

The Investment Lawyer

Covering Legal and Regulatory Issues of Asset Management

VOL. 29, NO. 1 • JANUARY 2022

REGULATORY MONITOR

SEC Update

By Jay A. Dubow, Ghillaine A. Reid, Meredith Sherman, and Zachary Epstein

SEC's New Enforcement Priorities Likely to Affect Settlement Requirements, Crowdfunding Regulation

In 2022, the Securities and Exchange Commission's (SEC) Division of Enforcement plans to continue to focus on (1) crowdfunding regulation and (2) more stringent settlement requirements. The agency demonstrated these priorities last year through both enforcement actions and announced policy shifts.

A Return to "Neither Admit nor Deny"

Division of Enforcement Director Gurbir Grewal said the agency will again require "admissions in cases 'where heightened accountability and acceptance of responsibility are in the public interest.'"¹

Grewal told attendees at the Practising Law Institute's "SEC Speaks" event² last October that "[w]hen it comes to accountability, few things rival the magnitude of wrongdoers admitting that they broke the law. 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's occurring in their firm."³

Grewal's remarks signal a return to the policy instituted under former SEC Chair Mary Jo White in 2013. Before White's tenure, the SEC's "traditional neither admit nor deny approach" allowed a defendant "to be found guilty of criminal conduct

and, at the same time, settle parallel SEC charges while neither admitting nor denying civil liability."⁴

In 2012, the SEC began requiring admissions of wrongdoing in cases "involving parallel criminal convictions" or non-prosecution or deferred prosecution agreements "that include[d] admissions or acknowledgments of criminal misconduct."⁵ The following year, the SEC expanded the policy to encompass cases that did not necessarily include accompanying criminal prosecutions.⁶

At the conclusion of White's tenure, former SEC Chair Jay Clayton and the co-directors of the Division of Enforcement reverted to the "traditional" approach.⁷ The shift resulted in a decrease in admissions of guilt in SEC enforcement actions.⁸

Requiring more defendants to admit wrongdoing to settle may have additional consequences for the SEC's enforcement program. Crucially, those admissions can serve to strengthen claims made by plaintiffs in concurrent civil litigation.⁹ The policy could lead to an increase in litigation should defendants prefer to fight their actions in court rather than admit guilt as part of a settlement agreement.

Regulating Crowdfunding Startups and "Gatekeepers"

Following 2020's drastic increase in the annual limits permitted for crowdfunding campaigns, the SEC has increased its focus on the regulation of

crowdfunding, particularly for antifraud measures targeted at startups and crowdfunding “gatekeepers.”

“Crowdfunding” refers to a financing mechanism, where small startups raise equity online by targeting large numbers of small investors. Crowdfunding was a key part of the 2012 Jumpstart Our Business Startups (JOBS) Act that passed under President Obama. The SEC promulgated rules relating to crowdfunding in 2015. In 2020, the SEC raised annual limits for crowdfunding campaigns from \$1 million to \$5 million.

A key motivation behind the promulgation of crowdfunding through the JOBS Act was to facilitate small capital raises for startup operations. However, regulators are concerned about ensuring that there are adequate disclosures relating to any funds solicited through crowdfunding and preventing fraud during the capital raising process.

Accordingly, the crowdfunding rules promulgated by the SEC contain certain provisions designed to address investor protection. For example, Section 227.1 of the JOBS Act provides that companies must raise money through an SEC-registered intermediary—either a broker-dealer or a funding portal. Additionally, if funds are raised through a funding portal, then Section 227.4 of the JOBS Act mandates that the portal must be a member of the Financial Industry Regulatory Authority (FINRA) to allow for appropriate oversight. Finally, Section 227.5 of the JOBS Act provides that the portals must conduct background checks and determine whether disqualification issuers or offerings are warranted due to fraudulent conduct.

Last September, the SEC filed its first enforcement action against crowdfunding companies and related intermediaries since crowdfunding was authorized in 2016. Filed in the Eastern District of Michigan,¹⁰ the SEC’s complaint alleged that two real estate investment entities, Transatlantic and 420 Real Estate, raised funds through a crowdfunding portal called TruCrowd, Inc. (d.b.a. Fundanna) in violation of Securities Act Sections 4A(a)(5),

5(a), 5(c) and 17(a) and Exchange Act Section 10(b).

