

SEC and CFTC Enforcement Update

October 2019 - March 2020

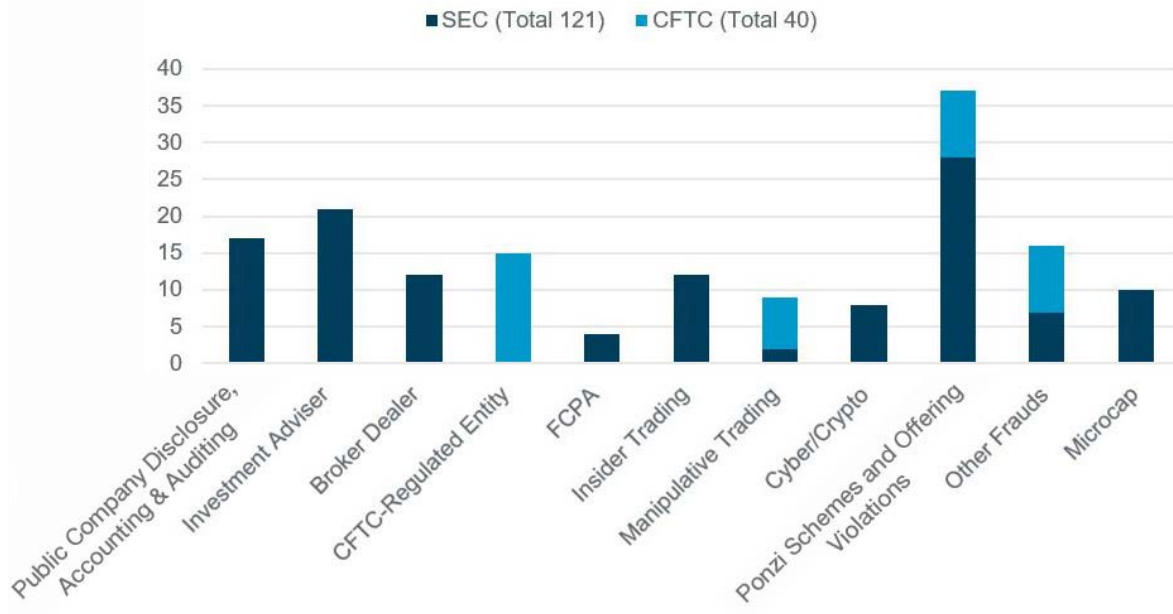
In this edition of the newsletter, we discuss recent developments over the first half of the agencies' fiscal year: October 1, 2019 to March 31, 2020. As illustrated below, the agencies initiated a mix of different actions during this period.

Of the 121 total SEC actions, 17 were accounting and disclosure-related cases, 12 were insider trading cases, 8 cases were related to cyber or digital assets, and 4 included FCPA violations. Approximately one quarter of all actions were against broker-dealers or investment advisers, and nearly one-third involved the ponzi schemes, offering frauds, and microcap frauds typically perpetrated against main street investors. The SEC staff has transitioned to work-from-home status due to the coronavirus (COVID-19) pandemic, and we have seen enforcement activity continue in cases not dependent on in-person interaction. We expect to see increased activity in cases related to the coronavirus, as well as the typically flurry of filings near the close of the fiscal year at the end of September. It remains to be seen whether the limitations imposed by social distancing will impact the SEC's ability to meet last fiscal year's 526 standalone cases, which included nearly 100 cases from the Share Class Selection Disclosure Initiative.

The CFTC brought 40 cases in the first half of its fiscal year, indicating that it may be on track to bring a higher number of cases in fiscal year 2020 as compared to fiscal year 2019 (when it brought 69 total cases). Of these 40 cases, nearly one quarter involved spoofing and other manipulative trading.

