

January 12, 2012

SEC to Increase Enforcement Activity Significantly in 2012

At a December 2011 conference of the Consumer Federation of America, the Director of the Division of Enforcement of the U.S. Securities and Exchange Commission (SEC), Robert Khuzami, delivered a clear message to all members of the securities industry - SEC enforcement activity will increase significantly in 2012. The SEC's commitment to increasing enforcement is part of its ongoing efforts to "investigate and hold accountable those who had contributed to the financial crisis," and to protect investors from the harm caused by securities fraud and unlawful securities practices. The SEC has consistently increased its enforcement efforts since the onset of the financial crisis, with 2011 being the most active year in the SEC's history. The SEC filed a record 735 enforcement actions in 2011 - a 9 percent increase from 2010 - and, based upon Khuzami's comments, that number is only going to rise in 2012 and in years to come.

While much of the SEC's forthcoming enforcement initiatives will continue to focus on financial-crisis related cases against executives and entities, the SEC has also committed to pursuing unlawful conduct that results in harm to individual investors, and will closely examine the conduct of investment advisers who handle investment management matters for individuals and their families. Indeed, the SEC is in the process of conducting a focused review of the registration documents of "high-risk" investment advisers in an effort to identify the early warning signs of fraud and "cut off schemes in their infancy." According to Khuzami, investment advisers who lie on their registration documents about their educational achievements, business affiliations, and assets under management "might well be the same persons who outright steal [investors'] money when the markets turn against them." Thus, by catching investment advisers who commit small infractions, the SEC hopes to prevent them from graduating to bigger ones. This approach is reminiscent of the "broken-window" crime-fighting agenda adopted by New York Mayor Rudolph Giuliani in the 1990s.

One of the ways in which the SEC has positioned itself to increase its enforcement efforts is to reform the organizational structure of the Enforcement Division. First, the Enforcement Division "flattened [its] management structure by taking attorneys out of management positions and putting them back on the front lines to conduct investigations, bring cases and hold bad actors accountable." By freeing up its attorney personnel from management duties, the SEC has greater capacity to identify unlawful conduct and pursue it.

Second, the SEC reconfigured the Enforcement Division's organizational structure by creating five specialized units that focus entirely on the following complex, "high-priority" areas:

- asset management and mutual funds
- illegal trading and other market abuses
- structured and new products, including complex mortgage-related products

- foreign corrupt practices
- municipal securities and pensions.

According to Khuzami, the establishment of these units has allowed the SEC to "build specialized, institutional knowledge and experience that allows [Enforcement Division] attorneys to recognize and respond to suspicious activity more quickly."

Moreover, the SEC recruited industry experts with specialized experience relating to the focus of each specialized unit to assist in SEC investigations. With these industry experts, the SEC has further enhanced its ability to understand the intricacies of highly technical areas of the securities industry and identify unlawful conduct that might otherwise go undetected.

The SEC will also use two additional tools that will enable it to gather evidence of fraud more quickly than it could in the past, and to terminate fraudulent schemes earlier than would otherwise be possible. The first is the SEC's "Cooperation Initiative," which encourages insiders with knowledge of wrongdoing to disclose unlawful conduct to the SEC. According to the SEC's Web site, "[t]here is a wide spectrum of tools available to the Commission and its staff for facilitating and rewarding cooperation by individuals, ranging from taking no enforcement action to pursuing reduced charges and sanctions in connection with enforcement actions."

The second is the SEC's Whistleblower Program, as required by the Dodd-Frank Act. That program likewise expands the SEC's authority to reward individuals who approach the SEC with useful information regarding securities laws violations. Under this program, the SEC is authorized to provide monetary awards to eligible individuals who deliver to the SEC high-quality, original information that leads to an SEC enforcement action in which more than \$1 million in sanctions is ordered. The awards can range between 10 percent and 30 percent of the money collected from the wrongdoer.

In light of the SEC's renewed commitment to enforcement, it will be important for members of the securities industry to have programs in place that ensure compliance with the securities laws, and to be able to demonstrate that those programs get enforced. Moreover, given the SEC's increased focus on the business practices of investment advisers, all advisers should, at a minimum, review their registration documents for accuracy and amend them as necessary.

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