Gupta v. Securities and Exchange Commission
Doc. 16 Att. 1

EXHIBIT A

Dockets.Justia.com

U.S. Securities and Exchange Commission

Speech by SEC Staff: Remarks at SIFMA's Compliance and Legal Society Annual Seminar

by

Robert Khuzami

Director, Division of Enforcement
U.S. Securities and Exchange Commission

Phoenix, Arizona (Video Presentation)
March 23, 2011

I'd like to thank Dick Walker *(moderator)*, my fellow panelists, and all of the SIFMA members in the audience for the opportunity to speak with you today.

We are seven days shy of my two-year anniversary at the SEC. That seems like an appropriate point to take stock of what we have accomplished.

First, we completed the most significant restructuring since the Division was created almost 40 years ago.

The restructuring, while composed of many initiatives, had some common goals – to make us smarter about the products, markets, transactions and practices that we police; to make us quicker to stop fraud and misconduct before it's on the front page and all the investor money is squandered; to make us more efficient in how we use our resources, thus allowing us to do more within existing budgets; and to maximize our deterrent impact by moving quickly to address newly-emerging threats before they take hold across entire business lines or even industries.

Highlights of the restructuring include:

- The introduction of five new national specialized investigative units dedicated to developing expertise in high-priority areas of Asset Management (including investment advisers and private funds), Market Abuse (large-scale trading-related issues, including computer-driven trading platforms and related services and arrangements); Structured Products, Foreign Corrupt Practices Act violations, and Municipal Securities and Public Pensions.

- A doubling of our front-line manager-to-staff ratio by eliminating the branch chief position, an entire layer of management, thus adopting a flatter, more streamlined organizational structure and reallocating many of these highly qualified former managers back to front-line

investigative work.

- The establishment of an Office of Market Intelligence to utilize technology and improved workflow to collect, risk-weight, triage, assign, and monitor the thousands of tips, complaints and referrals received by the Division each year.

- Creation of an Office of the COO with a network of business managers throughout the Division to handle operations such as IT, workflow, budget, HR and project management tasks, thus relieving investigative staff from these tasks so they can focus on their core competency of conducting investigations.

- Delegation of authority to approve formal orders to senior staff, so that we no longer have to get Commission pre-approval to issue a subpoena; we also eliminated the necessity of obtaining approvals from the Home Office for MUI openings, routine settlements and Wells Notice calls.

- Adoption of a Cooperation Program, where we offer reduced or even no sanctions to encourage “insiders” with knowledge of wrongdoing to come forward early, thus allowing us to bring stronger cases and shut down fraudulent schemes earlier than would otherwise be possible.

Lastly, not specifically related to the restructuring, the talent we have hired into the Division in the last two years has been remarkable. Adding to the tremendous talent of the current staff, over half of the senior staff of the Division is new, and of those, over half are from outside the agency, bringing incredible knowledge and perspective to the job.

Effective Results Metrics

While we do not measure our work by statistics alone, metrics for Fiscal Year 2010 suggest the Division continues to perform at a high level, an accomplishment particularly noteworthy since much of the year was spent absorbing the restructuring changes. Let me just tick off some of these.

- 681 cases filed in fiscal year 2010, more than in any of the previous five years.

- $2.85 billion in disgorgement and penalties was ordered in fiscal year 2010, an increase of 17 percent over fiscal year 2009 and 176 percent over fiscal year 2008.

- Nearly $2.0 billion distributed to injured investors from 42 separate Fair Funds.

- And, lastly, some of my favorite metrics, we are both filing and closing cases more quickly – an 11 percent decrease in the last two years in the average amount of time it takes to file an action; a nearly 10 percent increase in the percentage of actions first filed within two years of the opening of an investigation, and a 33 percent increase in cases closed in fiscal year 2010 and 2009 as compared to previous years. This trend translates into more timely cases with

greater deterrent impact, and a decrease in the uncertainty for the subjects of our investigations about their status.

