

BINGHAM PRESENTS 2014

Current Issues in Broker-Dealer Enforcement

September 15, 2014

ERIC ROITER: Good afternoon and welcome to Bingham Presents 2014: Current Issues in Broker-Dealer Enforcement, broadcast live from Bingham McCutchen's offices in New York and online at www.sechistorical.org.

I am Eric Roiter, Lecturer in Law at Boston University School of Law, and moderator for today's program.

Since its debut in 2009, the Bingham Presents series has examined current cutting edge issues in financial regulation of interest to the legal profession. The series is made possible through a partnership between Bingham McCutchen and the SEC Historical Society.

With lawyers and offices on three continents anchored by major commitments in the world's key financial centers, Bingham offers market-leading practices focused on the financial services industry. Bingham lawyers understand how capital markets fit together, how taxes shape financial policy, how regulations compete and conflict, how litigation integrates with business objectives, and how cross-border legal strategies must coordinate.

The SEC Historical Society through its virtual museum and archive at www.sechistorical.org, shares, preserves, and advances knowledge of the history of Financial Regulation.

I am a member of the Society's Board of Trustees and serve on the Museum Committee, advising on the growth and outreach of the virtual museum and archive.

Past Bingham Presents programs have examined such issues as asset management, criminal enforcement of securities laws, harmonization of the regulation of investment advisers and broker-dealers, and enforcement after the Dodd-Frank Act.

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The SEC Historical Society is grateful for the continuing, generous sponsorship of Bingham for the series. This evening we will be examining current issues in Broker-Dealer Enforcement.

Joining with me are Timothy Burke, Co-Chair of Bingham's Financial Institution Regulatory Enforcement and Litigation Group, and practice group leader of the firm's Broker-Dealer Regulatory Practice. Tim is also a member of the SEC Historical Society's Board of Advisors.

Andrew Ceresney, Director of the SEC Division of Enforcement, is here. Prior to his SEC appointment, Andrew served as Assistant U.S. Attorney in the Southern District of New York, where he was a Deputy Chief Appellate Attorney and a member of the Securities and Commodities Fraud Task Force in the Major Crimes Unit.

Eric Grossman, Chief Legal Officer of Morgan Stanley, is here. Eric joined Morgan Stanley in 2006 and has served as Global Head of Litigation and General Counsel of the Americas before his 2012 appointment as Chief Legal Officer.

Joaquin (Jack) Sena, Associate General Counsel, Bank of America. Jack leads Bank of America's Regulatory Inquiries Group and previously served as Assistant Chief Litigation Counsel in the SEC Division of Enforcement.

Welcome all. I have had the privilege of working with the presenters to prepare today's discussion and would like to begin with a question for Andrew, and it's a very broad question. Andrew, could you give us all an overview of the enforcement strategies and priorities at the SEC as they apply to broker-dealer litigation and enforcement? In particular, we've heard some discussion of the "broken windows" philosophy and strategy. How does this work in the broker-dealer context?

ANDREW CERESNEY: Sure, let me start with thanks for having me today. Let me start with my usual disclaimer which has become second nature to me. I think whenever I speak to anybody even outside of panels I say this first, which is the views expressed are my own and do not necessarily reflect the views of the Commission or staff.

I am pleased to be here today. Let me address the question and then maybe go a little broader and maybe anticipate what is your next question. I don't want this impression to be left that broken windows is our broker-dealer strategy. But I will address the broken windows issue and then I will speak more broadly.

A lot has been made of the broken-windows strategy but I think what we're really trying to do here is focus on areas that we see as lacking in compliance or focus over the recent history. The way that we've been doing that is through streamlined investigations as well as streamlined settlement approaches to cases. The idea here is to use big data that is now available to us and other resources now available to us that maybe haven't been available to us in the past, use tools that allow us to parse through that data in ways that are very efficient and that allow us to find violations. The other side maybe through a questionnaire or some other letter asking them for information about what we see as a potential violation, asking them if there is any explanation. Then if there is a violation that we have found talking to them about some potential settlement in a streamlined way. What we typically do is we have a matrix of how we would settle the case in a settle context, and often that's a more favorable resolution than if we were to litigate it.

What this has allowed us to do is to really target violations that haven't received much attention before, but do so without taking up many resources and allowing us to continue what is obviously our broader strategy of addressing other types of violations.

We've done this now in a couple of areas, Rule 10-5 cases which we brought last year which involved 23 firms that settled with us and those are firms who are individuals who traded in securities in advance of public offering within five days of the public offerings. Those are strict liability violations. We were able to bring those very quickly with minimal resources. Just this past week we announced 34 cases involving reporting violations under Section-16A and 13D and G, and again in that situation we were able to expend minimal resources and obtain what we think are significant settlements. But also more importantly, send a message to the marketplace about the importance of focusing on the areas. I suspect from the reaction to these cases that folks are much more focused on these areas than they were before we brought these cases, and that's exactly the reaction that we would like.

