Testimony of William F. Galvin
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Examining Settlement Practices of U.S. Financial Regulators

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Chairman Bachus, Ranking Member Frank, and other members of the Committee, thank you for this opportunity to discuss regulatory settlements in the financial services industry.

I am Bill Galvin, Secretary of the Commonwealth and Chief Securities Regulator of Massachusetts.

Regulation without effective enforcement makes such regulation little more than political rhetoric and, worse, leads to a false sense of financial security for our citizens.

My Securities Division carries out an active program of civil enforcement in order to detect and stamp out securities fraud. These enforcement actions have returned over 400 million dollars directly back to defrauded investors. As our reputation for effective securities enforcement has grown, we have deterred fraud from entering our state – promoters of many stock frauds do not want to risk dealing with our Enforcement Section, and they stay out of Massachusetts.

I have long spoken out against the established pattern in federal settlements of allowing respondents to enter into settlements where they neither admit nor deny the allegations in the administrative complaint for the enforcement action. In 2003, I had the opportunity to testify before a subcommittee of the U.S. Subcommittee on Government Affairs. I said at that time, "too often the guilty neither admit or deny any wrongdoing and routinely promise not to cheat again until they can come up with a more clever method to do what they just said they would not do again."

I repeat these words today with even a greater sense of urgency as events of recent days have shown.

One of the priorities of the Securities Division is that firms and persons that have violated laws should be required to acknowledge what they have done. Permitting a firm to enter into a settlement where it pays a fine, but neither admits nor denies that it has done anything wrong, permits that firm to avoid basic culpability for its actions. In some instances, we have seen firms enter into regulatory settlements, pay large fines, and also issue press releases stating that the firm settled the matter in order to "avoid the distractions" created by prolonged litigation. Permitting firms to take this kind of posture allows the firms to avoid acknowledging their misconduct and permits such firms to publicly take the stance that such settlements are part of business as usual.

If we intend to reform the worst practices in the financial industry, then the firms that have violated the law must acknowledge that what they have done is wrong.

The settlement of enforcement actions involves the evaluation and balancing of many factors. Settling a case is a dynamic process that requires considerable skill and persistence. In many cases, there is a thin line between arriving at a satisfactory settlement and failing to reach any settlement at all.

In determining the resolution of any case, the Massachusetts Securities Division gives the highest priority to the protection of investors. We do not pursue or resolve cases to enhance our prestige. Acting in the public interest and protecting retail investors are our paramount concerns.

Restitution and Other Remedies

However, in many cases, the best resolution we can achieve is to require an issuer of securities or securities broker to repay defrauded investors and make them whole.

One of the greatest satisfactions of my role is getting restitution for investors, and preventing the operators of financial frauds from simply walking away from their victims with their ill-gotten profits. Obtaining such restitution for investors means that they will be able to recoup their financial nest eggs: they will be able to cover college costs, they will be able to fund their retirements, or they will have the funds needed to pay the costs of long-term care. When we have obtained restitution for investors, in many cases we have saved them from financial ruin.

Our enforcement actions also seek other sanctions and remedies. We have imposed significant fines designed to deter future violations of the law and to serve as a warning to the industry that misconduct will not be tolerated.

In 2011, the Division settled the Goldman Sachs "analyst huddles" case, which involved the practice of Goldman Sachs giving its best research recommendations to preferred customers in order to attract more business from those customers. This practice gave some Goldman customers unfair advantages over other customers. Goldman settled the case by agreeing to reform its practices and by paying a 10 million dollar fine. In the settlement, Goldman admitted the factual allegations in the Consent Order, which we believe will deter Goldman and other firms from engaging in the same sorts of conflicts in the future.

Massachusetts participated in a national settlement of cases relating to improper sales of auction rate securities by three major brokerage firms. In that settlement we prioritized restitution: the firms neither admitted nor denied the facts that were alleged, but the firms agreed to repurchase those securities from investors, paying 19.6 billion dollars in restitution.

