Testimony Concerning Investigating and Prosecuting Fraud after the Fraud Enforcement and Recovery Act

by

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I. Introduction

Chairman Leahy, Ranking Member Sessions, Senator Kaufman, and Members of the Committee, thank you for the opportunity to testify today on behalf of the Securities and Exchange Commission (SEC). I am pleased to be here to testify before you alongside my colleagues from the U.S. Department of Justice (DOJ) and the Federal Bureau of Investigation (FBI).

When I first testified before the Committee in December of last year, we were emerging from an economic crisis that threatened our financial system and tested the public's confidence in the institutions charged with enforcing the laws governing the financial system. That December 2009 hearing was titled "Mortgage Fraud, Securities Fraud and the Financial Meltdown: Prosecuting Those Responsible." Although there is much more work to be done, during the nine months since I last testified, we have achieved significant results in our efforts to enforce the securities laws, particularly in areas relating to the recent financial crisis.

In the last nine months, we brought enforcement actions against companies and individuals that:

- Concealed from investors the risks and exposures from subprime mortgage-based securities;
- Concealed business strategies that heightened the risks relating to mortgage-based securities;
- Failed to disclose to investors the involvement of adverse parties in structuring complex mortgage-based securities;
- Concealed that investment funds contained high-risk mortgage-based securities; and
- Marketed high-risk mortgage-based securities while secretly divesting themselves of their own holdings.

We obtained hundreds of millions of dollars in penalties; the disgorgement of additional hundreds of millions of dollars in unlawful profits; barred wrongdoers from engaging in improper business practices in the future; required companies to institute internal controls to prevent future harm from such practices; and required other remedies that send a strong deterrent message. We accomplished these results while implementing the most significant reorganization of the Division of Enforcement in decades.

We also are embracing a range of initiatives designed to increase our ability to identify hidden or emerging threats to the markets, and to stop that misconduct early in order to minimize harm to investors and to the public's confidence in our markets.

Across our Division, whether in the Regional Offices or in Washington, we are launching risk-based investigative initiatives, tapping into the expertise of our colleagues in the Office of Compliance, Inspections and Examinations ("OCIE") and other SEC offices and divisions, hiring talent with particularized market expertise, and reaching out to academia, law enforcement, and the regulated community to collect data on where misconduct is occurring and ideas on how to prevent it. In short, we are being smarter and more strategic, and as a result more successful.

One example of this approach is our new national specialized units, which were staffed and fully launched in May 2010. These units have focused on the key areas of Structured and New Products, Market Abuse, Municipal Securities and Public Pensions, Asset Management, and violations of the Foreign Corrupt Practices Act. The Units are hiring industry experts to work directly with our teams of experienced attorneys and accountants to ensure that we stay on the cutting edge of industry trends. And, we have been using these units as a platform to enhance training for our investigative staff. By refining our expertise in financial market structural issues, suspicious trading techniques, novel and complex structured products, indicators of suspicious hedge fund performance, and other investigative initiatives, we are enhancing our already strong knowledge base for the benefit of investors.

In addition to the work of the specialized units, our completion of other organizational reforms – such as streamlining our management structure and obtaining delegated authority from the Commission to allow us to swiftly obtain formal orders and related subpoena power – has enabled our staff of attorneys and accountants to focus on what they do best: investigating and stopping securities fraud. Our staff has responded

to these challenging times by concentrating on making smart investigative decisions, obtaining key evidence, tracing investor funds and aggressively pursuing wrongdoers.

To augment our staff's efforts, we continue to build on our already strong working relationships with our law enforcement partners, particularly the Department of Justice and the FBI, as well as the banking regulators, other federal and state agencies, and our other partners around the world. In particular, our work as co-chairs of the Securities and Commodities Fraud Working Group of the Financial Fraud Enforcement Task Force facilitates effective communication with our law enforcement partners nationwide engaged in parallel investigations alongside of our own.