I have also heard the sense that everything is going to be turned into an enforcement violation now. The answer is no, we still have OCIE out there examining firms, still issuing deficiency letters in appropriate circumstances and the like. But I do think these are areas that we think have not received sufficient attention and the idea is to try to increase focus on them. We will have more of these areas coming down the pike, there is a number of initiatives like this that are in process some of which impact broker-dealers. I think you'll be seeing more of this as time goes, but I think the big message on these cases is we think these are areas that need increased focus in compliance, but it's not going to distract us from our broader mission of protecting investors by punishing misconduct more broadly.

That's the answer to the broken windows.

ERIC ROITER: Andrew, for those of us who get our financial news from the New York Post, we have seen the article that featured the broken windows enforcement policy, but in the wake of the Madoff and Stanford Ponzi scheme scandals, the SEC was subject to some criticism about focusing too much energy going after low priority cases, easy to bring cases, easy to obtain settlements. What is the current view with respect to that criticism in terms of the dedication of resources it takes to bring cases like this and the potential that, with a broken windows strategy, you're missing other more important matters?

ANDREW CERESNEY: I don't think our focus on these areas has taken us away from our broader focus on issues like Ponzi schemes and other larger scale frauds. I think we are as aggressive as we can be in that area and will continue to be. I think all you have to do is look at some of the cases we brought recently where I think we have been aggressive and we have brought. I think you'll see in the coming weeks and months that you'll see even more of that. I don't think that's any issue, and then in terms of is this taking away from our resolve to continue to pursue those cases. One of the striking statistics that I've seen this year is we've had almost double as many trials this year as in past years. I think we're up to 31 or 32 versus 16 or 17 last year. We have actually had five times as many jury trials. I don't suspect next year we will have those kinds of numbers, I think it ebbs and flows, and it just so happens that's what happened this year.

What it does show is that we're willing to take these cases all the way and willing to stick to it and be aggressive about it. People ask me why is it that we're seeing that increase in trials, and I actually attribute it to our aggressiveness both in terms of bringing the cases, but also in terms of the remedies we're seeking. I think in the past we might have settled for lesser money or lesser bars, now we're insisting on that and that sometimes means we're going to have to go to trial and that's fine, we're willing to do that.

ERIC ROITER: Big data sounds ominous. It sounds like Big Brother but we know that the SEC is not that kind of agency. How do you decide what to look at in terms of enforcement priorities? One could look at this from a distance and ask, "How do you process data, let's figure out how to process it and then see what violations become apparent." Or do you first say, "Here are our substantive areas of priority, now let's figure out how we can work with the data to serve the priorities that we've identified?"

ANDREW CERESNEY: I think it's more the latter. Obviously data just out there is not going to help you advance your cause, you need to be looking for patterns in that data. You need to be looking for how that data reveals misconduct. I think it is quite transformative in the last five to ten years, the increase in data available, and then also the increase in the tools that allow you to review that data. Just to mention a couple of areas where this has become very important. Insider trading, for a long time and they still do it, FINRA has been excellent in terms of processing referrals to us, looking for suspicious

activity and they have done a great job with it and continue to do it on a daily basis, but what we're doing now is actually doing our own analysis of the data and finding patterns in terms of traders that trade in unison and that allows us to work backwards and then find the source for that information. We have a bunch of investigations in process that really have been created as a result of that. In some cases the investigations have really blossomed through that kind of data. That's been very helpful. There are other ways that the data has been readable, for example we're talking a little bit about the Broker-Dealer Task Force, but there is now an ability to look at firm trading on a much broader basis.

OCIE, for example, when they go in for an exam they actually ask for the trade blotter for the last three or four years, whereas they in the past may have asked for a week or a month, and now when they get that trade data they are able to really parse it and look for patterns of activity that are problematic, cherry-picking, front-running, etc. It really sort of opens up a whole new world for us. What we have done in the Enforcement Division is we are leveraging obviously the other aspects of the agency that have been using data but we are also trying to create a group called Center for Risk and Quantitative Analytics, which is meant to coordinate this sort of data analysis.

ERIC ROITER: Is that within the Division?

ANDREW CERESNEY: That's within the Division of Enforcement, Lori Walsh is the head of that group. The idea there is we have both quant folks and economists, and others who are familiar with the data including lawyers who have had investigative experience. If there is a person in the Denver office who has an idea that there's this statute data out there that might show patterns they can call CRQA and say to CRQA help us develop a tool that will allow us to parse through this data and find the patterns that we're looking for. Obviously where you started off you need to have an idea about what I'm looking for in order to actually be directional about that.

I think it is transformative, and the other thing it's doing is it's allowing us to get through the investigations much more quickly. Whereas before you got hard copies of phone records or bank account records, and you needed to spend months looking through those and looking for the patterns, now you can just input it all into a program and it – I don't want to say spits out, because that makes it sound so easy, but it really processes the data in a way that allows you to see the patterns and to see the issues much more quickly. It takes minutes which previously would have taken you months. It's very exciting.

