AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

OVERSIGHT OF THE SEC'S DIVISION OF ENFORCEMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

MARCH 19, 2015

Printed for the use of the Committee on Financial Services

Serial No. 114–9

U.S. GOVERNMENT PUBLISHING OFFICE

95–053 PDF WASHINGTON : 2015

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

JEB HENSARLING, Texas, *Chairman*

PATRICK T. MCHENRY, North Carolina, *Vice Chairman*
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
SCOTT GARRETT, New Jersey
RANDY NEUGEBAUER, Texas
STEVAN PEARCE, New Mexico
BILL POSEY, Florida
MICHAEL G. FITZPATRICK, Pennsylvania
LYNN A. WESTMORELAND, Georgia
BLAINE LUETKEMEYER, Missouri
BILL HUIZENGA, Michigan
SEAN P. DUFFY, Wisconsin
ROBERT HURT, Virginia
STEVE STIVERS, Ohio
STEPHEN LEE FINCHER, Tennessee
MARLIN A. STUTZMAN, Indiana
MICK MULVANEY, South Carolina
RANDY HULTGREN, Illinois
DENNIS A. ROSS, Florida
ROBERT PITTENGER, North Carolina
ANN WAGNER, Missouri
ANDY BARR, Kentucky
KEITH J. ROTHFUS, Pennsylvania
LUKE MESSER, Indiana
DAVID SCHWEIKERT, Arizona
ROBERT DOLD, Illinois
FRANK GUINTA, New Hampshire
SCOTT TIPTON, Colorado
ROGER WILLIAMS, Texas
BRUCE POLIQUIN, Maine
MIA LOVE, Utah
FRENCH HILL, Arkansas

MAXINE WATERS, California, *Ranking Member*
CAROLYN B. MALONEY, New York
NYDIA M. VELÁZQUEZ, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
STEPHEN F. LYNCH, Massachusetts
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
GWEN MOORE, Wisconsin
KEITH ELLISON, Minnesota
ED PERLMUTTER, Colorado
JAMES A. HIMES, Connecticut
JOHN C. CARNEY, JR., Delaware
TERRI A. SEWELL, Alabama
BILL FOSTER, Illinois
DANIEL T. KILDEE, Michigan
PATRICK MURPHY, Florida
JOHN K. DELANEY, Maryland
KYRSTEN SINEMA, Arizona
JOYCE BEATTY, Ohio
DENNY HECK, Washington
JUAN VARGAS, California

SHANNON MCGAHN, *Staff Director*
JAMES H. CLINGER, *Chief Counsel*

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

SCOTT GARRETT, New Jersey, *Chairman*

ROBERT HURT, Virginia, *Vice Chairman*
PETER T. KING, New York
EDWARD R. ROYCE, California
RANDY NEUGEBAUER, Texas
PATRICK T. MCHENRY, North Carolina
BILL HUIZENGA, Michigan
SEAN P. DUFFY, Wisconsin
STEVE STIVERS, Ohio
STEPHEN LEE FINCHER, Tennessee
RANDY HULTGREN, Illinois
DENNIS A. ROSS, Florida
ANN WAGNER, Missouri
LUKE MESSER, Indiana
DAVID SCHWEIKERT, Arizona
BRUCE POLIQUIN, Maine
FRENCH HILL, Arkansas

CAROLYN B. MALONEY, New York, *Ranking Member*
BRAD SHERMAN, California
RUBÉN HINOJOSA, Texas
STEPHEN F. LYNCH, Massachusetts
ED PERLMUTTER, Colorado
DAVID SCOTT, Georgia
JAMES A. HIMES, Connecticut
KEITH ELLISON, Minnesota
BILL FOSTER, Illinois
GREGORY W. MEEKS, New York
JOHN C. CARNEY, JR., Delaware
TERRI A. SEWELL, Alabama
PATRICK MURPHY, Florida

CONTENTS

	Page
Hearing held on:	
March 19, 2015	1
Appendix:	
March 19, 2015	41

WITNESSES

THURSDAY, MARCH 19, 2015

Ceresney, Andrew J., Director, Division of Enforcement, U.S. Securities and Exchange Commission	6

APPENDIX

Prepared statements:	
Ceresney, Andrew J.	42

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Ceresney, Andrew J.:	
Written responses to questions submitted by Representatives Duffy and Foster	50

OVERSIGHT OF THE SEC'S DIVISION OF ENFORCEMENT

Thursday, March 19, 2015

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS AND
GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:09 a.m., in room 2167, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Hurt, Royce, Neugebauer, Huizenga, Duffy, Fincher, Hultgren, Wagner, Messer, Schweikert, Poliquin, Hill; Maloney, Sherman, Lynch, Himes, Ellison, and Carney.

Ex officio present: Representative Hensarling.

Chairman GARRETT. Good morning. The Subcommittee on Capital Markets and Government Sponsored Enterprises is called to order. Today's hearing is entitled, "Oversight of the SEC's Division of Enforcement." And I thank our witness for being here today.

Before I begin today's proceedings, I will just take a moment of personal privilege. When you are on the Floor, and you come to the conclusion of a major piece of legislation, whether it is the budget or the defense bill or something else, at the very end of that whole process, what always happens is that the chairmen from both sides get onto the Floor, and they give thanks to all the people who made the culmination of that project possible.

So I am going to do that before we start this hearing today by thanking a member of my staff, who has been with me for a very long time, for making not just the culmination of this hearing, but a culmination of the last 12 years, my entire tenure here in Congress possible, and as successful as it has been.

It is through this gentleman's dedication, his interest, his keen insight into the issues, and just his general interest in all of the topics that we cover in capital markets and the financial services generally and specifically, whether they are issues that are fun issues, or issues that are totally boring to other people. This gentleman always was there to look at them and make them interesting, and make them understandable not only to me, but to the rest of my office, and I think to our committee as well.

And I very much appreciate all that he has done. As I said, it has been 12 years now, which is, in Washington's time, a lifetime. Many people come in every 2 or 3 years, come and go. But 12 years is a lifetime.

And during that lifetime, I have seen this gentleman go from an unmarried guy who spent a lot of his time down on the ball fields playing sports, and downtown doing other things, which I won't go into, to a gentleman who is now married with a couple of kids, and is probably going to spend more or all of his time—some, but all of his time, when he is not with me, back at home with his beautiful wife and children, taking care of them, but still able to, at the end of the day, make me look good, and make me look as if I actually know all this stuff that I am talking about here today.

So I would like to take this moment again to thank Chris Russell for all that work, and all that dedication, and just being there for us, for myself, for our committee, and for my family as well. So thank you so very much.

[Applause.]

Our loss is, I guess, as I say, downtown's gain. I have a feeling that we will still see him up here on a regular basis, right? Good. Because I still have lots and lots and lots more questions to ask as we go along. So thank you very, very much, Chris. I appreciate it.

With that said, that brings to a conclusion today's hearing, because he did not prepare any other opening statements or questions for me since he is leaving now. So I have nothing else to say. No, no, no.

Mr. HURT. We know that is not true.

Chairman GARRETT. What, that I have nothing else to say? Thanks.

We will now turn back to the matter at hand. Again, we thank the witness for being here for today's hearing on the SEC's Enforcement Division. We will begin with opening statements, and I will yield myself such time—I don't know where the clocks are around here—as I may consume.

Today's hearing, as I said, will examine the policies and procedures of the SEC's Division of Enforcement. Now, while the SEC is first and foremost a disclosure agency, I support a strong enforcement function of the SEC. This enforcement function, however, must be used in an evenhanded, non-political manner that preserves the due-process rights of issuers, regulated entities, and their employees.

Recently, I heard an interesting distinction between blue-collar and white-collar crime. The saying goes, "With blue-collar crime, you know there has been a crime committed, you just have to figure out who did it. With white-collar crime, you know who did the crime, you just have to figure out if it actually was a crime."

This saying implies that there is a degree of nuance required by regulators and enforcement officials when making decisions whether and how to bring civil actions against potential violators, one area where there is most need in this Commission's increased use of administrative proceedings. While bringing more cases through the administrative proceedings can lead to lower costs for the agency and increases in efficiency, it is important to realize that those benefits come with a cost.

The cost is less due-process protections for defendants. Because the SEC administrative proceedings use the SEC's procedural rules, respondents are forced to operate on a condensed timeframe,

and do not have the benefit of many of the fundamental due-process protections provided under the Federal Civil Procedures Act, and the Federal Rules of Evidence, such as full discovery rights, the right to a jury trial, and the exclusion of hearsay evidence.

Moreover, initial appeals of administrative law judge (ALJ) rulings must be made to the full Commission, an ALJ's employer, rather than Federal district court. While the Commission's decision may be appealed to the D.C. Circuit Court of Appeals, the SEC's interpretation of the security laws generally will be given significant deference. Appealing an administrative decision is a time-consuming and expensive proposition.

As a former SEC Division official put it, "The entire process ordinarily takes years during which many SEC targets are bankrupt by legal costs, and their ability to find work with reputable companies. Only after SEC Commissioners decide all appeals can the accused finally seek relief from the Federal court. But appeals rarely succeed, because the law requires the court to defer to the agency's judgment, especially on disputed facts."

So this, coupled with the SEC's 100 percent success rate—which is a pretty good success rate—100 percent success rate from the year 2014 illustrates a very troubling pattern of the SEC's attempting to stack the rules and process in a way that the outcome of the case is, well, predetermined. This is not appropriate in a country that values appropriate due process for its citizens. Due process is a fair process, and fair process is fair play.

Other issues that I am equally concerned about, and I hope to address today, are the inappropriate delegation of authority to SEC staff to issue subpoenas and to compel testimony and documents, the comments in SEC press releases by Enforcement officials that presume guilt instead of innocence of recently-charged market participants, the lack of cases against specific individuals compared to cases against the corporation, the lack of any structure or legal guidance around determining the sought-after penalties in settlements and cases, and finally, the backdoor changes to Commission policies included in the very enforcement actions at the end of the game.

So, let me reiterate. I strongly support the proper and stringent enforcing of our Nation's security laws. However, the enforcement of those laws, like any other, should be done in an evenhanded manner, removed from politics, with appropriate due-process protections for the defendants.

The current SEC enforcement policies come into question as to whether they meet the standards and need to be improved. The SEC should be less concerned about the press releases it sends out, and the headlines it receives, and really more concerned about having a clear and consistent approach to enforcing the laws.

With that, I yield back, and I recognize Mr. Lynch for such time as he may consume.

Mr. LYNCH. Thank you, Mr. Chairman. I, too, want to congratulate Chris Russell on his 12 years. That is a long time to be serving here. You have certainly helped the committee out greatly, and we appreciate your service as well. And we wish you very good luck in your next endeavor.

I do want to just comment briefly on subpoena power, and about the SEC extending subpoena power to its employees. I just want to remind my friends—and you are my friends on the other side of the aisle—that this Congress, the Republican House, has expanded subpoena power among—the woman who runs the elevator has subpoena power in this Congress.

We have expanded the subpoena power for many, many chairmen who never had it before. So I am much more comfortable with the SEC having subpoena power, and doing so in a deliberate and responsible manner, than I am having it so widely dispersed here in the Congress.

Director Ceresney, I want to just mention one area where I think we can do much better at the SEC with the limited resources that you have. And that is the revolving door situation with SEC employees.

We have had situations where—I am completely comfortable with folks at the SEC. They work, they learn the system. They understand, they have value in the knowledge that they gain because of their service at the SEC.

And then at some point, they make a lateral move. They go to the industry that can pay them much more money. And they have earned it. The same thing with our staff here. They toil here for a while, they do their sentence, and then hopefully they gain enough acumen and ability that someone seeks to hire them.

This is a different situation that I am addressing here. That is when SEC employees are involved in an enforcement action against a bank or financial services company, or any entity. And then while that enforcement action is ongoing, they leave, and they go to work for the other side, for that company that has an enforcement, or has a waiver pending. That cannot happen.

You can't have somebody working at the SEC, prosecuting an enforcement case, and then all of a sudden, the next week, they go out and they are working for the company that they were just prosecuting last week. That cannot happen.

But it does happen. And so, I recently introduced the SEC Revolving Door Restriction Act of 2015. This legislation will reduce the conflicts of interest beyond the current ethics rules; specifically, this bill amends the Securities Exchange Act of 1934 to prevent former employees of the SEC from seeking employment with companies against which they have participated in enforcement actions in the preceding 18 months. It just gives them a little cooling-off period.

You can't go to work for somebody you just prosecuted or waived an enforcement action against within 18 months. That would hurt the credibility of the SEC and hurt the integrity of the process.

If that employee wants to go to work for that person, they can—we leave an option here if they are low-level, not very much involved, they can go and get an ethics opinion that says that going to work for that company does not present the appearance of impropriety, or compromise the standing of the SEC, or put any party in that enforcement action at a disadvantage, or give them an advantage.

I believe that these added measures will improve confidence in the agency's ability to investigate suspected wrongdoing, and con-

tinue the SEC's recent efforts to strengthen the agency's enforcement actions. The SEC Revolving Door Restriction Act of 2015 is supported by the Project on Government Oversight, POGO, a nonpartisan, independent watchdog.

And POGO has detailed the dangers of the revolving door blurring the lines between the SEC and the interest that it regulates in a 2013 report, "Dangerous Liaisons: Revolving Door at the SEC Creates a Risk of Regulatory Capture."

They lay out the cases, the individual cases where this has happened. It is very powerful. And I want to give credit to POGO, the Project on Government Oversight, for the work that they have done on this. They really were the catalyst for my legislation.

The report highlights that some SEC alumni routinely help corporations try to influence the SEC rulemaking. They also help them counter the agency's investigations of suspected wrongdoing, and they often try to soften the blow that the SEC might otherwise deliver in enforcement actions.

They also block shareholder proposals, and they also, at times, win exemption from Federal law. So as I said, if we are going to maintain the SEC's integrity, and the integrity of this process, that cannot happen. I thank you, Mr. Chairman. And I yield back the balance of my time.

Chairman GARRETT. Thanks. And the gentleman yields back. The gentlelady from New York is recognized for such time as she may—

Mrs. MALONEY. Thank you. And my apologies. The meetings get earlier and earlier. I have already been in a meeting this morning. Thank you, Mr. Chairman, for holding this hearing, and we welcome you, Director Ceresney.

The SEC's Division of Enforcement has a very important job. It is the sharp end of the spear, so to speak, for the SEC. It investigates and prosecutes individuals and companies for violations of securities laws.

And it is fair to say that the Enforcement Division makes all of the other divisions at the SEC matter. After all, there is no point in writing rules if they are not enforced.

So the Enforcement Division is facing significant challenges. For example, despite a modest increase in your budget, the Enforcement Division is still vastly outspent by the white-collar defense bar. And the Second Circuit's recent Newman decision poses a real threat to the Enforcement Division's ability to police the markets for insider trading.

Nevertheless, the Enforcement Division has made significant progress under the leadership of Chair White and Mr. Sorinsky. And the SEC has adopted a broken-windows approach to enforcement, in which there is no violation too small to pursue. The goal is to make market participants feel like the SEC is everywhere.

While it is still too early to judge the success of this enforcement strategy, I believe we should start thinking about how we should measure the success of an enforcement strategy whose main goal is deterrence. I look forward to the hearing today. Thank you for being here.

Chairman GARRETT. Thanks for that. And so now we turn to Mr. Ceresney, the Director of the Division of Enforcement over at the

SEC. Thank you very much again for being with us, You are recognized for 5 minutes.

STATEMENT OF ANDREW J. CERESNEY, DIRECTOR, DIVISION OF ENFORCEMENT, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. CERESNEY. Thank you, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. Good morning, and thank you for the opportunity to be here today.

A strong enforcement program is at the heart of the Commission's efforts to ensure investor trust and confidence in the Nation's securities markets. And the Commission and the Division of Enforcement are committed to the swift, vigorous, and fair pursuit of those who have broken securities laws.

