



Speech by SEC Chairman: Remarks at 2012 New England Securities Conference

by

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Good afternoon. It's a pleasure to be here today as part of a coalition fighting on behalf of America's investors – and in particular the small, retail investors who rely on regulators to protect them from fraud and ensure that the field is level for every player.

It's important for us to remember and others to understand that – whether we work for a state or commonwealth or for the federal government, the individual tasks we carry out every day cohere into something vitally important for individual investors and the financial system as whole.

We show the public that there is a cop on the beat. When investors are being wronged, or simply need assurance that their money will be safe from fraud, they don't care where the cop comes from. They don't look at the small print on the badge. They just want help and protection – of the sort that we're providing, together.

This is a critical task. Because when investors have confidence in the integrity of the markets, they fuel economic growth through investing, providing the capital that entrepreneurs and established businesses need to drive production and job creation.

In the aftermath of the financial crisis, all of our jobs became more important than ever. And we have been making tremendous progress towards that goal.

The SEC Enforcement Strategy

I am especially happy to be here to talk about the evolution of the SEC's Enforcement program.

When I arrived at the SEC almost four years ago, Bernie Madoff had just been arrested, the financial markets were still in an uproar, the stock market was plummeting, Americans were angry at regulators and there were even calls to abolish the SEC.

If you ask the staff at the agency, they will tell you that the spotlight on us was unbearably bright.

But no one buckled under the pressure of that glare. And I honestly believe

that no agency has worked harder since or invested more in improving performance – in delivering the services every investor has a right to demand.

Fast forward and today we see a Securities and Exchange Commission that is firing on all cylinders. An agency that has more responsibility and authority, not less; an agency that brought a record number of enforcement actions in fiscal year 2011; an agency that has been through one of the busiest rule-writing periods in decades; and an agency that has been transformed from top to bottom.

Though a difficult path, our job has been made easier by the presence of people like Rob Khuzami, today's host David Bergers, and a whole Enforcement Division staffed by driven and creative people helping to lead the SEC's transition to a more aggressive and nimble agency.

Together, we pushed forward on a number of fronts. Our goal wasn't just to win a big case here and negotiate a large settlement there – though we do appreciate the impact such actions have – but rather to bring about fundamental changes in structure, attitude and approach. It was a strategy that would allow the outgunned and vastly out-spent professionals in Enforcement to go toe-to-toe with enormous financial institutions and to win.

Despite being up against firms that spend more money just on their IT budgets than we spend running our entire agency, SEC staff have shown their ability to ferret out and pursue fraud and manipulation hidden in the shadows of the global securities markets.

- We adopted a more aggressive and entrepreneurial approach, encouraging our attorneys to launch an expanding variety of actions, giving them more autonomy and trusting them with decisions that once took days or weeks to be approved.
- We moved to modernize the structure of the Division and the tools our staff use, lifting the level of internal expertise and putting in place technology that allows them to spend more time building better cases and less time plodding through paperwork.
- And we applied the internal imperative to work collaboratively to our external efforts, building closer and more effective ties to other agencies at the state and federal level, sharing information and leveraging each other's comparative advantages. And that's one reason I'm here today – to re-affirm our commitment to this important collaboration with all of you who share our determination to create a safer landscape for America's investors.

Aggressive Direction

When I came back to the SEC in 2009, I wanted an Enforcement Division that could move with speed and agility – with a determination to take on any wrongdoer, whoever they may be. That's why we acted quickly to cut internal red tape, allowing staff to begin investigations and settlement negotiations on their own initiative rather than requiring them to jump through the hoop of full Commission approval. That's why we eliminated a layer of management, putting experienced attorneys back on the front lines.

And that's why we have been so determined in our pursuit of those whose actions fueled the Financial Crisis, bringing actions against over 100 individuals and firms – including more than 50 CEOs, CFOs and other senior

officers, and obtaining more than \$2.2 billion in monetary relief – not to mention dozens of orders barring individuals from the financial industry.