ERIC ROITER: I you could take us inside the SEC. I don't know how many of us have looked at an organizational chart, but there seems to be more and more announcements about organizational restructurings. You have the Office of Economic and Risk Analysis, you have OCIE, you have the Division of Trading and Markets. It seems like an embarrassment of riches here, resources at the SEC that can be trained on, among other

things, broker-dealers. Doesn't it become more complicated in some ways to navigate these different offices in connection with any particular enforcement program, including the broker-dealer enforcement program?

ANDREW CERESNEY: Let me say this, one of the things that has struck me in my time at the SEC is the amazing amount of expertise that you have in the building. You just mentioned a whole bunch of areas that at least touch on the broker-dealer realm and there's no question that those are critical partners for us as we go forward. I would add FINRA to that list as well as some other external partners like state regulators and the like. I think you're right, it is a challenge to try to know where to go and know how to navigate it. At the same time it provides us with tremendous resources and ability. For example I'll just take one example, in the Enforcement Division we have several different areas in which are going to have broker-dealer related cases. We have the Market Abuse Unit, which is focused on trading activities of broker-dealers. Things like 15c3-5, Market Access Rule, regs show trading abuses, manipulative abuses. We have the Complex Financial Instruments Unit, which is focused on complicated products, the marketing sale, disclosures relating to those, as well as evaluation. Other issues related to complex products like CMBS, like structure notes, and other types of complex products. We have the Muni Unit which is focused on municipal securities, and some fixed income from the municipal market. Then you have other parts of the Division which are what we call the core which are non-unit parts, which are very focused on broker-dealer cases often through referrals that they get from OCIE in particular regions. For example the New York OCIE does an exam of broker-dealers and finds an issue they might refer that over to the New York office and that will be handled by the Enforcement Division in New York.

We have all of these different parts of the Division that are focused on broker-dealer issues and I think you might think it seems a little decentralized but I see strength in the broad breath. We have the units that are focused on particular areas but also Division core folks who are focused on other areas. I think it ends up working.

One of the things that we've done in this past year to try to increase national focus on broker-dealer issues and centralize some of this expertise and knowledge is created a broker-dealer Task Force, and that originated from what we've had in the past four years. We had a Management Unit we created four years ago amongst the five specialized units. That unit created a great relationship with the OCIE Asset Management, so the investment company, the investment advisor side of OCIE, they have a great partnership, they work together on initiatives, they share ideas, they meet quite often.

We did have a similar group on the broker-dealer side, we obviously had in the various regions broker-dealer examiners dealing with enforcement lawyers, but we didn't have anybody thinking about these issues on a national level and thinking about national initiatives, and also centralizing the expertise. We created this Task Force and what it is,

is it's a couple of senior officers, Andy Calamari and Tony Cheong, who are the chairs of it, but it also is staffed by folks from each of the regions so that we can then rollout throughout the Division initiatives and this Task Force is focused at least in the first instance they decided to focus on a couple of different areas, AML, obligations and churning, but they are looking at other areas in working in conjunction with OCIE to try to determine other areas of initiatives.

I think what we're trying to do as you suggest is bring some centralization but also have multiple aspects of the Division focused on that.

ERIC ROITER: I'd like to turn to Eric, thank you, and to Jack. We've heard a great deal about how robust the Enforcement Division's enforcement program is with regard to broker-dealers. I take it then that the SEC won't be looking for yet more funding to hire yet more people to work in that area. Let me ask Jack first and then if Eric could weigh in, how has this affected how you go about your respective jobs knowing the role that big data is playing now and knowing how many eyes and how many computer servers are focused on broker-dealer activities. Does it pose additional complexities for how you administer your own programs?

JOAQUIN SENA: From my perspective not a lot has changed in terms of feeling that we have a lot of eyes on us. That's always been a given. I think with respect to some of the requests that we see for more data, more information, not just trading data and such but emails and things like that, my understanding is the SEC over the last several years has really geared up its resources to churn through all this stuff. That always imposes a cost on us as more and more stuff is asked for, we're often wondering what do they do with all of this. Now I have a little bit more of an insight, but there's a heavy cost on the firms in terms of producing this stuff and trying to get ahead of it. We're producing a lot more data, a lot more information, we need understand what's there as we're producing it or hopefully before we produce it to understand whether we've got a problem that needs to be fixed that we haven't already sent.

ERIC GROSSMAN: He nailed it.

ERIC ROITER: Does that mean that everything now is at a faster pace for you because of the enhanced use of technology at the SEC? Do you have as much time to do the sorts of deliberations and planning and coordination, or do you feel that you've lost some ability to do so because the SEC is so much more efficient? I'm being a devil's advocate here.

ERIC GROSSMAN: I feel like it's always been a challenge to keep up with the demands that the staff makes in terms of an investigation. I can't draw a line and say since they acquired this technology or since the reorganized in this way all of a sudden things have changed for us. It's always a challenge, sitting back my impression is that

I've seen cases move along faster. I've seen more information sought but there are still those cases that linger on for years and years and you wonder why don't they just drop it, there really must not be a case there, they've gotten too attached to their case or their view. Overall yes, I think there is just a higher demand for information and it's more of a challenge for us to keep up with it.