The Division investigates potential violations of the Federal securities laws, recommends enforcement actions to the Commission, and litigates the enforcement actions to completion. Enforcement staff include investigators, accountants, industry experts, trial attorneys, and other employees in Washington, D.C., and the regional offices.

The Division works closely with the other divisions and offices of the SEC, and regularly coordinates investigations with other regulators and law enforcement agencies, including the criminal authorities. In Fiscal Year 2014, the Commission brought the highest number of enforcement actions to date, 755, and obtained monetary remedies at our highest level, totalling over $4.16 billion.

More importantly, though, these enforcement actions addressed significant issues, spanned the entire spectrum of the securities industry, and included numerous first-of-their-kind actions. We punished securities-law violators, returned funds to injured investors, and sent important messages of deterrence.

The Division is focused on a number of important areas that are central to protecting investors in the markets. Comprehensive and accurate financial reporting is critical to ensuring that investors have access to reliable information and can make informed investment decisions.

Because false or misleading financial information erodes the integrity of the markets, we have intensified our focus on this area and recently have seen a significant increase in financial reporting and auditing investigations and filed actions.

Investment advisors and the funds they manage also remain a focus of the Division. And we regularly investigate and bring actions against investment advisors for conflict of interest, misrepresentations regarding performance or investment strategies, breaches of their duties to their clients, and other fraudulent conduct.

The proliferation of sophisticated trading technology, such as algorithmic automated trading, has transformed the securities markets. These changes in the markets present significant potential risks to investors. The Division has recently filed a number of actions against market participants that pose a risk to the markets by failing to operate within the rules and has ongoing investigations into other potential violations of law related to equity market structure.

In the area of municipal securities, which are an important investment vehicle for retail investors, enforcement is focused on investigating misrepresentations in connection with bond offerings, failures by underwriters to meet their obligations, undisclosed conflicts of interest, and pay-to-play violations.

Policing insider trading has long been central to the Commission's mission of ensuring confidence in the markets. And the Division has sent a strong deterrent message to would-be violators by charging more than 590 defendants in civil insider trading cases over the last 5 years.

Pursuing violations of the Foreign Corrupt Practices Act (FCPA) remains a critical part of our enforcement efforts. In the last fiscal year, the Commission obtained orders for over $380 million in disgorgement and penalties in FCPA cases.

A common thread throughout these priority areas is the emphasis on the importance of gatekeepers to our financial system: attorneys; accountants; fund directors; board members; transfer agents; broker dealers; and other industry professionals who play a vital role in the functioning of the securities industry.

When gatekeepers fail to live up to their responsibilities, the Commission will hold them accountable. The Commission's ability to successfully litigate cases is critical to the mission of protecting investors. When the Division goes to trial, we have had a strong record of success, despite the difficulty and complexity of our cases.

The Division strives to be proactive and efficient as it investigates violations of the securities laws. And we continually work to assess and refine our approach. Some recent efforts include requiring admissions of misconduct in certain cases where heightened accountability and acceptance of responsibility by a defendant are appropriate and in the public interest, leveraging the knowledge of various experts hired to give insights into the market and industry practices in its investigations and litigation, and using large-scale data analysis to assist in the identification of misconduct, and conduct more sophisticated investigations.

Going forward, we will continue to take the steps necessary to permit the Division to more effectively and efficiently protect investors and the markets. Thank you again for inviting me to discuss the Division of Enforcement. I am happy to answer any questions.

[The prepared statement of Director Ceresney can be found on page 42 of the appendix.]

Chairman GARRETT. Great. Thank you very much. So I will begin with questioning, and recognize myself for 5 minutes.

Two or three major areas: one is the administrative proceedings, which I touched on in my statements. Last year you were quoted as saying, "There have been a number of cases in recent months where the SEC has threatened administrative proceedings. It was something that we told the other side we were going to do, and then they settled."

Based upon your statement, do you believe it is appropriate to use statements like that, I will say it, the threat, if you will, that you are going to use administrative proceedings against the defendant in the matter basically as a threat, knowing what the outcome is going to be if you go through an administrative proceeding (AP) hearing?

Mr. CERESNEY. Administrative proceedings is a procedure that is available to us. And we try to use it when it is appropriate to protect investors. And we look at a whole bunch of factors to determine whether an administrative proceeding is appropriate.

We have used it for years against regulated entities and individuals. And the only change, frankly, in the recent past that expanded the use of APs was the Dodd-Frank Act, which gave us the authority to obtain penalties against non-registered—

Chairman GARRETT. Why don't you just stress that point again. What is that change in Dodd-Frank?

Mr. CERESNEY. Dodd-Frank gave us the authority to obtain penalties against non-registered individuals and entities in administrative proceedings; whereas before, we could only obtain those penalties in district court actions. So that is the only expansion of the use of—

Chairman GARRETT. But that is a significant expansion, wouldn't you say?

Mr. CERESNEY. It is significant. But it allows us now to—

Chairman GARRETT. Has there been a significant uptick then in the number of ALJ cases versus trial cases?

Mr. CERESNEY. There has been, but most of those—

Chairman GARRETT. Can you give a percentage or increase or anything like that?

Mr. CERESNEY. I should just say that most of those cases are settled cases. So most of those cases are cases in which the other side is agreeing to a settlement with us. And so the uptick, I think, if you look at it, is probably more pronounced because we are settling more cases.

Chairman GARRETT. I threw out a number in my opening statement. What is the correct number of your success rate, if you will, when you go through ALJ? I said 100 percent, but what is the—

Mr. CERESNEY. That was for last year. It actually—yesterday, we actually lost an administrative proceeding against an individual; an ALJ ruled against us in connection with the Penson matter. And so—and that has been true in prior years.

Last year, we did have a unanimous record. I should say that doesn't necessarily reflect that we won every claim, doesn't necessarily reflect we got the remedies we were seeking. And in many cases, the ALJs are pretty—

Chairman GARRETT. The intention—the way I was toning my comments was that you have a fairly high success rate, 100 percent or akin to that, or in that area. So what are the rules, what are the—not the procedures, what are the guidelines that you use in order to make that determination that you are going to go that way and make that—I will use the word "threat" against the defendant in the case?

Mr. CERESNEY. We use a number of facts and circumstances. First, there are certain proceedings we can only bring as administrative proceedings. So that includes failures to supervise and causing violations.

Second, in cases where we need quick relief, where we want to get a bar very quickly, or we want to get investors relief quickly, administrative proceedings can be much quicker than district court actions. District court actions will often take years to get a resolu-

tion in. APs, we can get a decision within 300 days of the institution of the action. So that is important.

And another important point is where we have technical rules, where we have complicated rules, some of our rules are very complicated, we have sophisticated fact-finders who are the ALJs; whereas with a jury, it would be much more difficult for them to grasp those very, very complicated issues.

So those are some of the issues. But we also—there are many reasons to use district court, including where we can get summary judgment. We can't usually get summary judgment in an AP, including where we need discovery about privilege issues, including where we need expedited relief and emergency relief.

Chairman GARRETT. So you just laid them out here. Is that all in written format for your staff to follow?

Mr. CERESNEY. We do have some guidance internally for our staff.

Chairman GARRETT. Can you supply that to us so we can see what those guidelines are and understand them in better detail than I can get in 4 minutes here?

Mr. CERESNEY. Let me consult, but I will come back to your staff on that issue, yes.

Chairman GARRETT. And, this is not just me raising this case, this issue. Recently, District Judge Rakoff stated that bringing more cases before ALJs "hinders the balanced development of the securities laws. The results would be that law in such cases would be effectively made, not by neutral Federal courts, but by SEC administrative judges."

So even independent bodies, judges, are making the—or calling into question what is occurring right now at the SEC. So do you agree with what he is saying?

Mr. CERESNEY. I have great respect for Judge Rakoff. I disagree on this fact, which is I think that what you get when you have an AP is, you get the Commission weighing in on the securities laws, the Commission with the expertise they have. And then you have review by the Court of Appeals.

Chairman GARRETT. But aren't they developing law then by doing that, administrative law judges, when they make some of these decisions, making new Federal law? And they are not Article III judges, right?

Mr. CERESNEY. The Commission reviews those decisions. And the Commission, I think, is obviously appointed by the President, and confirmed by the Senate. And they have expertise in the securities laws. And then after that expertise is exercised, the Court of Appeals has the ability to review that.

So I do not think that you are taking away from the courts the ability to shape the law.

Chairman GARRETT. You laid out somewhat the procedures that you use in order to do this. Is it possible that you will bring these cases, both similar-situated cases, both in one day, is an ALJ case one day, the next day in an Article III judge case?

Mr. CERESNEY. The last year, if you look at our statistics last year, we brought 57 percent of the cases that were litigated in district court, and 43 percent as an AP

Chairman GARRETT. So does that mean that you get different results because of that interpretation of the law? And then I will yield back.

Mr. CERESNEY. Obviously, you can never tell whether a result would be different in one forum or the other. But our overriding goal here is investor protection, which is our mission. And we use the forum that we think is appropriate for the goals of investor protection.

Chairman GARRETT. I will yield back at this point. But since we don't have that many people, maybe we will get a second round of this. The ranking member of the subcommittee, Mrs. Maloney, is now recognized for 5 minutes.

Mrs. MALONEY. Thank you, Mr. Chairman. And following up on your line of questioning, any of us who has been in court knows it is incredibly time-consuming, and incredibly expensive. And as Mr. Ceresney noted, you can be in court for years without any solution. That doesn't help investors, and it certainly doesn't help business having a decision.

So I supported the expansion that was in Dodd-Frank that expanded the SEC's authority to try cases in an administrative forum where they could be made by administrative law judges in order to speed up the system. And some critics have said that the SEC's administrative proceedings amount to what would be called a "home-court advantage."

And some have even claimed that it deprives defendants of their due process. So I would like to ask you to speak to those issues. Do you think the SEC gets an unfair "home-court advantage" when they try cases in front of an administrative law judge?

Mr. CERESNEY. I do not. Administrative proceedings have additional protections that actually defendants don't necessarily have in district court, including our obligation to produce Brady material, exculpatory material to the defense, Jencks Act material, which is prior witness statements. We turn over the investigative files, usually within 7 days of filing our cases, which we do not do in district court proceedings.

There also are exhibit lists and witness lists provided typically in administrative proceedings, extensive such. And so there are lots of protections. I think the one major difference, defendants also get subpoenas if they show good cause, and they can subpoena documents.

The one major difference is obviously the lack of depositions. And I think the fact is if you look at our criminal cases, criminal authorities don't give deposition authority. That clearly is not a due-process violation. So I think it can't be a due-process violation to deprive defendants of depositions in this context.

Mrs. MALONEY. That is the second criticism that I have heard, that defendants are still not receiving their full due process. And can they appeal the administrative law judges' decisions?

Mr. CERESNEY. Yes, they can appeal to the full Commission. The Commission hears the appeal in the first instance and then they can also appeal after that the Commission's decision to the Court of Appeals.

Mrs. MALONEY. Could you just outline briefly what are the due process protections? You were talking in general, but can you just hit them like bullet points? What are the due process protections?

Mr. CERESNEY. We have obligations to turn over Brady materials, which is exculpatory evidence; and Jencks Act materials, which are prior witness statements. We turn over our entire investigative file including any prior testimony by any witness, within 7 days—typically within 7 days of our institution of the proceeding, we provide exhibit lists and witness lists that lay out in great detail what our case is going to look like. And, as I said, defendants also have the ability to obtain subpoenas of documents for good cause. And so I think the defendants have an extensive record which allows them to see exactly what we are charging.

Mrs. MALONEY. That sounds like a good process to me. Are you getting criticism from investors or institutions about the administrative law judge procedures?

Mr. CERESNEY. I have not heard criticisms from investors about the administrative law judge's procedures. Obviously, there has been some public dialogue about it.

Mrs. MALONEY. Okay. I would also like to ask you about the fact that when people talk about the Enforcement Division and whether or not it has been successful, they cite statistics on how many cases the SEC has brought and how much money they have collected in fines, and the bigger the numbers, the "more successful" the Enforcement Division is supposed to have been.

This has always seemed extremely strange to me. If the SEC is bringing a huge number of security fraud cases, for example, doesn't that suggest that there is more securities fraud in the markets? How is that a good thing? And, for me, this just highlights how foolish it is to judge the Enforcement Division based solely on statistics about the numbers of statistics and the numbers of fines and the number of cases.

For example, how do you quantify the number of violations that did not occur because they were successfully deterred by the Enforcement Division? So my question is, should we be looking beyond simple statistics and instead looking at a broader range of factors to judge the Enforcement Division, even if those factors can't be easily quantified. Could you comment on that? My time is up.

Mr. CERESNEY. I agree that numbers are easy to come up with and, therefore, those are often cited, but I agree with you that is not a major touchstone of success of our Enforcement Division. As I always say, the numbers are not the most important aspect of judging how well we are doing. From my perspective, it is about the quality of our cases—are we covering the entire security spectrum, are we bringing cases that have an impact on investors, and also deterring and punishing this conduct more broadly.

So we have tried—it is not easy as you suggest—to look at cases more qualitatively and to assign sort of measures qualitatively to the cases. And so we are trying to emphasize that we have talked about first-of-their-kind actions, where we are bringing cases in areas where we haven't before. I think that is important, as well. So there is no question that numbers are not the be-all and end-all in terms of measuring our success.

Mrs. MALONEY. Thank you very much.

Chairman GARRETT. Mr. Hurt is now recognized.

Mr. HURT. Thank you, Mr. Chairman. I know the gentlelady from Missouri, Mrs. Wagner, has some things she has to do so I am going to yield my time to her.

Mrs. WAGNER. I thank the gentleman very much for his courtesy. And welcome, Director Ceresney. Thank you for joining us today to discuss some of these enforcement issues with the SEC.

Earlier this year, a White House memo dated January 13th from Council of Economic Advisors Jason Furman and Betsey Stevenson was leaked that outlined the rationale for a new rulemaking from the Department of Labor to deal with conflicts of interest in the retirement advice market. Are you familiar with this memo?

Mr. CERESNEY. I am not. The Enforcement Division obviously enforces the rules. We are not really involved in policy decisions about what—

Mrs. WAGNER. Are you aware of the memos then?

Mr. CERESNEY. I am not.

Mrs. WAGNER. Commissioner Dan Gallagher recently referred to it as a "thinly veiled propaganda designed to generate support for a wildly unpopular rulemaking." Director, I am worried about the effects that such a rule would have on low- and middle-income Americans seeking financial advice for their retirement. And I would like to get your perspective on some of the claims regarding this area.

Mr. CERESNEY. In the Enforcement Division, we are in charge of enforcing the rules and the laws as they exist right now. And I think what you are referring to is a policy question as to what the law should be in the future. Should there be a different fiduciary standard, should that fiduciary standard apply to broker-dealers and the like. And that is a policy question that really is handled by other divisions at the SEC, not the one in which I am involved.

Mrs. WAGNER. Let me proceed here and say the memo stated that, "Consumer protections for investment advice in the retail and small plan markets are inadequate and that the current regulatory environment creates perverse incentives." Unfortunately, the memo does not analyze regulatory oversight or the protections investors currently receive from the SEC or FINRA. In fact, the memo doesn't even mention the SEC at all.

Isn't it true that there are rules that require clear disclosure to investors about payments and fees, including, sir, incentive fees and rules which prohibit the use of manipulation, deceptive or fraudulent practices?

Mr. CERESNEY. There certainly are statutes and rules on the books that preclude fraudulent activity and then we certainly vigorously enforce those.

Mrs. WAGNER. You vigorously enforce those. Could you please help us fill in the blanks left on how the SEC currently regulates and enforces conflicts of interest and issues of "perverse incentives in the investment advice market?"

