

Testimony on “Oversight of the SEC’s Division of Enforcement”

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Subcommittee on Capital Markets and Government Sponsored Enterprises**

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Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee:

Thank you for inviting me to testify on behalf of the U.S. Securities and Exchange Commission (“SEC” or “Commission”) about the Division of Enforcement (“Enforcement” or “Division”).

The SEC’s mission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The Division furthers this mission by, among other things, investigating and bringing charges against violators of the federal securities laws. A strong enforcement program is at the heart of the Commission’s efforts to ensure investor trust and confidence in the nation’s securities markets, and the Division is committed to the swift and vigorous pursuit of those who have broken the securities laws.

In FY 2014, the Commission brought the highest number of enforcement actions to date, 755, and obtained monetary remedies at our highest level, totaling over \$4.16 billion. More importantly, these actions addressed significant issues, spanned the entire spectrum of the securities industry, and included numerous first-of-their kind actions. We punished securities law violators, returned funds to injured investors, and sent important messages of deterrence. Our investigative efforts have been assisted by industry experts and by new tools developed to harness data, including trading and financial data. The Division also maintained its strong litigation record and implemented a new approach of requiring admissions in certain cases.

While I cannot today cover all of the Division’s responsibilities, initiatives, and day-to-day activities, I want to highlight certain of Enforcement’s areas of focus, specifically:

- Financial Reporting, Accounting, and Disclosure
- Investment Advisers
- Market Structure, Exchanges, and Broker-Dealers
- Municipal Securities and Public Pensions
- Insider Trading
- Microcap Fraud/Pyramid Schemes

- Complex Financial Instruments
- Gatekeepers; and
- Foreign Corrupt Practices Act (“FCPA”)

I also will discuss the Division’s litigation and trial work, and explain some of the recent enhancements in our continuing effort to make Enforcement more effective and efficient in furthering the SEC’s mission.

THE DIVISION OF ENFORCEMENT

The Division protects investors and the markets by investigating potential violations of the federal securities laws and litigating the SEC’s enforcement actions. Enforcement staff includes investigators, accountants, industry experts, trial attorneys and other employees in Washington, D.C. and the eleven Regional Offices. The Division has five specialized units focused on critical areas, including: the Asset Management Unit, the Complex Financial Instruments Unit; the FCPA Unit; the Market Abuse Unit; and the Municipal Securities and Public Pensions Unit. Also included within the Division are the Office of Market Intelligence, which is responsible for the collection, analysis, risk-weighting triage, referral and monitoring of the over 15,000 tips, complaints and referrals received by the Division each year, and the Office of the Whistleblower, which administers the whistleblower program created by Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Division also is responsible for the collection of monies owed as a result of legal action brought by the Commission, as well as the distribution of monies to harmed parties whenever practicable in a fair, reasonable, and cost-effective, manner. In addition to its various offices, working groups, and task forces, the Division works closely with the other divisions and offices of the SEC and regularly coordinates with other regulators and law enforcement agencies to enforce the federal securities laws and inform our priorities.

FY16 BUDGET REQUEST

The SEC’s FY 2016 Budget requests 93 additional positions for Enforcement. The Division will utilize these additional resources to support its three core functions – intelligence analysis, investigation, and litigation. Specifically, the Division will use the additional resources to:

- Expand Enforcement’s data analytics expertise to assist in the development and implementation of data projects and new investigative tools, as well as increase staffing for the collection, analysis, triage, referral, and follow-through on the thousands of tips, complaints, and referrals that the Division receives every year.
- Hire experienced accountants, attorneys, industry experts, and other professionals to promptly detect, prioritize, and effectively investigate wrongdoing in high priority areas.
- Hire additional experienced trial attorneys and support staff to prosecute the Division’s expanding docket of complex litigation and trials.

These additions to the Enforcement staff are designed to enable the Division to more effectively and efficiently protect investors and the markets.

ENFORCEMENT PRIORITIES

Financial Reporting, Accounting, and Disclosure

Pursuing financial reporting and auditing violations continues to be a focus of the Division. Comprehensive and accurate financial reporting is critical to ensuring that investors have access to reliable information and can make informed decisions. Because false or misleading financial information erodes the integrity of this disclosure regime, enforcement actions in this area are essential to ensuring public confidence in the securities markets. Significant actions filed addressed revenue recognition violations, false management estimates, auditor independence issues, and other false and misleading financial disclosures.

