectations, the Division continued the practice of penalty reduction in exchange for cooperation and issued important guidance about how it evaluates entities' compliance programs, calculates the amount of civil monetary penalties to recommend, and decides whether to formally recognize self-reporting and cooperation credit in the final settlement order.

Yet while the Division sought partnership with regulated entities, it did not hesitate to bring the hammer down when the facts warranted, as shown by a record civil monetary penalty against a major financial institution for spoofing and sharp fines for compliance lapses.

Division leadership underwent a change when Director James McDonald left the agency in the fall, clearing the way for a new director to take over in the new administration. In the meantime, long-time CFTC stalwart Vince McGonagle has stepped up as Acting Enforcement Director.

Vigorous enforcement year. By many measures, the CFTC delivered strong enforcement performance in FY 2020. According to the annual enforcement report:

- The Division filed 113 enforcement actions, the most in CFTC history. The average is 58 filings per year over the prior 30 fiscal years.
- The Division also prosecuted a docket of over 140 pending litigations.
- Over $1.3 billion in monetary relief was ordered in CFTC enforcement actions, the fourth highest in CFTC history.

Protecting customers and market integrity. About 65 percent of actions filed in FY 2020 involved some of the "most pernicious" forms of market misconduct: manipulative and spoofing conduct, commodity fraud, and false reporting.

Spoofing and anti-manipulation cases were a particularly strong enforcement focus this year. The Division filed 16 cases involving manipulative or disruptive trading, continuing a steady upward trend since 2011.

Spoofing enforcement also highlighted two other trends: effective market surveillance and individual accountability.

- *Effective surveillance.* The use of sophisticated surveillance technology resulted in the three largest spoofing cases in CFTC history, including *In re JPMorgan Chase & Co.* In that matter, the CFTC imposed a whopping $920 million in total monetary relief, the highest amount in agency history, including approximately $311 million in restitution, $172 million in disgorgement, and a $436 million civil penalty.
- *Individual accountability.* Spoofing cases featured prominently in crackdowns against individual defendants. Seven individuals were charged with manipulative trading or spoofing conduct, including a former executive at HSBC (*CFTC v. Rivoire*). Overall, 50 CFTC actions in FY 2020 involved charges against one or more individuals.

Other areas of focus included:

- *Retail fraud and customer protection.* The CFTC filed 56 retail fraud actions, the most in the agency's history for a single fiscal year, including seven actions involving digital assets.
- *Anti-money laundering.* The CFTC brought several cases involving the first-ever claims under CFTC Regulation §42.2, which requires certain types of entities to comply with the Bank Secrecy Act, including requirements to file Suspicious Activity Reports (SARs) and supervise employees' handling of certain customer accounts. The cases were brought in conjunction with the Division's Bank Secrecy Act Task Force.
- *Misappropriation of confidential information.* The CFTC continued its enforcement of insider trading prohibitions with the imposition of over $1 million in penalties against energy trader Marcus Schultz for passing along his employer's material, confidential block trade order information to a broker to make fictitious trades for personal profit. The CFTC also settled charges involving two individuals at NYMEX who passed material, nonpublic information about oil & gas derivatives trades to a broker, including counterparty identities, information about option trades, and volume data. The individual defendants and NYMEX itself were ordered to jointly pay a civil penalty of $4 million.
- *Foreign corrupt practices.* In the first CFTC settlement involving foreign corrupt practices, the CFTC ordered Vitol Inc., an energy and commodities trading firm in Houston, Texas, to pay $95.7 million for corrupt activity in the U.S. and global oil markets. Vitol made corrupt payments, including bribes and kickbacks, to employees and agents of state-owned entities (SOEs) in Brazil, Ecuador, and Mexico to obtain preferential treatment, access, and confidential information. The CFTC acknowledged Vitol's "substantial cooperation" with the investigation, demonstrating the benefits of cooperation outlined in a 2019 Enforcement Advisory on foreign corrupt practices. Vitol also entered into a deferred prosecution agreement with the DOJ in a parallel criminal action.