ERIC ROITER: One of the things that occurs to me, Andrew, is if the SEC has spent all this money and devoted all these resource in coming up with the technology that allows you to look at various trading data in a way that you find of interest, is that technology something that you would be willing to share with the industry because there's a lot of effort that goes into trying to monitor these same sort of behaviors on the industry side. Is that something that you foresee there could be some ability to partner with the industry?

ANDREW CERESNEY: I would say that's probably more of a question for somebody like Drew Bowden of OCIE. Drew has said publicly and he has been very vocal about the technology that the OCIE side has developed. I think sort of more public about what it consists of and how it works and that kind of thing. On the enforcement side we still have an interest in making sure that the folks who are out there engaging in misconduct don't know exactly what we're looking for and how we're looking at it and so that shapes what we're willing to share. For example I don't really want to share the kind of technology that we have on the insider trading side since that will allow people to tailor their activities to avoid that, that's on example.

ERIC ROITER: You do want to achieve a deterrent effect as well so if people know that you have these enhanced capabilities to detect insider trading, you don't need to share your program and your algorithms, just getting that message across I would think would be a good thing for everyone.

ANDREW CERESNEY: I agree, and I think we've been trying to do that some. In some of the cases we brought we have talked a little bit about how we've made that case, sometimes you're a little constrained in doing that just because you don't want there to be again sort of a record of how you do that, but we have been trying to do that and I think we will do that in the future is to sort of point out when it is we've made. For example the 16a initiative, we talked about quantitative analytics and use quantitative analytics to identify the violations. I think you'll see that in some of the other one.

ERIC ROITER: Great, well thank you. I'd like now to turn to Tim, in this segment focusing on the role of legal counsel for broker-dealer firms and for individuals. Tim let me start by asking what is new, what is the challenge these days regarding collateral consequences of enforcement sanctions and proceedings, and issuers of waiver when you're representing broker-dealers and individuals?

TIMOTHY BURKE: There is really two key areas that I wanted to tee up for discussion in this sense and one is the issue around requesting waivers so that collateral consequences do not happen or that you preserve important things that need to be preserved from an issues point of view. Secondly the SEC Enforcement staff's views with respect to requiring that respondents or defendants admit liability or guilt.

With respect to the first issue, as many of you know and let's assume for a moment that we are in one of those situations that is not the 36 cases that you're trying in front of juries, but it's a case that you're actually trying to settle, and there is a lot of dialogue and discourse back and forth through the Enforcement staff to reach a settlement that the staff says it would recommend to the Commission, and then after the settlement is reached, there's often a process of having to seek waivers. As I think most folks are aware one of the waivers that many issuers seek is known as a WKSI waiver or a "Well Known Season Issuer" waiver, which allows public companies to issue securities personal to self-registrations, it allows you test the waters and have communications that are a little bit more flexible. It allows you to use things like free writing perspectives and it allows frankly an easy and quick access to capital markets which most issuers want to preserve. In recent months there's been a lot of challenges to the use of WKSI waivers or the granting of WKSI waivers including a rare descending opinion that Commission Kara Stein issued in the RBS Libor case. That then fueled some commentary from Congress where Senator Brown from Ohio, and Congressman Lynch from Massachusetts have been fairly openly critical about the SEC's policy of treating certain issuers differently, in fact the phrase that's been used is issuers that are too big to ban or too big to bar.

Andrew, I'm curious in terms of the Enforcement staff's reaction to issues that might result in a major institution not being able to obtain a waiver because of the way in which the settlement is structured, for example if it includes a request for cease and desist, or a violation of a C-Entered Based Statute, is that something that comes into play as you're negotiating with counsel for the other side in terms of what the allegations or violations are going to be in the settlement document?

ANDREW CERESNEY: What I would say to that is we're pretty careful not to negotiate the waivers. The waivers are really for the most part not issues for the Enforcement Division, they're handled by the other divisions, Division of Corporation Finance and in the case of NYA waivers under the Investment Company Act by the Division of Investment Management. We don't get involved in negotiating them, it's not part of the dialogue. Obviously parties need and try to get those in connection with enforcement cases but we don't get involved in the dialogue back and forth with the Division of Corporation Finance or IM, so I would say they have no impact on the charges that we charge. We're pretty careful to charge the charges we think are appropriate and not let the waivers impact that. And it's also important that parties understand that we won't tie resolutions to the resolution of a waiver, it's not something

that's part because if we do that we start having negotiations and it's not something we negotiate.

Having said that, on the WKSI waivers, there was a revised statement put out by the Division of Corporation Finance earlier this year, which outlined the approach that the Division of Corporation Finance is going to take to WKSI waivers going forward. That revised policy statement I think provides good guidance on the situations that the Division of Corporation Finance how they view it. I think it reflects how the Commission views it, and generally even though it's a statement by the Division of Corporation Finance, I think it's tied mostly to at least in the WKSI waivers, whether the conduct raises questions about the disclosure practices of the underlying issue or whether the conduct raises a question about the integrity of the issue in such there's a question about reliance on the disclosure practices of the issuer. That's sort of the fundamental question, so that remains the question in connection with the WKSI waivers.

