

Governance Watch

Government Enforcement During & Beyond COVID-19

October 13, 2020



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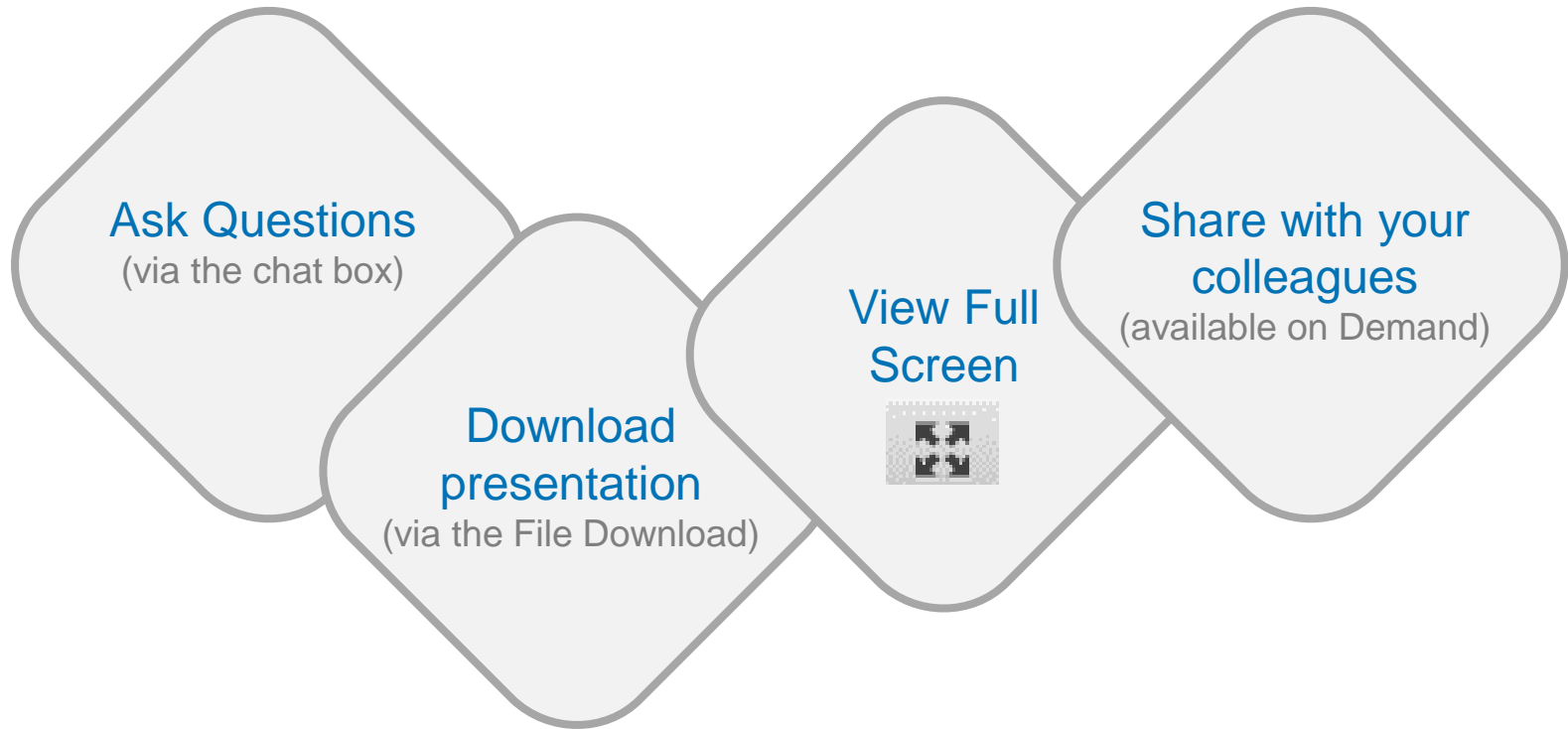
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With the *dashboard*, you can visualize trends across Russell 3000 and S&P 500 indexes, GICS business sectors, and company size groups.

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How should organizations support leaders in today's digital age and turbulent business environment, and how can we coach leaders to manage through the chaos and change in our workforce and business? Join this webcast to hear practical insights from organizations and coaches on how leadership capabilities are evolving in today's transformed world.