Working hand-in-hand with other regulators we have successfully pursued insider trading by both low-level conspirators and senior executives with ties to some of the nation's most prestigious organizations. And we've increased our assault on overseas bribery and corruption that puts honest companies at a disadvantage and enriches the corrupt.

We have had some extraordinary successes, winning record settlements against Goldman Sachs, Countrywide CEO Angelo Mozilo, and – working with the Justice Department and the FBI – a conviction of Galleon CEO Raj Rajaratnam, the linchpin of the largest insider trading ring ever discovered. These cases are vitally important because they send a strong and public message to investors and potential fraudsters: we are determined to keep the markets safe. If you invest, we will protect you. If you steal, we will punish you.

But enforcement actions that don't make headlines are just as important. When we claw back millions in bonuses awarded to an auto parts CEO while his company was committing accounting fraud, most investors may not notice. But accountants, auditors, and other CEOs do.

When we discover that a broker has weak internal controls causing millions of dollars in losses and we demand remedial action, the average investor probably doesn't read about it. But chief compliance officers do.

And when a series of groundbreaking cases reveals the systematic skimming of state and local tax dollars in hundreds of municipal bond offerings nationwide and results in the recovery of three-quarters of a billion dollars – we send a strong message that even long-standing cozy arrangements in dark corners of the financial world will be uncovered and pursued.

The simple fact is that the SEC – with the critical help of our enforcement partners – has brought a record number of cases, a docket distinctive not just for volume but for the importance, complexity and sheer variety of the cases involved.

Many of these are cutting-edge cases, involving intricate transactions, sophisticated parties, and complicated laws: from traditional accounting cases to internal control investigations that seem especially important in the wake of the financial crisis, to municipal securities practices, to the increasingly important area of hedge fund valuation practices.

Of course, I know this isn't news to many of you here, because you and your agencies have been partners with us in these efforts, and all of us at the SEC thank you for that.

A Restructured Division

A significant contributor to our ability to mount these varied and complex investigations is a major restructuring and upgrade within the Enforcement Division – changes that enhance both our human capital and our technological reach.

As the SEC staff in the audience knows, part of our restructuring involved the creation of five specialized units to focus on complex or critical areas of securities law.

The idea was to build pools of expertise in a few key areas. In doing this, we improve our ability to detect suspicious behavior, investigate thoroughly and efficiently, and when necessary build sophisticated cases. At last count, we had 30 new initiatives in the specialized units and more than 50 in the regional offices.

One of these new units – the Asset Management Unit – did something that likely would not have been done under the old structure. They took the time to survey a group of firms that were actively communicating through social media. They learned about the various approaches firms were using and got a sense of which were legitimate and which might not be.

Shortly thereafter, one of our staff who was familiar with the survey noticed something irregular in the operation of an Illinois-based investment adviser.

In short order, we discovered that the adviser was offering more than \$500 billion in fictitious securities through various social media websites, garnering significant attention from multiple potential buyers.

So, before any investors had lost a dime, a staffer who'd been able to dig deeply into the relatively new social media marketing world proactively detected a problem and helped the agency put an end to a potentially massive fraud.

This is just one example where specialization has paid off.

But in addition to reshaping our structure, we also wanted to put better technology in the hands of our investigators. Upgraded technology makes it possible to wade through literally millions of documents and thousands of hours of conversations to find the proverbial needle in a haystack that lets us sew up a case.

Unfortunately, when I returned to the SEC in 2009, the agency's IT budget was actually lower than it had been four years before, and with maintenance costs for aging existing technology rising, investment in new IT had fallen to less than half of earlier levels.

But that is changing too. Today we're enhancing the ability of staff to research large volumes of data to find evidence of wrongdoing.

Beginning this year, we're bringing online a new e-discovery system that will allow much faster access to information and more intuitive searching of data produced to the agency – making connections between search terms that only seem unrelated, allowing the staff to explore new paths towards an effective case, or revealing new evidence and relationships – needles that might have been missed or overlooked.

