

Crypto, Audit Cases Dominate SEC's Enforcement Focus In '23

By **Gerald Hodgkins, Linh Nguyen and Phoebe Yu** (November 29, 2023)

On Nov. 14, the U.S. Securities and Exchange Commission announced the results of its enforcement efforts in fiscal year 2023, which ended on Sept. 30.[1] As reflected in the SEC's report and our own analysis, fiscal year 2023 marked the SEC's third consecutive year of increasing enforcement activity since Chair Gary Gensler took the helm of the agency in 2021.

In fiscal year 2023, the SEC stayed on course with Gensler's 2021 objective of balancing cases against "everyday fraudsters" with ones that "change behavior" and "send a message." [2]

At the SEC Enforcement Forum last month, Gensler emphasized the SEC's continued focus on high-impact cases and highlighted the agency's efforts to protect investors from affinity fraud, combat crypto-related scams and increase compliance with recordkeeping obligations.[3] Accordingly, the gains in enforcement activity were largely concentrated in securities offering and broker-dealer cases.

2023 Enforcement Results

In the past year, the SEC brought 501 "stand-alone" cases — defined as civil actions filed or administrative proceedings instituted, excluding Section 12(j) proceedings against delinquent filers and follow-on administrative proceedings to obtain suspensions and bars based on prior enforcement actions by the SEC or other agencies.

Explore the SEC's 500 Standalone Actions from FY 2023

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The number of cases in the second and fourth quarters of fiscal year 2023 was 49% and 24% higher, respectively, than in fiscal year 2022. As in previous years, most of the cases (39%) came in the fourth quarter.

Following the convention used by the Division of Enforcement, these cases are tracked in nine different categories. Here is a breakdown:

Category	FY 23 Cases	FY 23 % of Total	FY 22 Cases	FY 22 % of Total	% Change between FY 22 and FY 23	FY 21 Cases	FY 21 % of Total	% Change between FY 21 and FY 22
Securities Offering	164	33%	106	23%	+55%	142	33%	-25%
Investment Advisers / Investment Cos.	86	17%	119	26%	-28%	120	28%	-1%
Issuer Reporting / Audit & Accounting	86	17%	76	17%	+13%	53	12%	+43%
Broker-Dealer	60	12%	46	10%	+30%	36	8%	+28%
Other (Exchanges, NSROs, Transfer Agents, Misc.)	34	7%	15	3%	+127%	12	3%	+25%
Insider Trading	32	6%	43	9%	-26%	28	6%	+54%
Market Manipulation	22	4%	32	7%	-31%	26	6%	+23%
FCPA	11	2%	6	1%	+83%	5	1%	+20%
Public Finance Abuse	6	1%	19	4%	-68%	12	3%	+58%
Category Total	501	100%	462	100%	+8.5%	434	100%	+6.5%
Follow-On Administrative Proceedings	162		169		-4%	143		+18%
Delinquent Filings	121		129		-6%	120		+8%

Notable Trends

Investment Advisers

After rebounding from fiscal year 2020 to fiscal year 2021, investment adviser cases leveled out in fiscal year 2022 and then decreased from 119 to 86 cases in fiscal year 2023.

In fiscal year 2023, the number of investment adviser cases dropped in nearly every subcategory. Although cases involving the misappropriation of client assets and undisclosed conflicts of interest led the category, the SEC also brought a few investment adviser sweeps, including ones focused on alleged violations of the SEC's marketing rule and failures to provide audited financial statements to investors.

In fiscal year 2021, the SEC began charging investment advisers and broker-dealers for failing to file or deliver their Form CRS by the respective deadlines.[4] Last year, we observed that Form CRS cases dropped from 21 in fiscal year 2021 to 11 in fiscal year 2022, suggesting that investment advisers as a whole were largely coming into compliance with Form CRS filing requirements.[5]

As we predicted, in fiscal year 2023, Form CRS cases dropped to zero.

Securities Offering and Cryptocurrency

Following a drop of 25% from fiscal year 2021 to fiscal year 2022, securities offering cases rebounded 55% from fiscal year 2022 to fiscal year 2023. Most of the jump was from offering fraud and cryptocurrency cases.