In addition, we are rapidly integrating the new authority and responsibility granted to us under the Dodd-Frank Wall Street Recovery and Reform Act of 2010 ("Dodd-Frank Act"). When I last testified in front of you in December, I discussed what were then our "legislative initiatives": to obtain congressional authority to institute a whistleblower program, to obtain nationwide service of process, to obtain the ability to seek civil penalties in cease-and-desist proceedings, to obtain the ability to seek penalties against aiders and abettors under the Investment Advisers Act of 1940, and the ability to charge aiding and abetting violations under the Securities Act of 1933 and the Investment Company Act of 1940, among other initiatives. The Dodd-Frank Act included many of those legislative initiatives, for which we are very grateful, and we must now demonstrate our ability to deliver on those requests.

As I will describe in more detail, as provided by the Dodd-Frank Act, we are in the process of establishing a Whistleblower Office within our new Office of Market Intelligence. In the last nine months, the Office of Market Intelligence has successfully

launched a system dedicated to triaging and assigning all tips, complaints, and referrals ("TCRs") received by the Division so that the right staff with the right skills and experience opens the right investigation in a timely and effective way. Information received through our new Whistleblower Program will enhance the ability of that Office to provide staff with a broader set of relevant evidence at the initial stages of an investigation.

I would like to use today's testimony to give you a more textured picture of the significant cases that we have filed since I last testified before you; the extent of our coordination with law enforcement partners; the impact of our internal management streamlining and investigative process reforms; the new fraud-detection and risk-based initiatives instituted by our staff throughout the Division, including within the national specialized units; and our efforts to incorporate the new authority and responsibilities given to us under the Dodd-Frank Act.

II. Recent Significant Cases

At the same time that we that we undertook the largest reorganization of the Division in recent history, we maintained a high level of enforcement activity. Although our efforts are ongoing, so far in fiscal year 2010, the Enforcement Division has:

- Filed 634 enforcement actions;
- Obtained orders requiring disgorgement of $1.53 billion in ill-gotten gains;
- Obtained orders requiring payment of penalties of $968 million;

- Obtained 45 emergency temporary restraining orders to halt ongoing misconduct and prevent imminent investor harm;
- Obtained 56 asset freezes to preserve funds for the benefit of investors; and
- Distributed to injured investors nearly $2.0 billion from 42 separate Fair Funds.

Statistics alone, however, cannot capture the breadth and complexity of the high-impact cases that we have filed in connection with the financial crisis. We have filed cases alleging accounting and disclosure violations by subprime lenders; fraud by companies and individuals involved in the bundling and marketing of mortgage-based securities; conflicts of interest by a collateral manager who managed multiple collateralized debt obligations ("CDOs"); misrepresentation of complex mortgage-based securities as appropriate for retail investors seeking safe financial products; fraud in connection with synthetic CDO marketing materials; and misleading disclosures to fund investors concerning fund exposure to subprime investments. .In particular, since I last testified in December, we have filed the following actions involving mortgage-related securities and mortgage-related products linked to the financial crisis:

- On April 15, we filed charges against Goldman Sachs & Co. and one of its employees, Fabrice Tourre, alleging fraud in connection with the marketing of a synthetic CDO, in which Goldman represented that the portfolio of securities underlying the CDO had been selected by a neutral, objective third party when, in reality, a hedge fund investor at whose request the CDO had been structured and

whose interests were directly adverse to CDO investors, heavily influenced the portfolio selection. The Goldman marketing materials failed to disclose the hedge fund's role in the transaction, its adverse economic interests, or its role in the portfolio selection. On July 20, 2010, the court entered a consent judgment in which Goldman agreed to pay $550 million to settle the Commission's charges. Of the $550 million paid by Goldman in the settlement, $250 million was returned to harmed investors through a Fair Fund distribution and $300 million was paid to the U.S. Treasury. As part of the settlement, Goldman expressly acknowledged that its marketing materials for the subprime product contained incomplete information, and agreed to tighten internal controls and assess the roles and responsibilities of Goldman personnel to ensure that disclosures in future offerings of mortgage-based securities are full and accurate. The SEC's litigation continues against Goldman employee Fabrice Tourre.