To focus resources on financial reporting and auditing violations, Enforcement created the Financial Reporting and Audit Task Force.¹ The Task Force's mandate is to develop methodologies and tools for detecting financial reporting issues, identify specific issuers with potential violations, determine whether further investigation is warranted, and refer appropriate matters to investigative staff across the Division. The Task Force is one of several initiatives across the Division designed to increase focus on financial reporting and auditing issues. These efforts are starting to produce results, as FY 2014 saw a 40% increase in financial reporting and auditing filed actions and investigations.

Investment Advisers

Investment advisers and the funds they manage traditionally have been, and remain, a focus of Enforcement. The Division regularly investigates and brings actions against investment advisers for conflicts of interest, misrepresentations regarding performance or investment strategies, breaches of their fiduciary duties to their clients, or other fraudulent conduct. The Division also has recently launched a number of successful initiatives concentrating on areas that have traditionally received less attention, including custody rule violations, the adequacy of investment adviser compliance programs, and undisclosed adviser fees. The Division works closely with the Division of Investment Management and OCIE on these initiatives. In addition, the Division's Asset Management Unit, in conjunction with Division of Economic and Risk Analysis, has developed the Aberrational Performance Inquiry, which uncovers potential misconduct by identifying unusual performance returns posted by unregistered and registered hedge fund advisers. To date, this initiative has generated more than ten enforcement actions.

Market Structure, Exchanges, and Broker-Dealers

Enforcing the statutes and rules related to market structure is an enforcement priority, as the proliferation of sophisticated trading technologies, such as algorithmic and automated trading, have transformed the securities markets. These issues present significant potential risks to investors and the markets, and the Division is keenly focused on keeping pace with these changes by leveraging the knowledge of its specialized units, closely collaborating with the other SEC divisions, including Trading and Markets and the Office of Compliance, Inspections and

¹ See SEC Spotlight on the Financial Reporting and Audit Task Force, available at <https://www.sec.gov/spotlight/finreporting-audittaskforce.shtml>.

Examinations (“OCIE”), and employing technology to more effectively analyze trading data. The Division has recently filed a number of actions against market participants that pose a risk to the markets by failing to operate within the rules. These include significant cases against exchanges and other trading platforms for violating rules governing their operation, broker-dealers for failing to live up to their obligations as gatekeepers providing direct market access, and other market participants for manipulative trading and related abuses. Indeed, earlier this year, we brought actions with record penalties against an exchange and an alternative trading system.

Municipal Securities and Public Pensions

Another priority for the Division is municipal securities, which are an important investment vehicle for retail investors, and public pensions. Particular areas of focus include misrepresentations in connection with bond offerings, failures by underwriters to meet their obligations, undisclosed conflicts of interest, and pay-to-play violations. This past fiscal year, the Commission brought its first emergency action to stop a fraudulent municipal bond offering, and also obtained its first penalty against a municipal issuer.² The Division also implemented a new self-reporting initiative, the Municipalities Continuing Disclosure Cooperation Initiative, designed to address widespread continuing disclosure violations by municipal bond issuers and underwriters. The voluntary initiative has resulted in a large number of self-reported violations and, more importantly, brought attention on disclosure compliance in the municipal securities area.

Insider Trading

Policing insider trading has long been central to the Commission’s mission of ensuring confidence in the markets. The Division has been very active in pursuing insider trading and has charged more than 590 defendants in civil insider trading cases over the last five years. These cases, which send a strong deterrent message to would be-violators, have involved a wide range of entities and individuals such as financial professionals, lawyers, and corporate insiders who breached their duties in unfair and unlawful pursuit of their own personal gain.³ Our efforts in this area have greatly benefitted from new technological tools developed internally that allow us to identify suspicious trading patterns and connections between traders and potential sources from massive amounts of trading data.

Microcap Fraud/Pyramid Schemes

Utilizing a coordinated approach to pursuing misconduct in microcap securities,⁴ the Division has created a Microcap Fraud Task Force to proactively address this type of fraud. Wrongdoing in this area frequently involves serial violators and organized syndicates that employ new media, including websites and social media, to conduct fraudulent promotional campaigns and engage in manipulative trading. This misconduct largely occurs at the expense of

² The financial penalty imposed to sanction and deter the municipality’s misconduct was paid from the relevant project’s operating funds without directly impacting taxpayers.

³ See SEC Spotlight on Insider Trading Cases, available at <http://www.sec.gov/spotlight/insidertrading/cases.shtml>.

