Speech

Remarks at the Securities Enforcement Forum

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It is a pleasure to be here. The website posting for this event says I am talking about "the most important issues" that you as inside and outside counsel will face.

So what exactly are those issues?

Let me spare you any suspense – we want you to start thinking that every issue you face in the SEC's space is a very important one.

There is a good reason for my saying that. One of our goals is to see that the SEC's enforcement program is – and is perceived to be – everywhere, pursuing all types of violations of our federal securities laws, big and small.

Striving to be Everywhere

I mentioned this goal in a speech I gave two weeks ago in Chicago. There were questions raised afterwards about what I really meant. Today I will flesh out the theme.

In the first instance, we of course recognize that our resources are not infinite. Indeed, they are not nearly sufficient to the enormity and scope of the responsibility we have. But we are making better and better use of our resources, new data tools and other "force multipliers."

In today's fast moving, complex and changing markets, it is important that we strive to be everywhere to enforce our securities laws and to protect investors.

It is important because investors in our markets want to know that there is a strong cop on the beat – not just someone sitting in the station house waiting for a call, but patrolling the streets and checking on things.

They want to know that would-be fraudsters are spending more time looking over their shoulders, and less time stepping over the line.

Investors do not want someone who ignores minor violations, and waits for the big one that brings media attention.

Instead, they want someone who understands that even the smallest infractions have victims, and tha
infractions are very often just the first step toward bigger ones down the road.

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They deserve an SEC that looks at its enforcement mission in exactly that way.

This approach is not unlike the one taken in the nineties by then New York City Mayor Rudy Giuliani and Police Commissioner Bill Bratton, back when I was the United States Attorney for the Southern District of New York.

They essentially declared that no infraction was too small to be uncovered and punished. And, so the NYPD pursued infractions of law at every level – from street corner squeegee men to graffiti artists to subway turnstile jumpers to the biggest crimes in the city. [1] The strategy was simple. They wanted to avoid an environment of disorder that would encourage more serious crimes to flourish. They wanted to send a message of law and order.

The underpinning for this strategy was outlined in an article, which many of you will have read or heard of, titled, "Broken Windows." [2] The theory is that when a window is broken and someone fixes it – it is a sign that disorder will not be tolerated. But, when a broken window is not fixed, it "is a signal that no one cares, and so breaking more windows costs nothing." [3]

The same theory can be applied to our securities markets – minor violations that are overlooked or ignored can feed bigger ones, and, perhaps more importantly, can foster a culture where laws are increasingly treated as toothless guidelines. And so, I believe it is important to pursue even the smallest infractions. Retail investors, in particular, need to be protected from unscrupulous advisers and brokers, whatever their size and the size of the violation that victimizes the investor.

That is why George Canellos and Andrew Ceresney, our co-directors of the Division of Enforcement, are working to build upon the strength of the division by ensuring that we pursue all types of wrongdoing. Not just the biggest frauds, but also violations such as control failures, negligence-based offenses, and even violations of prophylactic rules with no intent requirement, such as the series of Rule 105 cases that we recently brought. I'll say more about these cases in a minute.

But this does not mean we will not continue our vigorous pursuit of the bigger violations. Cases like the ones we brought recently against the likes of SAC Capital, Harbinger, J.P. Morgan, Oppenheimer, and the City of Miami not to mention the scores of significant financial crisis cases have always been, and will continue to be, important cases for us.

I believe the SEC should strive to be that kind of cop – to be the agency that covers the entire neighborhood and pursues every level of violation.

An agency that also makes you feel like we are everywhere. And we will do our best not to disappoint.

We recognize that we cannot literally be on every corner, looking over the shoulder of every trader, or watching each CFO as they certify their financial results.

But we can allocate our resources in such a way so that market participants understand we are at least looking and pursuing charges in all directions.

So how are we doing that?

First, we are expanding our field of vision and reach – by leveraging the strength of our exam program, incentivizing individuals to step forward, collaborating with our regulatory colleagues, and harnessing the power of our enhanced technological capabilities.

Second, we are focusing on deficient gatekeepers – pursuing those who should be serving as the neighborhood watch, but who fail to do their jobs.