In the Securities Division's case against Fairfield Greenwich, a Madoff feeder fund, the respondents did not admit or deny the facts that were alleged. However, in that settlement, Fairfield Greenwich again agreed to make full restitution to Massachusetts investors. We gave high priority to getting restitution for investors in order to protect their interests in a situation that was rapidly deteriorating.

Between 2003 and 2012, total investor restitution of $404,037,375 was paid directly to investors in Securities Division cases. This does not include amounts paid in the multi-state settlement of the auction rate securities cases.

We have also suspended or revoked the licenses of bad actors in the securities industry. We have required firms to adopt remedial measures and special supervision procedures to address compliance problems.

Balancing Policy Factors in Settlements

The Securities Division must consider an array of factors in negotiating the settlement of an enforcement action.

The key factor is whether we can get restitution for investors and the amount of that restitution. We also give high priority to requiring that the respondent broker or firm admit the wrongdoing that led to the enforcement action.

We do consider other factors as well. Often, we can make a strong statement to the marketplace and deter others from violating the law if we can settle a case quickly and decisively. Collecting significant civil fines can affect the bottom lines of these firms and can deter other potential violators. Because our agency has limited resources, a good settlement will free those resources to pursue other complaints.

In settlement negotiations, we always seek to settle on strong terms and to make investors whole.

The Massachusetts Securities Division analyzed the 82 Consent Orders (settlements) it has entered into from 2003 to the present.

Based on this analysis, the respondents admitted to the facts that the Securities Division alleged in its administrative complaint in more than 40% of the cases.

The Securities Division places a high priority on getting restitution for defrauded investors. This results in a clear variation in the number of respondents who admit to facts in cases where restitution is paid, and in those cases where no restitution is paid. Restitution was paid in connection with 42 consent orders, a majority of settlements. In the cases where no restitution was paid, nearly half of respondents admitted to the alleged facts.

Judicial Review

While the courts play an important role in overseeing civil cases filed by the SEC and in approving settlements of those cases, the courts must not second guess SEC settlement policy. I have spoken out to urge the SEC to be more assertive in the area of requiring respondents to admit wrongdoing. I continue to believe this is a valuable tool to enforce the securities laws in a meaningful way.

This hearing addresses the recent rejection of a proposed settlement between the SEC and Citigroup by Judge Rakoff, of the Southern District Court in New York. Judge Rakoff's rejection of the settlement is being appealed by both parties, and the District Court proceeding is stayed. Judge Rakoff raised important and valuable questions about the settlement. The Judge particularly questioned why Citigroup should be able to settle

very serious charges without any requirement that they admit what they had done. While many of the Judge's concerns were valid, by rejecting the settlement, he inappropriately substituted his own assessment of those issues for the assessment made by the SEC.

The SEC must maintain its independence on these issues. Those who in this case champion this Judge's view of this settlement should remember that once SEC independence is compromised, a different Judge in another case could weaken SEC settlement terms. As an executive agency, in the absence of obvious error, the SEC must be able to decide which matters to investigate, which cases to litigate, which charges to bring, and the terms of any settlements.

As the head of a securities regulatory agency, I understand the complex factors that go into the terms of a settlement. These include: limited agency resources, the anticipated testimony of witnesses, potentially uncertain issues of case law, the potential dissipation of funds available for restitution, and the activity of other regulators. Weighing these factors is the particular province of a regulatory agency –it will not serve the public interest or protect investors to permit courts to reject regulatory settlements based on a judge's sense that he would not have made the decisions that the regulatory agency made.

The Value of Requiring Admissions

Through my past public statements and through the way that the Massachusetts Securities Division handles its cases, my Office has taken a strong stand that persons and companies that have violated the law should admit what they have done. Dealing with other people's funds is a position of trust. Anyone who violates that trust should expect to be appropriately punished for violating the law – this includes a requirement to admit

those violations. Requiring such admissions is a powerful tool to correct past bad conduct and to deter future violations. This requirement is absolutely in the public interest and promotes the protection of investors.

Thank you for this opportunity to testify. I will address any questions you have.