⁴ Microcap securities are low-priced stocks issued by the smallest of companies.

less sophisticated retail investors. As part of our ongoing effort to combat this fraud, the Commission is aggressively using trading suspensions to cut off trading in securities that are the objects of “pump-and-dump” market manipulation schemes.⁵ In FY 2014, the Commission suspended trading in more than 250 dormant shell companies, which can be used as a vehicle for these schemes by stock manipulators, and in more than two dozen securities that were being used in apparent pump-and-dump schemes. At the same time, the Division is targeting the repeat offenders that help facilitate pump-and-dump schemes, including promoters, lawyers, accountants, and transfer agents, often collaborating with criminal law enforcement partners to build cases.

The staff also has recently seen what appears to be an increase in pyramid schemes⁶ under the guise of “multi-level marketing” and “network marketing” opportunities.⁷ These schemes often target the most vulnerable investors, and social media has expanded their reach. The Division is deploying resources to disrupt these schemes through a coordinated effort of timely, aggressive enforcement actions along with community outreach and investor education. We are also using new analytic techniques to identify patterns and common threads, thereby permitting earlier detection of potential fraudulent schemes.

Complex Financial Instruments

Our Structured and New Products Unit developed significant expertise in investigating complex products, such as RMBSs and CDOs, and obtained orders for over \$1.7 billion in financial crisis-related cases. While the stream of cases stemming from the financial crisis is coming to an end, the financial industry continues to innovate at a rapid pace. As part of our effort to leverage the expertise developed from the crisis, the Division decided to maintain a unit dedicated to complex market products, but rebrand it “Complex Financial Instruments” or “CFI.” The CFI Unit is currently focused on identifying and investigating potential violations in several priority areas, including credit rating agencies, other complex products such as Commercial Mortgage Backed Securities (“CMBS”), valuation issues for funds and other entities, and is preparing to enforce the derivatives-related provisions of the Dodd-Frank Act.

Gatekeepers

A common thread throughout the priority areas identified above is an emphasis on the importance of gatekeepers to our financial system: attorneys, accountants, fund directors, board members, transfer agents, broker-dealers, and other industry professionals who play a critical

⁵ “Pump-and-dump” schemes involve the touting of a company’s stock (typically microcap companies) through false and misleading statements to the marketplace. These false claims are often made on social media such as Facebook and Twitter, as well as on electronic bulletin boards and chat rooms. Often the promoters will claim to have “inside” information about an impending development or to use an “infallible” combination of economic and stock market data to pick stocks. In reality, they may be company insiders or paid promoters who stand to gain by selling their shares after the stock price is “pumped” up by the buying frenzy they create. Once these fraudsters “dump” their shares and stop hyping the stock, the price typically falls, and investors lose their money.

⁶ A pyramid scheme is a type of fraud in which participants profit almost exclusively through recruiting other people to participate in a particular program.

⁷ See SEC Investor Bulletin, Beware of Pyramid Schemes Posing as Multi-Level Marketing Programs (Oct. 1, 2013), available at http://www.sec.gov/enforce/investor-alerts-bulletins/investoralertsia_pyramidhtm.html.

role in the functioning of the securities industry. Gatekeepers are integral to protecting investors in our financial system because they are best positioned to detect and prevent the compliance breakdowns and fraudulent schemes that cause investor harm. When gatekeepers fail to live up to their responsibilities, the Division has held – and will continue to hold – them accountable.

Foreign Corrupt Practices Act (“FCPA”)

Pursuing violations of the FCPA remains a critical part of our enforcement efforts, as international bribery saps investor confidence in the legitimacy of a company’s performance and undermines the accuracy of a company’s books and records, among other negative impacts. The Division, and particularly the specialized FCPA unit, is active in this area, bringing significant and impactful cases, often in partnership with its law enforcement and regulatory counterparts both at home and abroad.⁸ Last fiscal year, the Commission obtained orders for over \$380 million in disgorgement and penalties in FCPA cases. In FY 2013, the SEC and DOJ released A Resource Guide to the U.S. Foreign Corrupt Practices Act. The guide takes a multi-faceted approach toward setting forth the statute's requirements, providing insights into SEC and DOJ enforcement practices.⁹

In today’s globalized marketplace, Enforcement’s ability to protect investors and maintain fair and efficient markets is often dependent on the Division’s ability to investigate misconduct that takes place, at least in part, abroad. In coordination with the SEC’s Office of International Affairs, the Division has expanded its efforts to obtain evidence of potential wrongdoing from around the globe. Many of Enforcement’s FCPA investigations rely on evidence obtained from foreign jurisdictions, and often are conducted in parallel with foreign governments. Other areas, such as financial reporting and accounting fraud, asset management, and insider trading, also often rely on evidence obtained through foreign regulators.

