



SECURITIES INDUSTRY

ALERT

SEC ENFORCEMENT STAFF GAINS SUBPOENA POWER (AND OTHER EVOLUTIONS IN THE DIVISION'S AUTHORITY AND RESPONSIVENESS)

The SEC Enforcement Division (Enforcement or the Division) recently announced a series of changes to its authority and structure that will make the Division more autonomous and quicker to act in its investigations. The changes look to make the Division more agile in all levels of its investigations – from the handling of tips that start investigations to the litigating of fully developed investigations. Based on these institutional changes – coupled with the Division's and the SEC's pronounced desire to be more "effective" – we advise clients to take note of these developments and prepare for a tougher, more aggressive regulator.

ENFORCEMENT STAFF'S NEW SUBPOENA POWER

To mandate document production and testimony from securities industry participants (indeed, anyone) in a given investigation, Enforcement attorneys generally need to have in place a "formal order of investigation" for the matter. Until now, to obtain that formal order, staff had to craft a convincing summary of a case; obtain approval from Enforcement management for the presentation of the formal order to the five commissioners themselves; and then delicately wait for a review by and meeting of those commissioners to grant the formal order of investigation in a case. In our experience, such procedures could stall the progress of an investigation for several months – even in cases where a respondent may be willing to cooperate with the Enforcement staff, but for legal reasons needed staff to present them with a subpoena before they could comfortably do so.

That logjam in the process has now been removed. On August 5, 2009, the SEC amended its rules to delegate to the Director of Enforcement the authority to issue formal orders of investigation (SEC Release No. 34-60448). Furthermore, in a speech that day, the new Director of Enforcement, Robert Khuzami, announced that he would soon be delegating that authority to senior officers throughout the Division. To emphasize the change this means for Enforcement investigations, we quote Khuzami himself:

Thus, Staff will no longer have to obtain advance Commission approval in most cases to issue subpoenas; instead, they will simply need approval from their senior supervisor. This means that if defense counsel resist the voluntary production of documents or witnesses, or fail to be complete and timely in responses or engage in dilatory tactics, there will very likely to be a subpoena on your desk the next morning. [Emphases added.]

BEEFING UP STAFF

Enforcement has recently been adding trial attorneys with the express purpose of presenting a more imposing presence to respondents in its investigations. As Khuzami stated, "It is imperative that we convey to all defendants in SEC actions that we are prepared to go to trial and we will win, as evidenced by our eight trial wins since April..." The Division has also recently tripled its paralegal and support personnel so as to free investigators to perform more "front-line" work and to relieve them from routine administrative burdens.

STREAMLINING THE INVESTIGATIVE PROCESS

In an effort to expedite cases, the Division is streamlining both its management structure and its investigative process, as follows (among other things):

- Redeploying "branch chiefs" from their current mid-level managerial functions to conducting investigations again, resulting in a flatter structure and more front-line decision-making.
- Delegating the power to approve all routine case decisions from the national Deputy Director to the Division's senior officers located throughout the country.
- Shortening the required length and detail of internal memoranda that recommend specific Enforcement actions (so-called Action Memos), reducing the number of reviews they must undergo and shortening the time of those reviews.
- Severely limiting the availability of "tolling agreements" (wherein respondents agree to "toll" (i.e., pause) the application of a statute of limitations in a matter in return

for more time from Enforcement staff to respond to staff requests and a delay by staff in making formal filings in the case).

- Creation of an “Office of Market Intelligence” to be responsible for the collection, analysis, risk-weighting, triage, referral and monitoring of the hundreds of thousands of tips, complaints and referrals that the SEC receives each year.
- Hiring the Division's first Chief Operating Officer, who will take over the Division's technology, project management and the collection and distribution of funds obtained in Enforcement cases.

NEW SPECIALIZED INVESTIGATION UNITS

Enforcement will soon be establishing specialized units of select attorneys, staff and resources to focus on practices, transactions, products, markets and regulatory regimes. Each will have a Unit Chief and will be staffed across the country, receiving focused, advanced training. The Division will also be hiring experts from industry for these units. The five units currently planned are:

- **Asset Management Unit**
To focus on investment advisors, investment companies, hedge funds and private equity funds and look for violations in relation to disclosure, valuation, portfolio performance, due diligence and diversification, transactions with affiliates, misappropriation, conflicts of interest and others.
- **Market Abuse Unit**
To focus on large-scale market abuses and complex manipulation schemes by institutional traders and market professionals, among others, and look for violations in relation to markets, equities, debt securities and derivatives, and across different markets, products, corporate announcements and other market events.
- **Structured and New Products Unit**
To focus on complex derivatives and financial products, including CDS, CDOs and securitized products, looking for violations typically masked by the complexity of the products, the limited availability of trading information and the prevalence of private offerings.
- **Foreign Corrupt Practices Act Unit**
To focus on U.S. companies bribing foreign officials for government contracts and other business, working more closely with foreign counterparts and taking a more global approach to these violations.

- **Municipal Securities and Public Pensions Unit**
To focus on offering and disclosure issues, tax and arbitrage-driven activity, unfunded or underfunded liabilities and “pay-to-play” schemes (in which money managers and advisors pay kickbacks and give other favors in return for the right to sub-advise the funds).

INCENTIVIZING COOPERATION

Khuzami is a former federal prosecutor, so it is natural for him to state that he deems it “critical” that Enforcement increase its incentives to individuals to cooperate in investigations. He has announced four initiatives in that regard (all still works-in-progress):

- **Enhance Individuals' Cooperation**
Establish and announce standards to evaluate cooperation by individuals in enforcement actions.
- **Criminal Immunity**
Seek authority for the Division Director to submit immunity requests to the Department of Justice.
- **Non-Target/Subject Assurances**
Explore ways to provide witnesses in the appropriate cases with verbal assurance early on in a case that Enforcement does not intend to file charges against them.
- **Deferred Prosecution Agreements**
Recommend to the Commission that the SEC enter into Deferred Prosecution Agreements, in which Enforcement agrees to forego an enforcement action against an individual or entity subject to full cooperation, a waiver of statutes of limitations and/or compliance with certain undertakings.

Some of these plans and initiatives are already in place. Others are in progress, and the rest are still in the conceptual stage. Some of these changes will make investigations more difficult for respondents, but others will accrue to some respondents' benefit.

Regardless, clients should take heed that the Enforcement Division – indeed, the SEC as a whole and all other financial regulators – is undergoing changes that will make it more proactive and vigorous in its evaluations of and judgments about professionals in the securities industry.

As always, Fox Rothschild LLP stands ready to assist you navigate these ever-changing waters.

For further information, please contact
Ernest E. Badway at 973.548.7530 or 212.878.7900; ebadway@foxrothschild.com
Joshua Horn at 215.299.2184; jhorn@foxrothschild.com
Joseph M. Pastore III at 203.425.1504; jpastore@foxrothschild.com
William M. Dailey at 203.425.1591; wdailey@foxrothschild.com
Visit us on the Web at www.foxrothschild.com.

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