



What to Expect During an SEC Formal Investigation

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Introduction

The SEC's formal investigation process is the structured means through which the Division of Enforcement considers whether a violation of federal securities laws has occurred. When the SEC opens an investigation, it is typically due to a referral from the SEC examination team, market and data analytics, or as a result of a credible whistleblower tip, referral from other regulators, customer complaint, or self-reporting.

The Division of Enforcement oversees the agency's civil law enforcement function by conducting investigations into possible securities law violations. Its ultimate goal is to restore harmed investors to the positions they would have been in had the violation not occurred.[1] Enforcement also aims to deter compliance violations, encourage remediation and maintain market integrity. Quality Tips, Complaints, and Referrals ("TCR") develop into formal investigations by the Division of Enforcement. Common examples of TCRs that the Division of Enforcement may investigate include Ponzi schemes, fraud, insider trading, and misleading statements filed with the SEC. Throughout the investigative process, one of the most critical responsibilities for a firm is to remain proactive, understand the nature of any allegations or concerns, cooperate with regulators, and take corrective action, as needed.

A commitment to compliance going forward whether through restitution, reforming firm policies, or enhanced oversight is critical. Regulators, investors, and your team all have a vested interest in seeing that trust is restored and enhancements are made when needed.

In this article, we will discuss the SEC's enforcement process. Through a case study, we will explore the role of the SEC's Division of Enforcement and their formal investigation process for assessing the potential violation. Then, we will explore the technical aspects of what to expect leading up to an enforcement hearing or proceeding, taking into consideration the February 2026 updates to the SEC Enforcement Manual [2] as they apply to a Wells Notice.

The Investigation Process

a. Regulatory Considerations

Once an investigation begins, it's important for any firm and/or individuals involved in the investigation to cooperate fully with the SEC staff. The SEC has broad investigative powers. For example, the Division of Enforcement has the authority to subpoena documents and witnesses as needed to obtain the necessary information for ascertaining if there were violations of securities laws. Once the SEC issues a formal order of investigation, the Division's staff may compel witnesses by subpoena to testify and produce books, records, and other relevant documents.[3] However, even before a formal order is issued, the SEC can require registered entities to provide documents and information under its examination authority.

For those who cooperate, the SEC generally awards credit, which is determined by the nature of the assistance provided by the individual. The amount to credit for cooperation is considered upon items such as whether the individuals' cooperation resulted in substantial assistance to the investigation, the timeliness of the cooperation, the quality of cooperation provided, and the time and resources conserved because of the cooperation.[4]

The benefits of cooperation during an investigation apply to both the charges and the remedies the Division of Enforcement may recommend and what the Commission may consider.[5] When cooperation is shown, the Division has the discretion to lower or even waive civil penalties. If meaningful remediation steps are taken, the Division may decide not to pursue any additional penalties or actions. Moreover, even if further measures are recommended, they are often limited in scope.[6] Common remedial measures used to address regulatory findings often include disciplining or terminating individuals responsible for the violations, enhancing internal controls and related policies and procedures, providing targeted training or retraining on the conduct at issue, hiring personnel with appropriate expertise, implementing clawbacks or recovering executive compensation, and reimbursing harmed investors.[7]

To illustrate these concepts, consider the following hypothetical case study.

CASE STUDY: "SEC Investigates Investment Adviser and Advisor Amid Misappropriation and Misleading Advertisements Concerns – What Executive Management Should Do"

In January 2025, the SEC Division of Enforcement received a tip from EXAMS who alleged that the business practices of NuCo, an SEC registered investment adviser (RIA), were in violation of the Advisers Act, and specifically Section 206 for breach of fiduciary duties and subsections 206(4)-1 for misleading advertising or marketing, 206(4)-2 for custody and misappropriation, 206(4)-7 for compliance program deficiencies, Rule 204-2 for recordkeeping violations.

NuCo is a growing advisory firm. Penny Wise serves as the CEO, and Justin Tyme is the firm's new CCO who just joined the firm in June 2025. In January 2024, NuCo onboarded a new advisor, Chris P. Bacon. Bacon started his own SPV in 2023. Bacon had seeded the SPV with his own money and wanted to make it available to NuCo's clients and commenced doing so in 2024.

