

Securities Litigation

August 10, 2009

SEC Enforcement Director Robert Khuzami Announces Revamping of Enforcement Program

In a speech to the New York City Bar Association on August 5, SEC Enforcement Director Robert Khuzami announced a number of significant changes in the SEC's enforcement program. The initiatives were unveiled as part of Mr. Khuzami's review of his first 100 days in office and reflect a serious effort on the part of the SEC to create a more agile and effective enforcement program following a period of unprecedented market turmoil and investor losses.

Streamlined Management and Internal Processes

The perceived bureaucratic and reactive nature of the enforcement program has been the subject of significant criticism both within and outside of the SEC for quite some time, with critics becoming more vocal as the credit crisis unfolded and investor losses mounted due to the Madoff and other massive frauds. Some of the more significant programmatic changes announced by Mr. Khuzami relate to the authorization and daily management of enforcement investigations. These changes, which had been reported as being in the works for several months, are designed to streamline the SEC's investigative process. They include the following:

Delegated Authority for Formal Orders and Routine Case Decisions; Shortened Action Memoranda

Previously, the manner in which the enforcement staff obtained formal orders of investigation to issue subpoenas involved extensive management review and approval by the Commission. This process in many instances involved weeks of delay as formal order memoranda passed through layers of review by regional and home office staff before going to the Commission for approval. Mr. Khuzami announced the elimination of this lengthy process through the adoption of a rule by the Commission on August 5. The new rule, which was previously reported in the August 7, 2009, edition of Katten's [*Corporate and Financial Weekly Digest*](#), vests the SEC's Enforcement Director with the authority to issue formal orders of investigation. Mr. Khuzami said that he intends to delegate his newly established formal order authority to other senior officers throughout the Division of Enforcement.

To further streamline the investigative process, Mr. Khuzami reported that the authority to approve "routine case decisions" will be delegated from the Deputy Enforcement Director to senior enforcement officers across the country. Although Mr. Khuzami did not provide guidance on what constitutes a "routine case decision," this delegation of authority indicates a reversal of the more centralized case management practices followed

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under Chairman Cox's leadership. Mr. Khuzami also indicated that enforcement recommendation memoranda (which set forth the staff's recommendations to the Commission regarding the initiation of enforcement proceedings) will be shortened, involve fewer layers of review and be subject to shorter review deadlines. Moreover, he expressed displeasure with the delaying effect of tolling agreements and indicated that such agreements would be entered into only in limited circumstances and in all instances would be subject to his approval.

We expect that these changes, which are similar to certain Justice Department case management processes, will in fact expedite SEC investigations. They will also enable defense counsel to have more substantial interaction with ultimate decision makers during the course of an investigation, which we believe will yield benefits for all parties in an investigation. However, because this new process may result in enforcement actions being recommended by the SEC staff within a more abbreviated time frame, defense counsel will need to develop early on a firm understanding of case facts and be prepared to respond quickly and effectively to staff action, including the issuance of *Wells* notifications.

Elimination of the Branch Chief Position

In his remarks, Mr. Khuzami also announced the elimination of the branch chief position, which removes one supervisory tier from the Division's organizational structure. Branch chiefs have historically served as the front-line supervisors and were directly responsible for the day-to-day management of enforcement investigations. With this restructuring, assistant directors will now shoulder the responsibility for direct oversight of staff attorneys in their ongoing investigations, and branch chiefs will either be reassigned to senior attorney positions or promoted to newly created assistant director positions. We understand that this decision was met with mixed reactions by the enforcement staff, and it remains to be seen how the daily management of enforcement cases will change. Presumably, senior staff attorneys below the level of assistant director will still oversee less experienced attorneys in testimony and other aspects of the investigative process and will continue to play an important role in case management and strategic decision making.