Teaming up—but not piling on. The CFTC continued its ongoing commitment to coordinating with criminal authorities at the federal and state levels. The CFTC filed 16 actions in parallel with federal criminal authorities, bringing the three-year total to 46—far surpassing the 27 such actions brought over the prior seven fiscal years. Monetary sanctions were typically offset in actions involving multiple enforcement authorities.

In a case involving the most partners in a single case in Commission history, the CFTC and 30 state regulators, all members of the North American Securities Administrators Association (NASAA), jointly filed an enforcement action alleging an ongoing nationwide elder fraud that solicited and received more than $185 million in investor funds (*CFTC v. TMTE, Inc.*).

Clear guidance. Acknowledging the need for clear expectations, the CFTC issued significant guidance relating to enforcement:

- *Civil Monetary Penalty Guidance*, explaining the CFTC's tripartite approach to evaluating the appropriate penalty to recommend: (1) the gravity of the violation; (2) mitigating and aggravating circumstances; and (3) other considerations.

- *Guidance on Evaluating Compliance Programs in Connection with Enforcement Matters,* outlining factors the Division will consider in evaluating compliance programs in connection with enforcement activities.
- *Memorandum: Recognizing Cooperation, Self-Reporting, and Remediation in Commission Enforcement Orders,* describing a pathway for respondents to have their efforts to self-report, cooperate, and remediate formally acknowledged in Commission orders.

Punishment for compliance lapses. Reflecting a continuing emphasis on robust self-oversight, the CFTC brought actions against registered entities for compliance lapses, including failure to follow external business standards, failure to maintain required capital, and failure to supervise accounts.

Penalties for compliance failures included:

- In a case featuring the largest penalty against a swap dealer in CFTC history, the CFTC ordered The Bank of Nova Scotia to pay $127.4 million for spoofing and making false statements to the CFTC. Compliance staff failed to stop unlawful trading despite having substantial information about spoofing misconduct. The bank also failed to provide timely and accurate pre-trade mid-market marks; violated requirements relating to the counterparty onboarding process, recordkeeping, chief compliance officer reporting, and supervision; and made false or misleading statements to CFTC staff concerning its audio retention and supervision. In addition to the monetary penalties, the CFTC required the bank to retain an independent monitor and, for the first time, conditioned the swap dealer's registration on fulfilling its undertaking relating to registration, remediation, and the monitor.
- Citibank failed to address a design flaw in an audio preservation program that it knew was a "ticking time bomb." This led to the deletion of records responsive to a CFTC subpoena, for which the CFTC imposed a $4.5 million civil monetary penalty. (*In re Citibank N.A., et al.*)

Whistleblowers. An effective enforcement program requires a strong whistleblower program. In fact, according to the annual report, between 30 to 40 percent of the Division's ongoing investigations involve some whistleblower component. In FY 2020, the Commission granted 16 whistleblower awards totaling approximately $20 million, including three orders involving multiple whistleblower awardees, two orders granting awards to whistleblowers located outside the United States, and one award based in part on related actions brought by another regulator.

Enforcement outlook for the coming year. Enforcement is likely to remain a strong focus after the transition to the Biden Administration. In a recent presentation, Mayer Brown partner Michael Levy said he expects the Biden Administration will be "considerably more aggressive" than the Trump Administration in enforcing against financial crimes.

As part of overall enforcement trends including the DOJ, Levy foresees:

- a focus on large scale matters involving large institutions;
- an emphasis on individual accountability in exchange for cooperation credit;
- sharper negotiations and higher civil monetary penalties overall;
- an increase in "regulation through enforcement," including use of DPAs, NPAs, and post resolution monitors;

- aggressive prosecution in areas where there is a perception of an "unfair playing field" including insider trading, market manipulation, and spoofing;
- pursuit of money laundering and BSA sanctions matters, as well as foreign corrupt practices;
- stronger international enforcement cooperation, if the U.S. increases its global engagement and diplomatic tensions with certain countries ease.

