wiley

ALERT

SEC Annual Whistleblower and Enforcement Reports Signal Continued Aggressiveness in 2023 and Beyond

December 6, 2022

On November 15, 2022 the U.S. Securities and Exchange Commission (SEC) released its Dodd-Frank Whistleblower Program fiscal year (FY) 2022 Annual Report to Congress.[1] The same day, the SEC reported on the Enforcement Division's FY 2022 activities.[2] Together, the two reports show that in 2022, the SEC Enforcement Division was extremely active. And, its future is buoyed by multiple high-dollar awards and a record-breaking number of whistleblower tips. The numbers in both reports suggest that next year, the SEC will continue to take an aggressive approach: We will likely see an increase in investigations activity and in the resulting penalties sought to be imposed by the Commission. Given the lag time from whistleblower submittal to resolution of any enforcement action, the reports also provide a glimpse into SEC Enforcement's focus well beyond 2023.

A. The Whistleblower Program

By any metric, the SEC's Whistleblower Program has been a resounding success since its first award in 2011. According to the Whistleblower Program's FY 2022 report, in total, the SEC has paid more than $1.3 billion in 328 awards to whistleblowers. Investigations started or aided by whistleblower tips have resulted in $6.3 billion in total monetary sanctions, including $4 billion in disgorgement, of which $1.5 billion is scheduled to be returned to investors.

In FY 2022, the program had its second most successful year, paying $229 million in 103 awards. Five payouts comprised the bulk of the FY 2022 awards: $40 million to two whistleblowers, $37 million to another two, $17 million to a single whistleblower, and $16 and $15

Practice Areas

Securities Enforcement and Litigation

White Collar Defense & Government Investigations million, respectively, to two sets of two whistleblowers. For context, FY 2021 saw $568 million paid to 108 individuals, with two awards of over $100 million each. These large payouts, which have grown in frequency and amount over the years, have had the intended effect of an increasing number of Whistleblower Program tips coming into the SEC. The SEC reports that it received a record-high 12,322 tips in FY 2022 compared to 12,210 in FY 2021 and an average of 4,600 over the preceding five years.

The mix of tips that came into the program largely mirrored years past with Manipulation (21%); Offering Fraud (17%); Initial Coin Offerings and Cryptocurrencies (14%); Corporate Disclosures and Financials (13%); Insider Trading (3%); and FCPA (1.5%) leading the way. Compared to the prior year, the most notable jump was in the percentage of Initial Coin Offering and Cryptocurrency tips, which was only 6% in FY 2021. Both Insider Trading (3.8%) and FCPA (2%) dropped slightly from FY 2021 to FY 2022.

B. The Enforcement Division in FY 2022

In FY 2022, the Enforcement Division reported 760 "total enforcement actions," which was a 9% increase over FY 2021. Of those, 462 were "stand-alone" actions – an increase of 6.5% over FY 2021, with the rest being delinquent filings and follow-on administrative proceedings (i.e., 102(e) actions for accountants and lawyers).

Notably, the penalties ordered in FY 2022 actions were a record $4.194 billion, while disgorgement fell 6% to $2.245 billion for a total of $6.439 billion. The record penalty figures were skewed upwards, however, by the $1.23 billion in resolutions with 17 entities in a series of actions related to the preservation of messages on employees' personal devices. Additionally, the SEC obtained a $675 million penalty from an investment fund complex in another action. Combined, those amounted to nearly half (45%) of the total penalties ordered in FY 2022. Yet even without those extraordinary resolutions, SEC FY 2022 penalties were closer—but still significantly higher—than the historical average: $1.4 billion in FY 2021 and an average of $1.2 billion in the preceding five years.

The FY 2022 Enforcement Division report focused on individual accountability and the Division's trial victories, noting that it obtained favorable verdicts in 12 of 15 litigated cases. This figure, however, is somewhat misleading as it provides little insight into whether the trial "victories" were split verdicts or resulted in findings or awards that were less than what the Division sought in its Complaint or could have obtained in settlements. Unsurprisingly, the SEC did not issue press releases detailing its trial losses with the same detail and flourish as the press releases it issued when it filed those cases.

Cooperation, data analytics, and whistleblowers all received a nod as important sources of cases in FY 2022. Notably, the SEC highlighted its enforcement actions to protect the whistleblower pipeline, such as the *Brinks* case.[3] The report asserts that the record number of tips to the whistleblower program is actually understated. The number undercounts the total number of tips, complaints, and referrals the Division received in total in FY 2022—a staggering 38,500 that its Office of Market Intelligence reviewed and triaged.

As to areas of focus in FY 2022, the Enforcement Division noted its actions against gatekeepers (attorneys, auditors, and transfer agents) as well as public companies and their executives for disclosure violations. Continuing its focus on individual accountability, the SEC identified several cases where it obtained clawbacks from executives under SOX 304. Crypto and ESG enforcement actions were also highlighted, along with FCPA, market abuses (insider trading and manipulation), and public finance cases.

C. Predictions for 2023

The SEC's Congressionally allocated budget is an important gauge of future enforcement activity. In FY 2021, the budget was $1.92 billion. In FY 2022, the budget was increased to $1.99 billion. Looking ahead, the SEC has requested $2.15 billion for FY 2023, including money for an additional 120 Enforcement Division staff – confirming that the SEC anticipates bringing more and potentially litigating more enforcement actions in years to come.

The Commission under Chairman Gensler and Enforcement Director Grewal has increased its aggressive rhetoric—threatening ever higher penalties, requiring admissions of liability, and insisting that it is willing to go to court if defendants refuse those demands. Given that recent Supreme Court losses have forced the SEC to shift away from using disgorgement to using civil penalties, we predict that the SEC will continue to demand higher penalty amounts compared to disgorgement amounts. All of the above will lead to an overall downtick in Enforcement actions ultimately completed as the Commission's posture encourages more individuals – and hopefully some entities - to litigate with the SEC. Forcing the agency to prove its allegations in court will certainly slow the pace of resolutions and likely lead to more trial losses.

As the Commission has stated repeatedly – penalties cannot just be a cost of doing business. That should run both ways, and companies and individuals will not continue to settle to increasingly unrealistic penalty demands merely to avoid the cost of defending themselves in court. Individuals and entities who believe they are innocent and have the ability to fight the Commission's allegations will likely do so confidently because it is questionable whether courts would consistently award the SEC the remedies the Enforcement Division now demands to settle a case. And that assumes the SEC can win its claims entitling it to penalties in the first instance.

Using the FY 2022 whistleblower report as an oracle to see 2-3 years into the future, we believe there will be more cryptocurrency activity —unless Congress strips the SEC of that authority. SOX clawbacks and accounting fraud cases will also be on the rise. Given the Gensler-led Commission's tendency towards regulatory overreach, the next two years will also see a raft of investigations involving cyber-breaches and ESG issues in the guise of disclosure violations. Finally, insider trading and FCPA will continue to make up a small but newsworthy part of the Enforcement docket.

[1] https://www.sec.gov/files/2022_ow_ar.pdf.

[2] https://www.sec.gov/news/press-release/2022-206

[3] https://www.sec.gov/litigation/admin/2022/34-95138.pdf