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Crypto and ESG Both on the Radar: SEC Outlines a Strong Enforcement Approach

U.S. Securities and Exchange Commission (SEC) Chair Gary Gensler outlined a vigorous enforcement approach in his keynote remarks at the annual Securities Enforcement Forum. In a clear reference to cryptocurrencies and tokens, he indicated that the agency is focused on the economic realities of a given product regardless of the industry, sector, technology, or name attached thereto. If money is being raised from the public, the commissioner's message was that all participants must work within the current investor protection regulations, and it is not acceptable to seek to arbitrage the rules. Division of Enforcement Director Gurbir Grewal, speaking on a panel with several former SEC enforcement directors, also highlighted themes of accountability and the responsibility of gatekeepers—including attorneys, accountants, and other trusted advisors—to not only advise their clients but to promote compliance and protect the public.

Overall, the SEC signaled a mandate to take on high-impact cases, to include novel and complex cases, whether in the special purpose acquisition company (SPAC), cyber, or crypto space, or elsewhere. In this spirit, the SEC will be looking to change behavior and send a message to the rest of the market through its enforcement. Chair Gensler acknowledged that some would call this "regulation by enforcement," but he just calls it "enforcement."

### **"Walks Like A Duck" Enforcement Principles**

Illustrating his vision of enforcement at the SEC, Chair Gensler invoked the "walks like a duck" test as the first of three principles that would guide SEC enforcement, stating that the SEC would look beyond superficial labels to "assess the economic realities of a given product or arrangement to determine whether it complies with the securities laws." While the line evoked the SEC's recent enforcement activity against digital asset offerings and related lending products as unregistered securities offerings, Chair Gensler signaled broader application of the "walks like a duck" enforcement philosophy across the SEC's enforcement jurisdiction. In particular, Chair Gensler called out as enforcement priorities deceptive conduct in the private funds space, offering frauds, accounting frauds, insider trading, market manipulation, Foreign Corrupt Practices Act (FCPA) cases, reporting violations, and fiduciary violations.

In discussing accountability, Chair Gensler's second enforcement principle, he echoed comments made by Director Grewal signaling an increased appetite at the SEC to seek admissions from wrongdoers in resolutions where "heightened accountability" and "acceptance of responsibility" are in the public interest. As Director Grewal explained, by requiring admissions of wrongdoing in "appropriate" cases, the SEC aims to send a strong message to market participants that they must ferret out and self-report misconduct. This announcement may indicate a return to Obama-era SEC enforcement practices under the direction of Chair Mary Jo White, though as Director Grewal acknowledged in his remarks, the SEC has not yet obtained an admission in a resolution under Chair Gensler's leadership.

Lastly, Chair Gensler outlined a third principle for enforcement—high-impact cases. He stated that while the SEC would continue in its role as a "cop on the beat" policing everyday fraudsters, the commission would not shy away from the high-impact cases that generate attention and send a message about impermissible conduct to market participants of all sizes. In Chair Gensler's words, "A high-impact case pulls many other actors back from the line." Director Grewal raised similar themes, promising "robust enforcement" across the entire SEC landscape. Chair Gensler emphasized his desire that high-impact enforcement would not be limited to low-hanging fruit but would tackle complex and novel cases, including those in emerging enforcement areas such as crypto.

## **Crypto**

Comparing crypto to a teenager striving to reach adulthood, Chair Gensler's message was clear that digital currencies need to fit into a broader public policy framework as the industry grows. The desire to impose restraints on these decentralized and innovative youngsters, to continue the analogy, is certain to spark elements of rebellion. Perhaps highlighting the fact that there are competing views on whether certain digital assets and related activities fall within the purview of current securities laws, a jury in federal court in Connecticut recently concluded that a group of crypto mining products were not investment contracts, and therefore not securities. *See Audet v. Fraser*, Case No. 3:16-cv-940-MPS (D. Conn.). Beware of reading too much into this civil jury verdict, however, because the unique jury instructions in that case may have played a role in this verdict. Moreover, the U.S. Department of Justice (DOJ) and SEC have many tools at their disposal—as exemplified by the fact that the co-founder and CEO of the companies involved in the Connecticut civil case was pursued and pled guilty to the non-securities crime of wire fraud related to these same crypto mining entities, and was sentenced to 21 months in prison in 2017.

