



## Legal Risk Management Tip March 2010

### SEC ANNOUNCES MEASURES TO FURTHER STRENGTHEN ITS ENFORCEMENT PROGRAM

On January 13, 2010, the United States Securities and Exchange Commission (“SEC” or the “Commission”) announced a series of measures intended to increase the effectiveness and efficiency of its examination and enforcement program. These measures include the announcement of an “Enforcement Cooperation Initiative,” which seeks to encourage greater cooperation from individuals and companies in the agency’s investigations and enforcement actions by establishing incentives for individuals and companies to cooperate with the SEC and provides new tools for investigators to use to encourage such assistance and cooperation.<sup>1</sup> Additionally, the SEC announced five new specialized enforcement units, each with a dedicated focus area relating to particularly complex aspects of securities law.<sup>2</sup>

#### *The Enforcement Cooperation Initiative*

The SEC’s new Cooperation Initiative provides incentives for companies and individuals to fully and truthfully cooperate and assist with SEC investigations and enforcement actions. The initiative also provides new tools to assist investigators with developing first-hand evidence to build a strong case and is expected to result in early assistance in identifying the participants, victims, and ill-gotten gains associated with fraudulent schemes.<sup>3</sup>

Until now, the SEC Division of Enforcement (the “Division”) has had no formal practice with respect to cooperation from individuals, although it has previously published guidance on the factors it would consider in evaluating cooperation by companies.<sup>4</sup> The new Cooperation Initiative authorizes the use of several new cooperation tools, which are modeled on those used by the Department of Justice (“DOJ”) to encourage cooperation in criminal investigations and prosecutions. The new tools are described in a revised version of the SEC’s *Enforcement Manual* in a new section entitled “Fostering Cooperation.”<sup>5</sup>

The new cooperation tools include the use of the following formal written agreements:

- **Cooperation Agreements**—A cooperation agreement is a written agreement between the Division of Enforcement and an individual or company whereby the Division agrees to recommend that the cooperating person receive credit for providing “substantial

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<sup>1</sup> Press Release, Sec. & Exch. Comm’n, SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations (Jan. 13, 2010) available at <http://sec.gov/news/press/2010/2010-6.htm> [hereinafter Cooperation Initiative].

<sup>2</sup> Press Release, Sec. & Exch. Comm’n, SEC Names New Specialized Unit Chiefs and Head of New Office of Market Intelligence (Jan. 13, 2010) available at <http://www.sec.gov/news/press/2010/2010-5.htm> [hereinafter New Specialized Units].

<sup>3</sup> Cooperation Initiative, *supra* note 1.

<sup>4</sup> *In re Gisela de Leon-Meredith*, Exchange Act Release No. 44970 (Oct. 23, 2001) available at <http://www.sec.gov/litigation/investreport/34-44969.htm> [hereinafter Seaboard Release].

<sup>5</sup> DIVISION OF ENFORCEMENT, U.S. SECURITIES AND EXCHANGE COMMISSION, ENFORCEMENT MANUAL, § 6.2 (rev. 2010), available at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

assistance” to the SEC staff and for cooperating “truthfully and fully” in its investigation and related enforcement actions, although the Commission itself is not bound by the agreement in its final determination.<sup>6</sup>

- **Deferred Prosecution Agreements**—A deferred prosecution agreement is a written agreement between the Commission and an individual or company to forego an enforcement action if the individual or company agrees to, among other things: cooperate truthfully and fully; comply with express prohibitions during a period of deferred prosecution (which should not exceed five years); and either admit or not contest underlying facts that could establish a violation of the federal securities laws. If the agreement is violated, the staff may recommend an enforcement action for the original misconduct as well as any additional misconduct, and it may use any admissions made by the cooperating individual or company to file a motion for summary judgment.<sup>7</sup>
- **Non-Prosecution Agreements**—A non-prosecution agreement is a written agreement entered into between the Commission and an individual or company in limited circumstances that provides that the Commission will not pursue an enforcement action if the individual or company agrees to cooperate truthfully and fully in the Commission’s investigation and related enforcement actions, and to comply with certain express undertakings.<sup>8</sup>