Actions initiated by the SEC and CFTC between October 1, 2019 and March 31, 2020¹

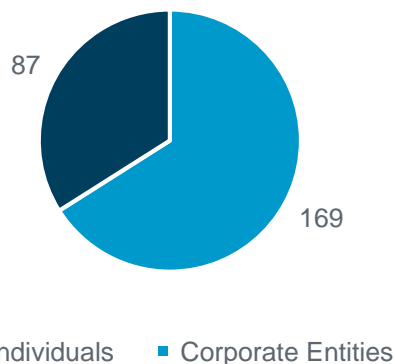
Actions categorized by matter type



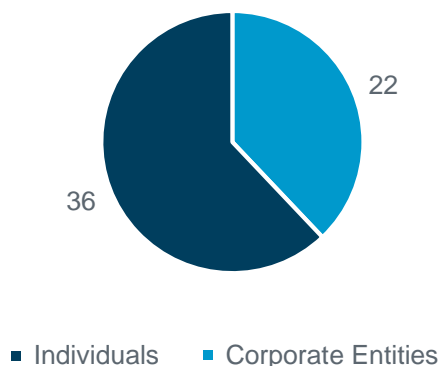
¹ Follow-on administrative proceedings, suspensions, bars, and delinquent filings excluded.

Types of Defendants/Respondents

SEC Defendants/Respondents
(Total 256)



CFTC Defendants/Respondents
(Total 58)



Key Cases and Developments

SEC Coronavirus (COVID-19) Response

The SEC took several enforcement actions relating to the coronavirus pandemic. First, the SEC suspended trading in three issuers based on coronavirus-related concerns, such as potentially inaccurate information about claims related to access to N95 masks, medical treatment marketing rights, and a product to treat the coronavirus. The SEC also suspended trading in the securities of Zoom Technologies, Inc. (“ZOOM”), which is *not* Zoom Video Communications, Inc. (“ZM”), the company with the videoconferencing platform.

[Praxsyn Corporation Order](#) | [Eastgate Biotech Corp. Order](#) | [Aethlon Medical, Inc. Order](#) | [Zoom Technologies, Inc. Order](#)

Additionally, and as we noted in a prior [client alert](#), Stephanie Avakian and Steve Peikin, the Co-Directors of the Enforcement Division, issued an unusual statement regarding the coronavirus pandemic, emphasizing the need for companies to comply with regulatory disclosure controls and carefully follow their insider trading policies during this time. The statement suggests that company executives might be more likely to have material nonpublic information because of the pandemic’s impact on financial performance or, possibly, because of efforts to develop effective treatments.

SEC Enforcement Division Statement

Supreme Court hears oral argument in *Liu v. SEC*

The Supreme Court heard arguments on March 3 in *Liu v. SEC*, which concerns the SEC’s authority to seek disgorgement as “equitable relief” in district court actions. The case follows the Court’s unanimous 2017 *Kokesh* decision holding that SEC disgorgement is a penalty and therefore subject to a five-year statute of limitations.

In *Liu*, the district court granted summary judgment to the SEC and found that Liu and Wang violated Section 17(a)(2) of the Securities Act. The court issued an injunction, imposed civil monetary penalties of \$6.7 million on Liu and \$1.5 million on Wang, and ordered disgorgement of “all funds received from [the] illegal conduct, together with prejudgment interest thereon,” which amounted to \$26.4 million. The defendants have challenged the SEC’s authority to seek disgorgement in district court actions.

Oral argument suggested that the Court might not be inclined to prohibit the SEC from seeking disgorgement in all circumstances, but also might not endorse unlimited SEC authority to seek disgorgement. Instead, the Justices asked questions indicating possible limitations, such as (1) limiting disgorgement awards to actual money defendants received and still possess (as opposed to profits that went to others or were spent); and (2) focusing disgorgement on cases in which the SEC will return disgorged funds to harmed investors. The latter approach could pose new challenges for the SEC because there are many cases in which the SEC does not distribute remedies to harmed investors. Generally, the SEC does not seek a Fair Fund to distribute money to harmed investors when it believes the cost of identifying victims, evaluating claims, and administering the distribution would outweigh the benefits of a distribution and result in very small payments to individual investors. For more information, see our prior client memorandum [here](#).

