

## **The SEC Speaks 2010: Fast-Paced Reform Continues in 2010**

**February 11, 2010**

In her opening remarks before the annual “SEC Speaks” conference on February 5 in Washington, D.C., Securities and Exchange Commission (SEC or the Commission) Chairman Mary Schapiro underscored that 2009 was a year of significant organizational and policy reform for the Commission and its Enforcement Division and that the SEC “has turned a corner” in restoring investor confidence. Schapiro emphasized that the Commission has and will continue its reform efforts in 2010 through creative cooperation initiatives, specialized units, and intensive investor-focused rulemaking to react swiftly and proactively to increase investor confidence. Following Chairman Schapiro’s opening address, senior members of the Enforcement Division noted that the Commission’s aggressive reforms in 2009 and 2010 have improved “real-time enforcement,” allowing the staff quicker access to evidence and increased witness cooperation.

### **Enforcement Reforms**

In 2009, Chairman Schapiro and SEC Enforcement Director Robert Khuzami worked together to restructure the Enforcement Division and streamline its procedures.<sup>1</sup> In one of the more significant changes, attorneys in the Enforcement Division no longer need to obtain full Commission approval to initiate a formal investigation or enter into settlement talks with corporate defendants. Further, the Enforcement Division “flattened” its management structure by redeploying its branch chiefs from their primarily supervisory roles to conduct more investigations. The calendar-year 2009 enforcement statistics demonstrate the effectiveness of these new initiatives and show increases in virtually every enforcement category.

Thus far in 2010, the Enforcement Division has adopted a sweeping new cooperation initiative designed to encourage companies and individuals to cooperate in investigations and enforcement actions. In addition, the Enforcement Division announced the leadership of new specialized units that it had created to enhance the staff’s knowledge of particular complex market segments that may need enhanced regulatory scrutiny. Finally, senior Enforcement staff signaled that the ever-increasing coordination with

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<sup>1</sup> See Morgan Lewis’s *2009 Year in Review: SEC and SRO Selected Enforcement Cases and Developments Regarding Broker-Dealers*, for a comprehensive review of SEC organizational and policy changes, enforcement actions, and enforcement statistics, available at [http://www.morganlewis.com/pubs/SecuritiesLF\\_2009YearInReview\\_28jan10.pdf](http://www.morganlewis.com/pubs/SecuritiesLF_2009YearInReview_28jan10.pdf).

the Department of Justice and other federal and state regulatory agencies will continue into 2010, consistent with the aims of the Interagency Financial Fraud Enforcement Task Force that President Obama established in November 2009.

### *New Cooperation Initiatives*

On January 13, 2010, the Commission published its formal statement concerning cooperation by individuals and companies. First, the Commission set forth for the first time formal guidelines to evaluate and reward cooperation by individuals in investigations and enforcement actions. Second, the Enforcement Division added several new sections to its Enforcement Manual, authorizing the staff to use new cooperation tools related to both individuals and companies, including cooperation agreements, deferred prosecution agreements, and nonprosecution agreements. In addition, the Commission streamlined the process for obtaining witness immunity requests from the Department of Justice (DOJ) when a party is cooperating in SEC proceedings.<sup>2</sup>

Lorin Reisner, Deputy Director of the Division of Enforcement, acknowledged defense counsels' skepticism about whether these new measures will provide concrete benefits to clients. In response to these concerns, Reisner promised that the Commission will indeed extend significant benefits to motivated cooperators that provide substantial assistance to the staff in investigations. He also promised, however, severe consequences for those that do not cooperate, indicating that the staff will inform the Commission of a failure to cooperate, and will seek harsh penalties when making enforcement recommendations. The Enforcement staff noted that various cooperation agreements are already in the works.

Reisner stressed that the degree of culpability will weigh heavily on the Commission's decision to reward cooperation and that cooperation agreements likely will not be available for egregious conduct. Reisner made clear that the Commission will not put investors at risk when evaluating cooperation. Nevertheless, recognizing that the cooperation program will only work if individuals actually see tangible benefits from the Commission, Reisner emphasized that the door is open for cooperation and that qualifying individuals can expect significant cooperation credit.

Reisner also noted that the Commission's new cooperation paradigm raises potential conflict-of-interest issues. He underscored that there can be only one first cooperator and that the staff will evaluate and raise ethical issues with counsel, where appropriate, in the context of multiple representations, if it appears that a conflict of interest exists.

### *Specialized Units*

On January 13, the Commission also announced the leadership of five national specialized units to enhance market specialization: the Asset Management Unit, the Market Abuse Unit, the Structured and New Products Unit, the Foreign Corrupt Practices Act Unit, and the Municipal Securities and Public Pensions Unit. Enforcement Director Khuzami explained that the formation of these units will enable

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<sup>2</sup> See Morgan Lewis's White Paper, *The Securities and Exchange Commission Announces New Cooperation Initiative* (January 2010), available at [http://www.morganlewis.com/pubs/WP\\_SECAnnouncesNewCooperationInitiative\\_Jan2010.pdf](http://www.morganlewis.com/pubs/WP_SECAnnouncesNewCooperationInitiative_Jan2010.pdf), for a more detailed discussion on these new cooperation initiatives.

the staff to develop particular expertise in complex markets or in targeted areas in need of enhanced enforcement scrutiny.

For example, the Enforcement staff commented that the municipal securities market represents an enormous portion of economic financing; yet this area of the securities market is thinly regulated. The Municipal Securities Unit will focus on pay-to-play, tax arbitrage, and bond valuation issues, as well as ensuring that investors have full and accurate disclosures in offering materials and public pension fund disclosures.