Mr. CERESNEY. The law now does have a different standard for investment advisors than it does for broker-dealers. The broker-dealers are obviously governed by the anti-fraud provisions, and investment advisors have a fiduciary duty to their clients. So there is a difference in some of the standards that apply—

Mrs. WAGNER. There is a difference in the standards. Does the SEC ever bring cases against investment advisors for violations regarding their fiduciary duty?

Mr. CERESNEY. Yes, we do.

Mrs. WAGNER. So there are still issues of investor protection even with a fiduciary duty at times?

Mr. CERESNEY. Yes, but there are different standards that govern investment advisors and fiduciary standard does have a different nature to it than the protections that apply to—

Mrs. WAGNER. There were also claims, sir, that the current regulatory environment incentivizes advisors to recommend excessive churning of retirement assets. Doesn't the SEC have rules that expressly prohibit brokers from churning client accounts?

Mr. CERESNEY. The anti-fraud laws do prohibit churning, and that is governed by a test that looks at things like turn-over ratios—

Mrs. WAGNER. Right.

Mr. CERESNEY. —and the like.

Mrs. WAGNER. From an enforcement perspective, how do you handle these cases?

Mr. CERESNEY. We look for churning and we try—if we see indications of churning, we look to try to prove it by looking at things like the turnover ratio and the like.

Mrs. WAGNER. What further ways can the SEC mitigate potential risks associated with conflicts as a deterrent through enforcement, sir?

Mr. CERESNEY. As I said, we in Enforcement enforce the statutes and rules that are on the books now. And we do that vigorously. Whether there should be a different standard or not is, again, not something that is within our purview.

Mrs. WAGNER. If the Department of Labor potentially steps into this space where you have decades of experience in regulating, could that make your job through Enforcement perhaps more difficult, sir?

Mr. CERESNEY. I don't know. I would have to know more about what it is that the Department of Labor is going to do. I will say that we enforce the law as we see it. Whenever we see a violation, we will bring an action.

Mrs. WAGNER. Thank you, and I appreciate it. I yield back my time, and I thank the gentleman for his courtesy.

Chairman GARRETT. And I thank you both.

Mr. Lynch, you are recognized.

Mr. LYNCH. Thank you, Mr. Chairman. Director, I wanted to talk to you about WKSI waivers. As you know, Congress and the SEC has the ability to withdraw well-known seasoned issuer (WKSI) status to a company if they are found to have, in particular, violated securities law and anti-fraud provisions.

So I have sort of made a hobby out of tracking how many folks actually have their well-known seasoned issuer status withdrawn as a result of prosecution. And it is far more common for waivers to occur than it is to actually see prosecution. We don't have a lot of success, I think, in—especially looking at the financial crisis, not a lot of people were prosecuted, at least high-level folks. Very little was done to hold people accountable. But this is a case where I

think just last year the SEC granted 80 specific waivers when they could have penalized these companies for wrongdoing.

One particular case that I have found troubling was against Credit Suisse and they actually pled guilty to a criminal violation and yet, when the SEC was asked whether they would withdraw their well-known seasoned issuer status—this is someone whose employees were guilty of criminal activity—we still didn't withdraw their status.

So I am just curious as to where is that line? How do we review this, because it looks like it is much more likely that you will get a waiver from a penalty established by Congress than you might ever be prosecuted or be subject to this withdrawal of benefits? And of course, I should add that the well-known seasoned issuer status allows them to use shelf registrations. So that is a real benefit to these companies and it seems to be a good leverage point that we could use to require them to refrain from violating the anti-fraud provisions or other securities laws that we have established. And I am just curious, why don't we use that tool?

Mr. CERESNEY. Enforcement is generally not involved in waiver recommendations or decisions. Those are typically handled by other divisions at the SEC. For example, the WKSI waivers are handled by the Division of Corporation Finance. My understanding is that waiver requests are carefully evaluated by the Commission staff and by the Commission based on the facts and circumstances of the case under applicable legal standards.

It is important to recognize that WKSI disqualifications are not enforced from remedies. We have remedies that are available to us to punish misconduct and deter misconduct. For example, we have disgorgement, we have penalties, we have bars, we have undertakings. We have lots of different remedies available to us.

But the disqualification and waiver question is a separate question, as Chair White indicated in her speech a couple of weeks ago, that is a separate question about whether it is appropriate for that particular issuer to function in this particular business activity going forward. And whether the conduct that is involved in the enforcement action suggests that they cannot do that responsibly. That is a different—

Mr. LYNCH. So Credit Suisse, you were involved in that prosecution? The criminal prosecution?

Mr. CERESNEY. I was not involved—we were not. We brought a separate case against Credit Suisse that was separate from the criminal case—

Mr. LYNCH. Okay.

Mr. CERESNEY. —regarding unregistered broker-dealer conduct.

Mr. LYNCH. I wonder if the prosecuting authority actually recommended that WKSI status be withdrawn or would that be overreaching on their part?

Mr. CERESNEY. I am not—again, without talking about any particular case, which I don't know if that would be appropriate for me to do, I am not aware of criminal authorities kind of expressing a view on a WKSI waiver decision.

Mr. LYNCH. I am just curious, what is—so you have 80 waivers. I am just wondering, do you know if we are using the threat of

withdrawing that classification, WKSI classification, as a bargaining chip, sort of, in negotiations?

Mr. CERESNEY. That is exactly why the Enforcement Division is generally not involved in the question—

Mr. LYNCH. I see.

Mr. CERESNEY. —about whether—because we do not want it to be a bargaining chip in our enforcement actions.

Mr. LYNCH. Okay. Thank you. I yield back. Thank you, sir.

Chairman GARRETT. Thank you. The gentleman yields back.

Mr. Huizenga?

Mr. HUIZENGA. I am up. All right.

Chairman GARRETT. Yes.

Mr. HUIZENGA. All right. Well, thank you. Sorry, I have to get back, gather my notes. I was being distracted by my Wisconsinite. He was bragging about how Wisconsin was going to win the tournament so I don't know—I have to—

Mr. DUFFY. Bill agrees Wisconsin is going to win, you guys.

Mr. HUIZENGA. You are—reclaiming my time. I am not going to offer my predictions. Yes. All right, all right. I am getting to the penalties phase and all that. Let's get back to business here. When former SEC Chair Schapiro announced her intention to return power to staff to determine penalties, it is my understanding she received a standing ovation; at least, that is what was reported.

And I would like to hear your thoughts on, should power to decide penalties really reside with staff or should it reside with the five Commissioners appointed by the President and confirmed by the Senate? And, you have to understand, I am a former staffer myself. I understand the importance and the power of staff but, at the end of the day, doesn't that seem like it should be political appointees and confirmed Presidential appointees who determine that?

Mr. CERESNEY. Every recommendation that we make, including about penalties, gets approved by the Commission. So, at the end of the day, every penalty decision is approved by the Commission. We recommend to the Commission what the penalty should be, but it is up to the Commission to approve that.

Mr. HUIZENGA. But the staff determines the level and then how often is that overturned by the Commission?

Mr. CERESNEY. I would say in the vast majority of cases, the Commission accepts our recommendation. That is true of penalties and other things. In the vast majority of cases, our recommendation is accepted. Occasionally there is an issue, but every penalty recommendation gets approved by the Commission ultimately.

Mr. HUIZENGA. All right. Tell me a little bit about company versus individual penalties on that. I have a quote here from you from 2013: "Monetary penalties speak very loudly and in any language a potential defendant understands. Enforcement needs to be aggressive in our use of penalties." And I am curious, do you believe that penalties against corporations actually deter actions and conduct that violates the rules? Or why are they easier to levy these against companies versus individuals, and is there some sort of level where the SEC isn't going to go after an individual or an employee at a certain level where public securities are—have been—there has been fraud within these public companies?

Mr. CERESNEY. There is no question that cases against individuals are the greatest deterrent. I think individuals who feel like they are at risk will be deterred in their conduct. I think that is the case. And actually, 70% of our cases last year were brought against individuals—involved individuals being charged.

Having said that, I do think that there is an important place for monetary remedies against corporations. I think those kind of penalties have great impact. I think they encourage the increase in compliance, they encourage increased focus on compliance, they encourage shareholders and directors to pay attention and to ensure that executives are focused on making sure that there is compliance. So, for all of those reasons, I think corporate penalties are important but individual cases are critical.

Mr. HUIZENGA. Is there a written policy as to what determines that for the recommendations?

Mr. CERESNEY. A written policy for corporate penalties?

Mr. HUIZENGA. No, is there a written policy that staff follows as they are trying to determine corporate versus individual?

Mr. CERESNEY. There are internal guidelines about generally how to look at penalties but I don't—

Mr. HUIZENGA. There are always internal guidelines.

Mr. CERESNEY. Right.

Mr. HUIZENGA. We have internal guidelines in my family but that doesn't mean they are necessarily written down. How are they written, are they policy when someone comes in and is new to this, is there something for them to review?

Mr. CERESNEY. I believe we have internal guidelines but they generally set forth factors to consider in each case. So, in other words—

Mr. HUIZENGA. So do you or don't you know whether they are written down?

Mr. CERESNEY. Well, there—for example, there is a 2006 release that the Commission put out on corporate penalties that contains 9 factors that are relevant to corporate penalties. And in every case, we consider how those factors impact the case, and in a particular case, we may look at couple or two or three of those as being more important than the others. But, yes, that is one example.

Mr. HUIZENGA. Okay. Would you be willing to provide this committee with those written policies?

Mr. CERESNEY. Sure. I am happy to provide the 2006 statement to the committee.

Mr. HUIZENGA. Okay. And that is the extent of any of the guidelines that you deal with and staff would deal with?

Mr. CERESNEY. I believe we do have some internal factors to be considered. I would have to go back and look at our internal guidelines. But the public around this—also I should note cases out there—case law that articulates particular factors that should be considered in looking at penalties and we obviously follow those, as well.

Mr. HUIZENGA. My time is expiring but I think what I would like to do is follow up in written form with you—

Mr. CERESNEY. Sure.

Mr. HUIZENGA. —and see what we can pull together. Okay. Thank you, Mr. Chairman. And I yield back.

Mr. HURT [presiding]. Thank you.

The Chair now recognizes the gentleman from Delaware, Mr. Carney, for a period of 5 minutes.

Mr. CARNEY. Thank you very much, Mr. Chairman. And thank you for coming in today, Director Ceresney. Just a couple of quick questions. One, and it has been referred to a little bit before, is that we as Members hear from our constituents all the time about the fact that so few people were prosecuted or went to jail. That is what I hear specifically from constituents, as a result of the big financial crisis. How would you respond to that?

Mr. CERESNEY. I would say—obviously, I can't speak to the criminal authorities, because we don't have criminal authority at the SEC, and I can't speak for the Department of Justice, which does. I will say that I think our record in the financial crisis was very strong. We brought cases against 175 entities and individuals including 70 CEOs, CFOs, and senior executives. We got tremendous amounts of relief and disgorgement and penalties as a result of the financial crisis cases.

And so I think when you look at our efforts during the financial crisis, they were extremely strong. One example, just to point to, is the Bank Atlantic case which we tried in Miami a couple of months ago and we got a verdict against the CEO and the firm for misrepresentations relating to loans arising out of the financial crisis. That is just an example of a case we brought that was very strong and important.

Mr. CARNEY. Could you characterize some of the other cases. What generally were you—or is it just a broad range of things?

Mr. CERESNEY. It was a broad range of things. I think it included cases like the case against Citi's CFO relating to the disclosure of the subprime exposure. A case against Countrywide Financial relating to issues relating to their mortgages. Cases against Thornburg Mortgage relating to representations they made to investors. A case against BankAtlantic involved misrepresentations by a CEO regarding the performance of loans on the books of the bank. Those are just some examples.

Mr. CARNEY. Shifting gears, considerably actually, I am interested in your reflections here. A number of us have heard presentations about the possibility of a venture-type exchange. And I have talked to folks in the business and there—some of the concerns they raise are around fraud and that kind of thing, and the example in Canada, there actually has been some fraud. What concerns would you have with respect to a venture exchange, if you will, from an enforcement—from a fraud perspective and if you are familiar with that at all? I would be interested in your viewpoint on that.

Mr. CERESNEY. Obviously, the question about venture exchanges is one for the Division of Corporation Finance or for the Division of Trading and Market—

Mr. CARNEY. But my question is more of what should we be concerned about and—

Mr. CERESNEY. Sure. I think it is—I wouldn't characterize it as anything different than we are often concerned about, which is in-

vestor protection and whether investors are being misled. You obviously want to make sure that any representations the company that lists on a venture exchange are accurate. And so we would obviously monitor that just like we are monitoring all kinds of other things. Like, for example, Rule 506 Jobs Act, and other types of initiatives that relate to raising money from investors. We do look for fraud and all. So I don't know whether venture exchanges would present a larger—

Mr. CARNEY. Yes, I think that is really the question.

Mr. CERESNEY. I don't know—

Mr. CARNEY. You don't have a view on that?

Mr. CERESNEY. —to have a view on that, yes.

Mr. CARNEY. Well, thanks very much. Thanks for being here. I yield back.

Mr. HURT. The gentleman yields back. The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, for a period of 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman, and thank you, Mr. Ceresney, for coming today.

Under Sarbanes-Oxley, the Commission is authorized to take pools of cash collected from defendants in the SEC enforcement actions and distribute the money to injured investors. I think they call those Fair Funds. The penalties are deposited into the Fair Fund which functions like a private class action settlement.

In an op-ed in November of 2014 in The Wall Street Journal, SEC Commissioners Gallagher and Piwowar expressed concerns about the use of those funds and said they believed that class action lawyers have an incentive to round up potential victims in the SEC insider trading cases and arrange a substantial contingency fee, then lead Fair Fund campaign under the guise of grassroots movement by harmed investors.

I think the particular case that Commissioners Gallagher and Piwowar were referring to was the *SEC* v. *CR Intrinsic Investors.* I think in that case there were thoughts that it was difficult to really tell who the injured parties were in that case, and that a substantial amount of money was involved in that transaction. And so I guess the question is, were you aware that before the vote, the Commissioner's office received dozens of suspiciously similar letters from purported victims urging the Commission to petition for a Fair Fund?

Mr. CERESNEY. The CR Intrinsic case did involve proceeds from a settlement that involved insider trading. Our assessment, based on the WAU and Congress' prior activity in this area, is that contemporaneous traders—that is, traders who traded at the same time as the insider trading occurred—were victims under the law as it has been defined by both the case law and by Congress in the past.

And so our recommendation to the court was that a Fair Fund be established both from the disgorgement and from the penalty amounts in that case and distributed appropriately, and we also reminded the court that the statute does not allow for the use of attorneys' fees—the use of the funds to pay attorneys' fees as part of that distribution.

And so our perspective was that a fund should be created and an administrator should be appointed to determine who the victims were, and then distribute the money, but that it shouldn't go to attorneys' fees.

Mr. NEUGEBAUER. You may not directly pay attorneys' fees, but if a bunch of trial lawyers get together and go out and solicit people who could have—say they could have been injured in that trading or that specific case, they get a contingency fee, while the funds from the pool don't directly go to pay those attorneys, indirectly they would go to the attorneys. I guess they would be netted from the settlement with the individual who claimed their damages. Wouldn't that be correct?

Mr. CERESNEY. I don't know what arrangements there are between investors and their attorneys and, obviously, we don't look into—we award a settlement—if money is awarded out of the Fair Fund to a particular investor what they then do with that money is not something that we can have visibility into. And so I think the only question that we were faced with was whether those contemporaneous traders were victims, and a majority of the Commission obviously approved the recommendation that we recommend to the court the creation of the Fair Fund.

Mr. NEUGEBAUER. What is the current policy of when you establish a Fair Fund and when you don't establish a Fair Fund?

Mr. CERESNEY. Whenever we have investors that have been harmed that we can identify, and wherever the money is sufficient such that it makes it justifiable to create a fund, we will recommend a Fair Fund. It obviously is a facts-and-circumstances determination based on the amount of money, who the victims were, what the conduct was, et cetera.

