

CEP Magazine – September 2022 SEC heightens compliance enforcement of public companies in 2022

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With the appointment of Gurbir Grewal as enforcement director of the Securities and Exchange Commission (SEC), 2022 has, as expected, seen more stringent oversight into public companies. Grewal formerly served as attorney general of New Jersey until 2021. The SEC selected Grewal to be tougher on Wall Street than his predecessors.

Between 2019 and 2021, SEC enforcement actions against public companies dropped by nearly half due to the pandemic and changing leadership. Grewal, along with other top SEC officials, outlined a list of new priorities for the agency, many of which focus on deterrence against corporate misconduct. Five main types of SEC enforcement actions have taken center stage with the new administration and are expected to continue to be top priorities throughout the year and beyond. Here, we examine these five main types of enforcement actions.

First of its kind

The SEC launched a series of novel legal actions designed to deter misconduct, applying securities law in ways it has not done before. Thus far, these actions have included cases against an unregistered broker-dealer involving decentralized finance and a former biopharmaceutical executive for engaging in “shadow trading” by using confidential information about his own company to trade the stock of a rival firm. As the SEC continues to expand and strengthen its enforcement protocols, it is becoming increasingly difficult for individuals to successfully engage in corporate malfeasance.

Such enforcement actions will face unique challenges but are focused on combating breaches of confidentiality, breaches of fiduciary duty, and fraud. The purpose of such enforcement actions is to ensure that the reasonable investor has a level playing field. In a statement given at the Securities Enforcement Forum in May, Grewal commented on the importance of swift enforcement actions and deterrence, with the goal of restoring the public’s trust. He stated, “An animating principle for me in this role has been to increase public confidence in our markets and government—to counter the declining trust in our institutions that we are experiencing. There is a perception among large segments of the population that corporate wrongdoers are not being held accountable and that there are two sets of rules: one for the big and powerful and another for everyone else. While there are many reasons for these beliefs and trends, delayed accountability does not help. That’s why, since day one, I’ve been asking staff to look for ways in which to push the pace of our investigations. The public needs to know when they read a news story about corporate malfeasance that we will move quickly to investigate what happened and hold wrongdoers accountable, even in the most complex cases.”^[1]

Insider trading

Insider trading cases have historically made up a large portion of the SEC's enforcement actions, since they are directly connected to the integrity and reliability of the market itself. Although SEC enforcement of insider trading decreased over the past year, the SEC has made a renewed priority of taking a stricter stance on misuse of nonpublic information in 2022. This was seen late last year in several enforcement actions against alleged sales of insider tips on forums on the dark web.

Advancements in market surveillance tools have made it easier to detect insider trading, and the agency is broadening its rules to combat unequal access to information. This includes monitoring of dark web activity once thought to be private. Proposed new rules will strip protection from corporate executives who were previously shielded from insider trading accusations when buying and selling their own company's stock. Now the SEC is taking a closer look at executive purchases of their own company stock and has proposed rules implementing a "cooling-off" period between sales and purchases, as well as require more frequent and detailed disclosures of corporate stock repurchases. The SEC's enhanced monitoring of potential insider trading aims to control unequal access to information—the very heart of such corporate malfeasance.

Cryptocurrency as securities

Going into this year, one of the highest priorities for SEC enforcement is cryptocurrency. Enforcement actions against players in the crypto space have been escalating under new leadership. The SEC remains firmly against unregistered crypto offerings and will likely begin investigating other areas of crypto for wrongdoing as well. Additionally, the SEC is focusing more on individual defendants in crypto enforcement actions and is expected to bring an increased amount of these cases.

The last fiscal year saw multiple actions against issuers of various digital assets who were charged with selling unregistered securities, as well as cryptocurrency trading platforms operating unregistered digital exchanges. Under the SEC's new regime, the ever-evolving sector of digital currency will continue to face heightened scrutiny, as digital currency is now seen as securities by the agency.

Individual responsibility

Under previous administrations, SEC enforcement actions focused on settlements with the public company at issue rather than individuals. Under current leadership, the SEC is viewing corporate executives within public companies as gatekeepers and viewing them with increased scrutiny. This group of gatekeepers includes accountants, attorneys, auditors, and compliance officers—all of whom have individual accountability. These individuals will continue to be a major focus for the SEC's enforcement division.

Holding individuals—not just corporations—accountable for corporate malfeasance is a major change from previous administrations, and highlights the importance of focusing on individual autonomy and the wide-ranging impact that an individual's wrongdoing may have on the financial health of many. This move is also an example of deterrence; no longer will corporate wrongdoers be able to shield themselves from responsibility and accountability by expecting enforcement actions and settlements to be directed at the company instead.

ESG

Environmental, social, and governance (ESG) issues are expected to be higher priorities under the new SEC leadership. The SEC is expected to sharpen its focus on companies that engage in greenwashing: a practice where a company misrepresents the environmental sustainability of its business or products.

Last spring, a 22-member enforcement task force was put together with the mission of developing processes to identify misconduct around ESG-related disclosures. Merely one month into this task force's existence, the

agency issued a risk alert highlighting weaknesses and deficiencies that it found in internal controls while examining a number of investment advisers and funds about ESG investing. Climate risks and human capital are important areas of concern to this leadership of the SEC, which informs that investors want and are entitled to useful and honest disclosures about the sustainability of the businesses or products they are choosing to invest in.

Under new leadership, the SEC's enforcement division has been rewarding companies that self-report misconduct and has been encouraging more stringent internal monitoring for compliance. As Grewal explained at the forum, "As we've seen in a number of recent cases, when clients take steps to self-report potential violations, or to proactively cooperate with our investigations and remediate violations, the Commission is often willing to credit that cooperation, including through reduced penalties, or even no penalties at all."

With market volatility and investor concern rising, it is more important now than ever that the SEC maintain its enforcement efforts to protect equal access to information and ensure compliance and transparency.

Takeaways

- New, first-of-their-kind legal actions are being used by the Securities and Exchange Commission (SEC) to deter corporate misconduct and strengthen enforcement protocols.
- Insider trading remains a priority for the SEC, with advancements in market surveillance making detection easier.
- Cryptocurrency assets will continue to face higher scrutiny and enforcement.
- SEC compliance enforcement actions are targeting individuals more than in previous administrations, which focused more on corporations.
- Environmental and social governance issues are high priorities for SEC enforcement.

¹ Gurbir S. Grewal, "Remarks at Securities Enforcement Forum West 2022," U.S. Securities and Exchange Commission, May 12, 2022, <https://www.sec.gov/news/speech/grewal-remarks-securities-enforcement-forum-west-051222>.

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