Newly appointed unit chiefs report that their units have already achieved positive results. For example, the Market Abuse Unit is taking a proactive approach in combating “organized” insider trading among large institutions and associated persons, and has penetrated these rings as reflected in recent enforcement actions and settlements. Other unit chiefs forecasted their units’ ability to better recognize, react to, and prevent market abuses.

#### *Increased and Effective Coordination with Regulatory Agencies*

The Enforcement staff acknowledged that now more than ever, investigations involve multiple federal and state agencies. In fact, in 2009, the Enforcement Division ramped up its coordination with criminal and other regulators, working in tandem on nearly all of its recent high-profile cases, and filing approximately 30% more enforcement actions in coordination with the DOJ. The Enforcement staff recognized that overlapping investigations present significant challenges to all involved and pledged to work efficiently with these other agencies to relieve unnecessary burdens, such as duplicate document productions and witness testimony.

With respect to cooperation across agencies, the staff announced that the Enforcement Division recently revised its standard proffer agreement. Under prior practice, the staff, in the course of an investigation, could grant federal and state agencies unrestricted access to its regulatory files, including access to witness proffer statements. This practice, however, afforded cooperating witnesses little or no protection with respect to how those agencies could use their statements. The Commission has now revised its standard proffer agreement, to provide that any agency seeking access to the staff’s files can obtain copies of witness proffers only if that agency agrees to abide by the same terms and conditions as the Commission.

#### *2009 Enforcement Statistics Evidence the Effect of New Reforms*

Chairman Schapiro noted that enforcement statistics in calendar year 2009 demonstrate that the Commission’s reform efforts are working.<sup>3</sup> In 2009, the Enforcement Division issued more than twice as many formal orders, sought more than twice as many temporary restraining orders and asset freezes, filed nearly 10% more enforcement actions, and obtained twice as much in corporate penalties and approximately \$540 million more in disgorgement, than it did in 2008.

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<sup>3</sup> The Commission’s fiscal year begins on October 1. Enforcement statistics for Fiscal Year 2009, which differ in some respects from the calendar-year statistics that Chairman Schapiro discussed, can be found in the Commissions 2009 Performance and Accountability Report, available at <http://www.sec.gov/about/secpar/secpar2009.pdf> and also at [http://www.morganlewis.com/pubs/SecuritiesLF\\_2009YearInReview\\_28jan10.pdf](http://www.morganlewis.com/pubs/SecuritiesLF_2009YearInReview_28jan10.pdf).

In 2009, the Enforcement Division instituted a wide range of enforcement actions, including pay-to-play and accounting fraud cases. The Enforcement staff also highlighted a recently settled civil action against a bank and trust company for misleading investors about subprime mortgage investments. The Enforcement staff emphasized an increase in institutional insider trading cases, headlined by the recent Galleon hedge fund prosecutions, and promised a strong national focus in this area. Further signaling aggressive enforcement, the Commission used for the first time the “clawback provisions” of Section 304 of Sarbanes-Oxley to seek recovery of compensation and profits from a chief executive officer, even though the officer was not charged with wrongdoing.

The Enforcement staff also reported increased enforcement efforts in the area of financial disclosure, including issues related to revenue recognition and the incorrect valuation of reserves. Further, the Enforcement staff warned about potential charges related to public audits and noted a recently settled administrative and cease-and-desist proceeding against an independent public accounting firm in connection with the firm’s unqualified audit opinions issued on behalf of a client that was engaging in financial fraud. On a related point, the Commission in 2009 sought to bar 46 accountants and seven attorneys from practicing before the Commission pursuant to Rule 102(e) of the Commission’s Rules of Practice.

### **Investor Protection**

Chairman Schapiro outlined an aggressive agenda to protect investors. First, she pledged to ensure that investors are provided adequate disclosures. Here, the Commission has proposed rules to improve the quality and timeliness of disclosure in the municipal securities markets. These new rules will require issuers to disclose within 10 days important information, such as determinations of taxability by the IRS, tender offers, bankruptcies, receiverships, and similar proceedings. Chairman Schapiro also pledged to demand more robust point-of-sale disclosures from financial professionals to investors, including full disclosure of the professional’s compensation and potential conflicts.

Second, the Commission has adopted rules that provide greater protections to investors who entrust their assets to investment advisers. Money managers who hold or control client assets will be subject to surprise inspections to verify assets, and affiliated custodians will be subject to an annual custody review by an independent third-party accountant. Chairman Schapiro also noted that the Commission has begun integrating its broker-dealer and investment adviser examinations. The full text of Chairman Schapiro’s speech can be found at <http://www.sec.gov/news/speech/2010/spch020510mls.htm>.

### **What to Expect**

The aggressive measures that the Commission adopted in 2009 and thus far this year send a clear message—the SEC will move quickly and aggressively to gather evidence and prosecute misconduct. In turn, corporate counsel must be proactive and vigilant in reviewing internal controls to prevent and detect wrongdoing and must be prepared to respond with all appropriate speed to regulatory inquiries.

The cooperation initiative presents new opportunities to seek tangible benefits for “motivated cooperation” but also presents challenges on multiple fronts, including in multiparty representations. Moreover, corporate counsel can expect some “growing pains” within the Enforcement Division in its efforts to apply criminal techniques in the civil regulatory context. Finally, financial companies and issuers can expect increased scrutiny in areas of financial disclosures and, in particular, significant rule changes making disclosure requirements more stringent in the area of municipal markets.

If you would like more information or have any questions on any of the issues discussed in this LawFlash, please contact authors Patrick Conner and Andrew Southerling, or any of the other attorneys listed below:

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