

I N F O C U S

CORPORATE LITIGATION WEBSERIES

Securities Enforcement Trends: SEC and DOJ Respond to the Crisis

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What Regulators are Confronting:

- Global Credit Crisis
- Subprime Lending
- Madoff (\$50B) and Stanford International (\$8B)
- Resulting Effect:
 - Public and political pressure
 - Respond to complex set of circumstances
 - Market Forces vs. Fraud

Who are the New Regulators?

- Securities and Exchange Commission (SEC)
 - Mary Schapiro, SEC Chairman
 - Former Chairman and CEO at NASD/FINRA (12 yrs)
 - Former CFTC Chair (2 yrs)
 - Former SEC Commissioner (6 yrs)
 - Rob Khuzami, Director of Enforcement
 - Former General Counsel for the Americas for Deutsche Bank AG
 - Assistant U.S. Attorney in Southern District of New York

Who are the New Chief Prosecutors?

- Southern District of New York (SDNY)
 - Preet Bharara – front runner for U.S. Attorney for the SDNY
 - Sen. Charles Schumer’s Chief counsel on the Senate Judiciary Committee
 - Former Assistant U.S. Attorney in the Southern District of New York
- Eastern District of New York (EDNY)

Task Force on Economic Crimes

- “Economic Crisis Financial Crimes Task Force”
 - Promoted by Senate Democrats
 - “Coherence and coordination”
 - Pros – More organization; higher profile; greater resources
 - Cons – Unlike Enron; more bureaucracy

Subprime Investigations

- SEC task force formed in March 2007
- 25-50 on-going investigations
- Focus on three categories:
 - Sub-prime lenders (improper accounting, disclosures, and insider trading)
 - Players involved in securitizing sub-prime obligations
 - Investment banks (write-downs, disclosures)
 - credit rating agencies
 - Banks and broker dealers involved in selling sub-prime investments to the public (suitability, undisclosed compensation)

Subprime Litigation

- Nine cases announced so far, including:
 - Bear Stearns portfolio managers – mortgage-backed securities disclosures
 - Tzolov/Butler – rogue brokers/auction rate securities
 - L.A. brokers – sub-prime refinancings and unsuitable/fraudulent recommendations
- SEC’s Deputy Director just announced that 3-4 new sub-prime cases are “coming”
 - Allegations of mortgage lenders manipulating the market, misleading investors regarding valuations, and in one instance insider trading

PONZI Schemes

- Madoff
- Stanford
- Other recent SEC cases – “tidal wave” of emergency actions in February 2009
- SEC interest includes roles of independent advisers and intermediaries – due diligence, especially regarding custody arrangements, identity of auditor
- Impact of ongoing SEC Inspector General investigation into Madoff tip and lack of follow-up

Foreign Corrupt Practices Act (FCPA)

- Record Growth in FCPA Cases
 - 15 cases in YE 9/30/08
 - 38 cases since 2006 (more than total from 1977 to 2005)
- Senior SEC enforcement officials promise that FCPA will be a centerpiece of the SEC enforcement efforts

Siemens AG

- Largest FCPA case in history
- SEC filed complaint in 12/2008
 - Charged that Siemens, German company listed on NYSE, had paid \$1.4B in bribes over a six-year period to government officials around the world to win business
- Siemens agreed to pay \$1.6B
 - SEC: \$350M in disgorgement
 - DOJ: \$450M
 - \$854M for German investigative expenses
 - Independent monitor for 4 years

FCPA – Other Recent Cases

- Halliburton/KBR: 2/11/09 (largest for US company)
 - \$579M to SEC/DOJ (\$177M disgorgement, \$402M fines)
 - Stanley faces possible 7 yrs in prison and \$10.8M fine; Tesler and Chodan indicted for FCPA violations
- Fiat: 12/22/08 – Subsidiary's kickbacks; Italian issuer traded on NYSE
 - SEC: \$7M disgorgement + pre-judgment interest and \$3.6M civil penalty; DOJ: \$7M

Insider Trading – Useful tool for Regulators

- Economic downturn may cause an increase in insider trading cases
- Allows Government to prosecute insiders who sell stock while perpetrating an overly complex fraud
- SEC focuses on preferential redemptions and account holdings confirmations
- SEC likely to continue to test pleading limit

Markopolos Effect – The Use of Whistleblowers

- SEC

- Seeks to improve its ability to process and pursue tips and referrals
- Office of Compliance Inspections and Examinations (OCIE)

- FINRA

- New Office of the Whistleblower
 - Expedite the review of high-risk tips conducted by FINRA senior staff

Hedge Fund Regulation

- SEC Examinations: 2008
 - 1,500 conducted
 - 68% deficiency letter; 41% referred to Enforcement; 31% no action
 - 38-42% significant findings
 - Common Deficiencies:
 - Disclosures and filings
 - Compliance Rule
 - Personal Trading
 - Advertising and Marketing

Hedge Fund Regulation ... con't

- SEC Initiatives: 2009
 - Greater hedge fund regulation
 - New Rules of the Game
 - Insider trading
 - SEC Rumors and Market Manipulation Group
 - Transparency
 - Hedge Fund Working Group
 - Rule 206(4)-8
 - Portfolio performance, valuation, liquidity assessments, counterparty information

Hedge Fund Regulation ... con't

- SEC Initiatives: 2009
 - Valuation process for complex vehicles
 - A liquidity process to monitor stress test
 - Valuation Committee
 - Redemptions
 - Selective redemptions while freezing others
 - Advisers favoring own interest
 - Redemptions based on inside information
 - Executive compensation disclosure
 - Improved communications regarding compensation and goals
 - Communication of policies to discourage excessive risks
 - Forensic Testing

Hedge Funds in a Post-Madoff Era

- Investors

- Drilldown due diligence
- Prime brokers, administrators, brokers, auditors

- Hedge Fund

- Complete review of policies and procedures
- Fee Structure
- Transparency

Parallel Investigations – The Players

- Securities and Exchange Commission
- Department of Justice
- Commodity Futures Trading Commission
- FINRA
- State Attorneys General

Parallel Investigations – How it worked in the past

- Many large government cases brought through parallel efforts in the past
 - Comverse backdating case
 - Computer Associates Accounting Fraud
 - Sonja Anticevic (Reebok) insider trading
- Impediments to a free flow of information
 - Legal issues: U.S. v. Stringer, 535 F.3d 929 (9th Cir. 2008)
 - Practical problems of sharing information between agencies

Parallel Investigations – Into the Future

- More Markopolos Effect = More cases referred to US Attorneys' offices
- New type of enforcement regulator for complex cases
 - Industry experts/consultants
 - Speed

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