

**SEC ENFORCEMENT DIRECTOR ROBERT KHUZAMI ADDRESSES NEW
INITIATIVES DURING HIS FIRST 100 DAYS**

On August 5, Robert Khuzami, Director of the SEC's Division of Enforcement, addressed The Association of the Bar of the City of New York to reflect on his first 100 days at the SEC. In addition to discussing highlights of the work of the Enforcement Division since his appointment, Mr. Khuzami provided his insights concerning developments in the Division's approach to enforcement, several of which represent significant departures from past practices.

New Initiatives in Enforcement

Mr. Khuzami outlined four guiding principles for the Enforcement Division going forward, which he called the four "S's" – to be strategic, swift, smart, and successful. The Enforcement Division will focus on cases involving the greatest potential harm and offering the highest degree of deterrence value. Moreover, the Enforcement Division staff will seek to accelerate this deterrent impact by reducing the time between conduct and consequences. The staff will also continue to develop methods of better utilizing its resources through selective charging and investigation. Finally, there will be a renewed effort to build cases strong enough to ensure either settlements on the Commission's terms or trials in which the evidence in favor of the Commission is overwhelming. These principles constitute the driving force behind four new initiatives announced by Director Khuzami.

Introduction of Specialized Units – The Enforcement Division will now contain five specialized units, each headed by a Unit Chief and staffed across twelve national offices. These units are designed to enable the Enforcement Division to consolidate existing expertise and conduct more targeted hiring from elsewhere within the SEC as well as from the private sector.

- **Asset Management** – The Asset Management Unit will focus on Investment Advisors, Investment Companies, Hedge Funds, and Private Equity Funds. This group will work closely with the Office of Inspections, Compliance, and Examinations to address issues ranging from disclosure to misappropriation.
- **Market Abuse** – The Market Abuse Unit will focus primarily on the pressing issues facing investors, namely large-scale market abuses and manipulation perpetrated by institutional investors and market professionals. Of particular note is the fact that this group will be involved in developing in-house technology to be used in analyzing suspicious trading activity and other market events deemed by the Enforcement Division staff as posing the risk of large-scale harm.
- **Structured and New Products** – The Structured and New Products Unit will focus on responding to the perceived lack of transparency in this sector of the market. This group will track complex derivatives and financial products, with particular attention paid to new and developing products.

- Foreign Corrupt Practices Act – The FCPA Unit will focus on taking a more global approach to violations of U.S. anti-bribery laws. This unit will likely serve as a contact point for coordination with the United States Department of Justice and foreign enforcement authorities, similar to the effort seen in the *Siemens AG* case in late 2008.
- Municipal Securities and Public Pensions – The Municipal Securities and Public Pensions Unit will focus on areas including but not limited to offering and disclosure issues, unfunded or underfunded liabilities, and “pay-to-play” schemes. The rationale for this unit is largely forward-looking, as the market for municipal securities is expected to grow in size and significance in the years to come.

Streamlining of Management Structure – There will be a significant “flattening” of the management structure within the Enforcement Division. The net effect of these management changes will have a considerable impact on authority within the Enforcement Division.

- Mr. Khuzami said that the branch chiefs will be “re-deployed” to the front lines of conducting investigations. We understand that the Division plans to effectively eliminate one level of supervision, and that the current Assistant Directors will become the first-level supervisors. In the short run, we expect that there will be a difficult transition as existing cases are reassigned and the potential for staff turnover increases. In the long run, however, a shorter chain of command should empower and reinvigorate the lead investigative attorneys, and promote quicker and more decisive decisions during investigations. If this new structure takes hold, no party should underestimate the increased importance of maintaining a good working relationship with the line investigator.
- Authority to Issue Formal Orders and Subpoenas – This authority will be delegated to the Division Director, who will in turn delegate it to senior officers throughout the Division. This will result in a marked increase in authority for senior officers who, subject to a few limited exceptions, will be able to issue subpoenas without prior approval from the Commission.
- Authority to Make Routine Case Decisions – This authority will also be delegated to senior officers across the national offices and will include the authority to make Wells calls and enter into settlements.
- Authority to Enter into Tolling Agreements – This authority will now rest with the Director of the Enforcement Division, whose approval will be required for all tolling agreements. In an effort to shorten the time of most investigations, such agreements will become less common and more difficult to obtain.
- Action Memo Process – The Enforcement Division’s recommendations to the Commission for specific enforcement actions will be subject to fewer and shorter reviews, making for a more rapid Action Memo process.