- On June 21, 2010, we charged investment adviser ICP Asset Management LLC and its founder, owner and, president, Thomas Priore, alleging conflicts of interest and fraud related to its simultaneous management of multiple CDOs, managed accounts, and an affiliated hedge fund as they came under pricing and liquidity pressures in 2007. Our case also alleges that ICP and Priore caused the CDOs to make numerous prohibited investments without obtaining necessary approvals, which were later misrepresented to the trustee of the CDOs and to investors. We allege that the prices of many of these investments were intentionally inflated to allow ICP to collect millions of dollars in advisory fees from the CDOs, and that

ICP and Priore executed undisclosed cash transfers from a hedge fund they managed in order to allow another ICP client to meet the margin calls of one of its creditors. Our litigation against ICP and Priore is ongoing.

- On June 16, 2010, we charged Lee B. Farkas, the former chairman of what was once the nation's largest non-depository mortgage lender Taylor, Bean & Whitaker ("TBW"), alleging that he orchestrated a large-scale securities fraud scheme and then attempting to defraud the U.S. Treasury's Troubled Asset Relief Program ("TARP") to cover up the scheme. Our Complaint alleges that Farkas, through TBW, sold more than $1.5 billion worth of fabricated or impaired mortgage loans and securities to Colonial Bank. Those loans and securities were falsely reported to the investing public as high-quality, liquid assets. We allege that Farkas also was responsible for a bogus equity investment that caused Colonial Bank to misrepresent that it had satisfied a prerequisite to qualify for TARP funds. Fortunately, the Treasury Department never awarded Colonial Bank any TARP funds. This case was the product of extensive cooperation with DOJ, FBI, SIGTARP, and other law enforcement partners within the Financial Fraud Enforcement Task Force. Our case is proceeding, and DOJ is pursuing a parallel criminal action against Farkas.

- On July 29, 2010, we filed an action alleging that Citigroup made misleading statements in earnings calls and public filings between July and November 2007 about the extent of its holdings of assets backed by subprime mortgages. We

alleged that throughout this period, Citigroup represented that the subprime exposure of its investment banking unit was $13 billion or less, when in fact, at all times during that period, the bank's subprime exposure was over $50 billion. To settle the action, Citigroup agreed to pay a $75 million penalty, which the proposed settlement would distribute to harmed investors. The SEC also instituted administrative proceedings against two former Citigroup executives, including the company's former Chief Financial Officer, for their roles in causing Citigroup to make certain of the misleading statements. To settle the administrative proceedings, the executives each were required to make monetary payments to the U.S. Treasury. The proposed settlement with Citigroup remains subject to final court approval.

- On September 2, 2010, we filed settled charges against a credit rating agency, LACE Financial Corp., for alleged misstatements in connection with its application to become registered with the Commission as a Nationally Recognized Statistical Rating Organizations ("NRSRO"). We alleged that LACE materially misstated the amount of revenue it received from its largest customer during 2007. This alleged misstatement was significant because LACE had applied for an exemption to a conflict of interest provision that otherwise would have been triggered by the amount of revenue it received from that customer. In addition, SEC charged LACE's founder and majority owner for his alleged role in LACE's conduct, as well as for his alleged participation in determining a credit rating for an entity whose stock he owned, and for failing to disclose in LACE's

registration application that it performed an extra layer of review on the credit ratings of issuers whose securities made up the pools for asset-backed securities managed by LACE's largest customer.

- On April 7, 2010, we announced administrative proceedings against Morgan Keegan & Co, Morgan Asset Management, and two employees, including a portfolio manager, accused of fraudulently overstating the value of securities backed by subprime mortgages. Our action alleges that Morgan Keegan failed to employ reasonable procedures to internally price the portfolio securities in five funds managed by Morgan Asset, and consequently did not calculate accurate "net asset values" ("NAVs") for the funds. We allege that Morgan Keegan recklessly published these inaccurate daily NAVs, and sold shares to investors based on the inflated prices.

