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## **Expanded Enforcement Tool Box Available to the SEC**

In response to the difficulties faced by the Securities and Exchange Commission (SEC) in 2009 related to the market crisis, the Ponzi schemes perpetrated by Bernard Madoff and Stanford Financial, the SEC's Inspector General reports criticize both the staff and process utilized, as well as the numerous Congressional proposals to restructure or abolish the agency. The SEC had to embrace the unprecedented pressure of having to re-invent and revitalize itself ... and apparently they have. To address those pressures, the SEC has implemented significant programs to restructure its enforcement organization as well as changes in its enforcement process.

Those changes were discussed by the panel on Current Developments in SEC Enforcement at the 32nd Annual Conference on Securities Regulation and Business Law Problems (which was co-sponsored by the Ft. Worth District Office of the U.S. Securities and Exchange Commission, the Texas State Securities Board and the Business Law Section of the State Bar of Texas). The apparent consensus of the panelists was that these changes would result in the SEC enforcement process looking more like how a criminal prosecutor or law enforcement agency would approach the process.

### **Partnering with the Justice Department and Criminal Prosecutors**

The SEC and law enforcement has found that by partnering in their investigations, they form a formidable team that results in a win for both the SEC and law enforcement. Historically, the SEC has been limited in their investigations, as they are not able to utilize the investigative tools available to criminal prosecutors or law enforcement agencies. On the other hand, law enforcement has been limited in their investigative capacity into white-collar, SEC crimes because they simply do not possess the manpower to investigate the complex accounting and books and records involved in SEC enforcement cases. However, when the SEC can provide those records, and lay out the case for law enforcement (such as the Justice Department and or state and county law enforcement agencies), then law enforcement can use the judicial system to provide tools not previously available to the SEC in prosecuting cases such as expanded use of electronic surveillance, such as wiretaps and bugs. The utilization of the powerful, investigative tools available to law enforcement has understandably resulted in impressive prosecutorial results for both the SEC and law enforcement.

This partnering has created interesting ethical and practical issues for compliance professionals as it has placed another layer of conflicts on the defense of a firm, and its associates. Not only does the attorney representing the firm on regulatory matters and civil litigation continue to have conflicts of interest between the representation of the company and the associated persons involved in any particular matter, but with entry of criminal prosecution and the use of negotiated cooperation agreements, the interests of the parties can clearly conflict. Additionally, since regulatory law, civil law and criminal law are different legal specialties, it appears that the number of attorneys on your legal team may have to be expanded.

## **Use of Negotiated Agreements**

The SEC has taken measures to further strengthen its enforcement program by encouraging greater cooperation from individuals and companies in the agency's investigations and enforcement actions. The new initiative utilizes tools historically available to criminal prosecutors, including cooperation agreements, with incentives for individuals and companies to cooperate and assist with SEC investigations and enforcement actions. The cooperation initiative is expected by the SEC to result in invaluable and early assistance in identifying the scope, participants, victims and ill-gotten gains associated with fraudulent schemes.

Robert Khuzami, Director of the Division of Enforcement stated that these changes were "a potential game-changer for the Division of Enforcement," and that "there is no substitute for the insiders' view into fraud and misconduct that only cooperating witnesses can provide. That type of evidence can expand our ability to conduct our investigations more swiftly, and to act quickly to file charges, freeze assets, and protect investors."

To improve the quality, quantity, and timeliness of information and assistance it receives, the SEC approved the Division of Enforcement to authorize its staff to use various tools to encourage individuals and companies to report violations and provide assistance to the agency. The new tools are laid out in a revised version of the Division's enforcement manual in a new section entitled "Fostering Cooperation." For many years, similar cooperation tools have been regularly and successfully used by the Justice Department in its criminal investigations and prosecutions. The new cooperation tools, not previously available in SEC enforcement matters, include:

### **Cooperation Agreements**

Formal written agreements in which the Enforcement Division agrees to recommend to the Commission that a cooperator receive credit for cooperating in investigations or related enforcement actions, if the cooperator provides substantial assistance such as full and truthful information and testimony.

### **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, among other things, to cooperate fully and truthfully and to comply with express prohibitions and undertakings during a period of deferred prosecution.