McGonagle's comments on the growth of the CFTC's enforcement program and commitment of staff presage continued strength in the year to come: "To maintain this historical level of enforcement activity amid a global pandemic says everything you need to know about the hard-working professionals in the Division of Enforcement," said McGonagle. "This is also a team that continues to hone its craft—investing in advances in our data analytics capabilities, expanding our federal, state, local and international parallel efforts, and providing more clarity and transparency to market participants. I look forward to working with our team in their continuing and unwavering commitment to ensuring the integrity of the markets and to protecting customers and market participants by diligently pursuing those who violate the law."

CFTC rulemaking and regulation in the time of COVID

Under the helm of Chairman Heath Tarbert, the agency pursued and executed upon an ambitious, and at times an unrelenting, rulemaking agenda. In so doing, the CFTC completed all required rulemakings called for under the Dodd-Frank Act. However, Dr. Tarbert's determination and drive, at times, came at the expense of bipartisan unity and consensus. The final rules for a new position limits regime, capital requirements for swap dealers, and cross-border registration thresholds for swap dealers, were all fiercely opposed by the two Democratic Commissioners. Still, of the 34 final rules adopted by the CFTC in 2020, 29 of those passed unanimously.

Like all organizations and businesses around the world, as the COVID-19 pandemic unfolded during 2020, the CFTC faced historic disruptions in its work environment. As a result, 12 of the agency's 14 meetings during the year were held virtually. Additionally, the CFTC granted an assortment of regulatory relief to address the pandemic's disruption of normal operations for market participants. In particular, the agency's staff issued 17 no-action letters during the year which granted relief from a variety of CFTC recordkeeping, reporting, capital, trading, and registration requirements.

While the financial markets generally demonstrated resilience and performed their intended functions of price discovery and risk management during the course of the pandemic, one notable exception arose. On April 20, the NYMEX May crude oil futures contract, fell from $17.73 per barrel at the market open to a closing settlement price of negative $37.63 per barrel. As a result of this unprecedented market decline, the comment period for position limits rule proposal was extended by 16 days, despite strident calls by Democratic commissioners for a much longer comment period extension to gain a fuller understanding of the contract's highly unusual behavior. In November, Commission staff issued an "interim report" in connection with the April 20 negative pricing event. The report was roundly criticized as being incomplete and inadequate from both within and outside the Commission.

Derivative position limits. When the CFTC approved its final rule on speculative position limits for commodity derivatives on a 3-2 vote along party lines, Chairman Tarbert proclaimed "Today we are removing a cloud that has hung over both the CFTC and the derivatives markets for a decade…Today we have reached the end of an arduous journey." Indeed, the final regulation had long been the source of controversy, having been the subject of five separate rule proposals since 2011, and being successfully challenged in a federal district court. Some of the main features of the final rule included:

- The rule adopted new and amended federal spot month position limits for derivatives contracts associated with 25 physical commodities, and amended single-month and all-months-combined federal limits for most of the agricultural contracts currently subject to federal position limits. Under the final rule, federal non-spot month position limits were not extended to the sixteen new physical commodities as initially proposed.
- The rule adopted new and amended definitions for use throughout the position limits regulations, including a revised definition of "bona fide hedging transaction or position" that includes an expanded list of enumerated bona fide hedges and a new definition of "economically equivalent swaps."
- The CFTC amended rules governing exchange-set position limit levels and related exchange exemptions and established a new streamlined process for non-enumerated bona fide hedging recognitions for purposes of federal position limits. Specifically, authority has been delegated to exchanges to set position limits outside the spot month.

Dan Berkovitz, a Democratic commissioner, observed, "The Final Rule fails to achieve the most fundamental objective of position limits: to prevent the harms arising from excessive speculation." He added, "It is another disappointing chapter in the Commission's 10-year saga to implement Congress's mandate in the Dodd-Frank Act to impose speculative position limits in the energy, metals, and agricultural markets." Recognizing the dominant role played by exchanges in the regulation's implementation, Berkovitz added that "the rule demoted the Commission from head coach to Monday-morning quarterback."

