



SEC ENFORCEMENT UPDATE

SEC Announces Record Number of Enforcement Actions for Fiscal Year 2011

With significant publicity, the U.S. Securities and Exchange Commission announced several weeks ago that it had filed the most enforcement actions in a single year in SEC history. For the fiscal year ending September 30, 2011, the SEC stated it filed a record 735 enforcement actions, with more than \$2.8 billion in penalties and disgorgement ordered.¹ The SEC partially credited this performance to the Enforcement Division's "strengthened" capacity resulting from significant recent reforms – reforms such as flattening the Enforcement management structure, revamping processes for handling tips and complaints, a formal program to encourage and reward cooperation, and national specialized units in five priority areas. What really lurks behind these numbers, however, and do they really signal a more robust Enforcement program? Although only time will tell, these statistics might signal less of an upward trend than first meets the eye.

Financial-Crisis Related Cases. Although the SEC used this announcement to highlight its recent enforcement activity relating to financial crisis-related cases and insider trading, those cases actually were not the driving force behind the increased numbers. Take the financial crisis-related cases for example. The SEC touted its performance in this arena, noting that in this last fiscal year, the SEC filed 15 separate actions naming 17 individuals, including 16 CEOs, CFOs and other senior corporate officers. Over the last two and a half years, the SEC has now filed 36 separate enforcement actions related to the financial crises, against 81 defendants, resulting in approximately \$1.97 billion in disgorgement, penalties, and other monetary relief. The SEC, understandably, wanted to highlight these cases to demonstrate action and results. But analyzing these cases only as a subset of the overall financial fraud/issuer disclosure category – which is presumably how the SEC classifies the financial crisis-related cases – is misleading. In FY 2011, the SEC filed 89 financial fraud/issuer disclosure enforcement actions, a 29% decrease from the 126 actions filed the year before. Even factoring in the 20 Foreign Corrupt Practices Act enforcement actions filed this past year – which the SEC did not track separately prior to FY 2011 – the SEC still experienced a 13.5% decrease in financial fraud/issuer disclosure enforcement actions.

This decrease could be attributable to a few factors, such as a decrease in staffing caused by the restructuring. When the SEC reorganized and created specialized units, many enforcement lawyers were selected to join these units to primarily investigate cases related to their unit. Surprisingly, the SEC did not create a financial fraud/issuer disclosure unit despite the high number of enforcement actions in years past. As a result, the financial

¹ Press Release 2011-234, SEC Enforcement Division Produces Record Results in Safeguarding Investors and Markets (Nov. 9, 2011), at <http://www.sec.gov/news/press/2011/2011-234.htm>.

fraud/issuer disclosure cases were left to the “generalists.” Given that these cases are generally time intensive and require multiple attorneys, an outflow of attorneys to these specialized units could have had a significant impact in this category. Moreover, the SEC likely had a heightened focus on financial crisis-related matters, resulting in a large number of investigations. This decrease in numbers may be a telling sign that many of those investigations did not result in enforcement actions. If this is the case, there will likely be a resurgence in financial fraud/issuer disclosure cases as the remaining financial crisis-related investigations work their way through the system.

Insider Trading. The SEC touted that, with 57 actions, it had filed more insider trading enforcement actions than in the previous year. But the difference is immaterial – merely 4 actions more than the insider trading cases the SEC filed in FY 2010. Moreover, that increase is largely attributable to the 18 actions arising out of a single matter, the investigation of hedge fund manager Raj Rajaratnam, the founder of Galleon Management, who was recently convicted of multiple counts of insider trading.

Offering Frauds. In other categories, the SEC filed fewer cases. Indeed, the SEC also experienced a significant decrease in its offering fraud cases, experiencing a decline from 144 to 124 actions, a 13.9% decrease. This category typically includes “Ponzi” scheme cases, a high-priority area.

Broker-Dealers and Investment Advisers. So where then has the SEC stepped-up enforcement? Enforcement actions against broker dealers and investment advisers both increased significantly. The SEC reported a total of 146 enforcement actions related to investment advisers and investment companies – a single-year record and a 30% increase over FY 2010. Moreover, the SEC brought 112 enforcement actions related to broker-dealers – a 60% increase over last year. This increase may be attributable to the aggressiveness of the Asset Management Unit and the enhanced referral process between the Office of Compliance Inspections and Examination and the Enforcement Division. In any event, the SEC has stepped-up enforcement in these two categories, and investment advisers and broker-dealers should expect this continued, increased scrutiny from the SEC.

Will the trend toward more enforcement actions continue? As stated above, only time will tell. Although the SEC has more staff and has undergone significant improvements in its Enforcement process, other factors – such as budget cuts and a greater willingness of some courts to reject settlements in SEC matters – might present countervailing pressures limiting the SEC’s ability to bring as many enforcement actions as it might prefer.

If you have any questions regarding this update, please contact the Sidley lawyer with whom you usually work.

The SEC Enforcement Practice of Sidley Austin LLP

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