- On February 4, 2010, we filed a settled action charging Boston-based State Street Bank and Trust Company with misleading investors about their exposure to subprime investments while selectively disclosing more complete information only to certain favored investors during the 2007 subprime mortgage crisis. To settle our action, State Street agreed to pay over $300 million into a Fair Fund for the benefit of injured investors.

- On August 31, 2010, we cautioned Moody's Investor Services and other NRSROs (more commonly known as credit rating agencies), through a Report of

Investigation under Section 21(a) of the Securities Exchange Act of 1934. This Report arose from the investigation of Moody's Investor Service's European credit rating committee's conduct in connection with an error in their ratings of certain constant proportion debt obligation ("CPDO") notes during the financial meltdown. As a result of significant uncertainty regarding a jurisdictional nexus to the United States in this matter, the Commission declined to pursue a fraud enforcement action against Moody's. The Commission's Report, however, warned that the conduct of Moody's European credit rating committee was contrary to the methodologies described in Moody's NRSRO application submitted to, and later approved by, the Commission. The Report cautioned Moody's and other NRSROs that deceptive conduct in connection with the issuance of credit ratings may violate the antifraud provisions of the federal securities laws and that under the new provisions of the Dodd-Frank Act they are required to establish, maintain, and enforce effective internal controls over their procedures and methodologies for determining credit ratings.

In addition to these significant cases arising out of the financial crisis, we have continued to bring cases in many other important areas including:

- ***Insider Trading***. On August 20, 2010, we obtained an emergency court order freezing the assets in the U.S. brokerage accounts of two Spanish nationals charged with insider trading in call options of Potash Corp. just prior to an August 17, 2010 public announcement by Potash that it had received and

rejected an unsolicited proposal from BHP Billiton Plc to acquire Potash's stock for $130 per share. As a result of the rapid response of our staff, we were able to file our emergency action successfully within 48 hours after the suspicious trading.

- On September 1, 2010, we filed charges against James W. Self, Jr., an Executive Director of Business Development at a pharmaceutical company located in New Jersey, and Stephen R. Goldfield, a former hedge fund manager, for engaging in unlawful insider trading in advance of the April 23, 2007 announcement that AstraZeneca would acquire MedImmune, Inc. (MEDI). The Commission's complaint alleged that Self tipped Goldfield, a friend and former business school classmate, with material nonpublic information regarding the MEDI acquisition and that Goldfield unlawfully purchased 17,000 MEDI call options and 255,000 shares of MEDI stock while in possession of the material nonpublic information provided to him by Self. Goldfield realized actual profits of approximately $14 million from his alleged unlawful trading. Self and Goldfeld agreed to settled the case by paying penalties and disgorgement, respectively.

- On March 25, 2010, we charged Igor Poteroba, an investment banker at a global financial institution, Aleksey Koval, a securities industry professional, and Alexander Vorobiev, a third person with whom they were acquainted, in connection with an alleged scheme to misappropriate confidential information

about at least eleven impending acquisitions, tender offers or other business transactions. We allege that in advance of each transaction, Poteroba tipped his co-schemers with material nonpublic information about the transactions using coded email messages that, among other things, referred to the securities as "frequent flier miles" or "potatoes."

- In addition, in the Galleon and Cutillo insider trading cases, we charged more than a dozen hedge fund managers, lawyers, and investment professionals in two overlapping serial insider trading rings that collectively constituted one of the largest insider trading cases in Commission history. In the parallel criminal prosecutions, eleven individuals have already pled guilty and nine additional individuals have been indicted.

- ***Offering Fraud.*** On September 2, 2010, we charged Sandra Venetis, a New Jersey-based investment adviser, and three of her firms with operating a multi-million dollar offering fraud involving the sale of phony promissory notes to investors, many of whom were retired or unsophisticated in investments. We alleged that Sandra Venetis falsely told investors that the promissory notes were guaranteed by the Federal Deposit Insurance Corporation and would earn interest of approximately 6 to 11 percent per year that would be tax-free due to a loophole in the tax code. She also told investors that she would use their money to fund loans to doctors that would be backed by Medicare reimbursement payments to those doctors. Instead of making investments, we

alleged that Venetis looted investor funds to pay business debts and personal expenses. To settle the charges, Venetis and the entities agreed to consent to a court order freezing their assets and requiring monetary payments, including financial penalties. Venetis also agreed to an SEC administrative action barring her from future association with any investment adviser or broker-dealer. The U.S. Attorney's Office for the District of New Jersey has filed a parallel criminal action in this matter.