Litigation and Trial

The Commission’s ability to successfully litigate cases is critical to its mission of protecting investors. The Division handles an expansive docket of complex litigation and trials, often against well-funded adversaries. Successful litigation sanctions wrongdoers, results in relief for victims, and deters wrongdoing. In addition to trial victories, the Division’s litigation efforts help it obtain strong settlements by making clear that the Division will go as far as required in order to obtain appropriate relief. When the Division does go to trial, we have had a strong record of success, despite the difficulty and complexity of our cases.

Enhancements to the Division of Enforcement

Enforcement strives to be proactive and efficient as it vigorously investigates and prosecutes violations of the securities laws. The Division continually works to assess and refine its approach. Below is an overview of a few of the recent efforts and changes.

⁸ See SEC Spotlight on FCPA Cases, available at <https://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml>.

⁹ See A Resource Guide to the U.S. Foreign Corrupt Practices Act, available at <http://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf>.

Admissions

In June 2013, the Commission changed its long-standing settlement protocol by requiring admissions of misconduct in certain cases where heightened accountability and acceptance of responsibility by a defendant are appropriate and in the public interest, including in cases where the violation of the securities laws involves particularly egregious conduct; where large numbers of investors were harmed; where the markets or investors were placed at significant risk; where the conduct obstructs the Commission's investigation; where an admission can send an important message to the markets; or where the wrongdoer poses a particular future threat to investors or the markets. While, for reasons of efficiency and other benefits,¹⁰ most cases will continue to be resolved on a "neither admit nor deny" basis, if admissions or other acknowledgements of wrongdoing are important, the Division will insist on obtaining them and is fully prepared to litigate if necessary.

Streamlined Investigations

Enforcement is committed to pursuing violations of varying type, including violations that have historically not received sufficient attention but whose prosecution is important to maintaining the integrity of the securities markets. To maximize its impact and send a strong message of compliance while still conserving investigative resources, the Division in some of these areas is pursuing streamlined investigative and settlement efforts that provide incentives to wrongdoers to resolve charges quickly. The Division, often in collaboration with other divisions and offices, uses data analytics to help identify potential wrongdoers and conduct streamlined investigations. For example, using data analytics to identify potential violators, the agency recently brought 34 actions against individuals and entities who repeatedly failed to comply with their transaction reporting requirements under Section 16(a) of the Exchange Act. Similarly, based on proactive trading surveillance, the Division brought charges against 13 firms for violating the minimum sales provisions of a municipal bond offering.

Industry Experts

The Division continues to leverage the expertise of various experts hired to give insights into the market and industry practices in its investigations and litigation. These experts are affiliated with the Division's specialized units, where they advise unit staff on particular investigations and help develop forward-looking risk-based initiatives. They are also available to other Enforcement staff for consultation on investigations and litigation.

Data Analytics

In collaboration with the rest of the agency, Enforcement is increasingly using large-scale data analysis to assist in the identification of leads and to conduct more sophisticated investigations. The Division is focused on developing tools that allow us to use the data we have

¹⁰ In many cases, the Commission determines that it is appropriate to continue to settle on a "no admit, no deny" basis, as do other federal agencies and regulators with civil enforcement powers. This practice allows the Commission to get significant relief, eliminate litigation risk, return money to victims more expeditiously, and conserve our enforcement resources for other matters.

available to us to develop leads in a number of areas, including insider trading, market structure, and financial reporting investigations. For example, the Division is partnering with the Division of Economic and Risk Analysis to develop a tool that will enable the staff to detect anomalous financial results disclosed in public company filing data. We also are affirmatively using an advanced investigative and analytical tool platform to assist with insider trading and microcap fraud investigations, thereby streamlining these investigations significantly, and in some cases identifying misconduct that previously might not have been identified. The Commission will continue to take advantage of its improved information processing and analytic capabilities in its efforts to identify, punish, and deter misconduct.

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Thank you for inviting me to discuss the Division of Enforcement. I am happy to answer any questions.