Offering fraud cases increased from 81 in fiscal year 2022 to 118 in fiscal year 2023. Most notably, the SEC put an increasing focus on affinity fraud,[6] which targets members of an identifiable group, such as a religious group, an ethnic community, the elderly or a particular workforce.[7] Violators of affinity fraud are often members of the group they are defrauding.[8]

A number of the affinity fraud cases brought by the SEC this year were alleged crypto fraud schemes.[9] As we predicted last year, the SEC ramped up enforcement activity against violations involving crypto,[10] as such cases increased from 18 in fiscal year 2022 to 44 in fiscal year 2023.

On Oct. 25, at the SEC Enforcement Forum, Gensler stated, "With wide-ranging noncompliance, frankly, it's not surprising that we've seen many problems in [the crypto] markets. ... This is a field rife with fraud, scams, bankruptcies, and money laundering. ... We have brought numerous enforcement actions against actors in this space — some settled, and some in litigation." [11]

In addition to crypto fraud schemes targeting affinity groups, the SEC charged various companies and individuals with failing to register the offer and sale of crypto-asset securities and programs,[12] or with operating an unregistered exchange, broker and clearing agency.[13]

In March, the SEC announced charges against Justin Sun and three of his wholly owned companies — Tron Foundation Limited, BitTorrent Foundation Ltd., and Rainberry Inc. — for the unregistered offer and sale of crypto-asset securities Tronix and BitTorrent.[14]

The SEC also charged eight celebrities, including Lindsay Lohan, Jake Paul, Soulja Boy, Austin Mahone, Kendra Lust, Lil Yachty, Ne-Yo and Akon, for illegally touting Tronix or BitTorrent without disclosing that they were compensated for doing so.[15] The celebrities, apart from Soulja Boy and Mahone, agreed to pay a total of more than \$400,000 to settle the charges.[16]

This is not the first time celebrities have been charged for illegally touting crypto-asset securities. In October 2022, Kim Kardashian agreed to pay \$1.26 million to settle the SEC's charges for touting on social media a crypto-asset security offered and sold by EthereumMax without disclosing the payment she received for the promotion.[17]

Signs indicate that the SEC's crackdown on violations involving crypto will continue to be a priority in fiscal year 2024. According to a spokesperson from the SEC, the agency has nearly filled the 20 additional positions it added to its Crypto Assets and Cyber Unit in fiscal year 2022, and is planning to grow the unit further.[18]

Additionally, in his testimony before the U.S. House Appropriations Committee on March 29, Gensler requested additional funding to, in part, address the "rapid technological innovation in the financial markets [that] has led to misconduct in emerging and new areas, not least in the crypto space."[19]

Issuer Reporting/Audit and Accounting

Issuer reporting/audit and accounting cases were up 13%, rising from 76 in fiscal year 2022 to 86 in fiscal year 2023. The largest increase came from corporate disclosure cases, which jumped from 22 in fiscal year 2022 to 39 in fiscal year 2023.

In December 2022, the SEC announced the largest settlement of the fiscal year: Danske Bank agreed to pay \$413 million to settle the SEC's charges against it for allegedly misleading investors about its anti-money laundering compliance program in its Estonian branch, and for failing to disclose risks posed by the program's deficiencies.[20]

One month later, the SEC ordered Stephen Easterbrook, former CEO of McDonald's Corp., to pay \$53.1 million for making false and misleading statements to investors about the circumstances leading to his termination in November 2019.[21]

Later in the year, the SEC announced that Exelon and ComEd agreed to pay \$46.2 million to settle charges for fraud in connection with a multiyear scheme to corruptly influence Michael Madigan, then-speaker of the Illinois House of Representatives, regarding legislation favorable to ComEd.[22]

In contrast, accounting cases decreased from 37 in fiscal year 2022 to 31 in fiscal year 2023. Issues relating to improper revenue recognition and overstated earnings continue to dominate the accounting category.

