

Alerts

## SEC Co-Director Speaks on Enforcement Division Changes

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At the SIFMA Legal and Compliance Monthly luncheon held in New York City in July, Andrew Ceresney, Co-Director of the SEC Division of Enforcement, provided an overview of changes at the Enforcement Division as well as the current focus of its activities.

Some of the changes he highlighted relate to how the SEC will address the settlement of its enforcement actions and penalties are expected to increase to reflect the "new reality" of the size of transactions and companies. We can also anticipate the SEC will seek aggressive forms of remedies for settlements of enforcement actions and conduct-based injunctions may become a base remedy.

However, he suggested that the majority of settled enforcement cases will continue to be handled on a No Admit/No Deny basis. Nonetheless, some cases will now require that defendants admit to conduct and securities violations in order to resolve enforcement action. Undoubtedly, this new policy may cause defendants to weigh the risks of an enforcement action trial more favorably rather than to be exposed to potential civil actions by investors and criminal actions by prosecutors.

The following is a non-exclusive list of factors that the SEC may consider when determining whether to demand admissions from a defendant:

- Number of harmed investors;
- Harm to markets;
- The nature of the defendants; and
- Message to the markets

Although the SEC will continue to be reactive to new developments, Cesney noted several areas on which the SEC will likely target its resources.

- **Accounting Fraud** - The SEC has formed a Financial Reporting and Audit Task Force that is dedicated to detecting fraudulent or improper financial reporting. Its work will enhance the Division's ongoing enforcement efforts related to accounting and disclosure fraud.
- **Investment Advisors** continue to remain a focus of the Division. Cesney noted that Ponzi schemes, conflicts of interests, and director oversight of funds are of increased interest to the SEC. By way of example, the recent SEC settlement with the Morgan Keegan bond funds reflects the SEC's intention to hold directors accountable for the activities of the funds they oversee. In the Morgan Keegan action, the SEC settled civil charges accusing eight former directors of failing to police the portfolio managers they oversaw.
- **Market Structure/Trading Issues** - Recent cases against the NYSE, NASD, and CBOE reflect the SEC's growing concern that SRO's do not have appropriate compliance and oversight systems in place. "Dark

Pools" also are a concern to both the SEC and off-exchange trading platforms. High Frequency trading and Rule 15(3)-5 (Market Access Rule) will likely receive increased scrutiny from the SEC as well.<sup>1</sup>

- **Structured and New Products** will remain active. Cesney used the commencement of the trial of Goldman Sachs trader Fabrice Tourre as an example. Tourre is accused of making misstatements and omissions to investors in a portfolio of 90 sub-prime and mid-prime residential mortgage-backed securities.
- **The Foreign Corrupt Practices Act** is another important area of focus for the Enforcement Division. Several recent enforcement actions provide guidance to companies in the area of cooperation.

For instance, the SEC and Ralph Lauren Corporation entered into a non-prosecution agreement (NPA) in which the company disgorged over \$700,000 in profits and interest obtained in connection with bribes paid by a subsidiary to government officials in Argentina from 2005 to 2009. The misconduct was uncovered in an internal review undertaken by the company and promptly reported to the SEC. The SEC decided not to charge Ralph Lauren Corporation with violations of the FCPA based on several factors, including the company's prompt reporting of the violations on its own initiative; the completeness of the information it provided; and its extensive, thorough, and real-time cooperation with the SEC's investigation. Ralph Lauren Corporation's disclosure and cooperation saved the agency substantial time and resources ordinarily consumed in comparable conduct investigations.

SEC intends to be proactive in deterring and uncovering fraud. One of the initiatives recently taken by the SEC is the formation of the Center for Risk and Quantitative Analytics ("CRQA"). The CRQA will act as the central point of contact for risk-based initiatives nationwide for all the SEC's Divisions, and it will serve as both an analytical hub and source of information about characteristics and patterns indicative of possible fraud or other illegality.

In summary, settlement of enforcement actions may become more difficult given the SEC's more aggressive approach of larger and more creative fines, and the possible demand for admissions of culpability from defendants. With the stream of the financial cases from the credit crisis slowing, the SEC intends to redeploy its assets into accounting fraud, supervision of investment advisers and investment companies, and market issues such as insider trading and new products. The SEC intends to combat fraud through technology and better coordination among its divisions.

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1. The SEC is not the only federal agency concerned about high frequency traders. The CFTC announced a settlement with Panther Energy Trading Partners on July 22, 2013. The firm agreed to a one year ban and a \$2.8 million fine to settle charges that it manipulated an energy market.