RECENT SETTLEMENTS PROVIDE INSIGHT ON THE SEC'S APPROACH TO SELF-REPORTING AND COOPERATION CREDIT IN ENFORCEMENT ACTIONS

Date: 10 October 2023

US Policy and Regulatory Alert

By: Theodore L. Kornobis

INTRODUCTION

A perennial message from the Securities and Exchange Commission (SEC) Division of Enforcement is to extol the benefits of cooperation with enforcement investigations. The link between cooperation and a meaningful benefit is, however, not always apparent. In several speeches, Division of Enforcement Director Gurbir Grewal has emphasized the value of self-reporting potential securities law violations to the SEC, cooperating with follow-on investigations, and taking steps to remediate wrongdoing.[1] Recently, the SEC has issued more settlements that contain specific examples of credited cooperation. These recent cases provide a roadmap on how cooperation and self-reporting can reduce penalties.

INCREASED INSTANCES OF COOPERATION CREDIT IN RECENT SEC SETTLEMENTS

Recently, SEC settlements that note respondents' cooperation are starting to describe with greater detail the types of activity that qualify for credit. The cases have involved respondents in varied industries and cover a broad spectrum of alleged violations. They share commonalities, however, in their emphasis on self-reporting, cooperation, and undertaking remedial measures. The following are some examples, all of which resolved without imposition of a financial penalty:

- On 25 September 2023, the SEC charged a telecommunications and internet service provider with failing to disclose material information about unsupported adjustments made in periodic SEC filings;[2]
- On 7 September 2023, the SEC announced settled charges against a crypto financial product provider for failing to register the offers and sales of its retail crypto-lending product;[3]
- On 3 July 2023, the SEC announced settled charges against a manufacturer of “smart windows” for failing to disclose millions of dollars in product warranty-related liabilities;[4] and
- On 20 June 2023, the SEC settled a matter with a global tool manufacturer alleging the company failed to disclose perquisites and personal benefits that it provided to certain executives.[5]

©2005-2026 K&L Gates LLP. All Rights Reserved.

Similarly, the SEC recently announced several more multimillion dollar settlements as part of its recent wave of cases alleging widespread failures by broker-dealers to maintain and preserve electronic “off-channel” communications, such as in messaging applications. Director Grewal emphasized that self-reporting and cooperation led one respondent's penalty (US$2.5 million) to be much smaller than others (which ranged above US$30 million).

SELF-REPORTING, COOPERATION, AND REMEDIATION ACTIONS

The SEC has not exhaustively articulated the actions it will consider when deciding to award cooperation credit. Nevertheless, these recent settlements provide some guidance for companies to consider.

First, an important driver in whether a penalty is imposed is whether the entity promptly self-reports potential misconduct upon learning it or not. In each of the actions described above that did not impose a penalty, the entity self-reported the conduct to the SEC.

A second factor cited in the orders is the extent to which the entity provides information to the staff as it investigates the matter. Among the actions cited favorably are hiring outside counsel to conduct an independent internal investigation, providing the SEC with facts developed in that internal investigation (including presentations of interim findings and highlighting key documents and witnesses), promptly making witnesses available, providing detailed explanations of factual issues, facilitating testimony of former employees, providing relevant documents without requiring subpoenas, and providing translations of foreign-language materials.

Third, the SEC has highlighted that the entities voluntarily took remedial measures in response to the issues discovered. Such measures have included replacing management and board members, commencing an audit of compliance programs, revising procedures, holding compliance trainings with employees, creating employee guides or toolkits with commonly asked questions regarding the federal securities laws, and voluntarily ceasing the at-issue conduct.

Much of this resembles the type of activity the US Department of Justice cites when providing cooperation credit in criminal and civil investigations.

UNCERTAINTY REMAINS

Despite these attempts to clarify cooperation, other SEC activity confirms that it is sometimes difficult to locate the “credit” that comes from cooperation. For example, in a case involving an unregistered offer and sale of securities, a large financial services firm self-reported the conduct and cooperated, but the settlement included a US$200 million penalty. Some other recent settlements involving self-reporting and cooperation have also involved multimillion dollar penalties. These cases involve some unique facts that may limit their use as guideposts, but the high penalties in the face of self-reporting and cooperation undercut the messaging that the SEC proclaims to be sending with its settlements.

KEY TAKEAWAYS

The decision whether and how to self-report potential violations is one of the most challenging that a company can make, and should be soberly reviewed with counsel. The uncertain outcome from a self-report must be

©2005-2026 K&L Gates LLP. All Rights Reserved.

weighed against the increasing likelihood that the government will discover the violation on its own through an exam, a whistleblower, or other means. Although there is still uncertainty in terms of what credit may be awarded, these recent cases provide some helpful guidance regarding the types of activity that enforcement staff will look to see from companies. Among other things, these cases emphasize the importance of having effective internal reporting functions, promptly conducting a credible and professional internal investigation when there is suspected wrongdoing, and establishing and maintaining a good relationship with the staff when an enforcement investigation begins.

FOOTNOTES

[1] Gurbir S. Grewal, Director, U.S. Sec. & Exch. Comm'n Div. of Enf't, Remarks at Financial Times Cyber Resilience Summit (June 22, 2023); Gurbir S. Grewal, Director, U.S. Sec. & Exch. Comm'n Div. of Enf't, Remarks at Securities Enforcement Forum West 2022 (May 12, 2022); Gurbir S. Grewal, Director, U.S. Sec. & Exch. Comm'n Div. of Enf't, PLI Broker/Dealer Regulation and Enforcement 2021 (Oct. 6, 2021).

[2] *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges GTT Communications for Disclosure Failures (Sept. 25, 2023), https://www.sec.gov/news/press-release/2023-195.

[3] *See* Press Release, U.S. Sec. & Exch. Comm'n, Linus Financial Agrees to Settle SEC Charges of Unregistered Offer and Sale of Securities (Sept. 7, 2023), https://www.sec.gov/news/press-release/2023-171.

[4] *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges “Smart” Window Manufacturer, View Inc., with Failing to Disclose $28 Million Liability (July 3, 2023), https://www.sec.gov/news/press-release/2023-126.

[5] *See In re* Stanley Black & Decker Inc., Exchange Act Release No. 97761, AP File No. 3-21497 (June 20, 2023), https://www.sec.gov/files/litigation/admin/2023/34-97761.pdf.

KEY CONTACTS



THEODORE L. KORNOBIS
PARTNER

WASHINGTON, DC
+1.202.778.9180
TED.KORNOBIS@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2026 K&L Gates LLP. All Rights Reserved.

©2005-2026 K&L Gates LLP. All Rights Reserved.