The firm commenced marketing the SPV as a new alternative strategy which touted performance returns of 20%+. Moreover, the Form ADV stated that if any client invests in the strategy, they would not be charged an advisory fee.

However, in practice, the firm assessed both the SPV's management fee and NuCo's advisory fee.

In August 2025, the CCO is contacted by SEC Enforcement Attorney Al Ledge who introduces himself and notifies Tyme that he is conducting an investigation related to the SPV. Nervously, Tyme commences his own investigation and discovers that not only had clients of the adviser and fund been "double billed" but that the firm had not conducted due diligence of the SPV. He approaches Penny Wise and shares this information.

Actions Executive Management Can Consider:

- Contact Legal Counsel who is well-versed in securities law and has expertise in dealing with SEC enforcement cases
- Take steps to stop double billing of any firm clients going forward
- Identify all clients that were double billed and discuss reimbursement strategy with legal counsel
- Have appropriate personnel perform due diligence on the SPV (including review of fee billing) and its service providers and provide a report to senior executives
- Check to determine if the firm has backup documentation to support the SPV performance that is being disseminated. If no backup, ensure that all marketing

materials (including emails, firm and personnel business social media and websites that contain reference to the performance of the SPV are pulled/removed from circulation.

b. Discuss With Senior Management the Value of Retaining Experienced Counsel

In determining whether an issue could lead to enforcement, it is critical to determine the value of engaging experienced Securities counsel.. By having your own counsel, they can dive deeper and help you understand the SEC's concerns, by evaluating the conduct at issue and deciding on the next steps, including whether corrective actions are immediately needed. Remember: any communications made between you and your attorney will also be protected by attorney-client privilege and thus will not be discoverable provided that further related violations cease. Furthermore, it is important to note that attorney-client privilege does not provide universal protection especially in sharing documents with third parties.

Counsel can further contact the staff and gain more insight into the nature of the SEC's concerns. Having your counsel communicate with the Enforcement staff early on is important to establish transparency and willingness to address the problems. With the assistance of legal counsel, parties are able to strategically evaluate and respond to requests for production of documents. Counsel can also play a critical role in ensuring that all required documentation is accurately prepared and complete, thereby mitigating the risk of errors or regulatory noncompliance.

Because of the complexities that are often involved, it is best to choose a securities lawyer who has experience in SEC matters and who understands the document production process.

c. Obtain a Copy of a Formal Order

The Commission authorizes an investigation by issuing a Formal Order of Investigation, which designates specific members of the staff to act as officers of the Commission. The formal order serves two key functions:

- Describes the scope and nature of the investigation that has been authorized; and
- Empowers designated staff members to act as officers with authority to administer oaths and affirmations, subpoena witnesses, compel testimony, take evidence, and require the production of documents and other materials.

Under Section 203.7(a) of the SEC's *Rules Relating to Investigations*, any person compelled or requested to provide documents or testimony during a formal investigative proceeding has the right to be shown the Commission's formal order.[8] An attorney representing a "target" individual may request to review the formal order on their client's behalf by submitting a written request to the Assistant Director assigned to the investigation. However, the formal order may not be copied or retained unless expressly authorized by the Assistant Director.

Because formal investigative proceedings are nonpublic, it is strongly recommended that the target or their counsel review the formal order carefully.[9] Doing so can provide valuable insight into the scope of the investigation, the activities and conduct under review, the individuals or entities identified as targets, and the types of evidence or documents being sought. Reviewing the formal order helps counsel and the accused understand the "who, what, and how" of the investigation and the underlying circumstances prompting regulatory scrutiny.

d. Prepare for the SEC Investigation

Thorough preparation is a critical step for any firm or individual facing an SEC investigation. Proper preparation begins with retaining and organizing all relevant documentation and reviewing books and records, and considering disclosures, policies, and procedures. This groundwork not only refreshes the firm's understanding of its compliance framework but also ensures that subpoena requests can be addressed accurately and promptly. Firms that take a proactive approach are better positioned to demonstrate both compliance competencies and their willingness to cooperate – two key factors shaping how the SEC views a registrant during an investigation.[10]

