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SEC Enforcement Director Announces "Aggressive" Policy Shifts, Including Requiring Admissions of Wrongdoing

On October 13, 2021, Gurbir Grewal, the SEC's new Director of Enforcement, announced in a speech that he intends to recommend "aggressive" use of available remedies in enforcement actions, including requiring admissions of wrongdoing in certain cases. [1] Grewal emphasized his intention to use other remedial tools, including officer and director bars, conduct based injunctions, and undertakings. Grewal also explained that, unlike prior Directors of Enforcement, he or the Deputy Director would not participate in "Wells meetings" unless the matters "present novel legal or factual questions, or raise significant programmatic issues." Grewal's "aggressive" approach could have significant implications for market participants. In particular, admitting to a violation of the securities laws in an SEC settlement could lead to significant collateral consequences for the settling entity, including increased risk in parallel private securities class actions. Requiring admissions of wrongdoing in certain SEC settlements could also discourage settlement negotiations in those matters and lead to an uptick in litigated cases. That said, it remains to be seen how the SEC will actually utilize these practices.

Background on "No Admit No Deny" Settlements

Prior to 2012, the SEC "settled virtually all of its cases on a no-admit-no deny basis," in which the enforcement target would agree to the imposition of certain penalties without admitting or denying the alleged conduct.[2] The SEC favored these settlements because they encouraged efficiency. As former SEC Chair Mary Jo White explained: "By settling, the agency is able to eliminate all litigation risk, resolve the case, return money to victims more quickly, and preserve [the SEC's] enforcement resources to redeploy to do other investigations."[3] The policy's detractors, however, argued that requiring admissions of wrongdoing served the public interest by promoting trust in the financial markets and deterring misconduct from other market participants.

The SEC's settlement policy shifted under the Obama Administration. In 2012, the SEC announced that it would require admissions of wrongdoing in cases involving parallel criminal conduct or non-prosecution or deferred prosecution agreements that included admissions of criminal conduct.[4] In 2013, then-Chair White announced that the SEC would begin requiring admissions in additional cases, including those involving large numbers of investors, egregious conduct, and significant market

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1 Gurbir Grewal, Director, Division of Enforcement, Remarks at SEC Speaks 2021 (Oct. 13, 2021), https://www.sec.gov/news/speech/grewal-sec-speaks-101321.

2 Mary Jo White, *Deploying the Full Enforcement Arsenal*, Council of Institutional Investors Fall Conference in Chicago, IL (Sept. 26, 2013), https://www.sec.gov/news/speech/spch092613mjw.

3 *Id.*

4 Robert Khuzami, Director of the SEC's Division of Enforcement, Public Statement (Jan. 7, 2012), https://www.sec.gov/news/public-statement/2012-spch010712rskhtm.

risk.[5] She explained that this approach gave the SEC a "powerful tool to use in appropriate cases, which has strengthened the program by increasing accountability."[6] In practice, although the SEC did begin requiring admissions in settlements, such settlements remained the exception; between 2014 and 2016, only 2% of SEC settlements involved admissions of wrongdoing.[7]

Under the Trump Administration, SEC Chair Jay Clayton, and Co-Director of Enforcement Steven Peikin, shifted the SEC away from the practice of requiring admissions, citing the agency's interest in "avoiding drawn-out proceedings that strain the resources of the Enforcement Division staff and lengthen the time it would take for resolution, including for investors to receive restitution."[8] Earlier this year, researchers from NYU reviewed settled enforcement actions filed during Chair Clayton's tenure and concluded that "it appears that the SEC has indeed, albeit slowly, shifted away from the more aggressive prosecutorial stance instituted under Chair White."[9]

Director Grewal's Statements Regarding Enforcement Policy Shifts

On October 13, 2021, Director Grewal spoke at the Practicing Law Institute's SEC Speaks conference about "the decline in trust in our financial markets," and announced policy shifts in the Division of Enforcement.

First, he indicated a return to the policy of seeking admissions in certain settlements. He explained:

> When it comes to accountability, few things rival the magnitude of wrongdoers admitting that they broke the law, and so, in an era of diminished trust, we will, in appropriate circumstances, be requiring admissions in cases where heightened accountability and acceptance of responsibility are in the public interest. Admissions, given their attention-getting nature, also serve as a clarion call to other market participants to stamp out and self-report the misconduct to the extent it is occurring in their firm.

Deputy Director of Enforcement Sanjay Wadhwa later elaborated that the agency would seek admissions "in cases involving egregious misconduct" and where a large number of investors were harmed or where defendants obstructed the SEC's investigation.[10]

Second, Director Grewal indicated that the agency would increasingly seek to impose officer and director bars in cases involving scienter-based violations, including against individuals who are not currently officers or directors of public companies. He explained: "if there is egregious conduct and a chance the person could have the opportunity to serve at the highest levels of a public company, we may well seek an officer and director bar to keep that person from being in a position to harm investors again."

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5 Mary Jo White, SEC Chair, *Deploying the Full Enforcement Arsenal*, Council of Institutional Investors Fall Conference in Chicago, IL (Sept. 26, 2013), https://www.sec.gov/news/speech/spch092613mjw.