Mr. NEUGEBAUER. What is the current status of the Intrinsic case?

Mr. CERESNEY. I am not 100%—I think an administrator has or will be appointed, I am not 100% sure of exactly where—I am happy to get back to you with the current status if I can go back and check. I believe it was in the planning stages still where we had—I think there had been an administrator appointed and now they have to come up with a plan.

Mr. NEUGEBAUER. And how many Fair Funds have you set up since the authorization in Sarbanes-Oxley, do you know?

Mr. CERESNEY. I don't have a number of Fair Funds. I can tell you the amount of money we distributed through—since Sarbanes-Oxley. It is almost $10 billion.

Mr. NEUGEBAUER. But you don't how many funds?

Mr. CERESNEY. I can't tell you. It is hundreds, but I don't know the exact number. I can get back to you with that if you would like.

Mr. NEUGEBAUER. And when you say you distributed $10 million, that was the amount of money that went into the fund?

Mr. CERESNEY. $10 billion.

Mr. NEUGEBAUER. $10 billion.

Mr. CERESNEY. Yes. I think that is the amount distributed. There are occasions I think where money goes into a fund but there is excess and it comes back, so I am not sure whether that—I think that $10 billion is actually disbursements.

Mr. NEUGEBAUER. I would be interested to know the current status of the Intrinsic case.

Mr. CERESNEY. Okay. We can get back to you on that.

Mr. NEUGEBAUER. Thank you.

Mr. HURT. The gentleman yields back. The Chair now recognizes Mr. Sherman for a period of 5 minutes.

Mr. SHERMAN. Thank you. I want to focus a little bit on some of the less sophisticated, more clearly illegal, but sometimes not detected, fraud that goes on out there. The best example is Madoff. I want to make sure that we have learned all the lessons that can be learned there.

One of the things with Madoff is he submitted audited financial statements, audited by a firm so small that they could not have done an audit of his operation. You might also have a circumstance where the firm is just barely enough to have done the work, but if they did it, that would have to be like half their fees for the year and they would have lost independence. You may have a circumstance where the audit firm doesn't exist. And you may have a firm that does exist but the issuer just steals a piece of stationery. What systems have you done—gone through to make sure that the auditor sends you a copy of the audit opinion, or emails it in to you, so you know that the issuer is not submitting a forged audit opinion?

Mr. CERESNEY. Obviously, the PCAOB was created by part—Sarbanes-Oxley to oversee the audit—public audit of public companies, and I think that they have—

Mr. SHERMAN. This is more, how do you—

Mr. CERESNEY. Is your question in connection with—

Mr. SHERMAN. Yes. When a registration statement is submitted—

Mr. CERESNEY. Right.

Mr. SHERMAN. —it is submitted by the issuer. How do you—when a reg D document is submitted, et cetera. At all levels from public to A plus to A minus to A triple plus, whatever, reg A, reg D. How do you make sure that, in fact, the CPA firm did in fact sign that opinion? It is not a forgery?

Mr. CERESNEY. Well, the Division—

Mr. SHERMAN. Do you bother to contact the firm?

Mr. CERESNEY. The Division of Corporation Finance reviews filings by companies.

Mr. SHERMAN. Do they have a system, or you don't know if they have a system?

Mr. CERESNEY. Sitting here today, I can't tell you what their system is. I know if they were to find a red flag that suggested there was an issue they would refer it to us.

Mr. SHERMAN. The answer, I believe, last I checked is that they have no system. Madoff happened because 10 or 12 of the barn doors were open. They have closed one or two, and they have gone on to other things. There will be more fraud, and then there will be more work for you folks to do and more big fines to collect, which will get the agency more big and good headlines.

What does your Enforcement Division do with regard to the Ponzi schemes that are out there being sold to people who wouldn't know a registration statement if it hit them in the face? Are you

trolling the internet and finding the Ponzi schemes or are you going to tell me that, well, you are not a law enforcement agency so you won't do that?

Mr. CERESNEY. We do do that, amongst many other things. We obtain over 15,000 TCRs, tips, complaints and referrals a year.

Mr. SHERMAN. I am not talking about—I am talking about, are you trolling or are you just waiting for people to tell you?

Mr. CERESNEY. We do have proactive efforts in a number of areas, including pyramid schemes, microcap fraud, and that kind of—

Mr. SHERMAN. You actually have at least one employee who is trolling the internet, finding the bogus offers that are out there to investors?

Mr. CERESNEY. We do in a number of areas, including microcap fraud, pyramid schemes and the like. We do do affirmative proactive surveillance.

Mr. SHERMAN. Got you. Now, you are asking for a 7 percent increase in the budget. How would that be spent? Why is it necessary?

Mr. CERESNEY. Yes, the portion of that budget that is related to the Enforcement Division relates to 93 positions that we have asked for. I think the way we break it down is really three categories of additional needs. One is data analytics. We anticipate 20 people would be into analytics. We have a huge amount of data now available to us. Using that to detect misconduct is a great opportunity and something that we really need to be doing.

The second is for investigators, about 50 additional people there. And there, I think the point is we have just tremendous resources that are necessary to investigate complex schemes. And the third area is trial attorneys—about 20 or so trial attorneys. And we have seen an increase in trials—

Mr. SHERMAN. And these 93 positions, that would be roughly a 7 percent increase of your Division or is it somewhat different than that?

Mr. CERESNEY. Our Division now is about 1,300 or so employees—

Mr. SHERMAN. It is pretty close to 7 percent.

Mr. CERESNEY. I guess it is close to 7 percent.

Mr. SHERMAN. Close enough for government work.

I yield back.

Mr. HURT. The gentleman yields back. It is my understanding that votes have been called. So what I would like to do is to have questions for—what I would propose doing, without objection, is that we have questions from Mr. Royce and then Mr. Himes and we would then recess.

So with that, I recognize Mr. Royce for a period of 5 minutes.

Mr. ROYCE. I thank the chairman.

Director, as you point out in your testimony, policing insider trading is central to the mission of ensuring confidence in the markets. And I assume that you often get anonymous tips on insider trading cases or have things referred to you from the Division of Corporation Finance.

I am wondering what other avenues you look to for information. For example, if a Federal judge raises serious questions about in-

sider trading in a ruling, is this something that could trigger the commencement of an investigation into securities laws violations? Or is an investigation—let's say there is an ongoing investigation, are issues raised in a court proceeding potential evidence for the Division of Enforcement?

Mr. CERESNEY. We have a number of sources of information relating to insider trading cases. A prominent source is SRO referrals, FINRA and ORSA refer cases to us often. We also now have developed internally a mechanism for finding insider trading through data that we have—blue sheet data that we have. Obviously, if a court decision were to come out which suggested there was insider trading, it clearly is also something we would look at.

Mr. ROYCE. The judge raised those serious questions, I see. As for what makes up the insider trading, do you look to the law for guidance? Do you discuss potential investigations with your colleagues in Corporation Finance? I assume it is not always as easy as Justice Potter's storage rule that you know it when you see it.

Mr. CERESNEY. We do. Obviously, we have dialogue internally, including with the Division of Corporation Finance about violations of the insider trading laws.

Mr. ROYCE. And it is clear to me that sometimes you have to answer complicated questions in order to bring an insider trading case to the Commission. Under the Securities and Exchange Act, and specially Rule 14e-3, there are many hurdles that have to be overcome. And I was hoping you could help me understand some of those today.

The first is this question of what constitutes a substantial step or steps toward a tender offer? Do you look for tactics commonly associated with a hostile bid? Say, for instance, Company A is making an offer to buy Company B. If Company A begins a PR campaign and hires financial and legal advisers and sends multiple threatening letters to Company B's Board of Directors, directly communicates with Company B, its customers and employees, would this not meet the threshold of commencing a hostile tender offer?

Mr. CERESNEY. I think it is a facts and circumstances inquiry. You know, what a substantial step towards a tender offer is really a—can be a complicated question, in certain cases, obviously. So I think it really depends on the facts and circumstances.

Mr. ROYCE. And here is a follow-up on this: What if Company A's board meeting materials clearly reflect a recognition by the board that a move to acquire Company B would most likely require a hostile takeover? Or what if Company A simply makes a self-serving statement that it is not taking a substantial step towards a tender offer. Is this enough to establish that as fact?

Mr. CERESNEY. Again, I think it is a facts and circumstances inquiry. I need to really sort of examine the set of facts and circumstances on that.

Mr. ROYCE. And another question that has only recently been raised is what is the SEC's definition of who would be considered a co-bidder or a so-called co-offering person and therefore exempted from the scope of the rule?

Mr. CERESNEY. Again, it depends on the facts and circumstances and what kind of conduct the individual or the entity takes.

Mr. ROYCE. Would a person or persons brought on as a strategist or financier by Company A qualify as a co-offering person under the rule? What would have to be established for this person to qualify for the exemption from the disclosed or abstain rule that applies to those with material non-public insider information.

I am hopeful that the SEC will provide some clear guidance on these issues in the future. And so, that is why I asked the question for the record. If I could have a response on those?

Mr. CERESNEY. Again, it is a facts and circumstances inquiry. I would really need to examine the facts more closely.

Mr. ROYCE. Thank you, Director.

Mr. CERESNEY. Thank you.

Mr. HURT. The gentleman's time has expired.

The Chair now recognizes Mr. Himes for a period of 5 minutes.

Mr. HIMES. Thank you, Mr. Chairman. Thanks for being with us, Director Ceresney. I have two questions pertaining to insider trading. Like my colleague, Mr. Lynch, I am working on a bill that takes a slightly different approach.

And my two questions are this. First, there is some ambiguity in the press reporting about the SEC's beliefs around the implications of the Second Circuit's Newman decision. Law 360—I think they quoted you as saying you have the ability to adapt, late January Southern District prosecutors say they are going to drop some prosecutions. And of course, we are hearing lots of talk about the possibility of convictions being overturned.

So my first question is, regardless of the future of the Newman decision, do you think we would be well-served, big picture, by clear statutory liability, in other words, a law prohibiting insider trading?

Second—I will let you divide up the remaining time in terms of how you want to answer these—and this would be helpful in thinking through the legislation that I am working on, how does the SEC think about the threshold between civil and criminal liability? I guess the right way to ask that is when do you and how do you take the decision to refer a case like this to the DOJ for criminal prosecution?

Mr. CERESNEY. First, let me just comment on the impact of Newman. I think it is fair to say it is a very significant decision and it will impact certain of our cases. Whatever has been reported about our views, it is very significant. It also, though, as I have said before, does not mean that we don't have insiding trader cases. We brought cases against 16 defendants since Newman and we will continue to do that. We will work within the confines of Newman.

We have a lower standard of proof on the civil side, where we have to show negligence by knowledge of a tippee, and so that helps. We have other circuits we can go to. So, there are ways we can deal with Newman. And I think courts may well distinguish the facts on Newman, as they did in the last couple of weeks in the Southern District. So, that is just our views on Newman.

And we filed an amicus brief. The rehearing is still pending. And so, obviously, whatever happens with that will impact our views.

As for the views on legislation, I think that obviously is a decision for the Commission to make about what their position is on legislation. And they have not taken a position yet. What we have

said and we will continue to do is, we are happy to supply technical expertise, as you and others work on bills.

And I think Chair White said last week—and I think this remains our overriding view—strong insider trading laws are critical to the markets. And we think that is important. And we think that is critical. So, that remains our overriding goal, making sure that insider trading laws are strong, and that people have confidence in the markets.

Now, as to the question about civil and criminal—

Mr. HIMES. Can I stop you there? Because, of course, some might argue that there are no insider trading laws, that you rely on antifraud provisions. So, can I interpret what you just said as encouragement that perhaps we should do away with some of the ambiguity emerging from the way these cases have been prosecuted?

Mr. CERESNEY. No, I think I am saying it is really up to the Commission, and they haven't expressed a view on this. And I don't want to be interpreted one way or the other on this. I think Section 10b-5 does prohibit insider trading, as the case law has shown. It is deceptive conduct, and it is illegal under Section 10b-5. So, that is really what I was saying.

And just on the civil/criminal question that you asked, obviously, violations of the securities laws—the only—the thing that makes it criminal is intentional conduct, where we can show intentional conduct beyond a reasonable doubt. That is what makes it criminal. Obviously, every violation to securities law could be criminal if it is done intentionally and we can prove it beyond a reasonable doubt.

And so, in insider trading cases, what we do is we often work with criminal authorities, as well. They have tools that aren't available to us, including undercover operations and the threat of jail and those kinds of things. And the question about whether something goes criminal versus civil is often a question of the evidence.

Typically, you will have a cooperator in a criminal case, or you will have a recording. Or you will have some sort of definitive evidence that can prove it beyond a reasonable doubt.

In our civil cases, we often have circumstantial evidence. You see somebody trading right before an announcement. You see them getting a call from an insider right before they trade. You see evidence of suspicious trading, where they are trading two thirds of their net worth right before an announcement. They have a relationship with somebody who is an insider.

So, there is lot of circumstantial evidence that shows it, and we think that can prove it by a preponderance of the evidence. But that is not always sufficient to show beyond a reasonable doubt.

Mr. HIMES. Last question. Newman hinged on the knowledge of the tippee, of the tipper's personal gain and the existence of that personal gain. Do you think that the tippee's knowledge of the possibility of personal gain on the part of the tipper—do you think that is sort of an essential feature to liability of the tippee?

Mr. CERESNEY. Well, that is what Newman says. And we had previously—our view was that it wasn't. But the Southern District didn't appeal that portion of the Newman case—didn't seek rehearing on that portion of the Newman case. And so, I think it will stand. So Newman, at least in the 2nd Circuit, governs there.

As I mentioned, the way we deal with that is we have a lower standard of proof on that. We just have to show that the tippee should have known that the tipper had a personal benefit. And that gives us an ability to show, for example, that the nature of the information was such that the tippee should have realized that it came from somebody who had personal benefit.

Mr. HURT. Thank you, Mr. Ceresney.

The gentleman's time has expired.

The list that I have now is Mr. Schweikert, Mr. Poliquin, Mr. Hill, and Mr. Duffy are the ones that we will expect to hear from, or have questions when we get back.

And, without objection, we will recess until 10:45.

[recess]

Mr. HURT. The subcommittee will come back to order. Thank you, Director, for your patience.

And what I have like to do is go ahead and recognize the gentleman from Wisconsin, Mr. Duffy, for a period of 5 minutes, starting now.

Mr. DUFFY. Thank you, Mr. Chairman.

Mr. Ceresney, you are a lawyer, correct?

Mr. CERESNEY. I am.

Mr. DUFFY. And you used to be a Federal prosecutor, correct?

Mr. CERESNEY. I was.

Mr. DUFFY. And now you have moved over to the SEC? Yes?

Mr. CERESNEY. Yes.

Mr. DUFFY. Yes. Very easy questions.

And you care about due process, I would imagine?

Mr. CERESNEY. Yes, I do.

Mr. DUFFY. Who hires the ALJs who work at the SEC?

Mr. CERESNEY. I am not sure of the exact process and I am not involved in the process—

Mr. DUFFY. But the SEC hires the ALJs, right?

Mr. CERESNEY. I believe, actually—

Mr. DUFFY. You should know the answer to that. It is not some outside group, right?

Mr. CERESNEY. I don't—I think that the chief judge, Judge Murray, may be well involved in it. I assume ultimately, it is approved by either the Chair or the Commission. I am not sure.

Mr. DUFFY. At the SEC? So the ALJs are hired by the SEC? They are paid by the SEC, correct? Yes.

Mr. CERESNEY. They are paid by the government. I don't know exactly where the money—

Mr. DUFFY. In the administrative law proceedings, who makes the rules in regard to those proceedings?

Mr. CERESNEY. The Commission.

