CORNERSTONE RESEARCH

Economic and Financial Consulting and Expert Testimony

# SEC Enforcement Activity: Public Companies and Subsidiaries

**Midyear FY 2019 Update**

**ANALYSIS AND TRENDS**

Share Class Selection Disclosure Initiative
Filings
Allegations
Enforcement Venue
Industry
Settlements

NYU Pollack Center for Law & Business

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# Executive Summary

SEC enforcement activity remained at near-record levels in the first half of FY 2019, continuing a resurgence in activity that began in 2H FY 2018. The SEC filed 52 new actions against public companies and subsidiaries in 1H FY 2019—with nearly half of these new actions stemming from self-reporting related to the SEC's Share Class Selection Disclosure Initiative (Share Class Initiative).

Findings on public company and subsidiary defendants are based on data from the Securities Enforcement Empirical Database (SEED), a collaboration between the NYU Pollack Center for Law & Business and Cornerstone Research. SEED data cover FY 2010 through the present.[1]

## Featured Analysis

- The SEC's Share Class Initiative drove enforcement activity against public companies and subsidiaries in 1H FY 2019, with almost 50 percent of new actions filed pursuant to this initiative. (page 2)

## Filings

- The SEC initiated 52 enforcement actions against public companies and subsidiaries in 1H FY 2019, the third-most in any half-year period tracked by SEED. (page 3)

## Allegations

- Driven by self-reporting as part of the Share Class Initiative, more than half (52 percent) of public company and subsidiary actions in 1H FY 2019 involved Investment Advisor/Investment Company allegations, by far the highest for that category in any half-year tracked by SEED. (page 4)

## Enforcement Venue

- Every public company and subsidiary action was filed as an administrative proceeding during 1H FY 2019, the only time all actions were filed as administrative proceedings in any half-year tracked by SEED. (page 5)

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*Compared to the same period in FY 2018, the number of SEC actions is up substantially in 1H FY 2019, with all new actions filed as administrative proceedings. The impact of the Share Class Initiative has been notable—we saw a record number of actions with Investment Advisor/Investment Company allegations as well as lower-than-average monetary settlements.*

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## Industry

- Public company and subsidiary actions targeted the Finance, Insurance, and Real Estate industry most frequently (67 percent of actions in 1H FY 2019). This was the second-highest percentage for that sector in a half-year tracked by SEED. (page 6)

## Settlements

- In 1H FY 2019, 88 percent of public company and subsidiary defendants cooperated with the SEC, the highest percentage in any half-year tracked by SEED. (page 7)
- Monetary settlements in public company and subsidiary actions totaled $742 million in 1H FY 2019. (page 8)

# Featured Analysis: Share Class Selection Disclosure Initiative

In February 2018, the SEC announced the Share Class Initiative as part of its focus on "Main Street investors."[2] Because actions under this initiative were a large percentage of enforcement actions in 1H FY 2019, they impact many of the trends discussed in this report.

- The Share Class Initiative relates to investment advisors failing "to make required disclosures relating to [their] selection of mutual fund share classes that paid the adviser . . . or its related entities or individuals a fee pursuant to Rule 12b-1" and "is intended to identify and promptly remedy potential widespread violations of this nature."[3]
- Under the Share Class Initiative, the SEC Division of Enforcement "will recommend that the [SEC] accept favorable settlement terms for investment advisers that self-report . . . possible securities law violations relating to their failure to make necessary disclosures concerning mutual fund share class selection."[4]
- Investment advisors had to self-report by June 12, 2018, to be eligible for the Share Class Initiative.[5]
- On March 11, 2019, the SEC filed settled actions against a total of 79 investment advisors as part of the Share Class Initiative. The SEC may still file additional actions under this initiative.[6]
- All actions filed under the Share Class Initiative had Investment Advisor/Investment Company allegations.
- Of the total actions announced on March 11, 2019, 25 were filed against 27 public companies and subsidiaries.[7]
- These 25 actions against public companies and subsidiaries were all filed as administrative proceedings and noted self-reporting. These characteristics differ from prior periods tracked by SEED.
- Average monetary settlements of $3 million for these actions were also lower than average, driven in part by the SEC's recommendation to impose no civil monetary penalties for "eligible advisers" as part of the initiative.[8] The monetary settlements imposed in these actions totaled $75 million.
- As noted in Figure 1, many of the characteristics of the other 27 actions filed in 1H FY 2019 were generally similar to past trends.