Third, we are looking for the "broken windows" in our markets – and not overlooking the small violations to avoid breeding an environment of indifference to our rules.

And finally we are continuing to prioritize the bigger cases – pursuing and punishing major offenses by significant and high-profile market participants, sending a strong message of deterrence to the industry and boosting the confidence of investors.

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We can do this because we have an extraordinary team at the SEC – a team, as many of you know, that has had great successes over the past several years – both with respect to cases related and unrelated to the financial crisis.[4]

Because of the many policy changes and structural enhancements in recent years, I began my tenure as Chair with an enforcement team that I believe to be the finest in all of government. We have an extremely strong platform on which to build.

Expanding our Reach

Striving to "be everywhere" is finding a way to have a presence that exceeds our physical footprint and to be felt and feared in more areas than market participants would normally expect that our resources would allow. And here is some of what we have been doing.

Leveraging Our Exam Program

We are taking advantage of the boots we have on the ground at registered entities – broker-dealers, investment advisers and exchanges – to enhance our presence in the marketplace. Those boots are part of our National Exam Program, which, executing on its core function, allows us to work with registrants to improve compliance, understand and monitor the latest risks posed by and facing these entities, and provide effective oversight.

But at the same time, our exam program gives us a real-time look into developing industry practices that may sometimes constitute violations that warrant further investigation and enforcement action.

More than ever before, the exam and enforcement teams are able to move quickly and effectively in response to suspected violations. Right now, for example, we have initiatives in the asset management and broker-dealer space where this coordination is happening.

Whistleblower

Another tool that we are using with growing frequency and success is our whistleblower authority, which enables us to award those who come forward with evidence of wrongdoing.

As you know, the SEC's whistleblower program allows us to give monetary rewards for valuable information about securities law violations. And, it has rapidly become a tremendously effective force-multiplier, generating high quality tips and, in some cases, virtual blueprints laying out an entire enterprise, directing us to the heart of an alleged fraud.

Just last week, one whistleblower was paid more than $14 million – the largest amount to date – for providing our investigators with this kind of very specific, timely and credible tip that we expect the whistleblower program to incentivize. The tip led directly to the opening of an investigation, and allowed us to bring, in just a few short months, a case that resulted in the return of tens of millions of dollars to investors. [5]

That is the benefit of significant whistleblower incentives.

They persuade people to step forward.

They put fraudulent conduct on our radar that we may not have found ourselves, or as quickly.

And they deter wrongdoing by making would-be violators ask themselves – who else is watching me?

The program also incentivizes companies to report misconduct before a whistleblower comes to us first.

When our whistleblower program was being set up, many in the securities bar – perhaps some here today – worried that the program would undermine internal compliance efforts. It seems, however, that the program may be having the opposite effect.

Today, we hear that companies are beefing up their internal compliance function and making it clear to their own employees that internal reporting will be treated seriously and fairly. And most in-house whistleblowe Return to Top to us went the internal route first.

We believe this program is already a success. And, as more awards are made, we expect more people to come forward, which will dramatically broaden our presence.

Collaboration

Of course, we are not alone in our enforcement effort. We collaborate continuously and effectively with our partners at the Department of Justice, FINRA, and the state securities regulators. We have, for example, worked side-by-side with the criminal authorities on the high profile insider trading cases of the last couple years; our Rule

105 initiative involved close coordination with FINRA whose market surveillance efforts often spot troublesome trades; and we work with our state partners in many areas, including the regulation of unregistered offerings.

Technology

Whistleblower incentives, examiners and collaborating with our various law enforcement partners are not the only force multipliers in our toolbox. We also are leveraging technology to make it easier for us to spot fraud early on.

Insider trading is a case in point.

Over the last four years, we have filed an unprecedented number of insider trading actions – some 200 actions – against more than 450 individuals and firms charging illicit trading gains of nearly $1 billion. In these types of cases, one of the most challenging issues is establishing the relationship between tippee and tipper.

So to deal with that, we have developed what we call the Advanced Bluesheet Analysis Program (ABAP).