The last thing I'll say is I think Mary Jo has made this clear in prior statements she's made on this issue is that from our perspective the waivers are not remedies, they are not enforcement remedies, they are not remedies that get imposed as part of penalties for the enforcement action. Instead from our perspective they are consequences, disqualifications that flow by the enforcement actions, and so they shouldn't be viewed as penalties or additional remedies, they should be viewed as whether those consequences are appropriate given the conduct.

ERIC ROITER: It would seem that if one of the consequences of a settlement or a consent decree is that you can no longer issue private placements that that would have to be something that the firm would need to take into consideration before it reaches a settlement with your staff. Maybe I could toss it to Jack or Eric, are those sort of business decisions being made much earlier in the process where you need to think about what the potential waiver risks might be before you agree to the consent?

JOAQUIN SENA: The truth is it's a relatively new phenomena, so the assumptions since I've been practicing law is that you get these of course unless you had engaged in conduct where it would not be justified. I think the change is that there is certainly in the descent, there is a creeping sense given the more generally aggressive posture towards financial institutions and broker-dealers which is what we're talking about right now that the old rules are new rules. I think sometimes you have no choice, they're right, they got us, we can't litigate this case, we'll just have to take our medicine and we'll get it or not get it and that's fine, but we need to get this case behind us.

I think this issue will be tested the next time a financial institution broker-dealer says we have a difference of opinion, which we have all the time with our regulators. They think this is really bad, we don't think we did anything wrong, but in the interest of peace and

getting this behind us we're going to resolve this case. Those are the kinds of cases where you wouldn't have had this discussion before. If you have to have this concern which based on what Andrew said can't be answered in advance in making a decision to go to the Commission with a proposed settlement, I think it's going to be problematic for those cases that as I said are the ones you'd like to settle and not because you agree but because it's the right thing to do to get it behind you. I think that's the change. There are a lot of things, whether or not you're going to be asked to give an admission, whether you're going to have to make some sort of statement of liability. We have wrestled always with this question before, the chicken and egg of whether an individual is going to get charged or not and I think one of the good things that happened over the years is that issue was linked. In my first ten years of practice it was not unusual for a financial institution to say we'll settle this case but only if the individuals go.

Obviously we don't have those conversations anymore, so the separation of those issues was good and I think now there's a clarity and understanding across the board. I think there are problems now that have flowed from that, I think the SEC on occasion uses the threat of individuals knowing that the financial institutions can't have a conversation about it to extract settlements that they otherwise would, and they put individuals on occasion in peril unfairly when they have no intention of bringing a case, very unlikely to bring a case but they can get the financial institution to the table as a consequent to that. I digress, I just think that this is all new, this is new stuff. The fact that Congress cares about this at all is new stuff. That Andrew is going to be called up on the Hill or Mary Jo is going to be called up on the Hill to explain what they've done in a particular case to some lunatic Senator, that's new stuff. We're all adapting to that.

ERIC GROSSMAN: I agree with all that. I also agree with what Andrew said, look what he put forth is a very pure substantive explanation of how the waiver process should work and how it has worked probably in the past. However it's in a state of flux right now. The process has changed, a lot of questions have been raised. This has become a real issue from this side, because the business wants predictability, they want to know what's happening. You settle a case to have finality and some sort of predictability and closure. When you open it up with things like you can't be sure if you're get a waiver, and there's a number of other collateral consequences for what you need waivers besides WKSI. But if you open it up to a lot of uncertainty, the business has a lot of concerns, and it used to be that yes, you would automatically apply for every waiver that was out there and you could have sort of an advance notice as to whether you were going to get it. Now you actually have to do something, and often it's not easy and a lot of work to determine whether you actually need that waiver or not. If you can't demonstrate it you cannot apply for it and hopefully you won't need it down the road.

ERIC ROITER: What kinds of informal dialogue can you have with Corp Fin as you're dealing with Enforcement as well? Are you able to have some dialogue? Does that narrow the areas of uncertainty?

ERIC GROSSMAN: It does to a certain degree, there's a lot of back and forth with the divisions, in terms of questions they have, their anticipating Commissioners' questions. I assume they're talking to the Commissioner's staff in getting questions back and forth, so it now appears to be a much longer process before you go in but still what has changed now is when they have, and I guess they still formally have delegated authority, but the Commission in some cases I don't know if it will be in all going forward has pulled back some of that authority. What I am hearing to some degree they can't give you any indication because ultimately it's going to the Commission for the Commission to decide and that's you send in your final letter and you wait for that and hope there isn't a political debate that we've sort of seen before at the end of the game. Why can't you just have a contingency or condition to your settlement offer that says here are the terms in which we're prepared to settle, and by the way we need.

ANDREW CERESNEY: We can't be in that business, the problem is that draws the enforced.

ERIC GROSSMAN: No, you're not part of it. It's going to the Commissioner.

ANDREW CERESNEY: You're making your settlement offer contingent on the waivers and you're drawing us in to that process and it becomes a settlement term and we don't want this to become and it shouldn't become a term by which we negotiate. If that were to happen it would draw us into the process in a way that I think.