Broker-Dealer

Broker-dealer cases increased 30%, from 46 cases in fiscal year 2022 to 60 in fiscal year 2023. Decreases in cases involving Form CRS and unauthorized trades were balanced out by increases in cases involving unregistered broker-dealers. Similar to investment adviser cases, Form CRS cases against broker-dealers dropped from six to one.

In fiscal year 2023, the SEC continued its efforts to curb failures in recordkeeping. Since

adopting rule amendments to modernize how broker-dealers preserve electronic records in fiscal year 2022,[23] the SEC has settled recordkeeping-related charges with 23 firms in fiscal year 2023, an increase of 35% compared to fiscal year 2022.

In August 2023, the SEC announced that 10 broker-dealers and one dually registered broker-dealer and investment adviser had admitted to failures to maintain and preserve electronic communications and agreed to pay combined penalties of \$289 million.[24] The following month, the SEC announced that five broker-dealers, three dually registered broker-dealers and investment advisers, and two affiliated investment advisers had agreed to pay combined penalties of \$79 million to settle similar recordkeeping failures.[25]

Prior to these two sweeps, the SEC had settled similar charges against two broker-dealers in May 2023.[26] According to the SEC, the firms did not maintain or preserve the communications their employees had on their personal devices about firm business.[27]

Since December 2021, the SEC has charged a total of 40 firms and ordered more than \$1.5 billion in penalties.[28] Given the firms' conduct implicated a prophylactic rule and thus, did not result in any identifiable harm to investors, the magnitude of the penalties levied by the SEC in this ongoing effort is surprising.

Insider Trading

After ramping up insider trading cases in fiscal year 2021 and fiscal year 2022, insider trading cases decreased 26% from 43 in fiscal year 2022 to 32 in fiscal year 2023.

Although the number of insider trading cases trended downward, in a June 29 statement announcing charges against 13 defendants in four separate insider trading schemes, SEC Enforcement Director Gurbir Grewal reaffirmed the SEC's "commitment to leveraging all the tools at [its] disposal, including [its] data analytics initiatives, to investigate these abusive trading practices, hold accountable bad actors and ensure the integrity of our markets." [29]

Individual Accountability

In fiscal year 2022, the SEC charged individuals in 68% of stand-alone cases, and in fiscal year 2023, the SEC charged individuals in 63% of stand-alone cases.

Although the proportion of cases involving actions against individuals decreased slightly, at the SEC Enforcement Forum last month, Gensler noted that the SEC "obtained 133 bars on individuals from serving as officers and directors — our highest in the decade." [30] He stressed that accountability is "about individuals, not just firms ... [and] includes protecting the public by barring individuals — whether from practicing before the SEC, association bars, or otherwise."

In one of the most high-profile cases of the year, in December 2022, the SEC charged Sam Bankman-Fried for defrauding equity investors in FTX Trading Ltd., a crypto trading platform. [31]

The SEC alleged that Bankman-Fried raised more than \$1.8 billion from investors and (1) diverted investors' funds to Alameda Research LLC, his privately-held crypto hedge fund; (2) provided Alameda with a virtually unlimited "line of credit" funded by FTX investors; (3) exempted Alameda from key FTX risk mitigation measures; and (4) failed to disclose risk stemming from FTX's exposure to Alameda's significant holdings of overvalued, illiquid assets. [32] The SEC's complaint further alleged that Bankman-Fried used commingled FTX

investors' funds at Alameda to make undisclosed venture investments, real estate purchases and political donations.[33]

Among other things, the SEC sought an injunction prohibiting Bankman-Fried from participating in the issuance, purchase, offer or sale of any securities, except for his own personal account; disgorgement of his ill-gotten gains; a civil penalty; and an officer and director bar.[34]

Penalties and Other Monetary Remedies

Total civil penalties and other monetary remedies were down from \$6.4 billion in fiscal year 2022 to \$4.9 billion in fiscal year 2023, a 23% decrease.

Despite the lower amount, both the disgorgement and civil penalties ordered were the second-highest amounts on record.[35] This decline came mostly from a drop of 62% in civil penalties. In contrast, disgorgement plus prejudgment interest increased 50%.