This program analyzes data provided to us by market participants on specific securities transactions. It identifies suspicious trading before market-moving events. It also shows the relationships among the different players that are involved in the trading – relationships that might not have been apparent at first.

We plan to step up our use of this program, but we have already seen significant results on the insider trading front.

The technology we are using is assisting us in many areas. We are using data analytics and related technology to enable us to conduct predictive analysis and spot trends, streamline our investigative efforts and leverage new data sources such as Form PF, which collects information from private funds – hedge funds, private equity funds – on, among other things, the type and size of assets they hold.

Pursuing Gatekeepers

In addition to finding ways to be more places, we also are focusing more on those who play the role of gatekeepers in our financial system.

Cases against delinquent gatekeepers remind them, and the industry, of the important responsibilities that gatekeepers share with us to protect investors.

Investment Company Boards

Recently, for instance, we brought actions related to the investor protection role played by the boards that oversee investment funds. One such action involved trustees whose responsibilities include approving investment advisory contracts on behalf of a mutual fund's shareholders. The Commission's case, which was settled, charged that the review of the contract by the trustees of the funds was inadequate. The core of the claim was that the reports to shareholders from the trustees contained misleading information or omitted material information about how the trustees evaluated certain factors in reaching their decision to approve the contracts on behalf of the funds.[6]

Investment company boards serve as critical gatekeepers and we will focus on ensuring that they appropriately perform their duties.

It has been suggested that our focus on gatekeepers may drive away those who would otherwise ser Return to Top
roles, for fear of being second-guessed or blamed for every issue that arises. I hear and I am sensitive to that concern. But this is my response: first, being a director or in any similar role where you owe a fiduciary duty is not for the uninitiated or the faint of heart. And, second, we will not be looking to charge a gatekeeper that did her job by asking the hard questions, demanding answers, looking for red flags and raising her hand.

Operation Broken Gate

We are also continuing our focus on auditors. Auditors serve as critical gatekeepers – experts charged with making sure that the processes that companies use to prepare and report financial information are ones that are built on strength and integrity. Investors rely on auditors and need them to do their job and do it very well.

As part of this focus, we recently launched Operation Broken Gate – an initiative to identify auditors who neglect their duties and the required auditing standards. This initiative probes the quality of audits and determines whether the auditors missed or ignored red flags; whether they have proper documentation; and, whether they followed their professional standards.[7]

Just last week, this initiative produced its first set of charges against three auditors. Two of them have already been suspended from the industry. You should expect more of these cases.[8]

Fixing Broken Windows

As I have said, we are casting our nets wider, and using nets with smaller spaces, paying attention to violations and violators regardless of size.

We are able to do this by streamlining our investigations, particularly those involving strict liability violations where we do not need to prove intent, like the Rule 105 cases.

The idea is to bring these cases quickly and establish a consistent approach to disgorgement and penalties, which allows us to incentivize parties to settle quickly.

Rule 105 of Regulation M

We used this new streamlined approach most recently when we brought actions against nearly two dozen firms for violating Rule 105 of Regulation M.

For those of you who do not know what it is, Rule 105 is a provision of the Exchange Act. It is an important rule that bans firms from improperly participating in public offerings soon after short selling those same stocks.

The rule is intended to protect a stock offering from potential manipulation by short sellers who artificially depress market prices and, in the process, guarantee themselves a profit while reducing the company's offering proceeds and diluting shareholder value.

We obtained disgorgement from nearly two dozen firms ranging from $4,000 to more than $2.5 million – showing that no amount is too small to escape our attention, and that going after smaller infractions will not distract us from larger ones.[9] Even the cases with modest disgorgement amounts still translated into some sizeable sanctions, as we obtained a minimum penalty of $65,000 for the smallest violations.

In the process, we sent a message that we will not tolerate any violations – big or small – that threaten the integrity of the capital raising process. And we think that the message is being heard.

Microcap

We also continue to make clear to the microcap community that, there too, we are watching and acting.

Abuses in this area frequently involve entities that use false or misleading marketing campaigns and manipulative trading strategies, largely at the expense of less sophisticated investors. Over time, these abuses have proliferated due to the increased use of the Internet and, in particular, social media to publicize fraudulent schemes and lure in unsuspecting investors.