6 Mary Jo White, SEC Chair, *A New Model for SEC Enforcement: Producing Bold and Unrelenting Results*, New York University School of Law Program on Corporate Compliance and Enforcement, Speech at the New York University School of Law Pollack Center for Law and Business (Nov. 18, 2016), https://www.sec.gov/news/speech/chair-white-speech-new-york-university-111816.html.

7 David Rosenfeld, *Admissions in SEC Enforcement Cases: The Revolution That Wasn't*, 103 Iowa L. Rev. 113 (2017), https://ilr.law.uiowa.edu/print/volume-103-issue-1/admissions-in-sec-enforcement-cases-the-revolution-that-wasnt/.

8 Hearing Before the Committee on Banking, Housing, and Urban Affairs on the Nomination of Jay Clayton, 115th Cong. S. Hrg. 115-9 (Mar. 23, 2017), https://www.congress.gov/115/chrg/CHRG-115shrg24998/CHRG-115shrg24998.htm.

9 Giovanni Patti & Peter Robau, *Admissions of Guilt to the SEC under Chair Jay Clayton*, Program on Corporate Compliance and Enforcement at New York University School of Law (Jan. 19, 2021), https://wp.nyu.edu/compliance_enforcement/2021/01/19/admissions-of-guilt-to-the-sec-under-chair-jay-clayton/.

10 Dave Michaels, *Wall Street, Companies May Have to Give Up More to Settle With SEC*, Wall St. J. (Oct. 12, 2021), https://www.wsj.com/articles/sec-to-seek-admissions-of-wrongdoing-in-some-enforcement-actions-11634139229.

Third, Director Grewal reiterated the importance of other agency "tools" and "remedies," including conduct based injunctions, and undertakings by the enforcement target, such as an agreement to hire an independent compliance consultant.

Fourth, Director Grewal discussed potential changes to make the Wells process "more streamlined and efficient." A Wells notice is a formal letter informing individuals or companies that the SEC is planning to bring an enforcement action against them. Traditionally, the director of enforcement or his or her deputy has afforded defense counsel an opportunity to meet with them to try and persuade the SEC not to pursue claims or to settle to lesser claims. Grewal indicated that he and Deputy Director Wadhwa would not attend all Wells meetings—particularly those that do not "present novel legal and factual questions, or raise significant programmatic issues"—and that investigation targets should not "expect a meeting in each and every case." He further explained that the agency would scrutinize Wells submissions for technical compliance with the rules, and that violations—such as attempts to limit their use or admissibility, or to include a settlement offer—could lead to their rejection.

Implications

As Director Grewal himself said, these are "aggressive" policy shifts that could have significant implications for companies and individuals enmeshed in SEC investigations. Chief among the collateral consequences, in particular for public companies, is the risk that any admission of wrongdoing in an SEC settlement could be used to bolster a private civil class action arising out of the same events. The exposure for public companies in private securities class actions are often significant, and plaintiffs' lawyers could cite public admissions of securities violations in their pleadings, and leverage admissions in motion practice, settlement negotiations, and trial. Admitting wrongdoing may also lead to reputational damage and negative business consequences, and, in some circumstances, could trigger "conduct" exclusions in D&O insurance policies that bar coverage for fraudulent conduct or intentional violations of the law. And, in particular for individuals, admitting wrongdoing could have dire consequences in parallel criminal proceedings.

Accordingly, some companies and individuals may consider litigating against the SEC rather than admitting to wrongdoing in an SEC settlement. Expressing a willingness to litigate if necessary will likely provide an important negotiation tactic, as the SEC has limited resources and will have to carefully select the enforcement actions worth taking to trial. Additionally, enforcement targets who do admit to certain wrongdoing in an SEC settlement will want to carefully negotiate the language used in the settlement document to try and mitigate the extent of the collateral consequences. For example, admissions to non-scienter based claims will be less impactful on private securities class action than admitting to engaging in a violation of Rule 10b-5 or Section 17(a)(1). Carefully crafted language may also ameliorate the impact of the admissions on parallel litigation or perhaps avoid triggering an exclusion under a D&O policy.

All that said, Grewal's intent to pursue admissions in cases involving large numbers of investors and egregious misconduct echo the policies under the Obama Administration, which led to only a modest uptick in settlements involving admissions. It remains to be seen how broadly the Enforcement Division intends to seek admissions in enforcement actions.

With respect to Director Grewal's comments about the Wells process, by not having the Director or Deputy Director regularly participate in Wells meetings there is an increased risk that similar matters reach inconsistent results which is not good from a policy or fairness standpoint.

Nonetheless, it is too early to say with certainty the practical significance of Director Grewal's comments about the Wells process. On the one hand, Grewal's comments could be interpreted as a signal that this Enforcement Division will recommend to the Commission that claims be brought whenever a Wells notice is issued unless there are "novel issues" or "programmatic issues." Similarly, Grewal's comments could be interpreted to suggest that Wells meetings will not result in settlements on terms more favorable than those set forth in a Wells notice except in truly unique circumstances. Less Director and Deputy Director participation in Wells meetings also signals increased deference to the staff, who have traditionally been viewed as more aggressive in pursuing enforcement actions than the Director and Deputy Director. On the other hand, in practice, Grewal could empower the Associate Directors and Unit Chiefs that will conduct Wells meetings in his absence to reach compromises with defense counsel as has often been the result of Wells meetings in the past.

In sum, these are aggressive policy shifts, but it remains to be seen how aggressively the Enforcement Division will pursue them in practice.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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