Increased Incentives for Cooperation by Individuals – The Enforcement Division will renew its efforts to seek cooperation from individuals with information and evidence pertaining to misconduct. These efforts, however, will be aimed at rewarding only those who demonstrate extraordinary cooperation.

- *Seaboard* for Individuals – The Enforcement Division is seeking to develop a public policy statement pertaining to individuals similar to the one for companies that emerged from the *Seaboard* case. This statement will provide a rubric for assessing cooperation by individuals in enforcement actions.
- Expedited Immunity from the DOJ – The Enforcement Division is seeking to develop an expedited process by which the Division Director can submit immunity requests to the Department of Justice.
- Oral Assurances for Witnesses – The Enforcement Division is looking to establish a means of offering witnesses against whom it does not intend to file charges oral assurances to that effect.
- Deferred Prosecution Agreements – The Enforcement Division will also recommend, where appropriate, that the Commission enter into Deferred Prosecution Agreements, in which enforcement actions will not be pursued subject to certain terms, such as cooperation and future compliance.

New Office of Market Intelligence – The Office of Market Intelligence is being created to serve as a clearinghouse charged with the task of triaging tips and information received by the Enforcement Division. This office will be responsible for prioritizing the Division’s responses and helping to manage the flow of information into and out of the Division.

Conclusions and Implications

Mr. Khuzami’s remarks demonstrate a shift in tone at the Division toward a more aggressive approach to enforcement. While it is predictable for a new enforcement head to promise tough enforcement, Mr. Khuzami has outlined significant structural changes that, once implemented, may allow the staff to deliver on that promise in ways that are faster and more efficient. As confirmed by the Division’s own statistics, there have been significant increases in the number of formal orders issued, Temporary Restraining Orders sought and granted, and actions filed, in part resulting from the rash of Ponzi schemes that have been shut down.

The changes in the Enforcement Division indicate that the distinction between voluntary proceedings and formal investigations is diminishing. Given the relative ease with which the Enforcement Division staff can now issue formal orders, one should assume that most investigations and inquiries will be formal rather than voluntary. Furthermore, the Enforcement Division staff will likely exercise its robust subpoena power more frequently under its newly expanded authority. In addition, the creation of specialized units is likely to emphasize high-priority areas for the Enforcement Division and provide the staff in these units with the means

and motivation to pursue more technical violations in their respective areas. Finally, based on Mr. Khuzami's stated goal of expanding the ranks of the trial unit, the Division also appears poised to more aggressively employ the threat of litigation to bring discipline and brevity to what has often been a protracted settlement dialogue.

Some of these changes, such as the use of specialized groups and the efforts to reduce the Division's internal bureaucracy, may represent a reversion to practices that served the Commission well in past years. Other efforts, however, such as the development of a specific framework to assess individual cooperation, the use of oral assurances to witnesses, and the possible use of deferred prosecution agreements, while well established in the world of criminal prosecutors, are new arrivals at the SEC. The Enforcement staff and the defense bar alike will likely welcome such newly conferred authority and flexibility, but the consistent implementation of this discretion will be challenging.

Given the amount and severity of misconduct uncovered during the past year, and the criticisms directed at the SEC by Congress, the press, and others, the Enforcement Division is going to great lengths to publicly reassert itself as the predominant law enforcement agency for the vast jurisdiction that the SEC patrols with its mandate of investor protection. The initiatives announced by Mr. Khuzami represent only the first phase in what will likely be a long process of reshaping the regulatory landscape of the financial markets, but also suggests that the SEC will not stay quietly in the shadow of other regulators. The next phase in the process will be the implementation of these initiatives, all of which lend themselves to a climate of higher stakes, more intense scrutiny, and minimal room for error by market participants and their advisors.

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