### **Non-prosecution Agreements**

Formal written agreements, entered into under limited and appropriate circumstances, in which the Commission agrees not to pursue an enforcement

action against a cooperator if the individual or company agrees, among other things, to cooperate fully and truthfully and comply with express undertakings.

### **Streamlined Immunity Requests**

The SEC streamlined the process for submitting witness immunity requests to the Justice Department for witnesses who have the capacity to assist in its investigations and related enforcement actions.

### **Credit Guidelines**

The SEC has set out, for the first time, the way in which it will evaluate whether, how much, and in what manner to credit cooperation by individuals to ensure that potential cooperation arrangements maximize the Commission's law enforcement interests. This pronouncement is expected to provide guidance and serve as an incentive for individuals to report violations and to cooperate fully and promptly in enforcement cases. It is similar to the so-called "Seaboard Report" that was issued in 2001 and detailed the factors the SEC considers when evaluating cooperation by companies.

With the utilization of partnering and these new tools, the SEC believes that it will be positioned to be pro-active with respect to its enforcement activities. However, it was determined that better enforcement tools would be more valuable with better market knowledge. As a result, the SEC also created specialized units in five priority areas that are dedicated to particular, highly specialized and complex areas of securities law.

## **The SEC's New Specialized Units or Areas of Concerns**

In response to organizational issues facing its enforcement activities, the SEC created specialized units. The specialized units, through enhanced training and improved access to specialists are targeted to obtain increased understanding of particular markets, products and transactions. That expertise will be used to adopt a more proactive approach to identifying conduct and practices ripe for investigation, to conduct those investigations with increased efficiency and effectiveness, and to share that expertise with all staff throughout the entire Enforcement Division who are conducting investigations in these specialized areas. Thus it is believed that the specialized units, in conjunction with the new office of market intelligence, as well as partnerships with law enforcement will help provide the additional structure, resources, and expertise necessary for enforcement staff to keep pace with ever-changing markets and more comprehensively investigate cases involving complex products, markets, regulatory regimes, practices and transactions. The specialized units that have been created are:

### **Asset Management**

This unit will focus on investigations involving Investment Advisors, Investment Companies, Hedge Funds, and Private Equity Funds.

### **Market Abuse**

This unit will focus on investigations involving large-scale market abuses and complex manipulation schemes by institutional traders, market professionals, and others.

### **Structured and New Products**

This unit will focus on complex derivatives and financial products, including credit default swaps, collateralized debt obligations, and securitized products.

### **Foreign Corrupt Practices**

This unit will focus on violations of the Foreign Corrupt Practice Act, which prohibits U.S. companies from paying, offering, promising to pay (or authorizing to pay or offer) money or anything of value to a foreign official, a foreign political party or party official, or any candidate for foreign political office. for the purpose of obtaining or retaining business for or with, or directing business to, any person.

### **Municipal Securities and Public Pensions**

This unit will focus on misconduct in the large municipal securities market and in connection with public pension funds including: offering and disclosure fraud; tax or arbitrage-driven fraud; pay-to-play and public corruption violations; public pension accounting and disclosure violations; and valuation and pricing fraud.

## **Office of Market Intelligence**

In addition to creating and staffing the new specialized units, the SEC created a new Office of Market Intelligence that is responsible for the collection, analysis, and monitoring of the hundreds of thousands of tips, complaints, and referrals that the SEC receives each year and will utilize the expertise of the SEC's other Divisions and the specialized units to help analyze the tips and identify wrongdoing.

The initiatives discussed herein are clearly part of the most significant reorganization of the Enforcement Division in more than 30 years. The reforms will not only re-invigorate the SEC's enforcement program, but it will result in an enforcement platform that includes not only regulatory action and civil litigation, but will integrate both criminal investigative tools with criminal sanctions. While corporate and market fraud will hopefully see the most impact of the new SEC platform, it will have an impact on broker-dealers, mutual funds, hedge funds and investment advisers as they will need to increase their diligence with respect to the oversight of their compliance programs, as there are potentially more eyes than ever as watching the securities activities of the impacted firms.

We hope you have found this information helpful. Should you have any additional questions or concerns, please feel free to contact Daniel E. LeGaye or Michael Schaps by e-mail or phone, at 281-367-2454, or consult with your legal counsel or third party consultant.

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