Mr. DUFFY. The SEC does, right?

Mr. CERESNEY. That is correct.

Mr. DUFFY. Right. So, not some third party. You actually make the rules by which you get to litigate cases or prosecute cases, correct?

Mr. CERESNEY. I think they are subject to notice and comment, but yes, it ultimately is—

Mr. DUFFY. But you make the final rule. You can say, "I will listen to you, I will hear you, but I am going to make the final decision."

Mr. CERESNEY. Like other rules, that is correct.

Mr. DUFFY. So with regard to discovery in the ALJ proceedings, do you have the same discovery requirements going the ALJ route as you do in Federal court?

Mr. CERESNEY. Actually, you have more extensive discovery.

Mr. DUFFY. More extensive?

Mr. CERESNEY. Yes. We turn over our whole file, typically within 7 days of—

Mr. DUFFY. Are you required per your rules to turn over those documents?

Mr. CERESNEY. Yes, we are.

Mr. DUFFY. So you are—your testimony is, the discovery requirements at the SEC going the administrative route is more extensive than the Federal courts?

Mr. CERESNEY. Our obligation to produce documents and items that are in our file is more extensive.

Mr. DUFFY. So do you have a duty to disclose exculpatory evidence to the defendant?

Mr. CERESNEY. In an administrative proceeding, we do, not in a district court action.

Mr. DUFFY. So you are required to—per your guidelines, to disclose exculpatory evidence?

Mr. CERESNEY. Per the rules of practice, yes.

Mr. DUFFY. Okay. And what happens if you violate that rule?

Mr. CERESNEY. I assume there are implications for the proceeding, but I am not familiar with instances where that has occurred. But I imagine there would be implications in the proceeding.

Mr. DUFFY. In regard to the admissibility of hearsay, is that admissible in Federal court?

Mr. CERESNEY. Hearsay is, unless it is subject to an exception—there are obviously a number of exceptions to hearsay—

Mr. DUFFY. It is not admissible, right?

Mr. CERESNEY. Hearsay that is not subject to an exception is not admissible.

Mr. DUFFY. Is it admissible in your proceedings?

Mr. CERESNEY. The rules of evidence are relaxed in an administrative proceeding, but the administrative law judge has discretion.

Mr. DUFFY. So the point is, you don't have the same rules on hearsay at the SEC as you do in Federal court.

Mr. CERESNEY. They could, although one thing to say is the administrative law judge decides on the weight of the evidence.

Obviously, if evidence is hearsay—

Mr. DUFFY. The administrative law judge that is employed by the SEC, that one?

Mr. CERESNEY. The administrative law judge—

Mr. DUFFY. —what was the—I thought I heard that incorrectly—what was the win rate last year in the cases you brought, in those administrative cases?

Mr. CERESNEY. Last year—

Mr. DUFFY. Did I hear it was 100 percent?

Mr. CERESNEY. Last year, but—

Mr. DUFFY. But 100 percent?

Mr. CERESNEY. Not in prior years, though.

Mr. DUFFY. But last year was 100 percent? You won every case?

How about with regard to the cases that you brought in Federal court? Was it 100 percent there?

Mr. CERESNEY. No—

Mr. DUFFY. No? You won 11 out of 18?

Mr. CERESNEY. That is correct—11 out of—

Mr. DUFFY. Do you think there could be any correlation when you actually hire the judges and you set the rules that you win all the cases? Do you see a correlation there?

And you might say, you know what? I want to bring more cases in front of the judges that I hire and abide by the rules that I set as opposed to letting these cases go into Federal court. And low and behold, wow, I win them all. And I believe in due process.

This is a great way to administer justice when you work at the SEC.

Mr. CERESNEY. I will just say this: We are not afraid to try cases in Federal court. In fact, we have won 11 of our last 13 jury trials in Federal court. We just won one yesterday.

And we still bring a majority of our cases in district court, so we are not shying away from using district court.

Mr. DUFFY. With regard to press releases, I read a few of your press releases. I don't know if you would agree, but when I read your press releases, I read them and say, "This defendant, man, the SEC says they are guilty. They lay out the case, they lay out the facts, and they conclude guilt."

As a former Federal prosecutor, from the U.S. Attorney's Manual, there is a requirement that says, "A news release should contain a statement explaining that the charge is merely an accusation, that the defendant is presumed innocent until and unless proven guilty."

And I was a former prosecutor, only a lowly State prosecutor, and we would abide by that rule as well.

I read this, and I am amazed at the stuff you put in your press releases with regard to defendants.

Thoughts on that?

Mr. CERESNEY. I think our press releases always make clear that the allegations are being alleged, and they make it clear that they have not been proved and they are subject to being—

Mr. DUFFY. What do you think a Federal judge would do if you, as a Federal prosecutor, put out a press release about a defendant, like you do, about a defendant at the SEC? Do you think he would say, "Oh, wow, that is right in line with Federal procedure?"

Mr. CERESNEY. I think it is in line.

Mr. DUFFY. You think it is?

Mr. CERESNEY. Yes, I do.

Mr. DUFFY. I would disagree in the most strong way.

I see my time—

Mr. HURT. Thank you, Mr. Duffy.

Mr. DUFFY. —is up. I yield back.

Mr. HURT. Thank you, Mr. Duffy. And the gentleman's time has expired.

The Chair now recognizes Mr. Poliquin for a period of 5 minutes.

Mr. POLIQUIN. Thank you very much, Mr. Ceresney, for being here this morning. I appreciate it.

And I want to thank you also for the good work of you and your staff in pursuing the bad guys in the financial services space. I know that you are doing the best you can to make sure you protect our consumers.

Now, if you don't mind me beginning by reminding both of us that the reason we have such a strong economy, in great part, here in America is because we have such a diverse and creative and liquid capital market and also financial services sector. Not only do they provide the capital that we need as an economy to grow and create better lives and more jobs for our citizens but it also provides the tax revenues we need to defend ourselves and take care of those who are truly in need.

Now, we both know that this country is a country of laws, and it is very, very important that whomever comes before you—and I am sure you would agree with this, Mr. Director—has a fair hearing. This is embedded in our Constitution, the 4th and 5th Amendments.

And I am sure you want to make sure that anybody who is brought before you folks has an opportunity to defend themselves in a fair and predictable way, whether you are in front of a traffic court in Bangor, Maine, or someone here in Washington who is in the financial services sector before you folks.

Now, one of the concerns that I have, to be very candid about with you, as we discussed a little bit this morning, Mr. Ceresney, is that during the past few years, you seem to have relied much more on an in-house administrative process to chase down those you think are—or have been accused of violating our securities laws.

Now, if I am not mistaken, internal in-house procedures are located and they take place at your offices. Is that correct? In-house?

Mr. CERESNEY. In D.C., we have a hearing room in the SEC—

Mr. POLIQUIN. Okay, so it is that essentially at your building?

Mr. CERESNEY. In the regions, actually, often, the hearings are not held in our offices; often, they are held in Federal courts or other places.

Mr. POLIQUIN. Okay, but I am just talking about your administrative process. And if I am also not mistaken, Mr. Ceresney, you folks actually select the administrative law judges who oversee these proceedings. Is that correct?

Mr. CERESNEY. As I mentioned, I am not 100 percent sure of the process by which the ALJs get hired. I know that the—

Mr. POLIQUIN. Okay, but you folks pay them.

Mr. CERESNEY. They are paid by the government.

Mr. POLIQUIN. Okay, they are paid by the government. Paid by the SEC in this case, part of your budget.

Mr. CERESNEY. I assume that is right. But I don't know where the money comes from.

Mr. POLIQUIN. Okay. I would make the case, if I may, sir, that if you are not in Federal court to pursue these alleged violations of the securities law and they are held, effectively on government property, your government property or thereabouts, and you folks

are involved in some way, are hiring and paying for these judges, I would make the argument with you or make the point that they might not be completely impartial.

And I want to just bring that to your attention.

Also, it is my understanding that there is no jury involved, correct?

Mr. CERESNEY. There is no jury—

Mr. POLIQUIN. Okay. And also, hearsay is admissible as evidence in these proceedings, is that correct?

Mr. CERESNEY. As I said before, hearsay evidence can be admissible. It is at the discretion of the ALJ and the amount of weight—

Mr. POLIQUIN. Okay. And these folks are the people that you hire for these proceedings.

And if someone comes before you and they—or they come out on the other side of the fence, and they want to appeal it, they appeal it before your people, right?

Mr. CERESNEY. They appeal it to the Commission.

Mr. POLIQUIN. Okay. So they—

Mr. CERESNEY. Presidential appointees.

Mr. POLIQUIN. Okay, so they appeal it to your organization, not an independent outside entity, correct?

Mr. CERESNEY. They ultimately can appeal to a court of appeals.

Mr. POLIQUIN. Okay, but the first appeal is to you folks, right?

Mr. CERESNEY. The first appeal is to the Commission.

Mr. POLIQUIN. Okay. Here is where I am going with that, Mr. Ceresney. Everybody wants to make sure that our investors and our consumers are protected, but we also want to make sure that the folks that you bring before you also have a fair and honest process. That is part of our Constitution.

Now, I would also, if I may, remind you that the financial services industry employs about 6 million people in this country in various functions. And they are good-paying jobs. And they provide opportunities for their families.

And what I am concerned about is that if you have a process that is perceived to be unfair or unpredictable, where it is stacked against the person that you bring before you or the company you bring before you, that this will have a negative impact on this part of our economy, which provides so much vibrancy and so much depth to our economy and so much employment, that this could actually hurt the folks whom you are trying to help.

Let me give you an example. If you are talking about a paper maker in Rumford, Maine, that I represent, or a teacher from Bangor, Maine, or a nurse from Lewiston, Maine, and they are preparing and saving for their retirement or to put their kids through college with savings, and they are dependent upon a mutual fund company or an investment management firm that helps them grow that retirement nest egg or that nest egg to put their kids through college, and all of a sudden the firms in this space are dragged before the SEC and there is not a fair opportunity to be heard, then that will have a negative impact and raise the cost, raise the fees, and reduce the performance of that nest egg that those retirees are trying to accumulate.

So I know there is all kinds of room to make improvement. And I would just encourage you, Mr. Ceresney, as you go through this

process, to make sure you are looking out for these middle-class families who are trying to prepare for their retirement by being fair to the people who are brought before you.

I bet there are ways you can make adjustments to make that happen.

Mr. HURT. Thank you, Mr. Poliquin.

The gentleman's time has expired.

The Chair now recognizes Mr. Messer for a period of 5 minutes.

Mr. MESSER. Thank you, Mr. Chairman.

And thanks to the Director for being here today. I appreciate your willingness to withstand testimony.

We all support the vigorous enforcement of Federal securities laws and believe that it is important that you go after bad actors. When, though, those bad actors are penalized, at times the payment for that falls upon innocent shareholders, who, of course, weren't a direct part of the bad activities that may have been prosecuted.

Could you talk a little bit about what, if anything, the SEC does to ensure or try to mitigate the impact on innocent shareholders of enforcement efforts?

Mr. CERESNEY. We have a number of factors that we consider when we think about corporate penalties. And I think you are focused on issuers that are not regulated. I think that is the area folks have focused on when it comes to shareholders and the like.

And there are a bunch of factors that we consider. We consider the conduct. We consider whether or not there was intent. We consider cooperation, remediation. We also consider whether there was a corporate benefit, that is, whether the shareholders got some benefit from the conduct. That is obviously an important factor. And then, also, what is the impact on the shareholders. We consider all of those things.

And in every case, we decide on the appropriate penalty that would be important and useful for punishment and deterrence, and that is really our goal, making sure that we are punishing and deterring. So in every case we weigh those factors and reach that conclusion.

Mr. MESSER. You have agency guidelines, as I understand it, that say that you can consider the impact on shareholders?

Mr. CERESNEY. There was a 2006 release that outlined a number of factors that should be considered. One of those factors was impact on shareholders. So it is one of the factors that is looked at in connection with a corporate penalty. But it is only one of the nine factors.

Mr. MESSER. And make sure when you say release, those releases are a set of guidelines of how you will analyze things, they are not requirements.

Mr. CERESNEY. They are not requirements. They were never binding on the Commission.

Mr. MESSER. Okay. So there is no assurance that each and every time the impact on innocent shareholders is required to be analyzed as part of the penalty?

Mr. CERESNEY. I will tell you that when it comes to making recommendations, we in the action memo will typically discuss all nine factors and how they impact a particular case. So one of the

factors we will discuss is impact on shareholders and inform the Commission of that. But there may be other factors that we will consider more compelling or important in a particular case that compel a penalty.

Mr. MESSER. I just would make the case that certainly it is important that we have strong enforcement. The bad actors ought to be penalized. But often innocent shareholders get caught up in the midst of this, at no fault of their own.

And we certainly, as a committee, are looking at a requirement that the SEC must consider the impact on innocent shareholders as part of your analysis. Do you have any thoughts on implementing that requirement?

Mr. CERESNEY. As I say, in almost every case, we consider it. It is one of the factors we look at. And then we weigh that against the other factors.

Mr. MESSER. Okay. Thank you very much.

Mr. CERESNEY. Thank you.

Mr. HURT. The gentleman yields back.

What I would like to do, without objection, maybe, is to start a second round of questions. And I know there are a couple of Members who are on their way back, so hopefully that will give them time to get back here. And I think the ranking member also had some questions.

But I would like to recognize myself for 5 minutes.

First, I think a common theme that we have heard here today certainly focuses on our system of justice and the rule of law and making sure that there is fairness in these processes.

One of the things I think that has been said is that the administrative procedure is not as time-consuming as the Federal court system, and I understand that. And perhaps there are efficiencies going through the administrative process. But I think that we should never, ever, ever take a shortcut for times' sake in pursuit of something that is not square with justice and fairness.

And I know you agree with that. But there are some questions that have been raised that I think are worth exploring.

One of my first questions is, what was the reason, if you know, that the nonregistered registrants were excluded from the administrative process from the beginning? Because, obviously, Dodd-Frank included nonregistrants. There must have been a reason for that. And I was wondering if you could speak to that?

Mr. CERESNEY. I am not familiar with the history. I just know that for a very long time, administrative proceedings have been available. Penalty authority was only given to us about 20 or 25 years ago. And so, when penalty authority was provided, we could obtain penalties against registered entities in administrative proceedings.

I don't know the history and that—

Mr. HURT. But it probably had something to do with the fact that registrants are submitting themselves voluntarily to the SEC and its processes, and nonregistrants are not, they are just regular citizens, whether they are bad actors or not.

Mr. CERESNEY. I think that was probably part of it, yes. I imagine that there could have been other issues, but, yes, I imagine that was part of it.

Mr. HURT. Now, with respect to the due process issues that have been raised, hearsay can be allowed in the administrative process. There is no jury trial.

Those are two fundamental constitutional rights that are afforded defendants in criminal trials, correct?

Mr. CERESNEY. That is right, although I should note that the Supreme Court had ruled in Atlas Roofing, which is a case from some years ago, that there is no Seventh Amendment right to a jury trial in connection with administrative—

Mr. HURT. But we are concerned with fairness and due process regardless of whether it is strictly required by the Constitution or not, correct?

Mr. CERESNEY. Oh, undoubtedly. I am concerned with fairness, and my view is that administrative proceedings do provide that fairness.

Mr. HURT. Okay. And so when you look at the appeals process, the way it would work is if a ruling is made within the administrative process, and then it gets appealed to the SEC, to the Commission, itself.

And then it bypasses any district proceedings and goes to the court of appeals. So that is not a trial court and they are not reviewing anything de novo, they are reviewing it is not de novo, is it?

Mr. CERESNEY. The Commission review is de novo. The court of appeals review is not de novo.

Mr. HURT. And so, what are the standards of review as it relates to this Commission's action? Do they give deference to the SEC in interpreting its own enforcement actions?