Capital requirements for swap dealers and major swap participants. Another final rule that passed 3-2 along partisan lines imposed new capital requirements on swap dealers and major swap participants that were not subject to supervision by a banking regulator. Under the new rule, to accommodate the variety in business operations of impacted firms, swap dealers are now provided with the option of selecting from one of three alternative methods to establish and meet minimum capital requirements. Chairman Tarbert lauded the capital rule's flexibility and ability to accommodate the wide array of swap dealers that touch every corner of the Commission's markets. Meanwhile, Commissioner Rostin Behnam objected to the rule's lower capital thresholds, noting that "capital is a cornerstone financial crisis reform that is critical to protecting our financial institutions and our financial system as a whole from systemic risk and contagion."

Cross-border rule for swap dealers. The Commission also approved a final cross-border rule that established a formal process for requesting comparability determinations for the requirements

from the CFTC by a 3-2 vote along party lines. This measure also defined key terms for the purpose of applying the Commodity Exchange Act's (CEA) swaps provisions to cross-border transactions. Additionally, the final rule included a risk-based approach that was calculated to advance the goals of the swap reforms of Title VII of Dodd-Frank, while fostering greater liquidity and competitive markets, promoting enhanced regulatory cooperation, and improving the global harmonization of swap regulation.

In supporting the rule, Commissioner Brian Quintenz stated that "Congress deliberately placed a clear and strong limitation on the CFTC's extraterritorial reach, recognizing the need for international comity and deference in a global swaps market." He further observed that the "rule provides important safeguards to the US financial markets in delineating which cross-border swap activity must be counted towards potential registration with the Commission."

In opposing the rule, Commissioner Dan Berkovitz argued against outsourcing protection of U.S. financial system to foreign regulators. Berkovitz further asserted that for the past seven years, the current cross-border regime had helped protect the U.S. financial system from risky overseas swaps activity. He implored, "The Commission should not be paring back these protections for the American financial system, particularly now, during a global pandemic."

Volcker Rule. The Commission also voted to adopt final rule amendments to the Volcker Rule by a 3-2 margin. The proposal, issued by the Commission in January 2020, follows other targeted revisions and specifically addresses covered funds. The proposal was issued jointly as an interagency rule with the CFTC, SEC, Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and the Board of Governors of the Federal Reserve System (FRB).

Electronic trading principles and bankruptcy reforms. The Commission capped off its rulemaking for 2020 with a flourish. At its final meeting of the year held on December 8, the CFTC finalized rulemakings on electronic trading risk principles and Part 190 bankruptcy regulations, and approved six other final rules on a seriatim basis. The electronic trading rule addressed risk controls related to automated trading systems and replaced the controversial Regulation AT proposal which was withdrawn earlier in the year. That rule passed on a 4-1 vote, with Commissioner Behnam dissenting. The final rule updating the Part 190 bankruptcy regulations passed unanimously, marking the first rulemaking on the topic in 37 years. Those final rules are geared to improve clarity, reduce uncertainty, and increase transparency in a bankruptcy setting.

Final rules passing by unanimous vote. As noted, the majority of rules enacted by the Commission during 2020 reflected broad consensus and passed by a unanimous 5-0 vote of the Commissioners. Some of these final rules included:

- *Post-trade name give-up on swap execution facilities.* This final rule adopted amendments to Part 37 of CFTC regulations to prohibit post-trade name give-up for swaps executed, pre-arranged, or pre-negotiated anonymously on or pursuant to the rules of a swap execution facility (SEF) and intended to be cleared.

- *Exemption from the swap clearing requirement for certain affiliated entities.* This final rule adopted amendments to the Commission's inter-affiliate exemption conditions under CFTC Regulation 50.52, which exempts certain affiliated entities within a corporate group from the swap clearing requirement under the applicable provision of the CEA.
- *Amendments to registration requirements for CPOs and CTAs: prohibiting exemptions for persons subject to certain statutory disqualifications***.** The Commission approved a final rule amendment to Regulation 4.13, which contains the regulations applicable to CPOs and commodity trading advisors (CTAs). In particular, the rule closes a loophole which permitted bad actors to avail themselves of an exemption from registration by prohibiting those persons who have, or whose principals have, in their backgrounds any of the statutory disqualifications listed in Section 8a(2) of the CEA.
- *Security futures margin rule*. At their first-ever joint open meeting, the CFTC and the SEC approved a joint final rule to harmonize the minimum margin level for security futures held in a futures account with the minimum margin level for security futures held in a securities portfolio margin account. The new margin rule would lower the margin requirement for an unhedged security futures position from 20 percent to 15 percent.