ERIC GROSSMAN: I take it you're agnostic on these. If you get it you get it and the other divisions will weigh in, we'll do our job.

ANDREW CERESNEY: What was my initial disclaimer?

ERIC GROSSMAN: So why can't they just deal with the Commissioner on that issue that Enforcement itself says we're agnostic on?

ANDREW CERESNEY: I think you can always get guidance and I think you still can as to what the other divisions will recommend. I think what you are suggesting is you're not sure whether that recommendation will carry the day but you can still get a recommendation, and I think it's certainly true to a larger extent that most recommendations get accepted, but obviously as you suggest this is an area with some additional focus.

ERIC ROITER: Another important issue around the settlement discussion is whether or not the staff is going to insist in certain cases on an admission of liability or guilt. About

a year ago Chair White came out with her statement that the Commission would in certain cases be seeking admissions from the settling party. That was perhaps fueled by Judge Rakoff's decision in the Citigroup case, as he put it quite colorfully that he could not determine whether or not the requested injunction was in the public interest without "cold, hard, solid facts established by either admissions or trials." Two months ago, the Second Circuit reversed Judge Rakoff and said that trials are about truth but consent decrees are about pragmatism. In the wake of that Second Circuit decision which recognizes that the SEC does have the discretion to enter consent orders without insisting upon an admission, in what sorts of cases should we expect to see the Enforcement Division nevertheless seek an admission from a settling party?

ANDREW CERESNEY: First of all as it concerns the Second Circuit decision, our perspective on the Second Circuit decision was that we obviously agreed with it. What it intentionally says is that it's within our discretion to decide whether or not we're going to seek admissions or not, and I think a judicial review is quite limited and that's I think consistent with what our view of what the law should be. I think it doesn't change the approach that we announced well before the decision which is to demand admissions in particular cases, and we've done that in the last year, we're now in double digits in terms of the numbers of admissions that we have. I think I have stopped counting so I don't know exactly what the number is right now, but it's in double digits. I think that's a positive thing. I think when we first came out with this policy there was a lot of talk about you're not going to be able to get it in particular cases and it's going to be impossible for you and people are going to litigate. I think those kind of predictions have been shown to be incorrect. It doesn't mean there won't be cases where people will litigate where we demand admissions and we understand that. But I think we have asked for it in the right cases where it increases accountability and acceptance of responsibility where it's an important facet of the case.

I would say that initially when we came out with the policy we announced certain situations where we would demand it. Things like for example harm to election on recent investors, egregious conduction, obstruction of the investigation, significant risk to the markets where the conduct was such that admissions would send a message to investors that they would understand ambiguous facts regarding the conduct of the defendant. Also cases where we thought it would enhance the message of the case, unambiguous facts would enhance the message of the case. Those remain the factors that we will consider, I will admit that in certain cases it is in the eye of the beholder, but we make lots of judgments in cases and this is one of the additional judgments that we make and I think the last year has sort of borne out that it will work and it's an important additional tool in our arsenal. I think it has paid dividends in terms of the way in which it has sent the right message in the cases where we've asked for them and I think that will continue.

ERIC ROITER: Is there anything in particular about broker-dealers as opposed to public issuers that might impact any of those factors that you mentioned, Andrew? I don't know how many of the cases you were referring to, actually involved admissions by broker-dealer firms.

ANDREW CERESNEY: The Convergenx case clearly did, there was improper markups, undisclosed markups and the conduct was egregious, went over the course of a number of years. The other case Scottrade, also a broker-dealer, that involved blue sheets, sort of the failure to produce blue sheet information over the course of six years. That was problematic for us and that impacted our ability to investigate the cases.

Just one thing to emphasize is and I think Scottrade sends this message is that we're not just talking about scienter-based violations, we're talking about Controls violations, too, in the right sort of circumstance and I think that's important because I think firms should understand it's not just scienter-based violations. And then we have gotten admissions from a couple of other banks, though not necessarily in their – Credit Suisse was the failure to register as a broker-dealer, so it was broker-dealer conduct to that extent although it was their private bank. And then Jack, Bank of America, admitted recently to a case involving disclosures and the like and that wasn't necessarily broker-dealer conduct, but I think financial institutions we had a number and I think we will in the future have additional ones.

ERIC ROITER: Tim, let me ask, we touched earlier about separating the individual, dealing with the individual separate from the institution. How does that play out in the defense of a client where you've got both vulnerability on the institutional side and on the individual side?

TIMOTHY BURKE: This is an issue I'm sure that's near and dear to most people in the room's heart, the decision as to whether or not you can represent multiple parties in the same investigation. A couple years ago, Andrew, your predecessor Rob Khuzami came out with his lawyers-behaving-badly speech where among the things he said he was surprised to see was that there was some lawyers representing multiple parties in cases where at least to him there were clear conflicts between the party's interest. That was coupled with the announcement that the SEC was going to adopt or borrow from any of the tools that the Department of Justice has used for many years that would foster cooperation including things like deferred prosecution agreements, non-prosecution agreements, perhaps even immunity, which suggests that an individual might have a real interest in cooperating if there is to be some leniency or perhaps immunity that might create itself a conflict for a lawyer who is representing that individual and any others, because in the risk to the Commission I would think he who gets there first gets the most credit.