Mr. CERESNEY. There is some deference given to the SEC with regard to findings of fact. I think when it comes to legal matters, obviously the court of appeals reviews that, and legal matters are not—are subject to the court of appeals views. But there could be deference there, as well, based upon Chevron deference.

So there is a fair amount of deference that does exist for the Commission's rulings.

Mr. HURT. Now, as a part of the penalties that are assessed, there is something called "undertakings" that are sometimes part of the order of the—in the administration process.

Mr. CERESNEY. Sometimes the—

Mr. HURT. Administrative process.

Mr. CERESNEY. Sometimes in settlements, we will agree to certain undertakings that the defendant has to undertake, yes.

Mr. HURT. Is there any concern, because there has been a concern expressed, do you have concern that those undertakings amount to rulemaking outside of the Administrative Process Act?

Mr. CERESNEY. I do not.

Mr. HURT. And why is that?

Mr. CERESNEY. Because I think in every case, the undertakings are tied to the actual conduct that is involved in the case and designed, typically, to ensure the conduct does not recur.

Mr. HURT. But, do you think that there is a danger that other participants in the marketplace look at these undertakings and then that creates uncertainty? And also of course, avoids the Ad-

ministrative Process Act, which allows for public comment and public notice?

Mr. CERESNEY. I don't think so. We are pretty sensitive to not doing rulemaking by enforcement. And those undertakings are only obligations of the particular party to the enforcement action—

Mr. HURT. Sure, but—

Mr. CERESNEY. —and they are typically closely, closely tied to the conduct.

Mr. HURT. Okay. My time has expired. Thank you Director, and I now recognize the ranking member, the gentlelady from New York, for a period of 5 minutes.

Mrs. MALONEY. Thank you.

You noted in your testimony that the SEC's Fiscal Year budget for 2016 requests money for 93 additional Enforcement staff positions. Can you describe the impact of having these additional people? And what would you do with 93 additional people in enforcement?

Mr. CERESNEY. There are three areas in which we would deploy people. First, data analytics, I think about 20 people for identifying misconduct. There is tremendous amounts of data now available to us, and developing tools that allow us to use that data to detect misconduct is critical. So, that is one area. The second area is investigative activities, I think approximately 50 employees would go in this area.

And here, I think I would point to the increase in resources that we need to devote to investigate complicated, large scale issues like financial reporting, like market structure, like asset management issues and the like.

These schemes have become much more sophisticated. There is tremendous amounts of email data and other data that is required to be reviewed, and so having additional people as well as experts in the area would be important.

And the third area is trial attorneys, approximately 20 people for trials. We have seen an uptick in the number of trials that we have. There could be many reasons for that. But we think that will continue, probably not as many as last year. I think last year was probably more than we will have this year, but we will still see an increase from historical levels. And the trials do take lots of resources, particularly district court actions.

Mrs. MALONEY. Are you active in cybersecurity in any way? This is something that I would say everyone in Congress is deeply concerned about. The private sector is deeply concerned about it, and it is a threat, really, to our national security and our economic security.

What are you doing in cybersecurity?

Mr. CERESNEY. We are very active in the cyber area. The number of ways in which that impacts SEC enforcement, obviously, there are lots of aspects of cyber that we don't have involvement in, but there are many that we do, including whether companies are disclosing cyber attacks promptly and appropriately, whether information is being stolen through hacking and used for insider trading or other misconduct. Also, where the registrants are developing policies and procedures that are necessary to guard against the misuse of information.

So, we have regulations like Reg S-P that is out there, where dealers have to develop policies and procedures to safeguard customer information. We brought five cases under that regulation, so we are very active. There were other regulations that also could apply, like Reg SCI, when it comes, is now online. But when it becomes effective and when companies have to comply, when investment advisors have to, when broker-dealers have to comply with it, as well as the market access rule and some other rules that do provide requirements for policies and procedures. So, we are very focused on this area. It is something that we obviously are devoting resources to.

Mrs. MALONEY. I believe that there would be bipartisan support for increased personnel in cybersecurity. And I think that would be an area that we really need to focus on. We know it, and we need to work in that area.

I want to thank you for your testimony today. Thank you so much.

Mr. HURT. The gentlelady yields back.

The Chair now recognizes Mr. Hultgren for a period of 5 minutes.

Mr. HULTGREN. Thank you, Mr. Chairman.

Thank you so much Director, we appreciate you being here.

I would like to bring up the issue of well-known seasoned issuer waivers, which I believe should not be in consideration for an additional penalty outside of the SEC's formal enforcement process. My understanding is that there was already a thorough review process in place to determine whether a waiver is appropriate and that this process was recently reviewed and tightened in April of this year, I wonder if you could walk us through the WKSI waiver review process, and the steps the SEC has recently taken to make this process even more thorough?

Mr. CERESNEY. Sure. The Enforcement Division generally doesn't make waiver recommendations or decisions. And so we are not—we don't make those kinds of recommendation decisions. That typically is handled by the other divisions, including in the case of WKSI, the Division of Corporation Finance.

Having said that, my understanding is that the Division of Corporation Finance follows the guidance that they have issued, and as you mentioned, they did update that guidance in April of this past year.

In determining whether a WKSI waiver should be provided, I understand it is a facts and circumstances determination based on the applicable legal standards, which include whether there is good cause to issue such a waiver.

Ultimately, I think it is important to recognize that the waivers—the disqualifications are not enforcement remedies. We have significant remedies for enforcement violations, including disgorgement penalties, bars, et cetera.

But the WKSI determination is really a determination about whether, going forward, the entity can be trusted to comply with these obligations under WKSI.

Mr. HULTGREN. Let me get into that a little bit more. Registration requirements for a new stock offering I know can be burdensome for a public company. The added red tape leads to a delayed

offering oftentimes, which can run up against changing market conditions, which certainly can adversely impact the issuer. WKSI is able to file an automatic shelf registration statement on Form S-3 when preparing a stock offering.

What does the accelerated process mean for those companies looking to raise capital?

Mr. CERESNEY. I would have to defer to the Division of Corporation Finance on the impact of that.

That is really a policy question, which is not really one in which I am involved.

Mr. HULTGREN. Okay. Let me move on then.

SEC maintains the authority to deem a WKSI an ineligible issuer and revoke its WKSI status for 3 years if the Commission views the company as having disclosure practices that would be less reliable than the disclosure of other issues, and thus unsuitable for short-form registration or ineligible for disclosure-related relief.

This authority, paired with the annual and quarterly filings, to me seems sufficient to address any issuers that may potentially abuse their WKSI status.

Do you agree with that?

Mr. CERESNEY. Again, I think that would be a question really for the Division of Corporation Finance, which is the policy division involved in determining WKSI waivers.

Mr. HULTGREN. Yes, I have one more question to see if you are able to answer this. On the issue of well-known seasoned issuer waivers, or WKSI waivers, my understanding is that there was already a thorough review process in place to determine whether a waiver is appropriate, and that—let me—any further thing? Let me just understand a little bit more about your role with WKSI, any suggestions you have there. I know it came up earlier in the hearing. I wasn't here, but I wonder if you could maybe just talk a little bit, again, about your role and suggestions we have, concerns certainly that we are hearing of maybe overstepping or additional problems that are being handed out?

Is there any other further involvement that you have or your Division has?

Mr. CERESNEY. We investigate the misconduct, so we know better than anyone, I think, at the Commission, what the nature of the misconduct was, who was involved, what was the duration, et cetera.

So, we provide all that information to the Division of Corporation Finance or the Division of Investment Management and provide our views on that.

They then go and apply the applicable legal standards to determine whether a waiver is appropriate.

And my understanding is that it is a rigorous process where they review the facts and circumstances closely to determine whether the applicable legal standards are met.

Mr. HULTGREN. Well, I would agree with you. My understanding is it is a rigorous process, the thorough review process is already in place, and with it being recently reviewed, I have some concerns of additional action being taken there.

I appreciate it. We will follow up with other authorities as well, just to get some more clarity for ourselves and to see if there is anything else we need to do.

With that, Mr. Chairman, I yield back.

Mr. HURT. The gentleman yields back.

And the Chair now recognizes the gentleman from Arizona, Mr. Schweikert, for a period of 5 minutes.

Mr. SCHWEIKERT. Thank you, Mr. Chairman. And Chairman Hurt, that seat sort of—you look good there.

Mr. HURT. Thank you.

Mr. SCHWEIKERT. We will explain the joke later.

Forgive me, but a lot of the obvious questions have already been asked, so could you help walk me through just a couple of things, you know, for the education of David?

One of my great frustrations is that 3-plus years ago, this body, and this committee did things like the JOBS Act. There is Reg A and crowdfunding, and apparently in the rulemaking side of the ledger, those things are backed up.

Will they ever reach out to you and your Division and say, "We are doing a rule set. Tell us how to keep the consumers safe?" Do you ever have input and dialogue in the crafting design of those rule sets?

Mr. CERESNEY. Obviously, rulemakings are handled primarily by the Policy Division, and we are not directly—they obviously handle—but in cases in which there is an enforcement angle that—on which we can be helpful, we obviously do provide—they do consult with us, they do ask us our views, and we provide input as requested to the Rulemaking Policy Division.

Mr. SCHWEIKERT. That doesn't bother me.

Mr. CERESNEY. Yes.

Mr. SCHWEIKERT. In some ways, that seems absolutely appropriate, whether it be in writing or watercooler conversation.

For some of the new technologies, whether it be crowdfunding or some of the new uses where we see people using 506 and sort of regional bases of those, from your sort of enforcement side and observations, has access to information very open disclosures and sometimes a readable fashion, is that an interest? Have you seen it done? Have you seen benefits from that?

Mr. CERESNEY. Again, I don't know that I am in a position to really judge the impact that has on capital formation, on the raising of capital, because I think that is a question for others. I am really focused more on the issue of, is there fraud, is there misconduct in connection with the offerings?

And when there is, obviously, we are very involved.

Mr. SCHWEIKERT. When you design, because you will be part of designing a consent decree or an agreement.

Mr. CERESNEY. A settlement agreement, yes.

Mr. SCHWEIKERT. Forgive me. All right, a settlement agreement.

Mr. CERESNEY. Yes, an order.

Mr. SCHWEIKERT. In that settlement agreement, have you ever done part of the mechanics for fixing the bad acts or the agreed-upon bad acts, the way the bad actors tell their story, or disclose risk, or put out information so for the investor or the consumer, the product, they are doing better decision-making?

Mr. CERESNEY. What we sometimes will do, if we see if there is a case involving failure of disclosures, for example, an investment advisor that has failed in their disclosures and misled investors, we sometimes will, as part of the undertakings, require them to craft policies and procedures aimed at ensuring that their representations to investors are accurate.

So yes, if—what we often do is we will design undertakings designed to try to get at the misconduct. And if the misconduct involves material misrepresentations and marketing materials, we very well may include a requirement that they have a consultant come in and provide advice on policies and procedures going forward.

Mr. SCHWEIKERT. Is some of your staff behind you?

Mr. CERESNEY. Yes, some of them.

Mr. SCHWEIKERT. I can almost tell generationally, because I don't see any gray hair. I have realized Washington is run by a bunch—

Mr. CERESNEY. I have gotten more gray hair since I have been here.

Mr. SCHWEIKERT. —of 30-year-old brilliant servants. For many of the young folks we work with who are entering into the investment world, they want to see it online. They want to see a blog discussion about the investment. They want to see sort of open dialogue where people are on each side of the trends—the good idea, bad idea.

You may actually have a very unique window, as part of your settlement operations to sort of reach out into that world and say, maybe it is time to enter this century of disclosure, instead of giving me another half-inch-thick binder with micro type that, with my aging eyes, I have trouble reading. So just one sort of suggestion, as we start to move into this generation, this century of regulation.

One last thing and this is a little bit more of a narrative than a question. How many enforcement actions were there in the last calendar year?

Mr. CERESNEY. In the last fiscal year, there were 755. We don't track it by calendar year.

Mr. SCHWEIKERT. Any sense of what the average settlement cost was?

Mr. CERESNEY. Well, it was—$4.16 billion was ordered. In some cases—

Mr. SCHWEIKERT. You have more of a mean.

Mr. CERESNEY. Yes, in some cases—

Mr. SCHWEIKERT. You probably have some very large ones.

Mr. CERESNEY. It is very hard to say, because some cases, obviously, have large large monetary remedies. Others have none. So it really varies.

Mr. SCHWEIKERT. For almost every Member, right and left, we have had that person who comes into our office and say, "I am subject to an action. I don't think I broke the rule. My lawyers are telling me it is cheaper just to agree and write a check."

I may send you sort of a little narrative question in writing. And I know that may be hard to quantify, but I am sort of curious how many of the settlements are actually—I admit I screwed up or I

admit it is cheaper to write you a check and admit than it is to defend myself.

Mr. CERESNEY. I can't comment on what the reasoning of somebody in settling with us is. I can only say that when we charge someone with misconduct, we believe that there is a violation of law and believe that, based upon our understanding of the law and the facts.

Mr. SCHWEIKERT. Thank you.

And thank you, Mr. Chairman.

Mr. HURT. Thank you. The gentleman's time has expired. The Chair now, on the second round of questioning, recognizes Mr. Poliquin for 5 minutes.

Mr. POLIQUIN. Thank you, Mr. Chairman.

And thank you, Mr. Ceresney. Again, I appreciate you being here. I would like to pursue a little bit more of what we were discussing a little bit ago. And again, I want to make sure that I salute you for your goal and your hard work and that of your staff for pursuing the bad apples in this particular industry. But I do want to continue to ask a few more questions about your in-house administrative procedure.

I think it was said just a moment ago that last year, you had a very high success rate, with respect to your in-house administrative procedures, as far as finding I am not sure—I am not an attorney, a conviction rate is concerned, about 100 percent.

Mr. CERESNEY. Liability. And yes, although as I said, yesterday we just lost one.

Mr. POLIQUIN. You poor thing. Yes, I am talking about last year. So you were completely successful.

Mr. CERESNEY. Yes, yes. And that was unusual.

Mr. POLIQUIN. Yes, okay. If I am not mistaken, last year also, when you went to Federal court to pursue some of these bad apples, that turned out not to be bad apples, you had about a 60 percent success rate. Is that right, roughly?

Mr. CERESNEY. Can I just—

Mr. POLIQUIN. Quickly, because my time is expiring.

Mr. CERESNEY. It was a little over 60 percent.

Mr. POLIQUIN. Okay. But there is a big difference.

Mr. CERESNEY. I would say most of the losses were in insider trading.

Mr. POLIQUIN. Okay. But when you have an in-house procedure, if I may—so I will ask you, Mr. Ceresney, where you select the administrative law judges, you pay them. They are held on-property and the home-court. And you can admit most heresy evidence and so forth and so on. But I would argue with you that you have to be really, really careful to make sure this is a fair process.

Now it seems to me that this process might be a little bit more art than science. And let me go down there, just a little bit, if I may. Do you have a written in-house set of benchmarks or procedures whereby you determine if you are going to pursue this case internally or you are going to let it play itself out in Federal courts? Do you have a written set of procedures on that?

Mr. CERESNEY. We have factors that people should consider, but we don't have a written set of procedures.

Mr. POLIQUIN. Okay. So, you don't. I might recommend that you think about doing that. I don't want to tell you how to do your job, but that would make me feel much more comfortable. Along that same line, sir, do you have a written set of procedures that allows you to determine which administrative law judges you are going to select for this particular case?

Mr. CERESNEY. We don't select the administrative law judge.

Mr. POLIQUIN. Okay. And do you have written procedures on how to determine what fines or penalties would be imposed on those you found to be in violation of the law?

Mr. CERESNEY. As I said, there are factors.

Mr. POLIQUIN. Okay. So it is really more of an art than a science?

Mr. CERESNEY. It is, yes.

