

October 11, 2021

In Inaugural Public Remarks, SEC Enforcement Director Identifies Key Steps to Promoting Market Integrity

Enforcement Director Gurbir Grewal’s Speech Stresses Importance of ‘Proactive Compliance,’ ‘Proactive Enforcement,’ and Proportional Penalties to Achieving ‘Shared Mission’ of Maintaining Market Integrity and Enhancing Public Confidence in Securities Markets.

SUMMARY

On October 6, 2021, Securities and Exchange Commission Division of Enforcement Director Gurbir Grewal made his inaugural public remarks at the Practising Law Institute’s Broker/Dealer Regulation and Enforcement 2021 event.¹ In his speech, Director Grewal identified three key ways to promote better conduct by market participants and, in turn, promote public confidence in the fairness of the public markets.

Proactive Compliance. First, Director Grewal counseled against efforts to “push the envelope” by exploiting “grey areas” around securities laws and regulations. Director Grewal urged market participants instead to “model[] excellence” by engaging in “proactive compliance,” which includes tailoring compliance efforts to account for the “emerging risks and Enforcement priorities” pertinent to their “specific business models and products.” Director Grewal noted the particular importance of this approach to compliance in this “time of rapid and profound technological change,” which he stated can “create[] new avenues for misconduct, and new responsibilities for compliance.” In particular, Director Grewal highlighted the importance of preserving records of “unofficial communications channels” that technological developments have made commonplace, such as text messages and communications on “ephemeral apps.” To highlight the Division’s focus on this type of compliance, Director Grewal described a recent action that the Division brought against a broker-dealer for failing to preserve business-related text messages, which had impeded an unrelated investigation of that firm.²

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Proactive Enforcement/Cooperation. Second, Director Grewal highlighted the Division’s commitment to “address[ing] emerging risks before they cause harm to investors,” and noted, at the outset, some of the Division’s “forward-looking enforcement initiative[s],” such as (i) an action against parties to a proposed SPAC merger *before* consummation of the merger, thereby “protect[ing] the SPAC’s investors from potential harm,”³ and (ii) a number of actions against firms that had failed to timely file their Client or Customer Relationship Summaries (known as “Forms CRS”), which are intended “to help retail investors better understand the nature of their relationships with financial firms and individual professions” and thereby “prevent future investor harm.”⁴

Director Grewal then stressed firms’ “key role” in “spotting and addressing emerging risks” through their cooperation with the Division’s investigations. With respect to cooperation, Director Grewal clarified that, in his view, cooperation deserving of credit “is not the mere absence of obstruction,” *i.e.*, complying with the “standard steps” of an investigation, “self-reporting” a violation only when it is about to otherwise be publicly announced, or conducting a “purportedly independent investigation” resulting in a presentation to the staff that amounts to an “advocacy piece.” He identified key written guidance on the kind of cooperation that *can* earn cooperation credit (including the *Seaboard Report*, the SEC’s Policy Statement Concerning Cooperation by Individuals, and the Enforcement Manual), and, by way of example, a recent order explaining the grounds for its decision to impose a reduced penalty against BMW as a result of its substantial cooperation during the pandemic.⁵ Director Grewal also identified key factors that are relevant to determining whether cooperation may be appropriate — namely, “whether the would-be cooperator took significant, tangible steps that enhanced the quality of [the SEC’s] investigation, allowed [the SEC] to conserve resources and bring charges more quickly, or helped [the SEC] to identify additional conduct or other violators that contributed to the wrongdoing.” Director Grewal counseled against efforts to appeal an Enforcement staff determination that cooperation credit was not warranted, noting that he would “generally defer to their expertise and judgment.”

Monetary Penalties. Finally, Director Grewal discussed the Commission’s tools for enforcement, including monetary penalties. He stressed the importance of tailoring penalties to “serve two interlocking purposes: punishment of the wrongdoer and deterrence of future misconduct, both by the penalized party and by others in the market.” With respect to deterrence, Director Grewal stressed the need to “design penalties that actually deter and reduce violations, and are not seen as an acceptable cost of doing business.” In that vein, Director Grewal explained that “more significant penalties” may be appropriate where previously imposed penalties have not been adequate “to achieve the intended deterrent effect.” This, he emphasized, applies not only to recidivists, but also to first-time offenders that commit violations “for which the SEC has previously and publicly charged other actors in their industry.” Director Grewal thus warned that, “while penalties levied in the past are certainly a relevant data point,” firms “should not expect comparable cases to be the beginning and end of [the Division’s] analysis.”

KEY TAKEAWAYS

Director Grewal's speech makes plain that the Division is committed to a robust enforcement program and expects regulated and other entities to be active participants in preventing misconduct, including by refraining from testing the boundaries of permissible conduct and considering, *ex ante*, how emerging technologies may create particular compliance risks that need to be mitigated. Director Grewal's reference to a recent action regarding the failure to preserve business-related text messages indicates that the Division is particularly focused on recordkeeping as an area of regulation that technological advances in communication have left vulnerable to violation.

Regarding cooperation, Director Grewal reiterated the continuing validity of longstanding cooperation guidance such as the *Seaboard Report*. Director Grewal also underscored the line between mere compliance with investigatory obligations and substantial assistance warranting cooperation credit, and suggested that regulated and other entities can expect a rigorous review of requests for cooperation credit to determine whether they have truly helped further the staff's investigation or helped conserve the Commission's resources. Director Grewal's emphasis on deference to the staff's cooperation determinations also underscores the importance of building a clear record of cooperation efforts from the earliest stages of an investigation.

Perhaps most significantly, the speech discusses the importance of monetary penalties to promoting both specific and general deterrence, and highlights the Division's position that comparable conduct will not necessarily result in comparable penalties where historic penalties have not, in the Division's view, achieved adequate deterrence. To that end, Director Grewal's speech warns that not only can a recidivist expect more substantial penalties for successive, albeit similar, violations, but so too can first-time offenders where they engage in conduct for which the Commission has already brought enforcement actions against others in their industries. Regulated and other entities should be aware of the difficulty of predicting the potential penalties for misconduct, and should stay abreast of the Division's enforcement priorities and actions in their industries.

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ENDNOTES

- ¹ Director Grewal's remarks are available at <https://www.sec.gov/news/speech/grewal-qli-broker-dealer-regulation-and-enforcement-100621>.
- ² See *In the Matter of Jonestrading Institutional Services LLC*, (Sept. 23, 2020), File No. 3-20050, available at <http://www.sec.gov/litigation/admin/2020/34-89975.pdf>. Relatedly, in recent weeks, the Enforcement Division has made inquiries of numerous broker-dealers regarding their compliance with recordkeeping requirements in connection with employees' use of personal devices for business communications.
- ³ See Press Release 2021-124, SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination (July 13, 2021), available at <https://www.sec.gov/news/press-release/2021-124>.
- ⁴ See Press Release 2021-139, SEC Charges 27 Financial Firms for Form CRS Filing and Delivery Failures (July 26, 2021), available at <https://www.sec.gov/news/press-release/2021-139>.
- ⁵ See *In the Matter of Bayerische Motoren Werke Aktiengesellschaft, et al.*, File No. 3-20060 (Sept. 24, 2020), available at <https://www.sec.gov/litigation/admin/2020/33-10850.pdf>.

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