Let me first ask Jack or Eric, have you seen increasing occasions where you have to separate counsel or get different counsel from multiple individuals as well as the firm?

ERIC GROSSMAN: I think as a matter of policy, concerning this case at Morgan Stanley, if we have any concern at all about an individual's conduct or that an individual may find themselves at a peril, different and apart from the firm, they ought to have their own counsel, that it's in their interest as well. I think like everything I have said today, I think the challenges always come when there's a difference of opinion on that, is this person just a witness or has the staff decided that this person is more than a witness.

The tension on this issues arises when there is a disagreement about that, and you're often if you're dealing with an attorney's office, you can have that conversation relatively early in the dialogue and you took your steer from that. If you heard told them as a witness, you say well I can take this person in, and I think over the years the attorney's office realized that there was a real benefit in company counsel working with someone who is a witness to try and understand the facts and maybe reserve the use of the subject and target of course.

I think like everything here the SEC as they become more prosecutorial from a law enforcement perspective in their approach, and lots of people on the staff are just kind of learning how to interact with counsel on these issues. I would say my experience over the years has been that the ability to have, and maybe we'll get there, but the ability to have this kind of candid dialogue early on with the Assistant U.S. Attorney is much easier with a junior person on the staff at the SEC.

Maybe you guys are working on that, I hope you are, and I'm not spending a lot of time anymore talking with junior people at the SEC, so this all getting filtered up from our outside counsel, but it's just a tougher nut to crack early on. Do you agree with that?

TIMOTHY BURKE: I agree 100% and I still spend my time talking to junior people at the SEC. I'm happy to do that, but I think you raise a good point. We've always been very conservative in terms of getting separate counsel for an individual. I'd rather get someone separate counsel, these are pretty sophisticated people, they know they have a right to counsel, they may be suspicious of counsel that represents the firm anyway, they want their own lawyer anyway so I'd rather do that rather than have them come back, management or a trader or somebody and say you stuck me with the firm's legal counsel and they weren't giving me independent advice. I'd rather do that early on. But on the point in terms of talking to the staff, I think that's important and they ought to understand that we do that and we're willing to listen to them. I've seen situations, I can think of a recent situation where the staff came to me and said hey, we approached this guy who is no longer employed by you but he went to counsel that represents you in another matter,

with the suspicion that we sent them there so the firm would be conflicted or steered to cause them to take a different direction.

If they would have come to us first we would have recommended and we usually do a few different choices from him to pick from as opposed to send them to a firm that represents us.

JOAQUIN SENA: I think the shame of it is it's actually counterproductive in what you guys are trying to accomplish.

ANDREW CERESNEY: Yes, let me say this. I hear what you're saying and I was obviously on the other side for a long time myself, I certainly have similar impressions but I do think since I've been there and even before Rob and George, have encouraged people to be more frank, upfront, with people about how they perceive witnesses and how they fit into the bigger picture. We don't have subject target witness designations that comes with a lot of baggage. But I have encouraged people to be more upfront about whether somebody's a focus of the investigation, whether we have concerns about their conduct. I think that's for various reasons critical. I have also been emphasizing because we would like to have witnesses when we get to trial and the way we get witnesses often is to give people some comfort that you're not necessarily targeting them and the lower level people giving them that comfort earlier on or fitting them into the cooperation program which you've paired with this topic. There is obviously some connection, I think is important, and so I hope you have seen us get better on that, I hope we'll get better in the future on that because I do think that there's a lot to be benefited from doing that kind of upfront.

ERIC ROITER: Great, well in the time remaining I thought we might turn to some of the newer kinds of enforcement proceedings, substantive violations that people might not have even thought about ten or even five years ago. I am speaking about this burgeoning and somewhat confusing electronic trading environment that we are now in. Andrew, could you start this off by telling us a bit about how the Enforcement Division is approaching these new kinds of trading abuses, algorithmic trading, automated trading, high frequency trading, what has happened and what kinds of guidance might you give people about what could be happening in the future?

ANDREW CERESNEY: Sure, obviously this is a high priority area for us. I call them broadly market structure type cases which are cases arising out of trading type issues. I think there's a tendency to think about this area maybe in terms, because the press has been focused on high frequency trading only, but I actually like to step back and remind people that this area is much broader than that and that our focus needs to be broader than that to really enforce the law correctly in this area.

I start with there are really, from my perspective, four different focuses in this area. Exchanges, ATS's, Broker-Dealers, and then Traders. When you think of it that way you sort of look at our Enforcement program in this area and you realize that we are very focused on each of those. Exchanges we brought against every major exchange in case in the last three years, in fact until three years ago we had not had a penalty against an exchange. In the last three years we've had six cases, over \$25-million in penalties and more to come.

