

2009 Year In Review: SEC and SRO Selected Enforcement Cases and Developments Regarding Broker-Dealers

January 28, 2010

The Morgan Lewis Securities Litigation and Enforcement Practice has published an outline highlighting selected U.S. Securities and Exchange Commission (SEC or the Commission), Financial Industry Regulatory Authority (FINRA), and NYSE Regulation enforcement actions and developments regarding broker-dealers during 2009. This LawFlash provides an executive summary of this year's publication. The full 2009 Year-In-Review Outline can be found at http://www.morganlewis.com/pubs/LIT_SECandSROYearlyReviewWP_Jan2010.pdf.

The economic crisis of 2008 and Bernard Madoff's Ponzi scheme led government officials, the public, and the media to call for an increase in securities enforcement activity. As a result, 2009 was a year of change at the SEC and FINRA.

The SEC installed new leadership who perceived a mandate to restore investor confidence by aggressively pursuing companies and individuals who engage in wrongdoing affecting the securities markets. The Commission's new leaders instituted a number of organizational and policy changes intended to make its Division of Enforcement more efficient and effective. Many of the metrics used to measure SEC enforcement activity reflect a significant increase compared to 2008.

With its own new CEO in place, FINRA also looked to make changes in its structure and enforcement processes. It did so last year, but perhaps in less noticeable and transformative ways. In 2009, FINRA's caseload increased; it also brought several actions with large fines, in stark contrast to the prior year.

Consistent with its more focused mandate, NYSE Regulation concentrated on trading and transaction reporting in its major cases and instituted fewer actions than the SEC and FINRA.

These developments are described in detail in the Outline; the major issues are summarized below.

Key Enforcement Developments at the SEC

In 2009, the SEC went through enormous changes. At the top of the list was the new leadership installed at the Commission. In January 2009, Mary L. Shapiro was appointed and confirmed as the new SEC Chairman. Among other senior personnel moves, Chairman Schapiro recruited Robert Khuzami, a former federal prosecutor, to head the Division of Enforcement. The Commission subsequently hired several other former criminal prosecutors to help Mr. Khuzami lead the SEC's enforcement efforts,

including a new Deputy Director and new heads of the Commission's New York and Miami regional offices.

Organizationally, the Division of Enforcement announced plans to develop certain specialized investigative units, streamline management, and create an office responsible for dealing with complaints, tips, and referrals.

First, in an effort to create enhanced specialization, Enforcement is introducing five units: (1) the Asset Management Unit, (2) the Market Abuse Unit, (3) the Structured and New Products Unit, (4) the Foreign Corrupt Practices Act Unit, and (5) the Municipal Securities and Public Pensions Unit.

Second, the SEC is implementing measures to streamline management and internal processes to improve efficiency, including redeploying Division of Enforcement Branch Chiefs to conduct investigations.

Third, the Commission is creating an Office of Market Intelligence, which is responsible for collecting, weighing, analyzing, and monitoring tips, complaints, and referrals received by the SEC each year.

From a statistical perspective, the SEC's fiscal year 2009¹ was a busy time for enforcement. Among the highlights, the Commission:

- Brought 664 cases, down slightly from its 671 actions in the prior year
- Increased the number of cases brought against broker-dealers to 109 actions from FY 2008's 60 cases, a rise of 82%
- Initiated 37 insider trading cases, a drop of 39% from 61 such actions in FY 2008
- Filed 154 enforcement actions in FY 2009 in coordination with criminal actions brought by the Department of Justice (DOJ), representing more than a 30% increase over FY 2008
- Started 944 investigations in FY 2009, up 6% from FY 2008, and issued 496 formal orders of investigation, an increase of more than 100% compared to the prior year
- Closed 716 investigations, down significantly from 1,355 actions closed in the prior year
- Moved quickly to halt and punish misconduct by seeking 71 emergency orders in FY 2009—an 82% increase from the prior year. The Commission also filed 70% of its first enforcement actions within two years of starting an investigation or inquiry, an 8% increase from the prior year.
- Obtained a “favorable” outcome in 92% of its cases—the exact same percentage it had achieved in the two prior years
- Obtained \$345 million in civil money penalties (up 35%) and \$2.09 billion in disgorgement orders (a 170% increase)

Keeping with the theme of change at the Commission, last year there were a number of new policy developments at the SEC. First, Chairman Schapiro ended the “penalty pilot” program in which staff attorneys had been required to obtain settlement ranges from the Commission before starting penalty negotiations with corporate respondents.