Figure 1: Key Trends in Public Company and Subsidiary Actions
FY 2010–1H FY 2019

(Dollars in millions)

| | FY 2010–FY 2018 *Average* | 1H FY 2019 *Share Class Initiative* | 1H FY 2019 *All Other Actions* | **1H FY 2019 *Total*** |
|---|---|---|---|---|
| New Actions (Half-Year Average) | 30 | 25 | 27 | **52** |
| Investment Advisor/Investment Company Allegations | 12% | 100% | 7% | **52%** |
| Actions Filed as Administrative Proceedings | 68% | 100% | 100% | **100%** |
| Defendants with Settlements Noting Self-Reporting | 13% | 100% | 15% | **53%** |
| Defendants with Monetary Settlements Imposed | 85% | 100% | 88% | **93%** |
| Average Monetary Settlements Imposed by the SEC | $29 | $3 | $26 | **$15** |
| Median Monetary Settlements Imposed by the SEC | $4 | $1 | $7 | **$3** |

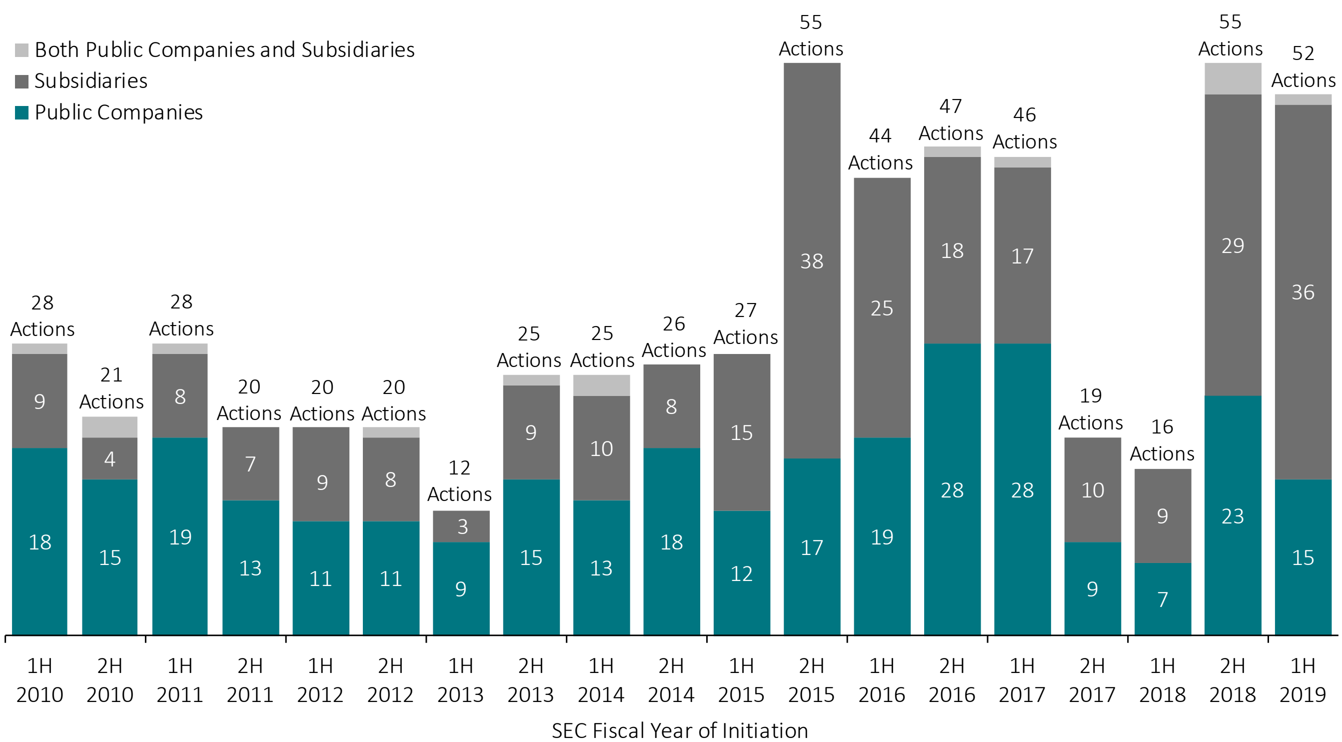
# Number of Filings

- The SEC filed 52 new enforcement actions against public companies and subsidiaries in 1H FY 2019, a 5 percent decrease from 2H FY 2018, but a 225 percent increase from 1H FY 2018.
- The SEC discontinued non-emergency enforcement operations on December 27, 2018, due to the federal government shutdown and recommenced normal operations on January 26, 2019.[9] One public company and subsidiary action was filed during the shutdown, and three actions were filed on January 29, 2019, three days after normal operations recommenced.
- The number of new actions continued to rebound from the decline seen in 2H FY 2017 and 1H FY 2018, despite the government shutdown. The 52 actions in 1H FY 2019 were the third-most for any half-year in SEED.
- Driven by 25 actions under the Share Class Initiative, a record 30 new actions were filed in March 2019, the largest monthly total in the fiscal years covered by SEED.
- The Share Class Initiative accounted for almost half of the actions filed against public companies and subsidiaries in 1H FY 2019.
- A record 71 percent of new actions against public companies and subsidiaries in 1H FY 2019 had a subsidiary as a defendant, compared to an average of 44 percent from FY 2010 to FY 2018. Again, the Share Class Initiative accounted for the majority (24 of 37) of these actions involving subsidiaries.

**25 of 52**

Number of public company and subsidiary actions brought in 1H FY 2019 related to the Share Class Initiative.

Figure 2: Public Company and Subsidiary Actions
FY 2010–1H FY 2019




Source: Securities Enforcement Empirical Database (SEED)
Note: Relief defendants are not considered.