CLEARY GOTTLIEB

Government Enforcement During and After COVID-19



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Overview

The economic effects of COVID-19 are distinct from past financial crises

But past financial events – like the 2008 financial crisis and the 2000s accounting scandals – can provide useful lessons

Enforcement during COVID-19:

- Short term: agencies have expressed a desire to work constructively with companies to confront the consequences of COVID-19
- Medium and long-term: enforcement agencies will want to be seen as having taken action
- Likely areas of government focus going forward:
 - Accounting improprieties and disclosure issues
 - Misuse of MNPI
 - Government relief-related claims
- In addition to these areas of focus, there will be other effects on enforcement, including a likely increase in whistleblower claims

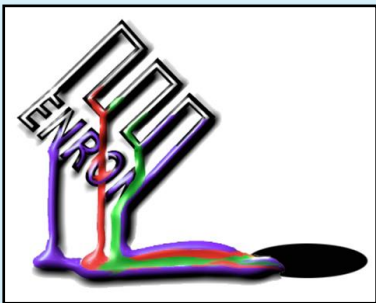
COVID-19 related inquiries may lead to scrutiny into unrelated conduct

Past Lessons

2000s Accounting Scandals

THE DOWNTURN

- The dot com bubble burst in the early 2000s
- A wave of accounting scandals followed
- The scandals included some of the largest in history, including Enron and Worldcom



ENFORCEMENT LESSONS LEARNED

- Economic downturns can expose underlying issues
 - The accounting frauds weren't uncovered until the economy slowed
- The government responds to public pressure for action
 - Corporate executives faced jail time
 - Congress passed Sarbanes Oxley



Past Lessons

2008 Financial Crisis

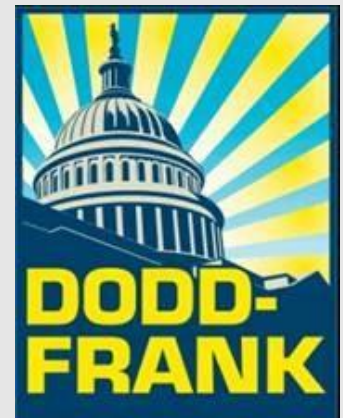
THE DOWNTURN

- Demand for RMBSs led to relaxed standards for the underlying mortgages
- A housing market crash led to widespread defaults and to a loss of value in the RMBSs
- Several major financial institutions collapsed
- The government provided a massive relief program focused on shoring up U.S. financial institutions (TARP)



ENFORCEMENT LESSONS LEARNED

- Led to expanded enforcement authority pursuant to Dodd-Frank
- Authorities used then-novel enforcement methods and theories
 - The DOJ brought FIRREA claims against banks
 - The SEC used “negligent fraud” charges for large institutions given the difficulties of proving individual scienter
 - Prosecutors began using wiretaps in insider trading investigations
- Enforcement focus on entities that received federal relief funds, including by the Special Inspector General (SIGTARP)
- Non-U.S. regulators played a substantial role
- Financial crisis served as catalyst for other enforcement actions
 - LIBOR cases
 - FX cases
 - ISDAFIX cases



Comparisons to the Current Crisis

DIFFERENCES

- Current crisis was principally caused by the COVID-19 pandemic
 - Roots of the crisis are extrinsic to the economy and the financial markets
- Current crisis developed suddenly, and the economic impact was felt immediately

SIMILARITIES

- The economy took a sharp downturn with millions of Americans losing their jobs
- Stock market volatility rose sharply
- Blue chip institutions suffered huge losses, and household names filed for bankruptcy
- May be public pressure for the government to take action against companies that are seen as profiting from the crisis or have underestimated the impact of the crisis on their business

Government Response to Date

Market Intervention

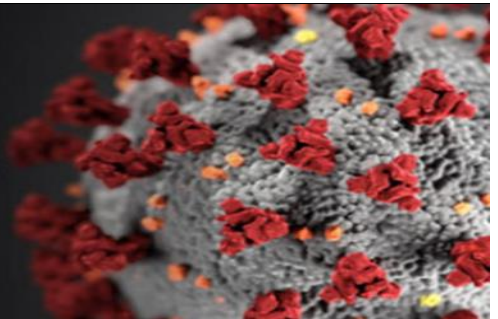
Congress passed the CARES Act

- Provides funds for loans to help businesses weather the crisis
 - Provides funds for loans to small and mid-sized businesses, grants to airlines, and direct payments to taxpayers
- Provides a right for homeowners experiencing COVID-related financial hardship to request and obtain a mortgage forbearance

Federal Reserve intervention

- The Federal Reserve has taken unprecedented steps, including buying short-term commercial debt and municipal bonds
- Efforts are aimed at providing credit to companies, in addition to preserving market liquidity