To stay on top of this, the division recently created a Microcap Fraud Task Force to ensure that the ap Return to Top expertise and attention be brought to bear on these types of frauds.[10]

This task force targets broker-dealers, transfer agents, attorneys, accountants and other market participants who unfortunately often have key roles in facilitating these schemes. The Task Force's aim is to develop real-time enforcement so that we can stop schemes in their early stages, with tools like trading suspensions and asset freezes. These cases also often involve cooperation with criminal authorities.

Prioritizing the Bigger Cases

All of this talk about being everywhere should not be taken to suggest that the SEC's investigative flashlight will shine only or mostly into the dark corners and hidden nooks of the financial system.

Quite the opposite. It is critical that we continue to focus on the larger, tougher, and more complicated cases.

There are many examples that I could cite, and you may have read about some of the Enforcement Division's recent successes, but I will today just add a few words about our newly created Financial Reporting and Audit Task Force.[11]

This task force brings together an expert group of attorneys and accountants who are developing state-of-the art techniques for identifying and uncovering accounting fraud. This group relies on the latest data analytic tools to identify high-risk companies, as well as on "street sweeps," where appropriate. These cases often involve large, resource intensive investigations that I know keep many in this audience busy.

In all our cases, we will strive for settlements that have a deterrent effect, and where appropriate, the added measure of public accountability that an admission often brings.[12]

In addition, we will continue to aggressively seek monetary penalties whether against corporations or individuals. Strong penalties play an important role in a strong enforcement program.

With respect to corporate penalties, it is important to note that the decision to seek a corporate penalty, and how high it is, is something that is left to my judgment and that of each of my fellow Commissioners after a consideration of all the facts. And we will all have our own perspectives on this issue. In the end, each of us will, within our legal authority, exercise our individual discretion in making this assessment.

One final note, I appreciate that some in the defense bar may not want the SEC to be a tough cop, and believe that the SEC, as a regulator, should play more of a remedial role.

I disagree with the first half of this observation. The SEC is, in very important part, a law enforcement agency, and should be seen by investors to be "their cop." And, the SEC must continue to be the tough cop because in many cases, particularly when there is no criminal violation, it is the only agency that can play that role.

Although some of those who defend parties against SEC actions may have forgotten it was Congress in 1990 that gave the SEC broad authority to assess penalties and to punish the wrongdoer. Taking actions as simply a regulatory body is not enough to achieve its goals. The SEC must employ its tools to achieve the maximum amount of deterrence.

Let me not finish these remarks, however, without making clear that a critical part of a strong enforcement program is also to act only when the evidence justifies acting and to always go about our investigations and cases fairly, and with the mindset of doing the right thing in the right way.

Conclusion

So to conclude, I recognize the SEC cannot literally be everywhere, but we will be in more places than ever before. Our aim is also to create an environment where you think we are everywhere – using collaborative efforts, whistleblowers and computer technology to expand our reach, focusing on gatekeepers to make them think twice about shirking responsibilities, and ensuring that even the small violations face consequences.

Investors feel more confident about participating in our markets if they know we are doing more than waiting for something to happen, if they know we are trying to be one step ahead of the fraudsters, rather than one step behind, and if they know we are out there protecting them and the integrity of our markets. They desReturn to Top

Thank you.

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[1] http://www.nytimes.com/1996/03/27/nyregion/bratton-resignation-legacy-bratton-hailed-pioneer-new-style-policing.html?ref=williamjbratton; http://articles.latimes.com/2006/apr/20/opinion/oe-harcourt20

[2] "Broken Windows," http://www.theatlantic.com/magazine/archive/1982/03/broken-windows/304465/

[3] Ibid.

[4] http://www.sec.gov/spotlight/enf-actions-fc.shtml

[5] http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539854258

[6] http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171514096

[7] http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539850572

[8] Ibid.

[9] http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539804376

[10] http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171624975

[11] Ibid.

[12] http://www.sec.gov/News/Speech/Detail/Speech/1370539841202

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