# Allegations

- For the first time in the fiscal years covered by SEED, Investment Advisor/Investment Company was the most common allegation type in 1H FY 2019 (27 actions).
- Of the 27 Investment Advisor/Investment Company actions, 25 were actions filed in March 2019 related to the Share Class Initiative. The 27 actions represented the largest number of Investment Advisor/Investment Company actions in any fiscal year covered by SEED.
- In 1H FY 2019, the 27 Investment Advisor/Investment Company actions were more than double that of Issuer Reporting and Disclosure actions, which has been the most frequent allegation type in seven of the nine fiscal years tracked by SEED.
- However, the number of Issuer Reporting and Disclosure actions (11) filed in 1H FY 2019 remained in line with the average over prior half-years (10 actions).
- Broker Dealer and Investment Advisor/Investment Company allegations combined for nearly two-thirds of 1H FY 2019 actions.
- Foreign Corrupt Practices Act allegations continued to remain below their historical average of 19 percent, accounting for 12 percent of 1H FY 2019 actions.

52%

Percentage of 1H FY 2019 actions involving Investment Advisor/Investment Company allegations.

Figure 3: Heat Map of Allegations against Public Companies and Subsidiaries
FY 2010–1H FY 2019

| | SEC Fiscal Year of Initiation | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Allegation Type | Average 2010–2018 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 1H 2019 |
| Investment Advisor/ Investment Company | 12% | 6% | 4% | 10% | 14% | 10% | 7% | 19% | 18% | 18% | 52% |
| Issuer Reporting and Disclosure | 36% | 41% | 33% | 30% | 49% | 49% | 22% | 26% | 40% | 34% | 21% |
| Broker Dealer | 12% | 10% | 13% | 10% | 0% | 14% | 13% | 12% | 12% | 27% | 13% |
| Foreign Corrupt Practices Act | 19% | 24% | 35% | 25% | 14% | 14% | 12% | 20% | 15% | 13% | 12% |
| Securities Offering | 5% | 6% | 4% | 8% | 19% | 4% | 0% | 7% | 0% | 1% | 2% |
| Public Finance Abuse | 9% | 4% | 10% | 10% | 0% | 4% | 39% | 12% | 0% | 1% | 0% |
| Market Manipulation | 2% | 0% | 0% | 5% | 5% | 2% | 1% | 0% | 6% | 1% | 0% |
| Other | 4% | 8% | 0% | 3% | 0% | 4% | 5% | 4% | 8% | 4% | 0% |
| Number of Actions | 59 | 49 | 48 | 40 | 37 | 51 | 82 | 91 | 65 | 71 | 52 |

Source: Securities Enforcement Empirical Database (SEED)

Note: Relief defendants are not considered. Percentages may not add to 100 percent due to rounding. "Public Finance Abuse" includes actions that were categorized by the SEC as "Municipal Securities and Public Pensions" prior to FY 2016. "Other" includes actions categorized by the SEC as "Other" or "Transfer Agent."