The CARES Act
Coronavirus Aid, Relief, and Economic Security Act



Government Response to Date

Enforcement

Government agencies are focusing on preventing fraud related to COVID-19

- Each U.S. Attorney’s Office has been directed to “prioritize the detection, investigation, and prosecution of all criminal conduct related to the current pandemic”
- The SEC has been issuing trading suspensions for companies engaged in fraudulent conduct related to COVID-19, and has begun charging companies for COVID-related fraud

The SEC has issued several statements regarding COVID-19

- Statement by the Co-Directors of Enforcement on Market Integrity
 - Companies should be mindful of disclosure controls, insider trading prohibitions, codes of ethics, and selective disclosure provisions
- Statement by the Chief Accountant on the Importance of High-Quality Financial Reporting
 - Highlighted areas that may require significant “judgments and estimates” in light of COVID-19
- Statement by Chairman Clayton and Director Hinman
 - Encouraged companies to make forward-looking statements in reliance on safe harbors
- Combined statement by the SEC and PCAOB on disclosures surrounding emerging market investments
 - Warned of the risks associated with investments in emerging markets

Accounting Improprieties and Disclosure Risks

The crisis may incentivize overly-optimistic accounting judgments

- SEC Chief Accountant highlighted several areas that will require significant “judgments and estimates”:
 - Fair Value and Impairment Considerations
 - Leases
 - Debt Modifications or Restructurings
 - Hedging
 - Revenue Recognition
 - Income Taxes
 - Going Concern
 - Subsequent Events
 - The Adoption of New Accounting Standards

The crisis may exacerbate already-existing accounting issues

- *“Only when the tide goes out do you discover who’s been swimming naked”* - Warren Buffet
- Potential problem areas include the use of Non-GAAP financial measures:
 - Use of Non-GAAP financial measures by companies has increased in recent years
 - The current crisis may expose misleading use of these measures

Companies may face challenges in making disclosure decisions during the crisis

- The SEC has released guidance on disclosure decisions, and highlighted analyses companies should perform
 - How has COVID-19 impacted your capital and financial resources?
 - How do you expect COVID-19 to affect assets on your balance sheet?
 - Has remote work adversely affected your ability to maintain operations, including financial reporting systems?
- The SEC has encouraged companies to rely on safe harbors for forward-looking disclosure statements
- Other potential areas of focus:
 - Credit risk
 - Supply chain risk
 - Loss contingencies

Accounting Improprieties and Disclosure Risks

Takeaways

- 1** Focus on compliance with internal policies and procedures around financial reporting
 - Remote work presents additional difficulties
 - Policies and procedures should be tailored to each individual business, including with respect to the company's COVID-19 response
- 2** Balance the risk between disclosing and not disclosing
 - Disclosures made too early can be mistaken and/or give rise to a duty to update
 - Disclosures made too late can result in an accusation of failing to timely disclose risk
- 3** Watch out for red flags concerning business counterparties
 - Business partners' misdeeds can lead to scrutiny of your company – including as a potential aider and abettor of allegedly unlawful practices
- 4** Exercise care when relying on safe harbors for disclosures
 - Forward-looking statements should be identified as such and should include appropriate cautionary language

MNPI Risks

INSIDER TRADING

- Insider trading investigations may present “low hanging fruit” for the SEC
- COVID-19 and rapidly changing economic landscape mean there may be more MNPI than is normal
- Individuals who typically lack MNPI may have access to such information now
- Liability for insider trading by employees
 - Enterprise liability for knowingly or recklessly failing to prevent insider trading by its employees
 - Direct insider trading liability if an employee trades on behalf of the company

SELECTIVE DISCLOSURE AND REG. FD

- Reg. FD prohibits the selective disclosure of MNPI to specified groups of “outsiders” by the company or by company officials
 - Company has an obligation to remedy such selective disclosure by informing the market
- Given market volatility and rapid changes due to COVID-19, decisions need to be made quickly
- Nonetheless, companies need to be careful to satisfy Reg. FD

Companies have an affirmative obligation to adopt reasonable policies and procedures to safeguard MNPI

MNPI Risks

Takeaways

1 Robust and tailored policies to address information flow and prevent insider trading

- Companies should consider additional trainings for individuals who don't regularly possess MNPI

2 Rule 10b5-1 affirmative defense for companies and individuals who trade while in possession of MNPI when:

- The individual making the investment decision was not aware of the MNPI, and
- The company implemented reasonable policies and procedures to ensure that individuals making investment decisions wouldn't violate insider trading laws

