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Enforcement To Be Top Priority at Schapiro's SEC

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by [Randall J. Fons](#), [Michael V. Sachdev](#)

Early each year, the SEC hosts its most important conference: The SEC Speaks. At the conference, the Chairman and each Commissioner, as well as the heads of the various divisions, attempt to summarize the SEC's activities of the previous year, and indicate what the agency's priorities and major initiatives will be for the coming 12 months. This year's conference lasted two days, last Friday and Saturday, February 6-7, but it was obvious after only a few hours of the first day that the SEC — which has recently been thought by some to be a toothless tiger — has as its highest priority in 2009 to regain its reputation as, first and foremost, a law enforcement agency. Newly appointed Chairman Mary Schapiro, quoting the SEC's first Chairman — Joe Kennedy — stated, "The Commission will make war without quarter on any who sell securities by fraud or misrepresentation." To emphasize the point, Chairman Schapiro and other SEC Commissioners and senior staff spent much of their time Friday providing further details of policies and procedures that will make it easier for the Division of Enforcement to commence and conduct investigations, bring enforcement actions, and impose penalties on wrongdoers.

Further spotlighting Schapiro's changes to the Enforcement Division, current Director of the SEC's Division of Enforcement Linda Chatman Thomsen is expected to resign from her post. The current front runner for the position is Robert Khuzami, a former federal prosecutor and chief of the securities fraud unit at the United States Attorney's Office in Manhattan. In addition, a bill was recently introduced in Congress to fund the hiring of more SEC enforcement officials. On January 22, Senators Charles Schumer (D-NY) and Richard Shelby (R-AL) introduced the Supplemental Anti-Fraud Enforcement ("SAFE") Markets Act, which provides \$110M for the hire of, among other law enforcement personnel, 100 new SEC enforcement officials.

Ending the "Penalty Pilot" Program

Chairman Schapiro announced that the Commission is ending its two-year-old penalty pilot program, which required agency enforcement attorneys to get approval from the SEC Commissioners before negotiating civil monetary penalties with companies. This pilot program, originally put in place under prior Chairman Christopher Cox, was an attempt to bring "consistency" into the imposition of penalties against companies subject to enforcement action.

The policy had been criticized in many quarters, even by many companies themselves, for often slowing down the process by which settlements of enforcement actions have been completed. Chairman Schapiro explained that the old policy "introduced significant delays into the process of bringing a corporate penalty case; discouraged staff from arguing for a penalty in a case that might deserve a penalty; and sometimes resulted in reductions in the size of penalties imposed."

"At a time when the SEC needs to be deterring corporate wrongdoing, the 'penalty pilot' sends the wrong message," Schapiro said. "The action I am taking to end the penalty pilot is designed to expedite the Commission's enforcement efforts to ensure that justice is swiftly served to those public companies who commit serious acts of securities fraud."

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What does this mean for public companies? SEC Enforcement attorneys will no longer be required to get Commission input prior to entering into settlement negotiations. The Enforcement Division will, once again, control the negotiation process and exercise its own discretion concerning when a penalty is necessary to settle an action, and how high that penalty will be. The likely result will be more penalties, in greater amounts, thus reversing a recent trend towards lower penalty amounts.

Faster Investigative Approval and Authority

In addition to ending the penalty pilot policy, Schapiro announced that she would provide for more rapid approval of formal orders of investigation, which permit SEC staff to issue subpoenas to compel witness testimony and the production of documents.

Schapiro explained that the procedure had become cumbersome, requiring the approval of all five commissioners to commence an investigation, almost always at a Commission meeting held weeks after the enforcement staff had requested subpoena authority. "To ensure that subpoena power is available to SEC staff when needed," she said, "I've given direction for the agency to return to the prior policy of timely approval of formal orders by seriatim approval or where appropriate, by a single Commissioner acting as a duty officer."

Even that effort at expediting enforcement investigations is not enough for at least one Commissioner. Commissioner Luis Aguilar stated his belief that the Commission should delegate the power to commence an investigation and issue subpoenas to the Director of Enforcement and the various Regional Directors around the country. This would be an unprecedented step, and significantly empower the enforcement staff to compel document production and testimony expeditiously with little if any input from Washington.