# Enforcement Venue

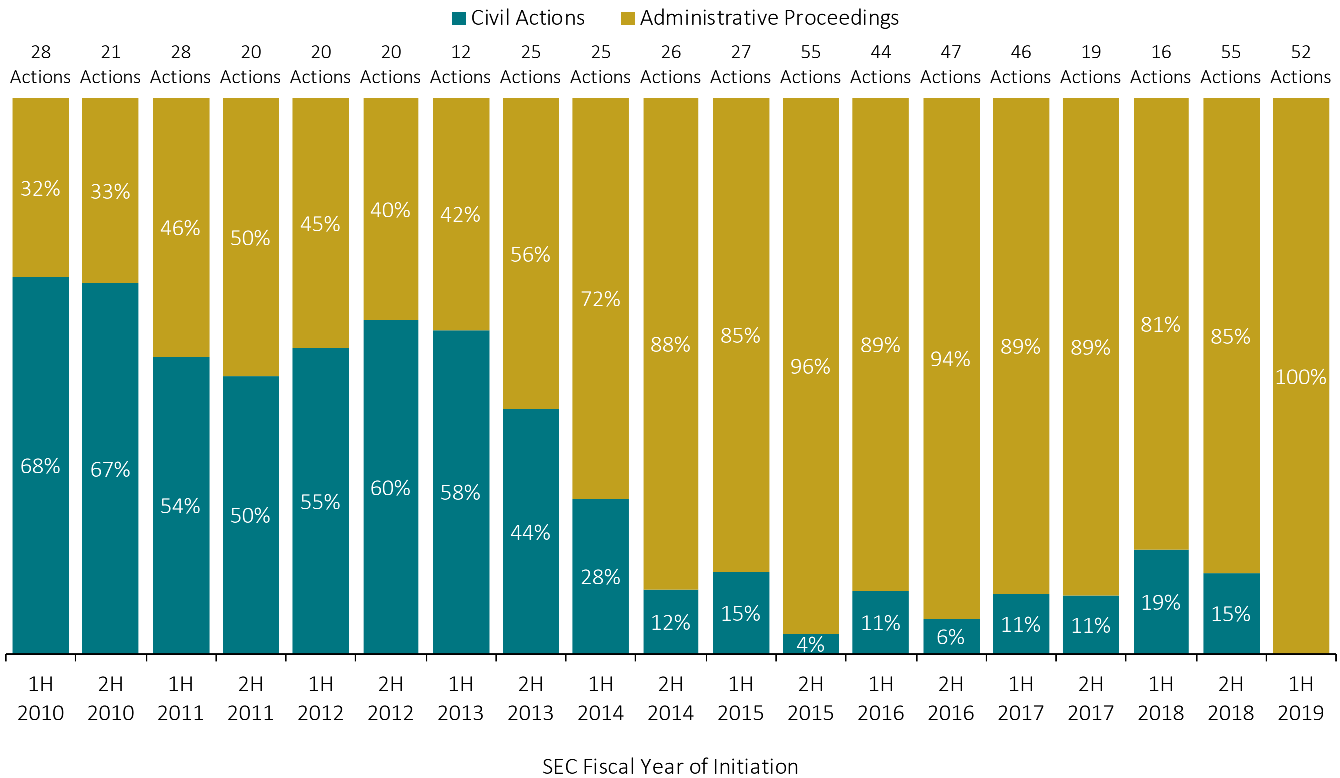
- Following the U.S. Supreme Court ruling in *Lucia v. SEC* in June 2018,[10] the SEC has continued to face scrutiny of its administrative forum. A new lawsuit by Lucia, alleging that the removal process for the SEC's administrative law judges is unconstitutional, was filed in November 2018.[11]
- Nonetheless, in 1H FY 2019, the SEC brought all public company and subsidiary actions as administrative proceedings, the only time this has happened in any half-year covered by SEED.
- Since FY 2010, Investment Advisor/Investment Company actions have always been brought as administrative proceedings. This trend continued with all 27 Investment Advisor/Investment Company actions filed in 1H FY 2019.

**100%**

**Percentage of public company and subsidiary actions filed as administrative proceedings in 1H FY 2019.**

- All 11 Issuer Reporting and Disclosure actions were brought as administrative proceedings in 1H FY 2019, the first half-year period covered by SEED in which this occurred. For comparison, the percentage of Issuer Reporting and Disclosure actions brought as administrative proceedings averaged 58 percent during FY 2010–FY 2018.

Figure 4: Public Company and Subsidiary Actions by Enforcement Venue
FY 2010–1H FY 2019




Source: Securities Enforcement Empirical Database (SEED)
Note: Relief defendants are not considered. Percentages may not add to 100 percent due to rounding.

# Industry

SEED classifies public companies and parent companies of subsidiaries by Standard Industrial Classification (SIC) code.