Going forward, this system will be integrated with other tools, such as audio-searching technology that allows phonetic searches of voice recordings.

Adding yet another dimension to our investigative capabilities is the Automated Bluesheet Analysis Project. Enforcement staff is using newly-developed analytics to identify suspicious trading patterns and relationships among multiple traders and across multiple securities, generating significant enforcement leads and investigative entry points.

Still in its early stages, this project has already generated significant insider trading enforcement actions including a notable case filed against Matthew

Kluger and Garrett Bauer, who ran a lucrative insider trading scheme spanning two decades. Kluger and Bauer successfully hid their scheme for years by communicating through a middleman using public telephones and prepaid disposable mobile phones.

At first, investigators were unaware either of Bauer or the middleman's relationship with Kluger, but parallel analysis of the Bluesheet trading data led us to identify the middleman and uncovered Bauer's relationship with him. The parallel trading gave away the nature of their relationship, despite their efforts, and it informed our theory of the case.

In some cases technology upgrades and organizational changes come together to yield important results, as with the Aberrational Performance Inquiry team. The "API" as it is known is structured around the idea that investment performance data can be used to identify hedge fund managers engaging in fraudulent practices, before a tip is received or a routine examination discovers questionable behavior.

Comprised of staff from across the agency, the API team uses risk models and technology developed in-house to identify hedge fund firms that are worthy of further review.

Already, the Commission has filed fraud enforcement actions sourced directly from the API and staff is actively investigating additional firms identified through the analytics. In addition, we have brought questionable behavior to the attention of regulators in 17 countries – a number of whom have asked for help in developing analytics-based approaches of their own.

We also continue to expand our reach by creatively exploiting the information we get from outside the agency, through whistleblowers and our Tips, Complaints and Referrals (TCR) system.

Launched in 2010, the system allows us – for the first time – to centralize the vast collection of tips we receive, and to integrate the information into our enforcement and examination activities. It's a system that also allows for robust and comprehensive searching, and can be used to improve staff's ability to identify risk patterns and help focus limited resources more efficiently.

In concert with this new system, we created an Office of Market Intelligence to ensure that the tips we receive are followed up appropriately – which is all the more important now that we have put in place the whistleblower program that I have long believed would help us detect fraud.

In fact, this summer, we awarded our first payment – to a whistleblower who helped the SEC stop a multi-million dollar fraud by providing detailed information and cooperating extensively with investigators.

Together, the market intelligence unit, the whistleblower office, and the new tips and complaint system are significantly expanding the agency's reach and ability to build cases on information that comes to us. And the technological advances can be seen across the agency.

Better organization and technology are lifting performance of the division as a whole, elevating our investor protection efforts to a higher level of effectiveness than ever before.

Greater Collaboration

A final critical strategy for improving our investor protection efforts is working ever more closely with our partners outside the agency, both at the federal and state level.

The SEC has a long history of collaboration with the FBI and Justice Department. The Galleon case is a classic example.

In that case, analysts from the SEC's Division of Risk, Strategy and Financial Innovation helped Justice Department prosecutors challenge expert testimony that it was reasonable for a "well-informed, professional investor" like Mr. Rajaratnam to trade as he did without inside information. And, of course, FBI wiretaps were critical in documenting the insider trading that our analysis uncovered. This type of collaborative effort occurs often, as a symbiotic relationship among agencies results in stronger cases.

Collaboration with state agencies is critical, as well. Each agency has its own advantages – sometimes procedural, sometimes in the experience and expertise of its staff – that come together to make stronger cases.

In the aftermath of Dodd-Frank, we are working closely with states on a smooth transition of private fund oversight – with larger hedge fund advisers coming under the SEC's jurisdiction while smaller funds come under state oversight. Right now, the SEC is dealing with 200 new registrants in New England – 20 of which are already under examination. At the same, we're making sure that state regulators get the information from us that they need to take on their new responsibilities.

