

Legal Updates & News

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SEC Announces Enforcement “Game-Changers”

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Yesterday, the SEC announced important new steps it will be taking in seeking cooperation in Commission enforcement matters. Robert Khuzami, Director of the Division of Enforcement since February 2009, characterized the changes as “a potential game-changer for the Division of Enforcement.” As described below, these new steps will significantly “change the game” not only for the Division of Enforcement, but also for individuals and entities caught up in an SEC investigation. Along with the announcement of the new push for cooperation, the Commission also announced that it had finalized the creation of specialized enforcement units, and appointed the leaders of each of those new units.

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The SEC’s New Cooperation Tools

With yesterday’s announcement, the SEC issued a revised version of its Enforcement Manual containing a new section entitled “Fostering Cooperation.” The new Manual discusses the “wide spectrum of tools available to the staff for facilitating and rewarding cooperation.” In particular, the Manual highlights five tools, many of which have long been used by criminal prosecutors.

First, as of yesterday’s announcement, the Director of the Division of Enforcement (or senior officers designated by the Director) may enter into cooperation agreements with individuals or entities involved in an investigation. According to the new Commission policy, such an agreement may be provided to “a potential cooperating individual or company prepared to provide substantial assistance to the Commission’s investigation and related enforcement actions.” If the signer cooperates “fully and truthfully,” provides “substantial assistance,” waives the statute of limitations, and satisfies other requirements, the staff will agree to recommend to the Commission that the signer receive cooperation credit or, in some cases, make a specific enforcement recommendation. Notably, cooperation agreements will not bind

the Commission, which could approve enforcement action (or ignore an enforcement recommendation) despite the staff's agreement. This differs significantly from criminal cooperation agreements, which make explicit the specific terms to which prosecutors are bound. The new SEC cooperation agreements, in contrast, allow for the Commission to reject the agreements and, presumably, instruct the staff to bring any enforcement action that the Commission, in its discretion, feels is appropriate. Thus, entering into a cooperation agreement with the staff will not provide certainty that the signer will get the "benefit of the bargain."

Second, the Commission may now enter into deferred prosecution agreements. Under these agreements, which have long been used by criminal prosecutors, the Commission can agree "to forgo an enforcement action" against the individual or company if the individual or company, among other things, cooperates, enters into a long-term tolling agreement, and complies "with express prohibitions and/or undertakings during a period of deferred prosecution," generally not to exceed five years. For example, the agreement could require payment of disgorgement and penalties, or that an entity under investigation engages an independent compliance monitor. In addition, the agreement could require the signer to "agree to either admit or not to contest underlying facts that the Commission could assert to establish a violation of the federal securities laws." A failure to comply fully with the agreement could result in an enforcement action based, at least in part, on the admissions or uncontested facts in the deferred prosecution agreement. Significantly, the SEC's deferred prosecution agreements can be made available to the public upon request.

Third, the Commission may now enter into non-prosecution agreements. Like the deferred prosecution agreements, the non-prosecution agreements must be approved by the Commission itself. Moreover, non-prosecution agreements will be used only in "limited and appropriate circumstances." As the name suggests, the Commission agrees that it will not pursue an enforcement action against the signer if the individual or entity, among other things, cooperates "truthfully and fully" and complies "with express undertakings." These agreements, "in virtually all cases," will not be available to individuals who previously violated the securities laws.

Fourth, the SEC announced streamlined procedures for transmitting to the Department of Justice requests for immunity from criminal prosecution. The Commission delegated to the Director of Enforcement the authority to make these requests. Prior to this change, the Commission itself had to approve such requests before the staff could approach the Department of Justice.

Finally, the SEC staff will continue to be able to enter into proffer agreements. These are agreements "providing that any statements made by a person, on a specific date, may not be used against that individual in subsequent proceedings," except for impeachment purposes, to rebut later contrary evidence, or to support charges of perjury or obstruction of justice. The staff, however, may use information learned during the proffer session to advance its investigation. Any Assistant Director or higher-level supervisor may approve a proffer agreement. These proffer agreements, along with oral assurances that no enforcement action will be taken against an individual or company, represent the most basic cooperation tool in the SEC's toolbox.