- In 1H FY 2019, actions with public company and subsidiary defendants in the Finance, Insurance, and Real Estate industry accounted for 35 actions, or 67 percent of all actions. The percentage of actions targeting the industry was higher than any fiscal year from FY 2010 to FY 2018.
- More than two-thirds of actions in the Finance, Insurance, and Real Estate industry (23 of the 35) were the result of the SEC's Share Class Initiative.[12]
- The next two most-targeted industries were Manufacturing (six actions) and Services (five actions).
- The SEC's investigation into abusive American Depository Receipts (ADR) pre-release practices led to four actions against Commercial Banks (included in the Finance, Insurance, and Real Estate industry) in 1H FY 2019. Overall, public company and subsidiary actions against Commercial Banks accounted for 38 percent of actions in 1H FY 2019, a greater than 10 percentage point increase over FY 2018.

67%

Percentage of 1H FY 2019 actions against public companies and subsidiaries in Finance, Insurance, and Real Estate.

Figure 5: Heat Map of Industries of Public Companies and Subsidiaries
FY 2010–1H FY 2019

| SIC Industry Division | SEC Fiscal Year of Initiation | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Average 2010–2018 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 1H 2019 |
| Finance, Insurance, and Real Estate | 48% | 37% | 33% | 53% | 46% | 53% | 63% | 58% | 41% | 51% | 67% |
| Manufacturing | 27% | 37% | 38% | 33% | 27% | 20% | 17% | 19% | 35% | 20% | 12% |
| Services | 10% | 20% | 15% | 8% | 5% | 12% | 9% | 3% | 8% | 11% | 10% |
| Nonclassifiable | 4% | 0% | 0% | 5% | 8% | 4% | 1% | 8% | 2% | 10% | 4% |
| Transportation, Communications, Electric, Gas, and Sanitary Service | 2% | 0% | 2% | 3% | 5% | 0% | 0% | 4% | 6% | 0% | 4% |
| Mining | 4% | 2% | 8% | 0% | 8% | 4% | 4% | 3% | 5% | 4% | 2% |
| Retail Trade | 1% | 0% | 4% | 0% | 0% | 2% | 2% | 1% | 0% | 1% | 2% |
| Other | 3% | 4% | 0% | 0% | 0% | 6% | 4% | 3% | 5% | 3% | 0% |
| Number of Actions | 59 | 49 | 48 | 40 | 37 | 51 | 82 | 91 | 66 | 71 | 52 |

| Legend | 0% | 1–10% | 11–20% | 21–50% | 51–100% |
|---|---|---|---|---|---|

Source: Securities Enforcement Empirical Database (SEED)

Note: Relief defendants are not considered. SIC industry divisions are as of the SEC enforcement action initiation date, or otherwise are as of the latest available date within the five-year period preceding the initiation. Subsidiaries are categorized according to the SIC industry division of their public parent company. "Other" contains all SIC industry divisions that did not have any actions filed in 1H FY 2019: Construction; Wholesale Trade; and Agriculture, Forestry, and Fishing. Percentages may not add to 100 percent due to rounding.

# Settlements

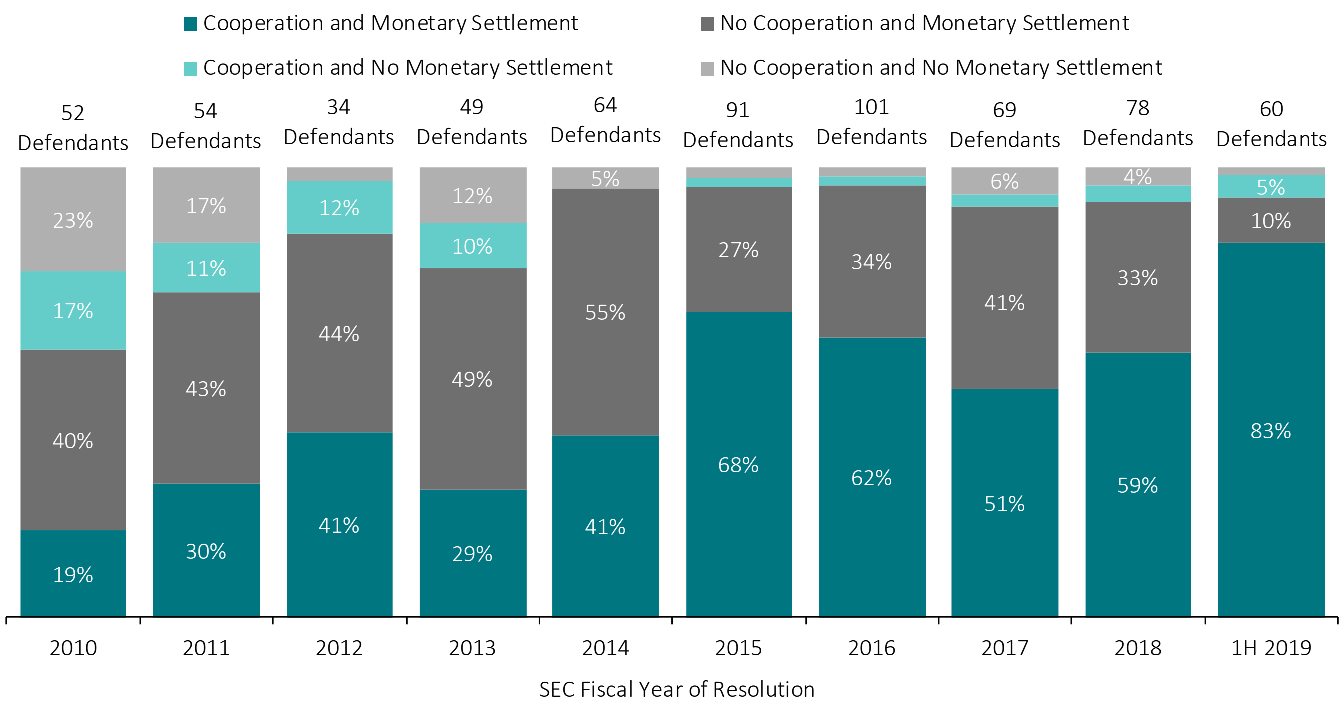
The SEC considers four factors when negotiating a settlement with a cooperating defendant: "self-policing, self-reporting, remediation, and cooperation."[13] SEED measures the latter three factors as an indication of whether a public company or subsidiary defendant cooperated with the SEC based on whether the SEC acknowledges voluntary reporting or explicitly mentions "remediation" or "cooperation" by the defendant in the settlement announcement (collectively referred to in this report as "cooperation" or "cooperated").