## **Environmental, Social, and Governance**

Among other hot topics, Chair Gensler recognized that environmental, social, and governance (ESG) and climate disclosures are of significant interest to investors. The basic bargain that applies in all other areas applies to ESG and climate as well—that is, (1) companies must provide information upon which investors can make decisions, and (2) the information provided must be free from material omissions and misstatements. For now, the SEC's focus seems to be on scrutinizing whether companies are making misleading statements to the public or saying one thing and doing another when it comes to ESG issues. But looking ahead, there is likely to be more focus on the horizon regarding what climate related disclosure are required. In addition to referencing the SEC's 2010 Climate Change Guidance, Chair Gensler indicated that the commission was considering rule amendments to expand disclosure requirements in this area.

## **Process**

After outlining his three principles for SEC enforcement, Chair Gensler turned to process, devoting a significant portion of his prepared remarks to comments on the enforcement process and the SEC's engagement with investigation subjects and their counsel.

## **Battling Delay and a "Burn-the-Clock" Approach**

Citing the adage "justice delayed is justice denied" both Chair Gensler and Director Grewal foreshadowed a faster approach to investigating cases and less tolerance for delay, which may translate into fewer accommodations afforded to companies responding to informal SEC requests and formal subpoenas. Both leaders, however, referenced that staff will cut back on meetings to discuss Wells submissions, suggesting that counsel should not expect such meetings to be a routine part of every case, and that when granted, the pitch should be targeted with no expectation of having multiple opportunities to present on the same matter. Chair Gensler went as far as to say that the defense bar often makes a strategic decision to "burn clock" but that the SEC had a different mission.

## **Cooperation Deserving of Credit**

Both Chair Gensler and Director Grewal also emphasized that cooperation credit from the SEC requires more than the bare minimum of conducting a "self-serving" independent investigation and complying with legal requirements like lawful subpoenas and lawfully compelled testimony. While neither Gensler nor Grewal offered

clarity on the specific steps necessary to elevate an investigation from the "self-serving" category, in general, Chairman Gensler advised that cooperation credit requires steps that enhance the SEC's investigation, allow the SEC to move quickly, or help the SEC identify additional misconduct.

### **Aligned With DOJ Corporate Criminal Enforcement Policy Changes**

Like the corporate defense bar, Chair Gensler and Director Grewal are closely attuned to last week's announcement from Deputy Attorney General Lisa Monaco regarding [changes to DOJ's corporate criminal enforcement policies](#). Chair Gensler highlighted in particular the DOJ's instruction to prosecutors to consider a corporation's entire history of misconduct and DOJ's consideration of whether non-prosecution or deferred prosecution agreements are appropriate for certain recidivist companies. Additionally, Director Grewal noted that the enforcement staff would seek "robust remedies," by considering, among other things, whether penalties in prior comparable cases have been sufficient to deter others, and by seeking additional penalties from recidivist actors. While emphasizing the SEC's independence from DOJ, Chair Gensler shared that the DOJ's recent changes are consistent with his own view of corporate enforcement.

### **Internal Evaluation of Case Sourcing**

Finally, Chair Gensler indicated that he had tasked Acting Director Dan Kahl of the Examinations Division and Director Grewal to evaluate existing practices and identify improvements in the SEC's process for identifying new cases. While Chair Gensler noted the importance of the SEC's whistleblower program and corporate self-reporting as avenues for case development, his remarks appear to signal an interest in strengthening the SEC's capacity to identify and develop potential cases without external referrals.

### **Gatekeepers**

Both Chair Gensler and Director Grewal appealed to those occupying positions of trust in the capital markets to take seriously their responsibility to the public to uphold the law and to foster a culture of "robust compliance" among their clients. In Chair Gensler's closing remarks, while acknowledging that attorneys, auditors, accountants, and other trusted advisors have obligations to their clients, he asserted these gatekeepers function as a first line of defense when a client is "getting close to crossing the line," and urged the audience to "think of the duck test, and not to help paper over the cracks."

Especially in novel areas involving emerging technologies, Director Grewal noted that gatekeepers have an obligation to think rigorously about how to tailor their compliance practices to account for unknown or unfamiliar risks.

In their remarks, both leaders evoked a sense of shared responsibility among gatekeepers—in particular attorneys—and the SEC to promote compliance and protect the public. But lest anyone forget, Director Grewal also stated clearly that the Enforcement Division would continue to take a hard look at gatekeepers who give cover to market participants seeking to cut corners.

### **Not Like Water Off a Duck's Back**

None of these pronouncements will flow like water off a duck's back for anyone concerned about SEC scrutiny or enforcement, and they certainly signal a need for careful thought about strategy for those swimming in the evolving ponds of digital assets and ESG reporting. While the topics may differ, being proactive with compliance in both will help to keep waters calm in the months ahead.

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