- In June 2010, we obtained an emergency asset freeze against two Canadian nationals we charged with fraudulently touting penny stocks through, among other venues, social media websites such as Facebook and Twitter. The method of communication – using social media websites and text messages – was a twist on traditional fraudulent conduct and is an illustration of our responsiveness to developing trends.

- ***Municipal Securities Fraud.*** On August 18, 2010, we charged the State of New Jersey with violations of the securities laws in connection with its offer and sale of over $26 billion in municipal bonds from August 2001 through April 2007. We alleged that, in 79 municipal bond offerings, the State misrepresented and failed to disclose material information regarding its under-funding of the State's two largest pension plans, the Teachers' Pension and Annuity Fund ("TPAF") and the Public Employees' Retirement System ("PERS"). More specifically, we alleged that the State did not adequately

disclose that it was under funding TPAF and PERS, the reason it was under-funding TPAF and PERS, or the potential effects of the under-funding.

- ***Pension Fund Fraud***. On April 15, 2010, in a pension fund pay-to-play case, we filed an action against a private investment firm, Quadrangle Group LLC, and one of its affiliated entities, charging them with participating in a widespread kickback scheme to obtain investments from New York's largest pension fund. To settle the charges, Quadrangle agreed to pay a $5 million penalty and consented to a permanent injunction barring it against future violations of the Securities Act of 1933. This investigation was coordinated with the Office of the New York State Attorney General.

- ***Accounting and Financial Fraud.*** In the area of accounting and financial fraud, auditor Ernst & Young LLP consented to make a payment of $8.5 million – one of the largest payments ever by an accounting firm – to settle charges that it facilitated a fraudulent scheme carried out by its audit client, Bally Total Fitness Holding Corporation. In addition, six current and former partners were held accountable for their conduct in the audit of Bally, including abdicating their responsibility to function as gatekeepers while their audit client engaged in fraudulent accounting.

- ***FCPA Violations.*** On April 1, 2010, we filed charges against Daimler AG alleging that Daimler paid at least $56 million in bribes in order to obtain and

retain business in numerous foreign countries over a period of more than 10 years. The payments involved more than 200 transactions in at least 22 countries. Daimler earned $1.9 billion in revenue and at least $90 million in illegal profits through these tainted sales transactions, which involved at least 6,300 commercial vehicles and 500 passenger cars. We alleged that Daimler also paid kickbacks to Iraqi ministries in connection with direct and indirect sales of motor vehicles and spare parts under the United Nations Oil for Food Program. To settle the SEC's charges, Daimler AG agreed to pay $91.4 million in disgorgement and retain an independent consultant for a three year period to review its FCPA compliance. To settle a separate criminal proceeding brought by DOJ, Daimler AG agreed to pay a separate $93.6 million fine.

- On March 18, 2010, we charged Innospec, Inc. with paying millions of dollars in bribes to Iraqi and Indonesian officials in exchange for contracts under the UN Oil for Food program. On August 5, we followed up with charges against the two Innospec executives, alleging that they were responsible for the payment of the company's bribes. To settle the SEC's charges, Innospec agreed to pay $11.2 million in disgorgement and retain an independent consultant for a three year period to review its FCPA compliance. To settle a separate criminal proceeding brought by DOJ, Innospec agreed to pay $14.1 million in fines. In addition, as part of a global settlement, Innospec agreed to pay $12.7 million to settle charges brought by the U.K.'s Serious Fraud

Office. This case was the first global settlement between the SEC, the DOJ, and the U.K. Serious Fraud Office in an FCPA matter.