Creation of Specialized Enforcement Units

As described by Mr. Khuzami, the enforcement restructuring also will involve the creation of five national, specialized units dedicated to complex areas of the securities laws. These units are designed to enable the staff to develop deeper knowledge and expertise and facilitate more rapid and effective enforcement activity in high risk areas. The new units are as follows:

- **Asset Management Unit.** This unit will focus on investment advisers, investment companies, hedge funds and private equity funds. Mr. Khuzami indicated that the unit will focus on disclosure, valuation, portfolio performance, due diligence and diversification, affiliate transactions, conflicts of interest and other issues, and will work in conjunction with the SEC's Office of Inspections, Compliance and Examinations (OCIE) on asset management cases.
- **Market Abuse Unit.** This unit will focus on large-scale market abuses and complex manipulation schemes by institutional traders and other market participants and, according to Mr. Khuzami, will develop new technological tools and screening programs to detect improper trading activity.
- **Structured and New Products Unit.** This unit will focus on complex derivative and other financial products, including credit default swaps, collateralized debt obligations and securitized products.
- **Foreign Corrupt Practices Unit.** Citing the Division of Enforcement's recent focus in this area, Mr. Khuzami indicated that this unit will seek to develop new and proactive approaches to detecting FCPA violations and work more closely with foreign regulatory counterparts to develop a global approach to prosecution of these violations.
- **Municipal Securities and Public Pensions Unit.** Mr. Khuzami indicated that this group will focus on municipal securities offering and disclosure issues, tax- and arbitrage-driven activity, unfunded or underfunded liabilities, and money manager "pay-to-play" schemes.

Mr. Khuzami also reported that the SEC's Subprime Task Force will remain in place.

Development of Individual Cooperation Standards

Mr. Khuzami announced that the Division of Enforcement is now seeking to increase incentives for individuals to cooperate in SEC investigations. This initiative may very well prove to be one of the most important aspects of the enforcement overhaul, as individuals with key information about wrongdoing may now be able come forward and cooperate with the staff without fear of prosecution. Previously, defense counsel were often prudent to advise individual clients that “no good deed goes unpunished” when it came to sharing information with the enforcement staff. The staff is pursuing increased individual cooperation through the following four avenues:

- **Seaboard Factors for Individuals.** Mr. Khuzami reported that the staff is seeking to create a set of Seaboard factors for individuals, referring to the Seaboard case in which the Commission articulated cooperation criteria for corporations involved in enforcement actions. While Mr. Khuzami did not provide specific information about these criteria, we anticipate that they will include factors such as the degree of cooperation of the individual, whether the individual volunteered important information rather than doing so in response to a subpoena or other request for information, and the nature and severity of any wrongdoing committed by the individual.
- **Expedited Grants of Criminal Immunity.** The staff is attempting to develop an expedited process by which immunity requests will be submitted to the Department of Justice.
- **Oral Assurances of No Action.** The staff is exploring ways to provide witnesses in appropriate circumstances with oral assurances that the Division of Enforcement does not intend to recommend enforcement action against them.
- **Deferred Prosecution Agreements.** The Division of Enforcement will now utilize deferred prosecution agreements in which the staff will forego enforcement action against an individual or entity subject to their full cooperation, compliance with undertakings and other conditions.

Once again, it appears that Mr. Khuzami has drawn upon his prosecutorial experience to develop these policies. We believe that the policies will provide benefits to the enforcement staff by enabling the staff to gather key information from witnesses more quickly and effectively, and also benefit the defense bar by enabling counsel to obtain greater protection or expeditious settlements for individual clients in certain cases.

Formation of Office of Market Intelligence

Mr. Khuzami also announced the formation of the Office of Market Intelligence (OMI), which will be responsible for the collection, analysis and management of the thousands of tips, complaints and referrals received by the SEC each year. Again, this is an area where the SEC has been subjected to significant criticism, particularly in the wake of the Madoff fraud, and the formation of the OMI should result in more effective screening and analysis of potentially valuable information.

Conclusion

The initiatives outlined by Mr. Khuzami signal a significant change in the pace and overall execution of the SEC’s enforcement activities. We anticipate that these changes will enable the staff to manage a greater number of cases and pursue individual cases on a faster track. Most significantly, the rules of the game appear to be changing substantially for individual witnesses in investigations, and the staff will now have greater latitude to encourage cooperation in its pursuit of evidence. Now more than ever, it is important for individuals and entities to consult with experienced counsel at the very outset of an SEC inquiry.

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