3 Companies should be able to demonstrate that they were thoughtful in designing and implementing their processes to guard against the misuse of MNPI

REG. FD

- Take extra care in communications to those outside the company in order to avoid a Reg. FD violation
- Review process for addressing inadvertent disclosure

Government Relief-Related Claims

CARES ACT

- There will likely be scrutiny into whether companies have made false or misleading claims about their business when applying for CARES Act funds
 - The DOJ can bring both civil and criminal actions for violations of the False Claims Act
 - The False Claims Act also allows for *qui tam* actions which are brought by private actors on behalf of the government
- Those institutions who serve as gatekeepers for CARES Act funds, such as banks for Paycheck Protection Program (“PPP loans”), may also face scrutiny
- The Special Inspector General for Pandemic Recovery (“SIGPR”) will conduct audits and investigations of loans, loan guarantees, and other investments
- State AGs may be active as well
 - Various state laws can be used to investigate and charge companies
 - In New York, the Martin Act prohibits deceitful practices related to the offer, sale, or purchase of securities in New York

FEDERAL RESERVE INTERVENTION

- The Federal Reserve will require participants in its financing program to provide certifications regarding their eligibility for financing
- The Federal Reserve is only providing financing for investment grade debt
 - If the Federal Reserve provides financing and subsequently suffers a loss, it will raise questions regarding whether the debt was investment grade when it was purchased

Government Relief-Related Claims (cont'd)

The CARES Act oversight seems to be modeled after the oversight Congress put in place for TARP

- SIGTARP – the Special Investigator General for TARP – worked with other agencies to investigate the misuse of TARP funds, as well as conduct that led to the financial crisis
- For example, SIGTARP worked with other agencies to investigate Bank of America and its merger with Merrill Lynch

Bank of America
Merrill Lynch



TAKEAWAYS

- Companies should expect authorities to investigate abuse of CARES Act funds
- To mitigate risk:
 - Reinforce the importance of complying with the law and company policies
 - Ensure that the compliance department is involved at the early stages of discussions about receiving CARES Act assistance
 - Once funding has been received, implement specific controls to track the use of funding and ensure that it is being appropriately spent
- Companies should also pay attention to red flags relating to the receipt of funds from other countries, and take a hard look at current policies surrounding FCPA risks

Whistleblowers

With millions of Americans having lost their jobs due to COVID-19, companies should expect an increase in whistleblower complaints

- The SEC incentivizes whistleblowers by offering a bounty on successful enforcement actions

Total reported FY 2020 whistleblower payments are more than 4 times those made in FY 2019

- In June, the SEC announced a \$50 million whistleblower payment to an individual – the largest in the history of the program



TAKEAWAYS

- Recognize that the number of whistleblower complaints is likely to grow with the pandemic
- Assess and test systems for whistleblower reporting, particularly in a remote work environment
- Investigate internal reports promptly and implement any necessary remediation
- Be sensitive to SEC settlements in relation to retaliation and ensure that investigators are aware of their responsibilities
- Ensure that the board, auditors, and others are appropriately kept apprised
- Manage communications with regulators and law enforcement that may have been contacted by a whistleblower or their counsel

The “Fifth Risk”

Regulators won't limit investigations to problems surrounding COVID-19

- The LIBOR, FX, and ISDAFIX cases all grew out of 2008 financial crisis-related investigations
- In the aftermath of the crisis, regulators focused efforts on insider trading



Regulators may be looking for “villains”

- Regulators may attempt to build cases against those seen as unfairly profiting from COVID-19
- Possible examples:
 - Businesses that are seen as “abusing” taxpayer funds
 - Businesses that profit from increased market volatility

Companies should focus on compliance generally, beyond activities related to COVID-19

- Ensure that concerns are properly investigated, escalated and aggressively remediated if identified





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EDUCATION

Georgetown University Law Center, J.D., *magna cum laude*
Wesleyan University, B.A., *magna cum laude*

Matthew C. Solomon's practice focuses on securities enforcement and litigation, white-collar criminal defense and complex commercial litigation. Before joining Cleary in 2017, Matt served for 15 years as a white-collar prosecutor and unit chief with the U.S. Department of Justice and in senior leadership positions with the U.S. Securities and Exchange Commission—most recently as the SEC's Chief Litigation Counsel.