83%

Percentage of defendants with a monetary settlement imposed by the SEC and cooperation noted in 1H FY 2019.

- In 1H FY 2019, 88 percent of defendants noted cooperation with the SEC, a record-high percentage (due to the Share Class Initiative) relative to the FY 2010–FY 2018 average of 51 percent.
- All of the 27 defendants involved in the Share Class Initiative cooperated with the SEC by self-reporting. However, the percentage of defendants not involved in the Share Class Initiative that cooperated with the SEC in 1H FY 2019 was also high at 79 percent compared to the FY 2010–FY 2018 average of 51 percent.
- In 1H FY 2019, 53 percent of public company and subsidiary defendants self-reported. This was a substantial increase from the FY 2010–FY 2018 average of 13 percent. However, this trend was again driven by the Share Class Initiative. Excluding defendants in the Share Class Initiative (which all self-reported), 15 percent of the remaining defendants self-reported in 1H FY 2019.

Figure 6: Public Company and Subsidiary Defendants—Monetary Settlements and Cooperation Noted
FY 2010–1H FY 2019




Source: Securities Enforcement Empirical Database (SEED)

Note: Settlements are counted at the defendant level. Relief defendants, individual defendants, and non-public company/non-subsidiary defendants are not considered. Defendants that did not settle, either because the action is ongoing or because the action was resolved through trial, are excluded. A defendant with cooperation indicates the defendant cooperated with the SEC prior to the non-trial resolution of that action. The words "cooperation" or "remediation" must be mentioned in the document detailing the non-trial resolution, or the SEC must acknowledge voluntary reporting by the defendant. Percentages may not add to 100 percent due to rounding.

SEED includes data for monetary settlements imposed by the SEC on all types of defendants in public company and subsidiary actions: public companies, subsidiaries, individuals, and other entities.[14]