Mr. POLIQUIN. Okay. You know what would be really helpful to me is if you could get those guidelines, if you will, to my office or our office or—my LD right back here will be in touch with your office. Because I would like to see your written documentation on what the SEC follows to make sure we have a set of fairness when it comes to how you go through to determine who is going to meet internally in front of your people and who the judges are going to be and what fines will be imposed. That will be really helpful. And if you don't have those, and I think you just said that you do not, then we may come back to you with a few suggestions. But that would be very helpful.

Sir, may I ask you also, Mr. Ceresney, have you ever worked in the investment management industry?

Mr. CERESNEY. I have not.

Mr. POLIQUIN. You have not. Have any of your senior people who are involved with enforcement of the financial services industry who are around you, have they ever worked in the investment management business?

Mr. CERESNEY. Yes. We have industry experts who have worked—

Mr. POLIQUIN. Good. Industry experts. I don't mean academics, I mean folks who have actually worked in the industry.

Mr. CERESNEY. Yes, we do.

Mr. POLIQUIN. Okay, good. But you have not?

Mr. CERESNEY. I have not.

Mr. POLIQUIN. Okay.

Mr. CERESNEY. No. I have represented people from the industry, but I am—

Mr. POLIQUIN. Great, great. Well, we just had a new investment company move to our district with 200 new jobs in Lewiston, Maine. And we are thrilled to death to have these folks there. There are new jobs, they are good-paying jobs with benefits. And I would submit to you, as you consider these enforcement actions at the SEC, that you consider that the most important thing a mutual fund company or a pension investment firm has is their reputation and their good word, their good name. It is so important to make sure that investors and folks saving for their retirement or saving for their college education have trust in that firm. And part of that is making sure that if there is an allegation that they violated the law, there is a fair process. And that is why I was ask-

ing just a moment ago—and I know your office will get back to us with some paperwork on this—to make sure there is confidence in what you are doing.

And I will tell you the reason why I am concerned. Because if you look at the EPA or you look at the Internal Revenue Service, there has been a pattern during the last few years of overreach by these government agencies that causes American families to lose confidence in our government, that they are being treated fairly.

I know you don't want to go there and I am not saying that you are there. But what I am saying is that it would be terrific if you would think about people's reputation, their firm's reputation, and the confidence that people need to invest, to save for their retirement and their kids' college education. And that comes with, I think, due process or as close to due process as you can, given the guidelines that you have. The Fourth and fifth Amendments, all the things we have talked about, I would really appreciate it if you would consider that as you go forward and also make sure you get that paperwork to us in our office. I would be very grateful.

Thank you, sir.

Mr. HURT. Thank you, Mr. Poliquin. The gentleman's time has expired. I want to thank you, Director, for being with us today and being generous with your time.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

Without objection, this hearing is now adjourned.

[Whereupon, at 11:28 a.m., the hearing was adjourned.]

A P P E N D I X

March 19, 2015

Testimony on "Oversight of the SEC's Division of Enforcement"

Andrew Ceresney, Director
Division of Enforcement
U.S. Securities and Exchange Commission

Before the

United States House of Representatives Committee on Financial Services
Subcommittee on Capital Markets and Government Sponsored Enterprises

March 19, 2015

Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee:

Thank you for inviting me to testify on behalf of the U.S. Securities and Exchange Commission ("SEC" or "Commission") about the Division of Enforcement ("Enforcement" or "Division").

The SEC's mission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The Division furthers this mission by, among other things, investigating and bringing charges against violators of the federal securities laws. A strong enforcement program is at the heart of the Commission's efforts to ensure investor trust and confidence in the nation's securities markets, and the Division is committed to the swift and vigorous pursuit of those who have broken the securities laws.

In FY 2014, the Commission brought the highest number of enforcement actions to date, 755, and obtained monetary remedies at our highest level, totaling over $4.16 billion. More importantly, these actions addressed significant issues, spanned the entire spectrum of the securities industry, and included numerous first-of-their kind actions. We punished securities law violators, returned funds to injured investors, and sent important messages of deterrence. Our investigative efforts have been assisted by industry experts and by new tools developed to harness data, including trading and financial data. The Division also maintained its strong litigation record and implemented a new approach of requiring admissions in certain cases.

While I cannot today cover all of the Division's responsibilities, initiatives, and day-to-day activities, I want to highlight certain of Enforcement's areas of focus, specifically:

- Financial Reporting, Accounting, and Disclosure
- Investment Advisers
- Market Structure, Exchanges, and Broker-Dealers
- Municipal Securities and Public Pensions
- Insider Trading
- Microcap Fraud/Pyramid Schemes

- Complex Financial Instruments
- Gatekeepers; and
- Foreign Corrupt Practices Act ("FCPA")

I also will discuss the Division's litigation and trial work, and explain some of the recent enhancements in our continuing effort to make Enforcement more effective and efficient in furthering the SEC's mission.

THE DIVISION OF ENFORCEMENT

The Division protects investors and the markets by investigating potential violations of the federal securities laws and litigating the SEC's enforcement actions. Enforcement staff includes investigators, accountants, industry experts, trial attorneys and other employees in Washington, D.C. and the eleven Regional Offices. The Division has five specialized units focused on critical areas, including: the Asset Management Unit, the Complex Financial Instruments Unit; the FCPA Unit; the Market Abuse Unit; and the Municipal Securities and Public Pensions Unit. Also included within the Division are the Office of Market Intelligence, which is responsible for the collection, analysis, risk-weighing triage, referral and monitoring of the over 15,000 tips, complaints and referrals received by the Division each year, and the Office of the Whistleblower, which administers the whistleblower program created by Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Division also is responsible for the collection of monies owed as a result of legal action brought by the Commission, as well as the distribution of monies to harmed parties whenever practicable in a fair, reasonable, and cost-effective, manner. In addition to its various offices, working groups, and task forces, the Division works closely with the other divisions and offices of the SEC and regularly coordinates with other regulators and law enforcement agencies to enforce the federal securities laws and inform our priorities.

FY16 BUDGET REQUEST

The SEC's FY 2016 Budget requests 93 additional positions for Enforcement. The Division will utilize these additional resources to support its three core functions – intelligence analysis, investigation, and litigation. Specifically, the Division will use the additional resources to:

- Expand Enforcement's data analytics expertise to assist in the development and implementation of data projects and new investigative tools, as well as increase staffing for the collection, analysis, triage, referral, and follow-through on the thousands of tips, complaints, and referrals that the Division receives every year.
- Hire experienced accountants, attorneys, industry experts, and other professionals to promptly detect, prioritize, and effectively investigate wrongdoing in high priority areas.
- Hire additional experienced trial attorneys and support staff to prosecute the Division's expanding docket of complex litigation and trials.

These additions to the Enforcement staff are designed to enable the Division to more effectively and efficiently protect investors and the markets.

ENFORCEMENT PRIORITIES

Financial Reporting, Accounting, and Disclosure

Pursuing financial reporting and auditing violations continues to be a focus of the Division. Comprehensive and accurate financial reporting is critical to ensuring that investors have access to reliable information and can make informed decisions. Because false or misleading financial information erodes the integrity of this disclosure regime, enforcement actions in this area are essential to ensuring public confidence in the securities markets. Significant actions filed addressed revenue recognition violations, false management estimates, auditor independence issues, and other false and misleading financial disclosures.

To focus resources on financial reporting and auditing violations, Enforcement created the Financial Reporting and Audit Task Force.[1] The Task Force's mandate is to develop methodologies and tools for detecting financial reporting issues, identify specific issuers with potential violations, determine whether further investigation is warranted, and refer appropriate matters to investigative staff across the Division. The Task Force is one of several initiatives across the Division designed to increase focus on financial reporting and auditing issues. These efforts are starting to produce results, as FY 2014 saw a 40% increase in financial reporting and auditing filed actions and investigations.

Investment Advisers

Investment advisers and the funds they manage traditionally have been, and remain, a focus of Enforcement. The Division regularly investigates and brings actions against investment advisers for conflicts of interest, misrepresentations regarding performance or investment strategies, breaches of their fiduciary duties to their clients, or other fraudulent conduct. The Division also has recently launched a number of successful initiatives concentrating on areas that have traditionally received less attention, including custody rule violations, the adequacy of investment adviser compliance programs, and undisclosed adviser fees. The Division works closely with the Division of Investment Management and OCIE on these initiatives. In addition, the Division's Asset Management Unit, in conjunction with Division of Economic and Risk Analysis, has developed the Aberrational Performance Inquiry, which uncovers potential misconduct by identifying unusual performance returns posted by unregistered and registered hedge fund advisers. To date, this initiative has generated more than ten enforcement actions.

Market Structure, Exchanges, and Broker-Dealers

Enforcing the statutes and rules related to market structure is an enforcement priority, as the proliferation of sophisticated trading technologies, such as algorithmic and automated trading, have transformed the securities markets. These issues present significant potential risks to investors and the markets, and the Division is keenly focused on keeping pace with these changes by leveraging the knowledge of its specialized units, closely collaborating with the other SEC divisions, including Trading and Markets and the Office of Compliance, Inspections and

---

[1] *See* SEC Spotlight on the Financial Reporting and Audit Task Force, *available at* https://www.sec.gov/spotlight/finreporting-audittaskforce.shtml.

Examinations ("OCIE"), and employing technology to more effectively analyze trading data. The Division has recently filed a number of actions against market participants that pose a risk to the markets by failing to operate within the rules. These include significant cases against exchanges and other trading platforms for violating rules governing their operation, broker-dealers for failing to live up to their obligations as gatekeepers providing direct market access, and other market participants for manipulative trading and related abuses. Indeed, earlier this year, we brought actions with record penalties against an exchange and an alternative trading system.

Municipal Securities and Public Pensions

Another priority for the Division is municipal securities, which are an important investment vehicle for retail investors, and public pensions. Particular areas of focus include misrepresentations in connection with bond offerings, failures by underwriters to meet their obligations, undisclosed conflicts of interest, and pay-to-play violations. This past fiscal year, the Commission brought its first emergency action to stop a fraudulent municipal bond offering, and also obtained its first penalty against a municipal issuer.[2] The Division also implemented a new self-reporting initiative, the Municipalities Continuing Disclosure Cooperation Initiative, designed to address widespread continuing disclosure violations by municipal bond issuers and underwriters. The voluntary initiative has resulted in a large number of self-reported violations and, more importantly, brought attention on disclosure compliance in the municipal securities area.

Insider Trading

Policing insider trading has long been central to the Commission's mission of ensuring confidence in the markets. The Division has been very active in pursuing insider trading and has charged more than 590 defendants in civil insider trading cases over the last five years. These cases, which send a strong deterrent message to would be-violators, have involved a wide range of entities and individuals such as financial professionals, lawyers, and corporate insiders who breached their duties in unfair and unlawful pursuit of their own personal gain.[3] Our efforts in this area have greatly benefitted from new technological tools developed internally that allow us to identify suspicious trading patterns and connections between traders and potential sources from massive amounts of trading data.

Microcap Fraud/Pyramid Schemes

Utilizing a coordinated approach to pursuing misconduct in microcap securities,[4] the Division has created a Microcap Fraud Task Force to proactively address this type of fraud. Wrongdoing in this area frequently involves serial violators and organized syndicates that employ new media, including websites and social media, to conduct fraudulent promotional campaigns and engage in manipulative trading. This misconduct largely occurs at the expense of

---

[2] The financial penalty imposed to sanction and deter the municipality's misconduct was paid from the relevant project's operating funds without directly impacting taxpayers.
[3] *See* SEC Spotlight on Insider Trading Cases, *available at* http://www.sec.gov/spotlight/insidertrading/cases.shtml.
[4] Microcap securities are low-priced stocks issued by the smallest of companies.

less sophisticated retail investors. As part of our ongoing effort to combat this fraud, the Commission is aggressively using trading suspensions to cut off trading in securities that are the objects of "pump-and-dump" market manipulation schemes.[5] In FY 2014, the Commission suspended trading in more than 250 dormant shell companies, which can be used as a vehicle for these schemes by stock manipulators, and in more than two dozen securities that were being used in apparent pump-and-dump schemes. At the same time, the Division is targeting the repeat offenders that help facilitate pump-and-dump schemes, including promoters, lawyers, accountants, and transfer agents, often collaborating with criminal law enforcement partners to build cases.

The staff also has recently seen what appears to be an increase in pyramid schemes[6] under the guise of "multi-level marketing" and "network marketing" opportunities.[7] These schemes often target the most vulnerable investors, and social media has expanded their reach. The Division is deploying resources to disrupt these schemes through a coordinated effort of timely, aggressive enforcement actions along with community outreach and investor education. We are also using new analytic techniques to identify patterns and common threads, thereby permitting earlier detection of potential fraudulent schemes.

Complex Financial Instruments

Our Structured and New Products Unit developed significant expertise in investigating complex products, such as RMBSs and CDOs, and obtained orders for over $1.7 billion in financial crisis-related cases. While the stream of cases stemming from the financial crisis is coming to an end, the financial industry continues to innovate at a rapid pace. As part of our effort to leverage the expertise developed from the crisis, the Division decided to maintain a unit dedicated to complex market products, but rebrand it "Complex Financial Instruments" or "CFI." The CFI Unit is currently focused on identifying and investigating potential violations in several priority areas, including credit rating agencies, other complex products such as Commercial Mortgage Backed Securities ("CMBS"), valuation issues for funds and other entities, and is preparing to enforce the derivatives-related provisions of the Dodd-Frank Act.

Gatekeepers

A common thread throughout the priority areas identified above is an emphasis on the importance of gatekeepers to our financial system: attorneys, accountants, fund directors, board members, transfer agents, broker-dealers, and other industry professionals who play a critical

---

[5] "Pump-and-dump" schemes involve the touting of a company's stock (typically microcap companies) through false and misleading statements to the marketplace. These false claims are often made on social media such as Facebook and Twitter, as well as on electronic bulletin boards and chat rooms. Often the promoters will claim to have "inside" information about an impending development or to use an "infallible" combination of economic and stock market data to pick stocks. In reality, they may be company insiders or paid promoters who stand to gain by selling their shares after the stock price is "pumped" up by the buying frenzy they create. Once these fraudsters "dump" their shares and stop hyping the stock, the price typically falls, and investors lose their money.

[6] A pyramid scheme is a type of fraud in which participants profit almost exclusively through recruiting other people to participate in a particular program.

[7] *See* SEC Investor Bulletin, Beware of Pyramid Schemes Posing as Multi-Level Marketing Programs (Oct. 1, 2013), *available at* http://www.sec.gov/enforce/investor-alerts-bulletins/investoralertsia_pyramidhtm.html..

role in the functioning of the securities industry. Gatekeepers are integral to protecting investors in our financial system because they are best positioned to detect and prevent the compliance breakdowns and fraudulent schemes that cause investor harm. When gatekeepers fail to live up to their responsibilities, the Division has held – and will continue to hold – them accountable.

Foreign Corrupt Practices Act ("FCPA")

Pursuing violations of the FCPA remains a critical part of our enforcement efforts, as international bribery saps investor confidence in the legitimacy of a company's performance and undermines the accuracy of a company's books and records, among other negative impacts. The Division, and particularly the specialized FCPA unit, is active in this area, bringing significant and impactful cases, often in partnership with its law enforcement and regulatory counterparts both at home and abroad.[8] Last fiscal year, the Commission obtained orders for over $380 million in disgorgement and penalties in FCPA cases. In FY 2013, the SEC and DOJ released A Resource Guide to the U.S. Foreign Corrupt Practices Act. The guide takes a multi-faceted approach toward setting forth the statute's requirements, providing insights into SEC and DOJ enforcement practices.[9]

In today's globalized marketplace, Enforcement's ability to protect investors and maintain fair and efficient markets is often dependent on the Division's ability to investigate misconduct that takes place, at least in part, abroad. In coordination with the SEC's Office of International Affairs, the Division has expanded its efforts to obtain evidence of potential wrongdoing from around the globe. Many of Enforcement's FCPA investigations rely on evidence obtained from foreign jurisdictions, and often are conducted in parallel with foreign governments. Other areas, such as financial reporting and accounting fraud, asset management, and insider trading, also often rely on evidence obtained through foreign regulators.