In addition, the SEC streamlined the process for submitting witness immunity requests to the Justice Department for witnesses who have the capacity to assist in its investigations and related enforcement actions by authorizing the Director of the Division to make immunity requests directly to the DOJ, eliminating the requirement for pre-approval by the Commission.<sup>9</sup>

Additionally, the Commission has issued a policy statement detailing a formal framework for how it intends to assess cooperation by individuals with regard to SEC investigations and enforcement actions.<sup>10</sup> The policy statement is similar to the 2001 “Seaboard Release,” which detailed the factors the SEC considers when evaluating cooperation by companies,<sup>11</sup> but goes further than previously published guidance by providing a more detailed approach to assessing cooperation and providing greater certainty to individuals concerning the benefits of cooperation.

The SEC identifies four general considerations in the policy statement for evaluating whether, how much, and in what manner it will credit cooperation by individuals:

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<sup>6</sup> *Id.* § 6.2.2. In a cooperation agreement, the staff of the Division of Enforcement agrees to recommend that the cooperating individual or company receive credit for the assistance provided, but the Commission itself is not a party to, and thus is not bound by, a cooperation agreement. Therefore, the Enforcement Manual instructs staff entering into such agreements to advise the cooperating person that that no promises are being made as to whether or how the Commission may act on recommendations from the Division. *Id.*

<sup>7</sup> *Id.* § 6.2.3.

<sup>8</sup> *Id.* § 6.2.4.

<sup>9</sup> *See id.* § 6.2.5.

<sup>10</sup> Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions, Exchange Act Release No. 61340, 17 C.F.R. § 202.12 (2010).

<sup>11</sup> Seaboard Release, *supra* note 4.

1. The importance of the underlying matter in which the individual cooperated;
2. The assistance provided by the cooperating individual;
3. The societal interest in ensuring the individual is held accountable for his or her misconduct; and
4. The appropriateness of cooperation credit based upon the risk profile of the cooperating individual.

These measures are intended to incentivize cooperation with SEC investigations and increase the likelihood of more significant and useful cooperation by individuals.

### *Specialized Enforcement Units*

By creating five new specialized enforcement units focused on complex and high-risk areas, the SEC intends to more efficiently uncover potential violations in complex areas of the securities laws and markets. These enforcement units and a description of the specialty areas are as follows:

- **Asset Management**—this unit will focus on investigations involving investment advisers, investment companies, hedge funds, and private equity funds.
- **Market Abuse**—this unit will focus on investigations involving large-scale market abuses, complex market manipulation schemes, and organized insider trading by institutional traders and other market professionals.
- **Structured and New Products**—this unit will specialize in complex derivatives and financial products such as credit default swaps, collateralized debt obligations, securitized instruments and other structured and newly developing products.
- **Foreign Corrupt Practices**—this unit will concentrate on violations of the Foreign Corrupt Practice Act, which prohibits corporate bribery of foreign officials for government contracts and other business.
- **Municipal Securities and Public Pension**—this unit’s specialty will be misconduct in the large municipal securities market and in connection with public pension funds including pay-to-play and public corruption violations, accounting and disclosure violations, offering and disclosure fraud, tax or arbitrage-driven fraud, and valuation/pricing fraud.

These new specialized units are intended to improve the SEC’s understanding of complex products and markets, provide more efficient detection of fraud and misconduct, and increase the expertise throughout the Division.<sup>12</sup>

The measures described above are a significant step toward enhancing the Commission’s enforcement efforts. Notably, these latest steps mark the most substantial reorganization by the Division of Enforcement since 1972 and will likely result in an increased number of investigations and enforcement actions. The new structure will also enable the SEC to resolve more complex actions efficiently.

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<sup>12</sup> New Specialized Units, *supra* note 2.

For any questions on the enhancements to the SEC's examination and enforcement program or this article, please contact us at (619) 298-2880.

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