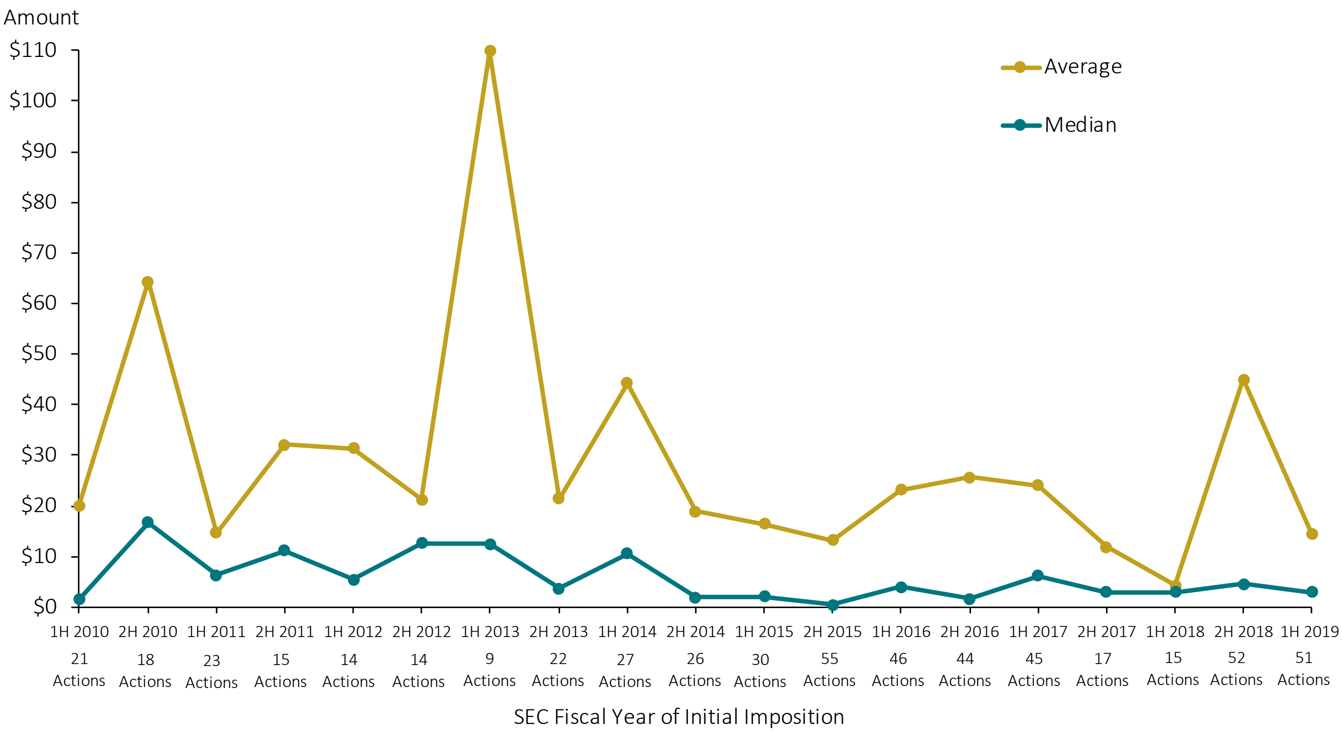
- Monetary settlements in public company and subsidiary actions totaled $742 million in 1H FY 2019, a 24 percent decrease from the half-year average over the prior three fiscal years.
- The average monetary settlement decreased from $45 million in 2H FY 2018 to $15 million in 1H FY 2019.
- In 1H FY 2019, the median settlement, $3 million, was 21 percent of the average during this period, generally consistent with historical trends.
- None of the 25 monetary settlements for Share Class Initiative actions included civil penalties, consistent with the SEC's stated incentive to recommend no civil penalties for "self-reported conduct that meets the requirements of the [initiative]."[15] For comparison, 88 percent of the other 26 monetary settlements in 1H FY 2019 included civil penalties.
- The majority of actions with monetary settlements in 1H FY 2019 were related to Investment Advisor/Investment Company allegations. However, these actions had an average monetary settlement amount of $3 million, substantially lower than the FY 2010–FY 2018 average for Investment Advisor/Investment Company allegations of $25 million.

**11%**

**Percentage of 1H FY 2019 total monetary settlement amount stemming from Investment Advisor/Investment Company actions.**

Figure 7: Monetary Settlements Imposed in Public Company and Subsidiary Actions FY 2010–1H FY 2019

(Dollars in millions)




Source: Securities Enforcement Empirical Database (SEED)

Note: Relief defendants are not considered. For actions where monetary settlements are not imposed on all defendants in the same fiscal year, actions are classified by the first fiscal year in which a monetary settlement was imposed. There are 10 actions for which not all defendants have settled. Total monetary settlements for those actions only include monetary settlements through March 31, 2019.

# Research Sample

- The Securities Enforcement Empirical Database (SEED) is a collaboration between the NYU Pollack Center for Law & Business and Cornerstone Research. The analysis in this report is based on data identified by NYU and Cornerstone Research as of April 30, 2019 (http://seed.law.nyu.edu).
- SEED identifies 586 SEC enforcement actions initiated against 512 public companies and subsidiaries between October 1, 2009, and March 31, 2019.
- SEED identifies 256 individuals that are named defendants in the 586 actions initiated against public companies and subsidiaries between October 1, 2009, and March 31, 2019.
- The sample used for the majority of this report is referred to as "actions initiated against public companies and subsidiaries" and includes only those enforcement actions with public companies or their subsidiaries listed explicitly as defendants. The sample does not include cases where the allegations relate exclusively to delinquent filings.
- Public companies are defined as those that traded on a major U.S. exchange as identified by the Center for Research in Security Prices (CRSP) at the time the enforcement action was initiated, or otherwise within the five-year period preceding the initiation. Thus, public companies that traded over-the-counter or only on major non-U.S. exchanges are excluded, as are companies that did not become publicly traded until after the enforcement action was initiated.