In its annual reports, the SEC disclosed the following monetary recoveries in the past seven fiscal years:

	Disgorgement Plus Prejudgment Interest	Civil Penalties	Total
FY 2023	\$3,369,000,000	\$1,580,000,000	\$4,949,000,000
FY 2022	\$2,245,000,000	\$4,194,000,000	\$6,439,000,000
FY 2021	\$2,396,000,000	\$1,456,000,000	\$3,852,000,000
FY 2020	\$3,589,000,000	\$1,091,000,000	\$4,680,000,000
FY 2019	\$3,248,000,000	\$1,101,000,000	\$4,349,000,000
FY 2018	\$2,506,000,000	\$1,439,000,000	\$3,945,000,000
FY 2017	\$2,957,000,000	\$832,000,000	\$3,789,000,000

Conclusion

As Grewal announced in his remarks at the New York City Bar Association Compliance Institute on Oct. 24, despite operating in an era of "faltering" public trust in our institutions, the SEC managed to have "another incredibly productive year." [36]

On the following day, at the SEC Enforcement Forum, Gensler continued to signal a robust enforcement approach, stating, "We use all of the tools in our toolkit to hold bad actors accountable — including bars, penalties, injunctions, undertakings, and litigating where appropriate."

In total, in fiscal year 2023, the SEC brought 501 stand-alone cases, and obtained judgments and orders totaling nearly \$5 billion.[37]

Consistent with the SEC's enforcement actions in fiscal year 2022, the commission

continued to focus on high-impact cases, specifically those affecting vulnerable investors, violations involving crypto and ones that "change behavior and bring greater compliance with the law."^[38] It is likely that this trend will continue as the SEC strives to restore public trust and confidence in our institutions, including banks, technology companies and large businesses.

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[1] SEC Announces Enforcement Results for Fiscal Year 2023, SEC Press Release (Nov. 14, 2023), <https://www.sec.gov/news/press-release/2023-234>.

[2] See Gerald Hodgkins, Linh Nguyen & Margaret Shin, SEC Enforcement Numbers Show Shift to High-Impact Cases, Law360 (Nov. 30, 2022), <https://www.law360.com/articles/1553691/sec-enforcement-numbers-show-shift-to-high-impact-cases>.

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[6] See, e.g., SEC Obtains Emergency Relief To Halt Nearly \$130 Million Fraud Targeting Indian American Community, SEC Press Release (Oct. 16, 2023), <https://www.sec.gov/news/press-release/2023-223>; SEC Alleges Son and Father-in-Law Touted Faith to Target Church Members in \$20 Million Offering Fraud, SEC Press Release (May 2, 2023), <https://www.sec.gov/news/press-release/2023-84>; SEC Charges Mexico-based Company, its CEO, and Four Individuals in Ponzi Scheme Targeting Spanish-Speaking U.S. Investors, SEC Press Release (Sept. 21, 2023), <https://www.sec.gov/news/press-release/2023-190>; SEC Charges California Resident with Multimillion Dollar Ponzi Scheme Targeting Tongan American Community, SEC Press Release (Sept. 19, 2023), <https://www.sec.gov/news/press-release/2023-187>; SEC Charges Los Angeles Individual With Perpetrating A \$47 Million Affinity Fraud Targeting Members Of The Orthodox Jewish Community, SEC Litigation Release (Jan. 12, 2023),

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[8] Id.

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[25] SEC Charges 10 Firms with Widespread Recordkeeping Failures, SEC Press Release (Sept. 29, 2023), <https://www.sec.gov/news/press-release/2023-212>.

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[32] Id.

[33] Id.

[34] Id.

[35] SEC Announces Enforcement Results for Fiscal Year 2023, SEC Press Release (Nov. 14, 2023), <https://www.sec.gov/news/press-release/2023-234>.

[36] Gurbir Grewal, Remarks at New York City Bar Association Compliance Institute, SEC (Oct. 24, 2023), <https://www.sec.gov/news/speech/grewal-remarks-nyc-bar-association-compliance-institute-102423>.

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