You see different types of cases, not having appropriate rules, not following rules, not having appropriate regulatory controls, and various other issues, control issues, and that's an important area. ATS's is a sort of burgeoning area as trading moves towards ATS's as ATS's become more important in trading. We have been very much focused there. The kinds of violations we're finding there include use of confidential information improperly in violation of the rules, or failure to disclose on form ATS which are actually doing, so failure to conform to how you're actually disclosing that your business is working.

We brought a number of cases in this area, the LavaFlow case which involved using confidential information that an affiliate had, the LiquidNet case involving using confidential trading information in marketing purposes. And there will be more of these sorts of cases in these areas as well as in some other violations, and I think what you're seeing here as trading migrates to this area, we're seeing abuses in this area as well.

Then broker-dealers, the key issues here include but are not limited to the market access rule 15c3-5, which requires you to have policies and procedures reasonably designed to guard against both financial and regulatory risks, and we broadened last year the first two cases under each of those prongs, so the Knight Capital case was under the financial risks and it was a case that we brought to trading where controls just failed. We can talk about that some more if you'd like and then the Wedbush case we brought out in San Francisco, which involved regulatory controls, the failure to pre-approve traders and then to insure that they're following the law.

That's an important area where you have the broker-dealers role in connection with this sort of trading coming to prominence and want it focused on.

Finally obviously there are the traders and there are manipulative trading strategies that includes frequency trading firms, but it's not limited to high frequency trading firms. Those are challenging cases because there is vast amount of trading, there are challenges in showing manipulative intent, and so they are complicated cases. But we do have a number of investigations related to high frequency trading firms, I expect we may well see cases. We have had cases involving manipulative trading conduct in the past few years, so most of them involved layering conduct which involves the use of non bona fide orders that the trader intends to cancel before they're executed to induce other people to

buy and sell securities at prices that don't represent actual supply and demand. We have had a number of these layering cases including one in April of this year against a trader, Ramius is another one, we've had a number of these cases involving layering and we're still seeing that conduct out there. So manipulative trading strategies is clearly a focus of ours as well.

ERIC ROITER: It seems that there are two challenges for lawyers, one is so densely technological. We're not trained as lawyers to understand technology in that depth. The skills that lawyers need to bring to bear is to ask the right questions of those who are in charge of technology and in charge of trading. The other challenge is that these cases are setting new precedents. There is not a lot of case law to guide practitioners. Can you help private practitioners by sharing how you deal with those issues within the SEC? How do you get your arms around the technology and the programming that comes with this trading?

ANDREW CERESNEY: No question these are incredibly complicated areas. A couple of things on this, first I think an important thing for us in the Enforcement Division has been the integration of expertise, particularly in the units but also in other parts of the Division. It allows really for people to become very experienced in this area, so the market abuse area, very focused on these areas has developed tremendous expertise.

What they do is they have a couple of sources that help them with this, because as you said they're lawyers, they haven't worked on the street for the most part. Two sources we have really drawn upon and used – one is industry experts we have in the market abuse unit, a number of industry experts that come to us from the industry as well as some of the other units, as well as OCIE. We draw upon that and that knowledge and it's really incredible. I have met with a number of them on many occasions and I think you really realize the importance of having in-house folks who know how this works. And then the second thing we do is we draw on the expertise of the other Divisions. Trading and Markets, I think the relationship between the Market Abuse folks and Trading and Markets is really just outstanding and they have just incredible amount of interaction on these cases.

As you suggest they are not necessarily intuitive cases to make, and so we really need to have that sort of expertise and we draw upon it and you probably see that in our orders.

Just to answer the second part of your question which is a lack of precedent, I think every rule, every statute, will not necessarily be clear when a violation has occurred, but you have to just interpret the rule. If you take the Knight Capital case, a lot of what you see in the Knight Capital case you see in the release relating to the market access rule, you see statements in the release which are aimed at getting at the type of conduct that was

issued. The same with the Wedbush case, you go back to the release and you see sort of the origins of our claim that there's a violation.

I think we've been careful, obviously there's a view out there and I agree with this view that we shouldn't be regulating by enforcement, that's not what we're doing here. What we're doing here is taking facts and applying them to rules that we think are pretty clear and we think there is a clear violation. We're not going to bring a case when we don't think there's a clear violation.

ERIC ROITER: We are running out of time, but I would turn to Jack or Eric with just a quick note that either of you have about how your respective firms are dealing with the new generation of enforcement cases that are based on electronic trading?

JOAQUIN SENA: With respect to electronic trading and the high tech issues, I think we're turning more and more to non-lawyers who have expertise in those areas.

ERIC ROITER: Thank you. We are coming to the end of our discussion. Tim, Andrew, Eric, and Jack, thank you very much for sharing your expertise and insights. I hope that our audience found this to be an informative discussion on current issues on Broker-Dealer Enforcement. Today's program will add to the valuable body of knowledge in the Bingham Presents series.

The audio of the broadcast will be available soon in the virtual museum and archive at www.sechistorical.org, and an edited transcript will be added later. Bingham's website will also have a transcript of today's discussion.

On behalf of the SEC Historical Society I would like to thank Bingham McCutchen again for their sponsorship and hospitality in making today's program possible.

Thanks also to our audience, both gathered here in New York and listening online. Good evening.