Another critical part of preparation is identifying the securities laws and regulations applicable to the firm's business and practice areas and reviewing existing policies and procedures for thoroughness and any potential gaps. Firms should evaluate whether their policies reflect current regulatory expectations and adequately address identified risks. Equally important is assembling and maintaining key compliance program documentation, including risk assessments, annual review reports, and training records that could help to demonstrate the firm's internal supervisory controls. [11] Proactively collecting and preserving these materials helps streamline the production process and enables a more efficient and confident response to subpoenas.

Beyond document production, SEC investigations frequently involve interviews with firm personnel. This highlights the importance of preparing members of the firm who will most likely be interviewed during the SEC investigation. To prepare, ask personnel to thoroughly review relevant compliance policies and procedures, especially as they relate to their specific responsibilities.^[12] Personnel should consider how they supervise others and interface with compliance. They should be able to communicate their roles and responsibilities, as well as the firm's procedures relevant to their practice area, because that will help demonstrate a culture of compliance. By taking these preparatory steps in advance, firms can better manage the investigative process, present a cohesive compliance narrative, and foster a constructive dialogue with the SEC.

Case Study Application:

When Penny Wise learns about the SPV, she shares with Tyme, "I would have never thought this would happen. I have known Bacon since high school. I didn't look into the SPV because I just trusted him and approved the SPV for our clients." She instructs Tyme to contact outside counsel.

With outside counsel's assistance, they commence an internal review. Tyme discovers that in 2024 Bacon met with accounting and told them to bill any of his clients who were invested in the SPV the firm's advisory fee; what accounting did not know was that doing so was contrary to the Firm's Form ADV disclosures. Bacon also had been the creator of the marketing collateral for the SPV. When asked about the 20% performance return, Bacon became agitated and accused marketing of "getting it wrong." Through an email review, compliance discovers it was Bacon who provided the initial marketing collateral, which the team assumed was accurate.

Next Steps to Consider:

- CEO or designee should meet with Bacon, prohibit his dissemination of marketing collateral without written pre-approval from CCO, and put him on heightened supervision or terminate, if deemed appropriate
- Implement control in accounting department requiring written approval from appropriate senior manager prior to changing any client billing process
- Revise policies and procedures to require that all marketing and advertising be approved by the CCO or designee prior to issuance.

- Provide training to all employees covering marketing and advertising regulations and requirements under Advisers Act and under Regulation D.

e. Remediation

When an SEC formal investigation is initiated, taking prompt and meaningful remedial action can significantly influence the outcome and demonstrate a firm's commitment to compliance. The SEC places great emphasis on a respondent's remediation efforts when evaluating potential sanctions or settlement terms. Accordingly, firms and individuals should take a proactive approach to identifying deficiencies, addressing root causes, and strengthening their overall compliance framework.

i. Strengthening Compliance Programs

A primary remediation involves reviewing and enhancing compliance policies, procedures, and supervisory systems. Firms should assess whether existing controls adequately address the area under investigation and implement revisions where gaps are identified. This may include adopting new monitoring tools, improving documentation practices, and ensuring that supervisory reviews are both effective and well-documented.

ii. Conducting Targeted Training

Comprehensive training is essential to prevent recurrence of violations. Firms should conduct targeted training sessions focused on the specific conduct at issue, while also providing broader refresher programs to reinforce compliance awareness across the organization. Training senior management and supervisors on accountability expectations is also a critical component of remediation.

iii. Personnel and Governance Actions

If individual misconduct or supervisory failures are identified, appropriate personnel actions—such as discipline, reassignment, or termination—should be taken. Firms may also consider hiring or consulting with compliance professionals who possess specialized expertise. Additionally, governance structures should be reviewed and, if necessary, enhanced to ensure stronger oversight by boards, compliance committees, or senior leadership.

iv. Financial and Client Remediation

In cases involving investor harm, prompt and transparent restitution is essential. Firms should reimburse affected clients and, where applicable, implement clawback policies or adjustments to executive compensation linked to the misconduct. Correcting inaccurate disclosures and communicating remedial actions can also help rebuild trust with clients and regulators.