Recent Significant Cases

As for particular cases filed in the past year, it is no secret that a priority for us has been misconduct arising out of the financial crisis. In total, we've filed 20 cases generally understood as constituting core financial crisis conduct, ultimately suing 40 defendants, including 26 CEOs, CFOs and other senior officers. Fifteen of these 20 cases have been settled in whole or in part, resulting in more than $1.3 billion in penalties, disgorgement, and other monetary relief. Noteworthy matters include actions against Countrywide Financial, Citigroup, Morgan Keegan, Goldman Sachs, State Street Bank, Charles Schwab, New Century Financial, IndyMac Bancorp, and collateral manager ICP Asset Management to name a few.

I also want to highlight other cases we have filed that might be of interest to this audience, including significant actions against broker-dealers, hedge funds, investment advisers, and financial advisers.

In January, Merrill Lynch paid a $10 million penalty because while representing to customers that their order information would be maintained on a strict need-to-know basis, the firm's proprietary trading desk obtained information about institutional customer orders from traders on the market making desk, and used that information to place trades on Merrill's behalf after executing the customers' trades. We determined that Merrill failed to establish and maintain written policies and procedures designed to prevent the misuse of material nonpublic information.

In September, we charged Pinnacle Capital Markets with failing to have an adequate Customer Identification Program to verify the identities of all of its customers. Although it had a CIP program on paper, it failed to comply with those procedures for a six-year period. This violation had real consequences, since Pinnacle marketed its direct market access business to foreign customers, thus presenting real AML risks.

In addition, we have held accountable those firms and individuals that failed to accurately describe product risk – especially the widely-held mutual funds that are the bread-and-butter investments of retail investors.

In February, we charged TD Ameritrade for failing to reasonably supervise certain registered representatives who misled customers when selling shares of the Reserve Yield Plus Fund – a mutual fund that "broke the buck" in September 2008. We found that these representatives mischaracterized the Fund as a money market fund, as safe as cash, or as an investment with guaranteed liquidity.

In January, we charged Charles Schwab affiliates and individuals with making misleading statements regarding the Schwab YieldPlus Fund – formerly the largest ultra short bond fund in its class – including statements concerning the pace of redemptions in the Fund. The Schwab Entities agreed to pay more than $118 million. Our suit against the individuals, including the former CIO for fixed income and the former President of the investment adviser, is ongoing.

We have also brought several recent cases against investment advisers who violated basic fiduciary principles. In the AXA Rosenberg case, we charged an investment adviser with concealing an error in the computer code of the quantitative investment model that they used to manage client risk, resulting in the firm paying $217 million to harmed clients and a $25 million penalty. We charged two former portfolio managers at Aquila Investment Management with defrauding a mutual fund that invests primarily in municipal bonds issued by the State of Utah by improperly charging municipal bond issuers more than a half-million dollars in undisclosed "credit monitoring fees" that they secretly pocketed for themselves.

We also have stepped up our enforcement activity against those who misappropriated investor funds or otherwise engaged in illicit schemes, including through the use of "side pocket" investments. These cases include Baystar Capital Management, where we charged a San Francisco Bay Area hedge fund manager with concealing more than $12 million in investment proceeds owed to investors through the use of a "side pocket" into which investors had limited visibility; and Hunter World Markets, where we charged two securities professionals, a hedge fund trader, two firms and a Chief Compliance Officer in connection with a scheme that manipulated several U.S. microcap stocks and generated more than $63 million in illicit proceeds through stock sales, commissions and sales credits, and allowed them to materially overstate by at least $440 million the hedge funds' performance and net asset values (NAVs) in a fraudulent practice known as "portfolio pumping."

At the same time, we continue to vigorously enforce insider trading laws. Earlier this month, we charged Rajat Gupta, former director of Goldman Sachs and Procter & Gamble, for illegally tipping Galleon Management founder and hedge fund manager Raj Rajaratnam with inside information about the quarterly earnings at both firms as well as an impending $5 billion investment by Berkshire Hathaway in Goldman. This case also represented the first use by the SEC of its new authority under Dodd-Frank to obtain penalties in an Administrative Proceeding against persons not associated with a regulated entity.

In addition, in the Expert Network Insider Trading Cases, we charged hedge funds and four technology company employees who, while moonlighting as consultants or "experts" without the knowledge of their employers, abused their access to inside information about such technology companies as AMD, Apple, Dell, Flextronics, and Marvell and passed it to the funds.