SEC Settles Case against Mutual Fund and its CEO, Files Contested Scierter-based Fraud Claims against Senior Portfolio Manager

SEC v. Walczak (W.D. Wisc. Jan. 27, 2020, Contested); In re Capital Catalyst Advisors et al. (A.P. Jan. 27, 2020, Settled)

The SEC announced enforcement actions against a mutual fund adviser and two individuals—the CEO and a senior portfolio manager—for alleged misstatements about fund safeguards and loss limit thresholds. The SEC alleged that marketing materials, including the fund prospectus, referred to specific risk modeling, “stop loss” triggers, and hedging strategies to limit the risk of loss to 8%. The matter is significant both because the SEC initiated actions against two senior individuals, and because it filed a contested case against the senior portfolio manager that included scierter-based fraud violations. In the contested district court action, the SEC alleges that the senior portfolio manager violated both scierter-based and negligence-based fraud provisions, including Securities Act Sections 17(a)(1)-(3) and Advisers Act Sections 206(1), (2) and (4). In the settled order, the SEC found that the mutual fund adviser violated negligence-based fraud provisions of the Advisers Act, Sections 206(2) and 206(4) and Rule 206(4)-8. The SEC found that the CEO caused the adviser’s violations, and failed to supervise reasonably the senior portfolio manager. Without admitting or denying the findings, the adviser agreed to pay disgorgement of \$8,176,722, prejudgment interest of \$731,759, and a \$1.3 million penalty, and the CEO agreed to pay a \$300,000 penalty.

[SEC Complaint](#) | [SEC Order](#) | [SEC Press Release](#)

SEC Brings Insider Trading Case Against Foreign Defendants

SEC v. Benjamin Taylor, Darina Windsor, and Joseph Abdul Noor El-Khoury (S.D.N.Y. Oct. 22, 2019, Contested); SEC v. Tomer Feingold and Dov Malnik (S.D.N.Y. Mar. 3, 2020, Contested)

The SEC filed the latest in a series of insider trading enforcement actions against foreign defendants. The SEC alleges that British investment bankers obtained material nonpublic information about potential acquisitions and tender offers involving U.S. public companies and then tipped two Israeli citizens who reside in Switzerland. The Israeli citizens then purportedly traded on that information to net more than \$4 million in profits. The case is an example of the SEC’s increasing use of data analytics; the SEC noted in its press release that the case originated with the Market Abuse Unit’s Analysis and Detection Center, which uses internally-developed tools to identify patterns of suspicious trading.

[SEC Complaint](#) | [SEC Press Release](#)

Personnel Changes

The SEC Enforcement Division has had a number of notable personnel changes at the senior level.

- Antonia Chion, an Associate Director at headquarters in Washington DC, retired after a 32-year career at the SEC.
[SEC Press Release](#)
- Kelly L. Gibson was named Director of the Philadelphia Regional Office.
[SEC Press Release](#)
- Paul A. Montoya was named Associate Regional Director in the Chicago Regional Office.
[SEC Press Release](#)
- Kristina Littman succeeded Robert Cohen as Chief of the Cyber Unit.
[SEC Press Release](#)
- Katherine E. Zoladz was named Associate Regional Director in the Los Angeles Office.
[SEC Press Release](#)

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

New York

Greg D. Andres	+1 212 450 4724	greg.andres@davispolk.com
Martine M. Beamon	+1 212 450 4262	martine.beamon@davispolk.com
Angela T. Burgess	+1 212 450 4885	angela.burgess@davispolk.com
Gary Lynch	+1 212 450 4582	gary.lynch@davispolk.com

Washington, DC

Robert A. Cohen*	+1 202 962 7047	robert.cohen@davispolk.com
Neil H. MacBride	+1 202 962 7030	neil.macbride@davispolk.com
Stefani Johnson Myrick	+1 202 962 7165	stefani.myrick@davispolk.com
Paul J. Nathanson	+1 202 962 7055	paul.nathanson@davispolk.com
Annette L. Nazareth	+1 202 962 7075	annette.nazareth@davispolk.com
Linda Chatman Thomsen	+1 202 962 7125	linda.thomsen@davispolk.com

*Mr. Cohen is admitted to practice in New York and Maryland, and is practicing in DC under the supervision of partners of the firm.

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