Case Study Application:

Penny Wise asks Tyme for his suggestions on how to best remediate. Based upon their findings, Tyme suggests that they immediately calculate how much investors were overbilled through the collection of advisory fees and suggests that NuCo rebate that amount plus 7% interest. They decided to share with the SEC that they found that the SPV investors, who were also advisory clients of NuCo, were overcharged, and are receiving rebates, with interest. They also confront Bacon and demand that as manager to the SPV he redeem NuCo clients' SPV interests and thereafter, terminate Bacon's employment with NuCo. Tyme works with operations and marketing to update their internal controls for client fee calculations and marketing reviews, and they immediately cease using any marketing collateral related to or recommending the SPV.

Other Steps to Consider:

- Implementing an ongoing compliance training program, consisting of quarterly reminders of regulations with employee certifications and annual compliance meetings.
- Having legal counsel perform a mock SEC exam to determine whether there are other potential or actual compliance issues.
- Performing and documenting an in-depth risk assessment and conflicts review.
- Enhancing frequency and depth of compliance testing for high and medium risk areas

f. Settlement

Upon completion of the investigation and evaluation of the recommendations provided by the staff, the Division of Enforcement will determine whether to proceed with the enforcement action through civil or administrative actions. Before doing so, generally, Enforcement will consider an offer of settlement or other proposed dispositions of an enforcement action.[13]

Settlement discussions typically occur between Enforcement and the respondent's counsel after investigative findings have been presented—sometimes before, but often following a Wells Notice or other indication of potential charges. The SEC staff may initiate settlement talks directly and will present:

- The specific violations to be charged;
- The sanctions or remedies (e.g., disgorgement, civil penalties, censures, suspensions, or undertakings); and
- Any required remedial measures.

If a tentative agreement is reached, the SEC will present a written offer of settlement that outlines:

- The respondent's consent to the entry of findings and sanctions
- A waiver of the right to a hearing, appeal, or judicial review
- An acknowledgment that the settlement, once accepted, is final and binding

Importantly, settlement negotiations are confidential, and the SEC staff cannot accept or reject an offer on its own—only the Commission itself can approve it.

Once executed, the offer is forwarded to the Commission for formal consideration. If accepted, the Commission issues a settlement order (often called an “Order Instituting Proceedings, Making Findings, and Imposing Remedial Sanctions”). This order is made public and sets forth the facts, violations, and sanctions agreed to.

If the matter is not resolved through the Offer of Settlement, it proceeds to enforcement.

Proceeding to Enforcement: Enforcement Manual Updates, the Wells Notice, and Response Prior to an Administrative or Judicial Hearing

a. Enforcement Manual Updates

On February 24, 2026, the SEC released the updated Enforcement Manual with the most notable changes to the manual since 2017.

Reflective of the current administration, the updated Enforcement Manual seeks to create open discourse towards timely resolution and remediation. The most significant changes to the Manual include the following.

i. The Cooperation Credit Framework

This provides guidance on how cooperation by the subject under investigation is evaluated and applied to reduce or even eliminate penalties. Cooperation credit can be considered during any stage of the investigation, including the Wells process.

ii. Settlement and Waivers

The updated Enforcement Manual also formalizes a policy change regarding the simultaneous consideration of settlement offers and waiver requests. Under this policy change, the SEC simultaneously reviews a settlement offer alongside any requests to waive consequences. This allows the subject under investigation to understand what they agree to before making a final decision.

b. The Wells Notice

A Wells Notice is a formal notification issued by the SEC's Division of Enforcement to an individual or entity that has become the target of an investigation. It outlines the potential violations identified by the staff and provides the recipient with an opportunity to respond before the Commission decides whether to pursue formal enforcement action.