The SEC's New Framework for Evaluating Cooperation by Individuals

In addition to announcing the implementation of its new cooperation "tools," the SEC yesterday issued a new policy statement on how it will assess cooperation by individuals. Following its own lead from 2001, when the Commission spelled out in its *Seaboard* Report the factors it considers in assessing the cooperation of entities, the SEC identified four considerations in assessing the cooperation of individuals: (1) the level of assistance provided by the cooperating individual in the investigation; (2) the importance of the underlying matter in which

the individual cooperated; (3) the societal interest in ensuring that the cooperating individual is held accountable for his or her misconduct; and (4) the appropriateness of cooperation credit based upon the profile of the cooperating individual.

The new policy statement details numerous specific factors that are to inform each of the four considerations. For example, when assessing the assistance provided by an individual (consideration one), the Commission and its staff will assess the “value” and “nature” of an individual’s cooperation. Among other things, the Commission will consider whether the individual voluntarily cooperated or was otherwise compelled to cooperate, and whether the individual was the first to approach the SEC. When assessing the importance of the matter (consideration two), the Commission will assess the “character” of the investigation and the “dangers to investors or others presented by the underlying violations.” When assessing society’s interests (consideration three), the Commission will determine the “severity” of the individual’s misconduct, the “culpability” of the individual, the “degree to which the individual tolerated illegal activity,” the “efforts undertaken by the individual to remediate the harm,” and the “sanctions imposed on the individual” by other agencies. Finally, when assessing the appropriateness of cooperation credit (consideration four), the Commission will review the individual’s history, “demonstrated □ acceptance of responsibility,” and “opportunity to commit future violations.”

The SEC’s New Specialized Unit Chiefs

Finally, many months after Director Khuzami announced the creation of five new specialized enforcement units, the SEC has announced their leadership:

- Bruce Karpati, Assistant Regional Director for the New York Regional Office, and founder and head of the former Hedge Fund Working Group; and Robert Kaplan, Assistant Director of Enforcement in Washington D.C., will be Co-Chiefs of the Asset Management unit. This unit will focus on hedge funds, investment advisors, and investment companies.
- Daniel Hawke, Director of the Philadelphia Regional Office, will head the Market Abuse unit. Sanjay Wadhwa, Assistant Regional Director for the New York Regional Office, will serve as Deputy Chief. This unit will focus on large-scale market abuses, complex manipulation schemes, and insider trading.
- Kenneth Lench, Assistant Director of Enforcement in Washington D.C., will head the Structured and New Products unit. Reid Muoio, Assistant Director of Enforcement in Washington D.C., will serve as Deputy Chief. This unit will focus on complex derivatives and financial products.
- Cheryl Scarboro, Associate Director for the Division of Enforcement, will head the Foreign Corrupt Practices unit.
- Elaine Greenberg, Associate Regional Director of the Philadelphia Regional Office, will head the Municipal Securities and Public Pensions unit. Mark Zehner, Regional Municipal Securities Counsel in the Philadelphia Regional Office, will serve as Deputy Chief.

The SEC also created the Office of Market Intelligence to analyze and address tips. Thomas Sporkin, Deputy Chief in the Office of Internet Enforcement, will lead this new office.

Enforcement Investigations Are as Complex as Ever

When Khuzami took office 11 months ago, he almost immediately announced various changes to the Enforcement Division. Khuzami promised a flatter, more efficient Division, with more streamlined processes, tighter controls, timely actions, and new enforcement tools. He now has delivered at least the structure and processes to make good on these promises. Although the SEC historically has claimed that cooperation by individuals is an important factor in its consideration of enforcement matters, it now for the first time has articulated policies, and put

tools in place that provide guidance on when, how, and why an individual can cooperate in an investigation. That guidance, along with Khuzami's other changes, will make navigating an SEC investigation as complex as it has ever been.