¹ The SEC's fiscal year begins on October 1. References to FY 2009 refer to the year that began on October 1, 2008 and ended on September 30, 2009.

Second, the process for obtaining formal orders of investigation was made more efficient by allowing senior Division of Enforcement officials to issue such orders, which allow the staff to subpoena documents and demand testimony under oath.

Third, the SEC began work on several initiatives to foster cooperation by individuals, including developing a public policy statement describing how the Commission evaluates a person's cooperation in its investigations. In mid-January 2010, these efforts came to fruition, with the publication of a formal statement concerning cooperation by individuals. The Division of Enforcement also added several sections to its Enforcement Manual concerning new "cooperation tools" relating to both individuals and corporations, such as Cooperation Agreements, Deferred Prosecution Agreements, and Non-Prosecution Agreements.

In November 2009, the SEC joined President Obama's interagency Financial Fraud Enforcement Task Force, which is designed to strengthen the country's efforts to combat financial crime. This initiative is yet another example of the Commission's efforts to coordinate its activities closely with federal criminal authorities.

Finally, in December 2009, the U.S. House of Representatives passed the Wall Street Reform and Consumer Protection Act of 2009. If approved by the Senate in its current form, the bill would enhance the SEC's enforcement powers by providing it with access to grand jury materials in certain instances, establishing a new whistleblower bounty program, and authorizing the Commission to obtain penalties in cease-and-desist administrative proceedings. The legislation would also force the SEC to either commence an action or close an investigation within 180 days of a Wells notice in most cases.

The SEC's changes in personnel and structure, enforcement statistics, policy, and legislative developments are described on pages 7–14 of the Outline. Summaries of the Commission's key actions against broker-dealers and their employees can be found on pages 15–55 of the Outline.

Developments Relating to Bernard Madoff's Ponzi Scheme

Of course, Bernard Madoff's December 2008 arrest sparked many of the changes in the enforcement landscape discussed in the Outline. That event also triggered a number of SEC and DOJ prosecutions targeted directly at Madoff's Ponzi scheme. The key Madoff-related actions, including those against his auditor, chief financial officer, and computer programmers, and certain individuals and firms that provided their clients' money to Madoff, are described on pages 56–62 of the Outline.

Auction Rate Securities

While the attention given to auction rate securities was arguably the enforcement story of the year in 2008, regulators continued to bring and/or finalize ARS cases in 2009. A list reflecting many significant ARS cases brought by the SEC, FINRA, and state regulators in 2008 and 2009 appears on pages 63–64 of the Outline.

Key Enforcement Developments at FINRA

Last year marked the second full year since NASD Regulation and NYSE Regulation merged to form FINRA in July 2007. On February 24, 2009, the Board of Governors of FINRA announced that Richard G. Ketchum had been appointed FINRA's CEO, replacing Mary Schapiro. Prior to his appointment, Mr. Ketchum served as CEO of NYSE Regulation and as Chair of FINRA's Board of Governors, and he

continues to hold the latter position.

Since becoming FINRA's CEO, Mr. Ketchum has, among other things, focused on the importance of restoring investors' trust in the financial markets and the regulatory system, and promised that FINRA's Department of Enforcement will have the resources it needs to investigate and discipline firms or individuals that harm investors.

The changes at FINRA last year, while not as striking as at the SEC, are noteworthy. To begin, in March 2009, FINRA created the Office of the Whistleblower to accelerate the review and analysis by senior FINRA staff of important tips, and to assure a prompt response to meritorious investigative leads.