Regardless of how the SEC opts to streamline its investigative approval process, the change could have a sweeping effect on the timing and nature of SEC investigations. When the enforcement staff was required to run the bureaucratic gauntlet to obtain the ability to issue subpoenas, it was often easier and quicker for the staff to give "cooperative" companies and individuals ample time to conduct internal investigations, locate and produce documents, enter into discussions with the staff to refine and limit the issues, and provide testimony on a voluntary basis. With an easier, more efficient process for obtaining a formal order of investigation, the enforcement staff is not likely to exhibit the same level of patience it has over the past few years. Companies and individuals who desire to be seen as "cooperative" will now need to react more quickly and decisively when the Commission's staff comes calling.

Investigations to Become More Streamlined

Further highlighting the SEC's commitment to enforcement, Deputy Director of Enforcement George Curtis stated that two of the Commission's priorities are to focus cases and move them more quickly. Curtis explained that the SEC was considering abandoning its longstanding practice of "turning over every rock" in its investigations. He further stated that the enforcement staff will be willing to take more risks in determining how far to go in its investigations, so as to not unnecessarily jeopardize speed and efficiency. Furthermore, Curtis stated that the Commission and its staff will be making better and faster use of the complaints, tips, and referrals it receives. The effects of these changes in policy and procedure will include more investigations that move faster, requiring companies and their counsel to respond quickly.

The SEC speakers also noted the efficiency of the SEC's work with other United States and international agencies. Chris Conte, Associate Director of the Division of Enforcement, stated that in the Foreign Corrupt Practices Act (FCPA) arena, the Commission has been and will continue to closely cooperate with the Department of Justice and foreign authorities. As an example, Conte pointed to the recent settlements with a large multinational corporation concerning allegations that it had bribed officials in several countries. After an investigation conducted by the SEC, Department of Justice Fraud Division, the United States Attorney's Office, the Federal Bureau of Investigation, the Internal Revenue Service, and authorities in the United Kingdom, Germany, and Hong Kong, the corporation ultimately settled with the SEC for \$350 million and the Department of Justice for an additional \$450 million.

Conte explained that, as one of the SEC's highest priorities, FCPA actions will be quickly and efficiently brought against both companies and individuals, resulting in civil penalties and disgorgement. Conte further explained that the SEC is working to identify industry-wide practices, and will be focusing particularly on gifts, travel, and entertainment, and the use of agents and

consultants.

A Manual for Enforcement

Many of the policy changes announced last week will leave the enforcement staff around the country with more discretion regarding when and how to conduct investigations. As a result, the SEC's recent Enforcement Manual will be helpful in predicting some of the steps to be taken by the enforcement staff in its investigations. Joan McKown, Chief Counsel to the Division of Enforcement, explained that the manual attempts to "put in writing" many of the longstanding policies, both formal and informal, of the Division. McKown stated several times, however, that the manual will not create legal obligations for SEC Enforcement staff, but will merely provide a suggested course of action. McKown reiterated that staff would still be expected to use their judgment, based on the facts and circumstances of each case. Nevertheless, the manual does alert the public to many of the Division's policies, and an understanding of it can be helpful to any company subject to an SEC investigation.

Enforcement Working Groups

Finally, the Division of Enforcement announced its current working groups, which are unsurprising in light of recent market events. The current working groups are as follows:

- Subprime Mortgages;
- Auction Rate Securities;
- Hedge Funds; and
- Municipal Securities.

The Commission is now in the process of winding down its working group on stock options backdating.

Conclusion

The SEC has recently been publicly flogged for its perceived failures by investors, the media, and state and federal lawmakers. Indeed, as nearly every speaker at the conference stated, the past year has been one of the most difficult in the SEC's history in terms of public perception and confidence. What is clear is that the Schapiro Commission is determined to reverse that course, and once again redeem the SEC's reputation as an effective "cop on the beat." Chairman Schapiro, taking a cue from Joe Kennedy, expressed her own vision of where she wants the SEC's enforcement program to be, and she was clear that she wanted to get there quickly:

"Those who break the law and take advantage of investors need to know that they will face an unrelenting law enforcement agency in the SEC — an agency that will pursue them until the full force of the law is the sure, certain, and sole reward for their wrongdoing. No one should be heard credibly to question whether enforcement is a priority at the SEC. It is, and always will remain, a foundation of our mission."