

Morrison & Foerster Client Alert.

The SEC Speaks Louder and Tougher in 2010

By Randall J. Fons and Nicholas George Miranda

Early each year, the SEC hosts its most important conference: The SEC Speaks. At the conference, the Chairman, the Commissioners, and the heads of the various divisions summarize the SEC's activities of the previous year and indicate the SEC's priorities and major initiatives for the coming 12 months. Though this year's conference, scheduled for February 5-6, was curtailed to one day because of the weather, the SEC had more than enough time to make clear that its main priorities were to continue the reforms it began last year and to further its aggressive pursuit of violators through new enforcement structures and tactics.

Chairman Mary Schapiro began the conference by focusing on the successes of the reorganized SEC in 2009 -- obtaining twice as many emergency temporary restraining orders and asset freezes, bringing twice as many enforcement actions against Ponzi-type schemes and ten percent more actions overall, recovering over \$550 million more in disgorgement than the previous twelve months, and imposing twice the amount of civil penalties as in 2008 -- but she noted that the SEC still has a long way to go protect consumers and restore their confidence. To emphasize this point, Chairman Schapiro and the senior staff spent much of their time providing details of policies and procedures that will enhance the SEC's investigative and enforcement functions. Of particular note, the speakers focused on the newly announced cooperation initiative, the creation of specialized units within the Division of Enforcement, the more effective pursuit of insider trading, and the ability of enforcement staff to engage in faster, more effective investigations.

The Cooperation Initiative

Deputy Director Lorin Reisner attempted to put more "meat" on the bones of the cooperation measures the SEC previously announced in January (covered in our January 14th client alert *available at* <http://www.mofo.com/resources/publications/>). As Reisner stated, the new measures are structured to encourage greater cooperation from individuals and companies in connection with the SEC's enforcement investigations. Reisner focused on three new tools that the division will use:

- 1) Cooperation Agreements: Formal written agreements in which the Division agrees to recommend to the SEC that a cooperator receive credit for cooperating in investigations or enforcement actions;
- 2) Deferred Prosecution Agreements: Formal written agreements in which the Commission agrees to forego an enforcement action against a cooperator if the individual or company agrees to cooperate fully, undertake certain actions, and comply with certain conditions during a period of deferred prosecution; and
- 3) Non-prosecution Agreements: Formal written agreements in which the Commission agrees not to pursue an enforcement action against a cooperator if the individual or company agrees to cooperate and comply with certain conditions.

Because the first tool, cooperation agreements, is likely to be used most often, Reisner discussed those agreements in particular. He stated that to qualify for such an agreement, the cooperation must be "substantial" and the cooperator must be prepared to provide "timely, thorough and useful" information to the staff. He further stated that this meant that a cooperator should expect to appear for meetings called by the staff, respond fully and truthfully to any questions the staff raises, appear voluntarily in any litigation instituted by the staff, and provide the staff with all non-privileged documents in the cooperator's possession. Reisner made it clear that the Division expects a "motivated and effective" cooperator to unlock an investigation by providing substantial assistance by whatever means would be most helpful to the staff. Reisner also noted that for the first time, the Division has put out a policy statement clarifying how it will decide whether to enter into these agreements and how it will credit cooperation. The policy statement indicates four considerations based on the 2001 "Seaboard Report": 1) the amount of assistance provided; 2) the importance of the underlying investigation or

enforcement matter; 3) the societal interest in ensuring that the cooperator is held accountable for their own wrongful actions; and 4) the appropriateness of cooperation credit based on future risk.

Reisner stressed that with this initiative, the Division of Enforcement should finally be able to put aside the historical problem of potential cooperators' uncertainty of the benefits they will receive and to make clear that tangible credit will be given for cooperation. Importantly, Reisner stated that the SEC's standard proffer agreement has also been changed to provide that, absent a legal obligation, the staff will not share information received from a cooperator with any other state or federal agency, unless that agency agrees to limit its use of the information in a manner which is consistent with the SEC's agreement with the cooperator. This is a significant change from the past policy of the SEC, and may go a long way in providing incentive to individuals to be the "first in the door" to cooperate.

Along with the carrot offered by the enforcement staff, however, comes the stick: Reisner made it clear that anybody appearing in an SEC investigation who does not cooperate with the staff will face "the full extent of charges and remedies" that can be sought by the Commission in court.

The speeches evidenced the high value the Division of Enforcement places in obtaining increased cooperation – which it deems crucial to obtaining compelling first-hand evidence – and there is every reason to believe that the changes implemented will have individuals and companies lining up to cooperate.

The Creation of Specialized Units

The Division of Enforcement also discussed the creation of the five newly-established specialized units – FCPA; Market Abuse; Municipal Securities and Public Pensions; Asset Management; and Structured and New Products – as well as the Office of Market Intelligence. Each unit chief spoke, and though the common thread was that the new structure would allow them to act sooner, more efficiently, and more often, each provided some additional insights about their units.