III. Looking ahead to 2021

The change in leadership is the single largest factor that will determine the direction of the SEC and CFTC in 2021. The new administration has not given any indication whom it may choose to lead the commissions, and both agencies will likely start the year under yet-to-be-named acting chairpersons. Despite the changes, look for the agencies to continue to operate along party lines as they have in recent years.

SEC

Proxy advisers and shareholder proposals. These controversial proposals passed with the support only of the Independent chair and Republican commissioners. A Democratic-majority Commission can be expected to do what it can to respond to shareholder concerns and to compensate for the loss of shareholder engagement in other ways, such as through the no-action process to the extent it can.

Commission staff may revisit guidance on shareholder proposals in the context of remote meetings. While a corporation's authority to conduct shareholder meetings remotely is largely a function of state law, the SEC issued guidance on the federal proxy requirements during the COVID-19 pandemic when many states authorized remote meetings on an emergency basis. However, the 2020 proxy season gave rise to concerns about shareholder disenfranchisement when AT&T reportedly required shareholders to summarize their proposals in 100-word statements to be presented by AT&T representatives rather than by the shareholder proponent. The SEC is likely to support remote meetings because they carry the environmental benefit of reducing travel, analogous to electronic filing and other paperwork-reduction initiatives. If the practice continues, however, the agency can be expected to issue further guidance that more clearly addresses requirements for shareholder participation.

Whistleblower program. With a change in Chairmanship and a new administration, the Commission's future direction on whistleblowers is difficult to forecast. The revisions adopted in September are seen by many as potentially weakening the whistleblower program, even as the Commission issued a record $175 million in total awards in FY2020, plus a record-high award of $114 million to a single whistleblower after the fiscal year ended.

A particular area of concern is the SEC's guidance on what constitutes "independent analysis." Even before the final rules were adopted, the September 2020 letter from the senators noted above expressed concern that the then-proposed guidance would inject ambiguity into the evaluation of whistleblower tips and create an "insurmountable hurdle" that would cause a potential whistleblower to stay silent. The senators argued that an objective, "bright line" standard is needed where individuals face great personal risk in coming forward. The dissenting commissioners, especially Commissioner Crenshaw, also worried that the guidance would "inadvertently impact the perception of the type of information the Commission considers valuable."

While a more detailed discussion of legislative efforts concerning the whistleblower program can be found in tomorrow's review of Congressional developments during 2020, it should be noted that the proposed Whistleblower Protection Reform Act of 2019 would legislatively reverse the *Digital Realty Trust* decision. Later in 2019, a bipartisan group of senators led by Sen. Chuck Grassley (R-Iowa) introduced a bill to amend the Commodity Exchange Act and the Securities Exchange Act to ensure that whistleblowers who report internally can partake of the Dodd-Frank Act anti-retaliation provisions. More comprehensive than the House bill, the Whistleblower Programs Improvement Act would, among other items, reverse *Digital Realty Trust*, require prompt payments to whistleblowers, and bar the waiver of the protections and remedies afforded to whistleblowers.

CFTC

As an appointee of President Donald Trump whose tenure began in July 2019, Heath Tarbert's time at the CFTC is coming to its end with the arrival of a new administration. As of this writing, the Biden transition team has not yet provided a clear indication of its plans in the commodities and derivatives realm. Under the CEA, Biden will have the opportunity to appoint a new chair, subject to Senate confirmation. He will also have the chance to replace outgoing Commissioner Brian Quintenz (R), whose term expired in April 2020. Current commissioners include Rostin Behnam (D; term ends June 2021); Dawn Stump (R; term ends April 2022); and Dan Berkovitz (D; term ends April 2023).

While 2020 was a year to remember with respect to the large volume of rulemaking, there are not any rule proposals currently pending. With the coming end to Trump Administration and the Chairman's imminent departure, one memorable era will be ending, and in all likelihood, another era of substance will begin.