At Cleary, Matt represents U.S. and foreign corporate, financial institution and private fund clients, as well as individual executives, on a broad range of issues and disputes spanning from compliance and remediation advice to litigation against the government and private parties. Matt routinely handles both internal investigations and litigations stemming from civil and criminal inquiries by the SEC, DOJ, CFTC and other regulatory and law enforcement authorities.

Securities Regulation: Enforcement

Chambers USA, 2020

Local Litigation Star: White Collar Crime

Benchmark Litigation, 2021

Outstanding Trial Advocacy Award

Assistant Attorney General's Award

Meritorious Service Awards

Special Commendation Award

U.S. Department of Justice Criminal Division

NOTABLE EXPERIENCE

- As the SEC's top litigator, led the SEC's litigation efforts in federal courts and administrative proceedings as conducted by 150 trial attorneys nationwide
 - Worked with other SEC senior officials and investigative staff nationwide in the supervision and negotiation of settled cases, and advised the Commissioners on litigation strategy and risk
 - Served in several prominent DOJ positions, including as Chief of the Fraud Unit for the 350-lawyer U.S. Attorney's Office in Washington, D.C. and a federal public corruption prosecutor
 - Civil and criminal prosecutions include the founder of S.A.C. Capital Advisors for securities law violations, Chinese affiliates of the "Big Four" accounting firms for securities law violations and NASA's former Chief of Staff for public corruption offenses
 - Experienced criminal, civil and administrative trial lawyer with over 20 bench and jury trials and dozens of district court and federal appellate arguments
- Sample representations at Cleary include:
 - Deutsche Telekom and T-Mobile U.S. in connection with a DOJ/FCC second request and a federal antitrust trial
 - Nissan Motor Co. in connection with an internal investigation and SEC disclosure case
 - OPKO Health, Inc. in connection with an internal investigation, SEC disclosure case and related class action/derivative litigation
 - Financial services and market making firm in connection with an internal investigation and SEC controls case
 - Citigroup, N.A. in connection with multiple SEC inquiries
 - A former CFO of a major European hedge fund in connection with an SEC investigation
 - A CEO of a cryptocurrency company in connection with an SEC investigation
 - A U.S. congressman in connection with a DOJ public corruption investigation
 - A former accounting executive of a Fortune 100 company in connection with an SEC investigation



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Lisa Vicens' practice focuses on a broad spectrum of civil litigation and regulatory enforcement matters with a concentration in complex, cross-border issues. Her litigation practice includes many notable securities actions and high-profile civil cases.

Lisa has significant experience working on matters in Latin America, particularly enforcement matters involving clients in the region. She has extensive experience representing companies and individuals in complex anti-corruption investigations and has also conducted numerous compliance program reviews on behalf of multi-national companies.

Next Generation Lawyer: Corporate Investigations and White-Collar Criminal Defense

The Legal 500, 2020

FCPA – Recognized Lawyer

Chambers, 2020

Latin America: Top 100 Female Lawyer

Latinvex, 2020

Future Star

Benchmark Litigation, 2021

Named Among Top 100 Women in Investigations

Global Investigations Review, 2018

NOTABLE EXPERIENCE

- Special committee of the board of directors of GOL Linhas Aereas Inteligentes S.A., in an independent investigation and representation before U.S. authorities of FCPA allegations relating to bribery
- FCPA and corporate governance advice to a Mexican construction company in connection with an investigation by the CNBV and potential investigation by the SEC
- Internal investigation for BNDES in Brazil into allegations of bribery relating to transactions with JBS and El Dorado
- Petrobras, PGF, and current and former officers and directors in securities class action and 35 individual actions in the U.S. District Court for the Southern District of New York in connection with Operation Carwash — reportedly the largest corruption scandal in Latin American history
- Special committee of the board of directors of M. Dias Branco, in an independent investigation of allegations of bribery asserted by Brazilian authorities
- Conducting FCPA due diligence on numerous transactions involving Latin American companies, including transactions in Brazil relating to assets implicated by Lava Jato
- Conducting reviews of and implementing anti-corruption compliance programs for companies in the transportation, paper, and pulp and oil industries
- FCPA compliance and corporate governance advice to a Brazilian bank
- Advising Mexican bank in connection with industry-wide investigation by two Mexican regulatory authorities
- Advised Mexican bank in connection with AML compliance review
- Overseas Shipholding Group (OSG) in civil class action litigation and SEC enforcement matters involving international tax issues
- Former members of the board of directors of R-G Premier Bank in Puerto Rico in litigation brought by the FDIC



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