FCPA: Cheryl Scarboro, Chief of the FCPA Unit, listed goals for her unit: be more proactive; be more coordinated and consistent; bring "impactful" cases; and "raise the bar" both domestically and internationally. She indicated that the Unit will no longer wait for, or rely heavily on, self-reporting, and will instead be more proactive in engaging in targeted sweeps, such as it did in the oil-for-food program. It will coordinate more with other agencies and make sure that its cases send a clear and unified message. And it will "raise the bar" by not just focusing on U.S. regulators, but attempting to prod foreign authorities to be more aggressive in FCPA enforcement as well. When asked, Scarboro also stated that companies who discover FCPA violations during M&A due diligence activities will continue to be a source of significant investigations.

Market Abuse: Daniel Hawke, Chief of the Market Abuse Unit, stated that his unit's primary aim is to enhance efforts on insider trading cases and share information to improve investigations. He made clear that the core focus will be on "organized insider trading" – complex trading schemes in the marketplace by sophisticated individuals and entities. The Unit will be looking for *Galleon*-type and other large scale abuses. He stated that the Unit will also work closely with the criminal authorities where appropriate and will hire specialists outside of the marketplace "who know where the bodies are buried."

Municipal Securities and Public Pensions: Elaine Greenberg, Chief of the Municipal Securities and Public Pensions Unit, spoke about the size and importance of the multi-trillion dollar municipal securities market and highlighted in particular the new Build America Bonds, which have raised \$64 billion since being introduced last year. She indicated that the marketplace is huge and growing but is very thinly regulated, beyond being subject to anti-fraud protections. She stated that her unit will be proactive in seeking violations in five areas: offering and disclosure fraud; tax fraud; pay-to-play and corruption schemes; public pension disclosure and accounting frauds; and valuation and pricing fraud.

Structured and New Products: Kenneth Lench, Chief of the Structured and New Products Unit, spoke about how crucial the \$700 trillion industry is to the SEC and investors. He set three priorities for the unit: completing investigations already under way that arose from the financial crisis, bringing high-impact enforcement actions, and engaging in "risk-based" investigations utilizing industry experts and new technology.

Asset Management: Robert Kaplan, Co-Chief of the Asset Management Unit, indicated that the Unit will seek to aggressively bring cases, but it will not supplant the rest of the Division in this area and instead will act as more of a "resource and repository" for expertise throughout the Division. He stated that the Unit will hire industry experts and will

have several core priorities. First, he said that the Unit will target preferential disclosure to big clients, and he cited as an example the *State Street Bank and Trust* matter in which State Street last week agreed to pay more than \$310 million in penalties and restitution for telling some preferred investors that one of its bond funds was heavily invested in sub-prime mortgages, allowing those investors to divest before the financial meltdown. Kaplan also emphasized that the Unit will focus on issues of trade allocations, valuation, disclosure of information in investment materials, and undisclosed conflicts of interest.

Market Intelligence: Thomas Sporkin, Chief of the Office of Market Intelligence, spoke about the Division's technological advances and indicated that his office is determined to utilize new and more powerful technology to investigate tips and complaints and to meld them into a nationwide database that can be managed and shared among SEC offices and with other enforcement agencies.

Effective Pursuit of Insider Trading

Associate Director Scott Friestad discussed the changes in the Division in the past year and how they have led to tangible results in the pursuit of insider trading cases. In particular he pointed to how increased collaboration between offices allowed five different SEC offices to bring large, coordinated enforcement actions concerning market professionals and how an aggressive approach targeting insider trading rings and market participants led to historic victories.

Friestad, of course, highlighted the Division's work in *SEC v. Galleon Management, LP. et al.*, in which the defendants allegedly ran a complex insider trading scheme generating over \$52 million in illegal profits. He also discussed *SEC v. Cutillo, et al.*, a case in which a Wall Street ring was charged with illegally making over \$20 million by serially trading on acquisition information tipped by an attorney at an international law firm. Friestad said that these cases would serve as a model going forward, and he stated that more such cases are already in the pipeline. Needless to say, insider trading continues to be a high priority for the SEC and the enforcement staff.

Faster, More Effective Investigations

Regional Director David Bergers focused on other changes in the Enforcement Division, including, most importantly, the delegation of authority to senior officers to issue formal orders of investigation, thereby allowing the staff to serve subpoenas. Prior to 2009, all formal orders were required to be issued by the Commission itself. However, as discussed in last year's client alert, the SEC changed that policy, and delegated formal order authority to each regional office. Bergers highlighted several benefits of this change, including the ability of the SEC to obtain evidence faster, freeze assets earlier, coordinate better, and obtain evidence that would not be available if the enforcement staff had to wait by even a day. Bergers provided stories of companies and their counsel who were greatly surprised at the speed at which subpoenas have "landed on the desks" of those with relevant information.

Conclusion

The SEC Speaks conference made clear that although the agency believes it has come a long way in the past year, it will continue down the path of acting more aggressively and proactively to restore confidence and protect investors. To that effect, it focused on new structures and practices it has put in place – the new cooperation initiative, the creation of specialized units within the Division of Enforcement, the more effective pursuit of insider trading, and the ability of officers to engage in faster, more effective investigations by issuing formal orders – that will allow it to conduct investigations and enforcement actions more effectively. Because many of these changes are new, only time will tell how effective they may be. For the time being, however, expect a more forceful, aggressive, and active Enforcement Division.