Litigation and Trial

The Commission's ability to successfully litigate cases is critical to its mission of protecting investors. The Division handles an expansive docket of complex litigation and trials, often against well-funded adversaries. Successful litigation sanctions wrongdoers, results in relief for victims, and deters wrongdoing. In addition to trial victories, the Division's litigation efforts help it obtain strong settlements by making clear that the Division will go as far as required in order to obtain appropriate relief. When the Division does go to trial, we have had a strong record of success, despite the difficulty and complexity of our cases.

Enhancements to the Division of Enforcement

Enforcement strives to be proactive and efficient as it vigorously investigates and prosecutes violations of the securities laws. The Division continually works to assess and refine its approach. Below is an overview of a few of the recent efforts and changes.

---

[8] *See* SEC Spotlight on FCPA Cases, available at https://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml.
[9] *See* A Resource Guide to the U.S. Foreign Corrupt Practices Act, available at http://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf.

Admissions

In June 2013, the Commission changed its long-standing settlement protocol by requiring admissions of misconduct in certain cases where heightened accountability and acceptance of responsibility by a defendant are appropriate and in the public interest, including in cases where the violation of the securities laws involves particularly egregious conduct; where large numbers of investors were harmed; where the markets or investors were placed at significant risk; where the conduct obstructs the Commission's investigation; where an admission can send an important message to the markets; or where the wrongdoer poses a particular future threat to investors or the markets. While, for reasons of efficiency and other benefits,[10] most cases will continue to be resolved on a "neither admit nor deny" basis, if admissions or other acknowledgements of wrongdoing are important, the Division will insist on obtaining them and is fully prepared to litigate if necessary.

Streamlined Investigations

Enforcement is committed to pursuing violations of varying type, including violations that have historically not received sufficient attention but whose prosecution is important to maintaining the integrity of the securities markets. To maximize its impact and send a strong message of compliance while still conserving investigative resources, the Division in some of these areas is pursuing streamlined investigative and settlement efforts that provide incentives to wrongdoers to resolve charges quickly. The Division, often in collaboration with other divisions and offices, uses data analytics to help identify potential wrongdoers and conduct streamlined investigations. For example, using data analytics to identify potential violators, the agency recently brought 34 actions against individuals and entities who repeatedly failed to comply with their transaction reporting requirements under Section 16(a) of the Exchange Act. Similarly, based on proactive trading surveillance, the Division brought charges against 13 firms for violating the minimum sales provisions of a municipal bond offering.

Industry Experts

The Division continues to leverage the expertise of various experts hired to give insights into the market and industry practices in its investigations and litigation. These experts are affiliated with the Division's specialized units, where they advise unit staff on particular investigations and help develop forward-looking risk-based initiatives. They are also available to other Enforcement staff for consultation on investigations and litigation.

Data Analytics

In collaboration with the rest of the agency, Enforcement is increasingly using large-scale data analysis to assist in the identification of leads and to conduct more sophisticated investigations. The Division is focused on developing tools that allow us to use the data we have

[10] In many cases, the Commission determines that it is appropriate to continue to settle on a "no admit, no deny" basis, as do other federal agencies and regulators with civil enforcement powers. This practice allows the Commission to get significant relief, eliminate litigation risk, return money to victims more expeditiously, and conserve our enforcement resources for other matters.

available to us to develop leads in a number of areas, including insider trading, market structure, and financial reporting investigations. For example, the Division is partnering with the Division of Economic and Risk Analysis to develop a tool that will enable the staff to detect anomalous financial results disclosed in public company filing data. We also are affirmatively using an advanced investigative and analytical tool platform to assist with insider trading and microcap fraud investigations, thereby streamlining these investigations significantly, and in some cases identifying misconduct that previously might not have been identified. The Commission will continue to take advantage of its improved information processing and analytic capabilities in its efforts to identify, punish, and deter misconduct.

* * *

Thank you for inviting me to discuss the Division of Enforcement. I am happy to answer any questions.

QFR Replies of Andrew Ceresney, Director
Division of Enforcement
U.S. Securities and Exchange Commission

In Connection with the Hearing

"Oversight of the SEC's Division of Enforcement"

Before the

United States House of Representatives Committee on Financial Services
Subcommittee on Capital Markets and Government Sponsored Enterprises

Hearing on March 5, 2015

Questions for the Record from Representative Duffy

1. Are SEC administrative proceedings different from federal district court proceedings in the areas of: discovery rights, the right to a jury trial, and hearsay evidence? How are they different?

Congress has authorized the SEC to bring its enforcement actions in either of two forums – a civil action in federal district court or a Commission administrative proceeding (and/or cease-and-desist proceeding). While both forums have significant procedural protections and both are fair, there are differences between the forums in the three areas identified in your question.

Discovery

Discovery in administrative proceedings is governed by the Commission Rules of Practice, while discovery in federal district court is governed by the Federal Rules of Civil Procedure. One difference in discovery between the two forums is the availability of depositions. The use of depositions in administrative proceedings is significantly more limited than in federal district court. The Rules of Practice provide that a hearing officer has discretion to order a deposition upon a finding that (1) the expected testimony will likely be "material to the proceeding," (2) it is likely that the witness will be unable to attend or testify at the hearing "because of age, sickness, infirmity, imprisonment, other disability, or absence from the United States," unless it appears that the absence was procured by the party requesting the deposition; and (3) the taking of the deposition will serve the "interests of justice."[1] There are also discovery procedures for respondents in administrative proceedings that go beyond what is available in federal district court actions. In administrative proceedings, the Division of Enforcement is required to provide its entire non-privileged investigative file to respondents and start making the

[1] *See* Rule 233(b) of the Commission Rules of Practice and Rules on Fair Fund and Disgorgement Plans ("Rules of Practice").

file available within seven days of instituting the proceedings.[2] The investigative file typically includes all non-privileged documents obtained by the Division in connection with the underlying enforcement investigation, as well as all investigative testimony transcripts and exhibits. This obligation to produce all non-privileged documents and other items in our investigative file is generally more extensive and produced earlier than it is in federal court, where discovery is based on individual document requests and other discovery mechanisms and often extends over a much longer time period. We also are obligated to produce to respondents in administrative proceedings all witness statements that would be required to be produced in criminal proceedings under the Jencks Act, 18 U.S.C. §3500,[3] and any material exculpatory information pursuant to the Supreme Court's decision in *Brady v. Maryland*, 373 U.S. 83, 87 (1963),[4] neither of which is required in federal district court civil actions.

Right to a Jury Trial

In enforcement actions brought by the SEC in federal district court, either party may demand a jury trial.[5] Federal court actions may also be tried before a judge as a bench trial if the parties agree to a nonjury trial or if neither party makes a timely jury demand. In an administrative proceeding, a hearing may be held before the Commission or a hearing officer designated by the Commission, who is typically an administrative law judge.[6]

Hearsay Evidence

The admissibility of evidence in administrative proceedings is governed by the Rules of Practice, while the admissibility of evidence in federal district court is governed by the Federal Rules of Evidence. Hearsay evidence is generally not admissible in federal district court unless it is subject to one of the hearsay exceptions set out in the federal rules.[7] In administrative proceedings, hearing officers have the discretion to admit hearsay evidence offered by either party if the evidence is relevant.[8] Hearing officers also have the discretion to determine how much weight to give the evidence admitted in administrative proceedings and may take into account the fact that evidence is hearsay in making this determination.

2. According to a recent article in the Yale Law Journal, since 2000 the amount of SEC civil penalties has grown 30% year-over-year although the number of enforcement cases has risen only 3%. Clearly SEC is imposing greater penalties on public companies accused of

---

[2] *See* Rule 230(d).

[3] *See* Rule 231(a). The Jencks Act requires the U.S. government in federal criminal actions to produce, on demand, any prior statements made by a witness that relate to the subject matter of the witness's testimony that are in the possession of the government..

[4] *See* Rule 230(b)(2).

[5] See Federal Rules of Civil Procedure 38 and 39.

[6] Rule 101(a)(5); 110.

[7] *See* Federal Rules of Evidence 802, 803, 804 and 807.

[8] See Rule of Practice 320.

wrongdoing. In your estimation, are the perpetrators of financial crimes being appropriately punished by these civil penalties?

While a number of factors likely have contributed to the increase in the amount of civil penalties over the last fifteen years, we have been more aggressive in our use of authorized penalties and other remedies in order to send a strong message that deters current and future wrongdoers. Civil penalties are meant to punish and deter, and the Division of Enforcement tries to recommend penalties at a level that is authorized by statute and will cause market participants to think twice before engaging in misconduct. We believe that meaningful monetary penalties – whether against companies or individuals – are appropriate and play an important role in a strong enforcement program.

3. Are shareholders able to recoup the money they've lost from civil penalties imposed by the SEC?

In a number of cases, shareholders harmed by the conduct underlying a Commission enforcement action may receive compensation from the civil penalties paid by wrongdoers. Specifically, Section 308 of the Sarbanes-Oxley Act of 2002 authorizes the Commission to use monies collected through penalties to compensate harmed investors via Federal Account for Investors Restitution (Fair) Funds.[9] Funds for distribution to investors may include civil penalties that have been made part of a Fair Fund, either pursuant to a Commission order in an administrative proceeding, or pursuant to a court order issued on the Commission's motion in a civil action. Distributions are effected through distribution plans approved by the Commission or an Administrative Law Judge in administrative proceedings, or ordered by the courts in civil district court actions. Distributions in administrative proceedings are governed by the Commission's Rules on Fair Fund and Disgorgement Plans.

4. Do you consider the best interests of shareholders when assessing civil penalties?

The Division of Enforcement considers a wide range of factors when we recommend the imposition of civil penalties to the Commission, including a penalty's impact on shareholders. Ultimately, we rely on the facts and circumstances of each case, and consider the objectives of a strong enforcement program, when determining appropriateness of penalties.

5. Is there a written policy Division management follows when making a recommendation to the Commissioners insofar as penalty recommendations are concerned?

The Commission's authority to assess civil penalties depends on the nature of the action. Specifically, where a matter is instituted as an administrative proceeding or a cease-and-desist proceeding, the Commission has the statutory authority to impose penalties, and where a matter is instituted as a civil action in federal district court, then the court has jurisdiction to impose the penalty.

The statutes governing monetary penalties in administrative actions set out factors to be considered in determining whether a penalty is in the public interest. The factors enumerated

---

[9] *See* 15 U.S.C. § 7246.

are: (A) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (B) the harm to other persons resulting either directly or indirectly from such act or omission; (C) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior; (D) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, state securities laws, or the rules of a self-regulatory organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in other specified sections of the relevant statute; (E) the need to deter such person and other persons from committing such acts or omission; and (F) such other matters as justice may require.[10]

Where the Commission seeks penalties in civil actions, the district courts have discretion to determine the amount of penalties in light of the facts and circumstances. Courts have enumerated factors to be considered when determining whether and in what amount to assess a penalty.[11]

In October 2001, the Commission issued a Report of Investigation and Statement explaining its decision not to take enforcement action against a public company it had investigated for financial statement irregularities. In this report, commonly referred to as the Seaboard Report, the Commission articulated an analytical framework for evaluating cooperation by companies. The report, while not directly related to the assessment of specific penalties, detailed the many factors the Commission considers in determining whether, and to what extent, it grants leniency to investigate companies for cooperating in its investigations and for related good corporate citizenship.[12]

In 2006, in connection with a settled matter, the Commission at the time issued a press statement concerning financial penalties against corporate entities.[13] While not guidance or binding on the staff or Commission, the Division of Enforcement generally considers, in addition to other factors, the factors described in that statement (to the extent relevant) when recommending to the Commission the imposition of corporate penalties.

---

[10] *See* 15 U.S.C. § 78u-2(c), 15. U.S.C. § 80a-9(d)(3), and 15 U.S.C. § 80b-3(i)(3).

[11] *See, e.g., SEC v. Tourre*, 4 F.Supp.3d 579, 593 (S.D.N.Y. 2014) (citing the following factors for consideration: (1) the egregiousness of the defendant's conduct; (2) the degree of the defendant's scienter; (3) whether the defendant's conduct created substantial losses or the risk of substantial losses to other person; (4) whether the defendant's conduct was isolated or recurrent; and (5) whether the penalty should be reduced due to the defendant's demonstrated current and future financial condition); *SEC v. Opulentica*, 479 F. Supp. 2d 319, 331 (S.D.N.Y. 2007); *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 386 (S.D.N.Y. 2007); *SEC v. Lybrand*, 281 F. Supp. 2d 726, 730 (S.D.N.Y. 2003); *SEC v. Coates*, 137 F. Supp. 2d 413, 429 (S.D.N.Y. 2001).

[12] *See* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions (Oct. 23, 2001), available at http://www.sec.gov/litigation/investreport/34-44969.htm.

[13] *See* Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006), available at https://www.sec.gov/news/press/2006-4.htm.

6. *If not, would the SEC benefit from a clear, public, predictable, and consistent policy when making penalty recommendations to the Commissioners?*

In my view, the items discussed above, most notably the factors set out in the statutes governing monetary penalties in administrative actions, the well-developed case law, and the Commission's public statements, all of which are publicly available, provide appropriate guidance to Enforcement staff for making penalty recommendations to the Commission.

7. *Should you support a written policy; will you submit this written policy to the House Committee on Financial Services?*

As discussed above, I believe that there is adequate guidance to Enforcement staff for making penalty recommendations to the Commission.

Questions for the Record from Representative Foster

Mr. Ceresney, as you know, last year the SEC implemented the Municipalities Continuing Disclosure Cooperation Initiative. My understanding is that participation in this program was particularly costly for smaller bond issuers and underwriters, not just in fines but also in out-of-pocket costs associated with reviewing five years of transactions. What is your assessment of the damage that investors incurred as a result of the issuers' violations and how does that net out against the costs for issuers and underwriters who participated in the program? In addition, what is your assessment of the impact that the penalty cap will have on smaller underwriters, for whom the $500,000 penalty could be significant?

The MCDC Initiative was a voluntary program in which the Division of Enforcement offered issuers and underwriters the opportunity to receive favorable settlement terms if they self-reported their own violations of the anti-fraud provisions of the federal securities laws. The Division considers these violations to be serious because they deprive investors in municipal securities (who are mostly retail investors) of critical information about their investments. We developed the MCDC Initiative to provide an opportunity for underwriters and issuers to resolve those violations on terms which were designed to encourage self-reporting, while still providing appropriate deterrence for future misconduct.

As noted, participation was entirely voluntary and no underwriter or issuer was compelled to make any self-report or to conduct any internal review of their files to identify violations. To the extent issuers or underwriters incurred costs in connection with identifying and reporting their own violations, we believe they made a judgment that participation in the Initiative was more cost effective than risking the potentially higher penalties which could be imposed in an enforcement action conducted outside of the MCDC Initiative.

With respect to penalties, the Division has taken a tailored approach which recognizes differences in the nature of the violator, the number of violations, and the relative size of underwriters. Thus, with respect to issuers, the settlement terms offered under the MCDC program include no penalty, fine, or other monetary relief. For underwriters, the Division developed a standardized approach to penalties which is based on the number of violations and

the size of each fraudulent offering. In addition, the Division further calibrated the approach by providing for a cap on the total penalty to be assessed. The cap, which will be applied regardless of the number of violations committed, is based on the overall annual revenue of the underwriter and ranges from $100,000 (for the smallest underwriters) to $500,000 (for the largest underwriters). This approach, which calibrates the penalty based on the degree of misconduct and the respondent's relative size and ability to pay, is consistent with the approach to penalties in all Commission enforcement actions.

○