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SEC Signals Tougher Enforcement for Corporate Executives, Posing Challenges for Resolving Enforcement Actions

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As predicted by many observers, the Biden administration is taking a more aggressive posture toward criminal and civil white-collar enforcement than the previous administration. Most recently, the Securities and Exchange Commission (SEC) announced it is reviving an old policy requiring the targets of civil enforcement actions to admit wrongdoing. The SEC hopes to hold high-level corporate actors directly accountable for their conduct—a decisive break from the previous administration's willingness to allow defendants to settle enforcement actions without admitting or denying fault. The SEC will also be more proactive in implementing and enforcing a "claw-back" provision that requires executives to return erroneously awarded compensation.

Revival of the Admission of Responsibility Requirement

During the Obama administration, the SEC often required an admission of wrongdoing in order to resolve certain enforcement actions, particularly those that were high profile or involved egregious allegations. The SEC under the Trump administration, by contrast, often settled enforcement actions without requiring defendants to admit or deny any wrongdoing.

In October, SEC Enforcement Division Director Gerbir Grewal signaled a return to the admissions requirement for certain cases in which "public interest" demands "heightened accountability and acceptance of responsibility." The SEC's reasons for the changes are part optics, part deterrence. Citing a decline in public trust of private institutions and a perception that regulators are not doing enough to hold wrongdoers accountable, Grewal expressed the commission's view that the public will not "invest their hard-earned money" in a market they perceive as unfair, which "has the potential to be detrimental to our economy." To strengthen investor confidence, Grewal noted, "few things rival the magnitude of wrongdoers admitting that they broke the law." Such admissions also have a deterrent effect, "serv[ing] 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."

By reviving the admissions requirement, the SEC is no doubt raising the stakes for those who want to resolve enforcement actions but are concerned about the impact of admitting responsibility. For example, those who are targets of parallel proceedings—civil enforcement actions by the SEC and criminal inquiries by the Department of Justice—will always be free to invoke their right against self-incrimination in the SEC action. But this new policy makes the decision to remain silent something of a Hobson's choice between resolving the civil matter and doing so at the risk of increasing criminal exposure. Those admissions would also likely be used against the target in shareholder litigation or other private causes of action based on the underlying conduct. Because of the high stakes involved with admissions, the SEC's bold stance could be met with more defendants willing to take their chances at trial. At the very least, we can expect the return to the admissions requirement to lead to delays in resolving civil enforcement actions while targets and their attorneys struggle to navigate the tricky landscape.

In addition to the reputational harm the admissions requirement will likely cause professionals and their companies, there could be other collateral consequences. Companies can be delisted from exchanges after admitting to certain conduct, and their directors and officers can be barred from serving in high-level corporate roles. An admission of responsibility might also trigger misconduct exclusions under applicable insurance policies indemnifying directors and officers and could void executive compensation agreements. These issues will undoubtedly add a layer of complexity to the process of shepherding clients through parallel investigations.

Clawing Back Unearned Compensation

In another move, Grewal expressed the commission's interest in heightened enforcement of an existing law requiring corporate executives to return compensation they did not earn. For many corporate executives, pay is tied to company performance—when the publicly traded company posts strong financial statements, the executives are rewarded with incentive-based bonuses. Oftentimes, though, a company will have to restate earnings if it later learns that it did not perform as well as previously reported, meaning that executives "may have been paid for meeting certain milestones that the company didn't, in fact, hit," according to Grewal.

Under a provision in the Sarbanes-Oxley Act that was later broadened under the Dodd-Frank Act, executives are required to return incentive-based pay in the three-year period leading up to the misstated financial statement, even if the misstatement was made in good faith. While the SEC proposed an initial rule to implement this "claw-back" requirement several years ago, the rulemaking process was never completed.

In October, Grewal announced that the commission will reopen the public comment period on the proposed rule so that it can be implemented and enforced. Among the questions the commission is considering is which types of restatements will trigger claw-back requirements. The SEC welcomes comments on the proposed rule.

Conclusion

The Biden administration has signaled clearly that it intends to take a more aggressive stance in enforcement matters. How that affects the willingness of litigants to resolve enforcement actions, with the potential for required admissions and exposure to compensation claw-backs, remains to be seen. But one thing is clear: It increases the complexity for attorneys and raises the stakes for their clients.

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