*SEED provides easily searchable and verified data on SEC enforcement actions to researchers, counsel, and corporations.*

- Subsidiaries are defined as those entities that had a publicly traded parent company at the time the enforcement action was initiated, or otherwise within the five-year period preceding the initiation. The public parent companies of subsidiaries were identified as those cited in the enforcement action document initiating proceedings when available, or those identified through SEC filings if no parent company was mentioned in the initial enforcement action document.
- Individuals are defined as individuals who are named as defendants in actions against public companies or their subsidiaries.

# Endnotes

[1] SEC fiscal years begin on October 1 of the prior year and end on September 30. SEC fiscal year 2010 through the first half of fiscal year 2019 spans October 1, 2009, to March 31, 2019.

[2] "Share Class Selection Disclosure Initiative," U.S. Securities and Exchange Commission, https://www.sec.gov/enforce/announcement/scsd-initiative; see also "Agency Financial Report: Fiscal Year 2018," U.S. Securities and Exchange Commission, November 15, 2018, pp. 18–19, https://www.sec.gov/files/sec-2018-agency-financial-report.pdf.

[3] "Share Class Selection Disclosure Initiative," U.S. Securities and Exchange Commission, https://www.sec.gov/enforce/announcement/scsd-initiative.

[4] "Share Class Selection Disclosure Initiative," U.S. Securities and Exchange Commission, https://www.sec.gov/enforce/announcement/scsd-initiative.

[5] "Share Class Selection Disclosure Initiative," U.S. Securities and Exchange Commission, https://www.sec.gov/enforce/announcement/scsd-initiative.

[6] "The SEC staff is continuing to evaluate self-reports that were received from investment advisers prior to the initiative cut-off date." "SEC Share Class Initiative Returning More Than $125 Million to Investors," U.S. Securities and Exchange Commission, March 11, 2019, https://www.sec.gov/news/press-release/2019-28.

[7] "SEC Share Class Initiative Returning More Than $125 Million to Investors," U.S. Securities and Exchange Commission, March 11, 2019, https://www.sec.gov/news/press-release/2019-28.

[8] "Share Class Selection Disclosure Initiative," U.S. Securities and Exchange Commission, https://www.sec.gov/enforce/announcement/scsd-initiative.

[9] "Operations Plan Under a Lapse in Appropriations and Government Shutdown," U.S. Securities and Exchange Commission, December 2018, https://www.sec.gov/files/sec-plan-of-operations-during-lapse-in-appropriations-2018.pdf; "Statement Regarding Recommencement of Normal Operations," U.S. Securities and Exchange Commission, January 26, 2019, https://www.sec.gov/news/public-statement/statement-regarding-recommencement-normal-operations.

[10] *Lucia v. SEC*, 585 U.S. ___ (2018).

[11] *Lucia v. SEC*, Case 3:18-cv-02692-DMS-JLB, Complaint for Declaratory and Injunctive Relief, November 28, 2018.

[12] See, e.g., "SEC Share Class Initiative Returning More Than $125 Million to Investors," U.S. Securities and Exchange Commission, March 11, 2019, https://www.sec.gov/news/press-release/2019-28.

[13] Andrew Ceresney, Director, Division of Enforcement, U.S. Securities and Exchange Commission, "The SEC's Cooperation Program: Reflections on Five Years of Experience" (speech, University of Texas School of Law's Government Enforcement Institute, Dallas, TX, May 13, 2015), https://www.sec.gov/news/speech/sec-cooperation-program.html.

[14] Total monetary settlements include disgorgement, prejudgment interest, civil penalties, and other monetary penalties imposed by the SEC in public company and subsidiary actions. For actions where monetary settlements are not imposed on all defendants in the same fiscal year, actions are classified by the first fiscal year in which a monetary settlement was imposed. There are 10 actions for which not all defendants have settled. Total monetary settlements for those actions only include monetary settlements through March 31, 2019.

[15] "Share Class Selection Disclosure Initiative," U.S. Securities and Exchange Commission, https://www.sec.gov/enforce/announcement/scsd-initiative.

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The authors request that you reference the NYU Pollack Center for Law & Business and Cornerstone Research in any reprint of the information or figures included in this report.

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