The Wells Notice serves several key purposes:

- **Notification of Preliminary Findings:** It informs the recipient that the SEC staff has made a preliminary determination to recommend that the Commission file an enforcement action or institute administrative proceedings.
- **Identification of Potential Violations:** It outlines the specific securities law provisions that the Staff believe may have been violated.
- **Opportunity to Respond:** It advises the recipient of their right to submit a Wells Submission—a written response to the SEC staff and the Commission presenting legal and factual arguments as to why enforcement action should not be taken.

The primary objective of a Wells Notice is to ensure fairness by giving the subject of an investigation a chance to address the staff's findings before formal charges are filed.

It is therefore essential to carefully review the notice and analyze the alleged non-compliant conduct in detail. If a Wells Submission is pursued, it should directly address each issue identified by the staff and provide supporting evidence, context, and remedial actions undertaken to demonstrate compliance and cooperation.

The 2026 changes to the SEC Enforcement Manual provide further opportunities for better and more timely outcomes during the Wells process including extending the time to file a Wells Submission from two weeks to four weeks.

c. Response Prior to an Administrative or Judicial Hearing – the Wells Submission

The Wells Submission, named after John A. Wells, the New York attorney and SEC Advisory Committee Chairman who developed the practice, provides an individual or firm under investigation with an opportunity to present their position before the SEC determines whether to pursue enforcement action. [14]

Upon receiving a Wells Notice, a recipient may elect to file a written or video statement—known as a Wells Submission—setting forth factual, legal, and policy arguments explaining why the Commission should decline to bring charges. This submission is designed to give the respondent a voice in the process and allow them to clarify the facts, provide context, or demonstrate remedial actions already taken.

While a Wells Submission is entirely voluntary, it must be prepared with great care. Any information provided in the submission is not privileged and may be discoverable in later proceedings. Moreover, the SEC may share it with other regulatory or law enforcement agencies, where it could be used in parallel or subsequent actions. For that reason, the submission should be narrowly tailored, factual, and strategic—avoiding unnecessary disclosures that could create additional exposure.

Before proceeding, it is crucial to weigh the potential benefits and risks. In some instances, a well-crafted Wells Submission can successfully persuade the SEC not to proceed with enforcement. In others, it may inadvertently provide information that strengthens the case for further action. Engaging experienced securities counsel is essential to evaluate whether filing a Wells Submission is in your best interest and to ensure it is drafted effectively and prudently.

Conclusion

If contacted by the SEC Division of Enforcement, it is important to understand their role and the investigation process. Stay calm; do not panic or make immediate statements before knowing about their concerns. Once known, preserve relevant documents and avoid altering or deleting documents. Formulate an investigative team and prepare. This begins by engaging qualified legal counsel experienced in SEC enforcement matters. Counsel will help to explain your rights, obligations and the investigation steps, and assist with responding to the staff in a timely and strategic manner. Counsel will also help prepare individuals for interviews or depositions, and prepare a Wells Submission, if necessary. Cooperating in good faith, documenting compliance and remediation efforts, and preparing strategically, can be extremely beneficial if enforcement action is considered. Early preparation and professional guidance significantly improve your ability to manage the investigation and mitigate potential consequences.

[1] <https://www.sec.gov/about/divisions-offices/division-enforcement>.

[2] <https://www.sec.gov/newsroom/press-releases/2026-20-secs-division-enforcement-announces-updates-enforcement-manual>.

[3] <https://www.sec.gov/about/divisions-offices/division-enforcement/how-investigations-work>.

[4] SEC Enforcement Manual *available at* <https://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

[5] <https://www.sec.gov/newsroom/speeches-statements/grewal-remarks-securities-enforcement-forum-west-052324>.

[6] *Id.*

[7] *Id.*

[8] <https://www.ecfr.gov/current/title-17/chapter-II/part-203/subpart-B/section-203.7>.

[9] <https://www.sec.gov/about/divisions-offices/division-enforcement/how-investigations-work>.

[10] Michelle Jacko, *Regulatory Examinations and Audits*, in *Modern Compliance: Best Practices for Securities & Finance* at 586 (John H. Walsh et al. eds., Wolters Kluwer 2015).

[11] *Id.*

[12] *Id.* at 579-86

[13] SEC Enforcement Manual, *available at* <https://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

[14] <https://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

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