

## Proposed Reforms to SEC Enforcement Program Call for Faster Action, Fewer Supervisory Checks and More Sweeping Powers

In testimony before the Senate Banking Committee on May 7, 2009, newly appointed Enforcement Director Robert Khuzami outlined concrete changes in the works to reform the SEC enforcement program. Mr. Khuzami, a former Assistant U.S. Attorney, was recently hired to “reinvigorate” the SEC’s enforcement program. In general, Mr. Khuzami envisions a restructuring of the SEC’s Division of Enforcement to make it more like a U.S. Attorney’s office—a faster moving program with fewer supervisory checks and more sweeping powers. The challenge the SEC will face in implementing this new USAO-like approach, given the lack of many of the checks imposed on a criminal prosecutor, will be balancing the rights of those individuals and entities involved in investigations with the need to take aggressive action to shore up investor confidence.

Mr. Khuzami’s framework for reform is briefly summarized below. In many areas, the details are still to be fully defined.

### Possible Legislative Proposals

Although not yet proposed to Congress, Mr. Khuzami stated that the following legislative proposals are under consideration to strengthen the SEC’s enforcement program:

- A whistleblower program,
- Additional aiding and abetting authority,
- Legislation in areas such as swap agreements and hedge fund regulation,
- Authority to seek penalties in cease-and-desist proceedings,
- Authorization of civil money penalties against aiders and abettors under the Investment Advisers Act, and
- Authorization for nationwide service of process in civil actions filed in federal courts.

### Possible Organizational and Operational Changes within the Division of Enforcement

Many of the proposals Mr. Khuzami discussed have been previously announced and could be implemented quickly without Congressional or Commissioner action:

- Specialization: reorganizing the SEC’s enforcement attorneys into specialized groups organized along product, market or transactional lines.
- Management: decreasing the number of managers and redeploying middle management into line enforcement roles.
- Approvals and Procedures: eliminating certain Division processes requiring approvals to proceed with an investigation or enforcement action.
- Metrics: measuring enforcement activity by timeliness, programmatic significance, and deterrent effect of a case.

- National Program: creating incentives for more collaboration across regions.
- Complaints, Tips and Referrals: retaining Mitre, a federally funded research and development company, to advise how to better collect, record, investigate, refer and track the hundreds of thousands of complaints, tips and referrals that the SEC receives each year.
- Rewards: implementing a whistleblower program and a greater use of benefits—reduced sanctions, immunity or agreements similar to a deferred prosecution agreement—for persons who come forward to identify and provide evidence against those who violate the law.
- Cooperation: increasing cooperation with other law enforcement agencies and regulators.

### Personnel Issues within the Division of Enforcement

Again, many of the changes proposed in this area by Mr. Khuzami have been previously disclosed and could be implemented quickly without Congressional or Commissioner action:

- Administrative and paralegal support: assigning document or organizational tasks to para-professional personnel, freeing staff attorneys to focus on more substantive tasks.
- Information technology support: implementing a number of technology initiatives designed to bolster its ability to detect, investigate, and prosecute wrongdoing. These initiatives include a review of how the SEC handles tips, complaints, and referrals; the improvement and expansion of the Division’s document management, reporting and case management capabilities; and the improvement of the SEC’s ability to better identify, track, and analyze data to identify risks to investors.
- Trial lawyers: increasing the capacity and ability of the SEC’s trial unit.
- New Administrator: hiring a Chief Operating Officer/Business Manager for the Division of Enforcement.

### Responses to the Recent GAO Report on the Division of Enforcement

Mr. Khuzami basically agreed with the recent GAO recommendations aimed at improving the [SEC’s Division of Enforcement](#), and offered the following specific observations:

- “We are considering how best to improve the administration of the Office of Collections and Distributions and to make sure that the Office’s workflows and processes are run efficiently.”
- “[T]he focus of any penalty policy should be assurance that malefactors get appropriately severe sanctions to sufficiently deter them and others from engaging in similar misconduct in the future.”

### Summary and Observations

Although it is too early to tell whether most or all of Mr. Khuzami’s ideas will be implemented, they generally point toward a restructuring of the SEC’s enforcement program that moves more quickly, with less supervision and review, takes more advantage of technology, and embraces inter- and intra- agency cooperation. Attorneys would specialize in subsets of the SEC’s jurisdiction, and favorable deals would be offered to whistleblowers and informants. SEC enforcement powers would be expanded, and the threat of vigorous litigation if targets elect to fight would be strengthened.



The danger of these changes is that the SEC will move too quickly and aggressively in marginal cases. Unlike the U.S. Attorneys, SEC enforcement attorneys are subject to fewer restrictions on the use of their powers: in the SEC's civil cases, the burden of proof is lower, assertions of the privilege against self-incrimination can be used against targets, the showing of scienter that must be made is often far lower, there is often no right to trial by jury, and evidence can often be gathered through application of inspection powers that are virtually without limit and unavailable to potential defendants. Even though safeguards to protect the targets of SEC enforcement actions are far lower than those that apply in the criminal context, the consequences of an SEC action can be draconian—massive fines, loss of livelihood, and severe reputational damage. As recent examples have illustrated, particularly in the hedge fund industry, a publicly known SEC investigation can, in and of itself, give rise to dire consequences (such as investor flight) for the company under investigation. The challenge for Mr. Khuzami will be to strike the right balance, “reinvigorating” the SEC's enforcement program without making that program reckless and unfair.

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