In addition to suing the real estate companies and the funding portal TruCrowd, the SEC also sued individual defendants Vincent Petrescu, Robert Shumake, Willard Jackson, and Nicole Birch. Mr. Petrescu, a CPA and TruCrowd founder and CEO, was sued in his capacity as the “gatekeeper”—that is, the individual under the SEC regulations who had responsibility for choosing which issuers could use the platform for their offerings. Defendants Shumake, Jackson, and Birch, however, were charged because they allegedly sold securities of the entities at issue. The SEC alleged that TransAtlantic raised over \$1 million through a campaign led by Shumake and Birch, and 420 Real Estate raised over \$800,000 through a campaign led by Shumake and Jackson. According to the complaint, investors were informed that the investments would be used by the entities at issue to acquire real estate that would be leased to cannabis-related businesses. However, according to the SEC, the funds were diverted for personal use.

The SEC alleged that Mr. Shumake’s prior criminal conviction was not disclosed, and he previously had pled guilty to two felony counts for accepting fees for mortgage audit services that were not provided. The SEC also alleged that Shumake was on probation—the terms of which forbade him from managing other people’s money—but violated that restriction by participating in the crowdfunding campaign. Finally, the SEC alleged that Petrescu knew (or should have known) of Shumake’s criminal history. The complaint alleged that Petrescu received correspondence from an individual who requested a “bad actor” check on Shumake, which was never run.

The action is one to watch for the resolution of questions in connection with crowdfunding, including those relating to what duties intermediaries have to entrepreneurs and investors engaging in crowdfunding. The SEC’s novel complaint—as well as its return to a policy requiring admissions of guilt in a

wider array of cases—demonstrates that the agency intends to hold entities of all kinds accountable for fraud.

Ms. Reid is a partner at the New York, NY office, **Mr. Dubow** is a partner and **Mr. Epstein** is an associate, at the Philadelphia, PA office, and **Ms. Sherman** is an associate at the Princeton, NJ office, of Troutman Pepper Hamilton Sanders LLP.

NOTES

- ¹ See Dean Seal, “SEC’s Top Enforcer Says Admissions Are Back On The Menu,” *Law360* (Oct. 13, 2021, 10:04 PM), <https://www.law360.com/securities/articles/1430619/sec-s-top-enforcer-says-admissions-are-back-on-the-menu>.
- ² See The SEC Speaks in 2021, Division of Enforcement, Practising Law Institute (Oct. 13, 2021), <https://www.pli.edu/programs/sec-speaks>.
- ³ See Dave Michaels, “Wall Street, Companies May Have to Give Up More to Settle With SEC,” *Wall St. J.* (Oct. 13, 2021, 2:48 PM), <https://www.wsj.com/articles/sec-to-seek-admissions-of-wrongdoing-in-some-enforcement-actions-11634139229>.
- ⁴ See Public Statement by SEC Staff, Robert Khuzami, Dir., Div. of Enforcement, Securities & Exch. Comm’n, Recent Policy Change (Jan. 7, 2012), <https://www.sec.gov/news/public-statement/2012-spch010712rskhtm>.
- ⁵ See *id.*
- ⁶ See Mary Jo White, Chair, Securities & Exch. Comm’n, Deploying the Full Enforcement Arsenal (Sept. 26, 2013), <https://www.sec.gov/news/speech/spch092613mju>.
- ⁷ Giovanni Patti and Peter Robau, “Admissions of Guilt to the SEC under Chair Jay Clayton,” *Compliance & Enforcement* (Jan. 19, 2021), https://wp.nyu.edu/compliance_enforcement/2021/01/19/admissions-of-guilt-to-the-sec-under-chair-jay-clayton/.
- ⁸ See *id.*
- ⁹ See William F. Johnson, “Collateral Consequences of No-Admit-No-Deny SEC Settlements,” *Law.com* (June 30, 2021, 12:45 PM), <https://www.law.com/newyorklawjournal/2021/06/30/collateral-consequences-of-no-admit-no-deny-sec-settlements/>.
- ¹⁰ SEC v. Shumake, Civil Action No. 2:21-cv-12193 (E.D. Mich. Filed Sept. 20, 2021).

Copyright © 2022 CCH Incorporated. All Rights Reserved.
 Reprinted from *The Investment Lawyer*, January 2022, Volume 29, Number 1,
 pages 34–36 with permission from Wolters Kluwer, New York, NY,
 1-800-638-8437, www.WoltersKluwerLR.com