We also remain focused on the conduct of boards and senior executives in contexts other than insider trading. For example, in addition to charging the Company and senior executives, we recently charged three outside directors and members of Audit Committee for ignoring obvious signs of the fraud at DHB Industries, including inappropriate management involvement in the internal investigation, resignation of the law firm conducting the internal investigation, and termination of the outside firm looking into allegation of unauthorized expenses by the CEO. Last year in the InfoUSA case, we similarly brought charges against senior executives based on the misappropriation of assets by the former CEO and we also charged an outside director and chair of the Audit Committee for failing to respond to obvious red flags relating to the CEO's misappropriation of funds.

We also have brought cases concerning the growing municipal securities market. In December, we charged Banc of America Securities, LLC (BAS) for repeatedly paying undisclosed gratuitous payments and kickbacks to various bidding agents and affirmatively misrepresenting that certain bidding processes were proper. To settle the SEC's charges, BAS agreed to pay more than $36 million in disgorgement and interest and another $101 million to other federal and state authorities.

Another new area is actions under Section 304 of the Sarbanes-Oxley Act. Passed in the wake of the Enron and WorldCom accounting scandals, this provision seeks to incentivize CEOs and CFOs to implement strong internal financial reporting and accounting controls by authorizing the SEC to clawback their incentive compensation and personal stock profits when their companies are required to prepare an accounting restatement as a result of "misconduct," even to clawback such compensation where the CEO or CFO are not personally charged with wrongdoing. We filed the first of these so-called "stand alone" cases against former CSK Auto CEO Maynard Jenkins, seeking that he reimburse the company for bonuses and stock sale profits that he received while CSK was committing accounting fraud. In another 304 case filed earlier this month, Ian McCarthy, the CEO of Beazer Homes USA, agreed to reimburse the company more than $6 million in bonuses and stock profits that he received while Beazer was issuing false and misleading financial results.

Dodd-Frank Act

I also would like to mention two provisions under Dodd-Frank that impact our program.

First is collateral bar authority, where we now can impose industry-wide bars for securities laws professionals who violate the law, meaning if the misconduct arises out of activity associated with a broker-dealer, the person can be barred not only from association with a broker-dealer, but from all regulated entities, including investment advisers, municipal securities dealers, municipal advisers, transfer agents and nationally rated securities rating organizations.

Second, we now have new whistleblower authority which authorizes the agency to compensate individuals who provide the SEC with useful information suggesting securities law violations. We have received and studied many comments to the proposed rules, and adoption of the rule is set for April. The proposed rule has provoked some passionate views, particularly on the issue of the role of internal corporate compliance programs. In the proposed rule, we have worked hard to strike the right balance between incentivizing and protecting whistleblowers who want to report suspected misconduct, but at the same time acknowledging the value and obligation of corporate compliance programs to identify and remediate misconduct in the company's operations. We look forward to implementing the whistleblower program in a way that factors in the important role of corporate compliance programs while providing whistleblowers a direct path to the SEC in appropriate circumstances.

Upcoming Priorities

There are no shortages of challenges to the enforcement program. We must

be current with market developments. For example, in the market abuse area, we need the expertise to understand and analyze new trading technologies such as high-frequency and algorithmic trading, data feed latency issues, and large volume trading, as well as systemic insider trading and manipulation schemes. In the asset management area, we must increase our understanding of issues related to valuation of illiquid portfolios, false performance claims, preferential redemptions, and high-risk emerging products.

In the municipal securities markets, we must be up-to-date on pension liability disclosures, valuation issues, and tax-arbitrage activities. These examples are just part of a broader array of challenges stemming from the fast-paced change and increasing complexity apparent in the financial products, markets, transactions, and practices that the Division confronts.

To give but one example of the technology challenges we face, critical to our mission is increased capacity to analyze large volumes of information, including both structured and unstructured data. The Division receives each month approximately three to four terabytes of electronic data. As a comparison, 20 terabytes is often noted as the equivalent to the printed book collection of the U.S. Library of Congress. The capacity and functionality of our systems to handle this volume is not what it should be.

But despite these limitations, I see every day the incredible talent and commitment of the staff, and I am confident that we will continue to bring new energy and vision to the critical task of policing our financial markets.

http://www.sec.gov/news/speech/2011/spch032311rk.htm