In October 2009, FINRA created the Office of Fraud Detection and Market Intelligence, which is responsible for analyzing allegations of fraud brought to the staff's attention either through its own internal processes or external sources. The new office encompasses several existing groups within the Departments of Market Regulation and Enforcement, but fraud cases will generally continue to be investigated in the field by examiners and enforcement staff.

The Department of Enforcement also spent time last year reviewing its case identification, opening, and investigative processes with the aim of being more "nimble and quick." Of note, it is likely that FINRA will increase its use of "onsite" enforcement investigations based upon the success it had with this technique in its 2008 ARS investigations.

Last year, FINRA significantly increased its use of sweeps, canvassing member firms on at least eight topics ranging from transactions with retail customers in various products to hedge fund advertising and sales literature to research and trading "huddles." This activity caused FINRA's Chief of Enforcement, Susan Merrill, to state that "sweeps are back in vogue."

FINRA resolved 1,103 cases last year, up 9.5% from the 1,007 such actions in 2008. It also appears that the fines imposed by FINRA in 2009 will substantially exceed the prior year's totals. Moreover, in 2009, FINRA announced six cases with fines of more than \$1.5 million; there were no such actions publicized in 2008.

These developments are described on pages 65–69 of the Outline. Summaries of the key FINRA disciplinary actions brought last year can be found on pages 70–120 of the Outline.

NYSE Regulation

Notwithstanding the creation of FINRA in 2007, NYSE Regulation retained independent oversight and enforcement responsibility for trading violations occurring on the NYSE's systems and facilities. Pursuant to a regulatory services agreement, NYSE Regulation also regulates the trading on NYSE Arca and NYSE Amex.

Not surprising, given its reduced mandate, the number of cases brought by NYSE Regulation in 2009 dropped substantially from prior years. NYSE Regulation released approximately 25 Hearing Board Decisions that have a 2009 case number (four of which relate to a single case involving four affiliates of one firm). In 2009, NYSE Regulation announced about 46 decisions relating to its oversight of NYSE Arca and NYSE Amex.

A discussion of selected NYSE Regulation and NYSE Arca enforcement actions in 2009 can be found

on pages 121–131 of the Outline.

Morgan Lewis regularly represents broker-dealers and other financial institutions in SEC and SRO enforcement matters. If you have any questions or would like more information on any of the issues discussed in this LawFlash or on other SEC or SRO enforcement matters, please contact the authors, who are members of Morgan Lewis’s Securities Litigation and Enforcement practice:

New York

Ben A. Indek	212.309.6109	bindek@morganlewis.com
Anne C. Flannery	212.309.6370	aflannery@morganlewis.com
Michael S. Kraut	212.309.6927	mkraut@morganlewis.com
Kevin T. Rover	212.309.6244	krover@morganlewis.com

About Morgan, Lewis & Bockius LLP

With 22 offices in the United States, Europe, and Asia, Morgan Lewis provides comprehensive transactional, litigation, labor and employment, and intellectual property legal services to clients of all sizes—from global Fortune 100 companies to just-conceived startups—across all major industries. Our international team of attorneys, patent agents, employee benefits advisors, regulatory scientists, and other specialists—more than 3,000 professionals total—serves clients from locations in Beijing, Boston, Brussels, Chicago, Dallas, Frankfurt, Harrisburg, Houston, Irvine, London, Los Angeles, Miami, Minneapolis, New York, Palo Alto, Paris, Philadelphia, Pittsburgh, Princeton, San Francisco, Tokyo, and Washington, D.C. For more information about Morgan Lewis or its practices, please visit us online at www.morganlewis.com.

This LawFlash is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius LLP. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship. These materials may be considered **Attorney Advertising** in some states. Please note that the prior results discussed in the material do not guarantee similar outcomes.

© 2010 Morgan, Lewis & Bockius LLP. All Rights Reserved.