And we work with the states on more urgent matters as well. Last June, the Massachusetts Securities Division passed to the SEC information on an individual who had defrauded at least 12 investors out of at least \$1.6 million – a man who in one case offered investors a chance to "own a piece" of the Facebook IPO.

In addition, the Vermont Securities Division conducted interviews of Vermont investors and an on-the-ground investigation of potential Vermont assets. Thanks to this multi-agency effort, which also included close communication with the Boston FBI and U.S. Attorney's offices, the SEC obtained an injunction and froze the defendant's assets, the Massachusetts Securities Division took action to bar him from activity in the state, and the individual was arrested and faces federal criminal charges.

The coordination of state and federal action maximizes our reach, supports rapid and effective action, and helps to ensure that victims have a better opportunity to recover some of their funds. And by presenting a coordinated front, we minimize the chances that a wrongdoer will be able to arbitrage different jurisdictions in an effort to minimize or escape liability.

Greater collaboration means a more seamless net – and an ever-greater chance that individuals attempting to evade securities law will be caught up in it and brought to justice by one of our agencies.

Penalties

As you can tell, I am proud of the successful reforms we have put in place and the strong record we have assembled through our enforcement actions. And I believe that the SEC is doing all it can under current law to make markets safer for investors through aggressive action, rapid restructuring, and increased collaboration.

Virtually all of these initiatives have been internal in origin. We didn't wait for Congress to act or stakeholders in the financial world to press for reform. We knew what we needed to do, and we did it.

But I can't talk about enforcement and especially deterrence without mentioning one area where I hope we will have better tools in the future and that is with respect to monetary penalties.

It wasn't long ago that the SEC was not empowered to levy monetary penalties at all. Our role was to work with registered entities to ensure compliance and bar individuals who violated the securities laws. But we couldn't impose penalties.

Over time that slowly changed. And today we play a more aggressive role.

But we are still restricted in what penalties we can obtain.

It is why perhaps some feel that despite record penalties, the punishments we can impose are not significant enough to intimidate corner-cutters or deter those who see the occasional fine as merely the cost of doing business. Increasingly, the public believes that the SEC should be levying penalties that send an even stronger deterrent message.

And that stems from the fact that, currently, the SEC can only force wrongdoers to disgorge their ill-gotten gains and impose a per-violation penalty of up to \$150,000 per violation by an individual, or up to \$725,000 by an entity. But, in most cases – particularly those involving large financial institutions – the maximum penalty is equal only to the amount of the wrongdoer's ill-gotten gains.

We are not permitted to base our penalties on how much investors have lost.

A bill introduced by a bipartisan pair of Senators – Jack Reed, the Rhode Island Democrat, and Charles Grassley, the Iowa Republican – would give us the bigger stick we need to make would-be violators think twice before they play fast and loose with investors' money, and allow us to recover a lot more money for investors when securities laws are violated.

It would raise the per-violation penalty we can impose on individuals to \$1 million – and raise the per-violation penalty on the institution to \$10 million. Second, it would allow the SEC to assess a penalty equal to three times the size of the ill-gotten gain – or up to the full amount of investor losses.

Last summer, a federal judge questioned our ability to deter violators and compensate victims when he approved an SEC settlement, saying that it represented "chump change" for the offending firm. After reviewing the SEC's legal authority, however, the judge altered his tone, noting in his decision the "limited powers that Congress has afforded the SEC to recoup investor losses." Wisely, he added, "Congress may wish to consider broadening the SEC's power to recover amounts more reflective of investor losses."

I agree.

Conclusion

In the last four years, we have helped to bring the SEC well into the 21st Century, revitalized our enforcement efforts and empowered our staff to

follow every lead wherever it takes them. We have strengthened our ties with our fellow regulatory agencies and brought record cases.

But we're not looking back. I consider all that we have accomplished the base for further improvements. The role of the SEC as an enforcement agency continues to evolve, an evolution that – with your help – has been dramatic in recent years and is bringing benefits to the investors we serve.

<http://www.sec.gov/news/speech/2012/spch101112mls.htm>

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