III. Cooperation and Coordination with Other Authorities

While we have actively pursued our own enforcement actions this past year, the Division also has continued to build on its historically close and cooperative working relationship with criminal and other regulatory authorities, including the DOJ, the FBI, self-regulatory organizations, foreign regulators, state securities regulators, the Commodity Futures Trading Commission (CFTC), IRS, the U.S. Postal Inspection Service, SIGTARP, and banking regulators. The nature and extent of the cooperation and coordination varies as appropriate from case to case and can include referrals, information sharing, simultaneous actions, SEC staff details, or other assistance on criminal cases. Just last week we entered into an agreement with the Federal Trade Commission, which will provide us access to certain data that will be extremely helpful source of investigatory information.

As noted in the case discussion above, we have brought several recent significant actions in conjunction with parallel criminal proceedings. We are continuing to work with DOJ on a number of active investigations. We also recently entered into an MOU with the FBI under which an FBI agent will be embedded within our Office of Market Intelligence. This initiative is another example of effective coordination to combat financial fraud. We are confident that our ongoing cooperative efforts will continue to heighten our shared law enforcement mission.

IV. Internal Process Reform and Management Streamlining

Turning to our internal efforts, as part of the now completed reorganization of the Enforcement Division, we have established five new national specialized units, the Office of Market Intelligence dedicated to the handling of tips, complaints and referrals, and the Office of the Managing Executive dedicated to reforming administrative processes and eliminating unnecessary administrative hurdles faced by our investigative staff. We also completed our management restructuring and investigative process streamlining, introduced new cooperation tools, and launched new training initiatives.

A. Office of Market Intelligence

Each year, the SEC receives an enormous number of tips, complaints and referrals ("TCRs") from a countless array of sources. The challenge is to identify from this unstructured mass of information, which includes anonymous submissions that may contain little specificity, those items that involve actual fraud and wrongdoing. To more effectively handle this critical task, we established the Office of Market Intelligence and staffed it with market surveillance specialists, accountants, attorneys and other support personnel. As noted above, we also recently added to the Office an embedded FBI Special Agent under a Memorandum of Understanding with the FBI.

As part of an agency-wide effort, the Office has updated policies and procedures to handle TCRs and, in April 2010, implemented an interim repository to serve as a central system for collecting all TCRs while new systems are being developed. The Office is also a key partner in developing a centralized information technology system for tracking, analyzing, and reporting on the handling of TCRs, which we expect to deploy in the coming months. The mission of the Office is to ensure that we collect all TCRs in

one place, combine that data with other public and confidential information on the persons or entities identified in the TCRs, and then dedicate investigative resources to those TCRs presenting the greatest threat of investor harm. Significantly, the Office of Market Intelligence also will serve a strategic function, harvesting the TCR databases to identify newly-emerging techniques and trends in securities fraud. This strategic function is critical to the Enforcement Division's top priority of being more nimble and proactive, thus permitting us to identify misconduct as early as possible in the life-cycle of a fraudulent scheme.

B. Office of the Managing Executive

Essential to the Division's success is a strong "back office" function with the expertise to handle important support areas such as IT, workflow, management processes, data collection and analysis, HR and other administrative responsibilities. For that reason, last year we launched an Office of the Managing Executive. This Office is leading the Division's efforts to create and collect data, including a "dashboard" of quantitative and qualitative metrics, and to incorporate this data into our regular review process with each member of the Enforcement Division, including its most senior officers.

The Office also is focused on initiatives to improve our electronic document management capacity, in order to provide greater capacity and functionality in loading, storing and searching the massive amounts of data we receive in the course of our enforcement investigations. Other initiatives including improved case tracking capabilities, enhanced closing processes for terminated or completed investigations (FY 2010 case closings are projected to increase 32 percent over FY 2009), and facilitating

ongoing hiring, including critically-needed paraprofessional hiring. In addition, the Office manages the Division's Digital Forensics Program. The Digital Forensics team is creating a new Digital Forensics Lab with added staff and improved technical capabilities to allow for more efficient forensic examination of software and hardware evidence, with advanced cell phone, smart phone and email processing capabilities.

C. Management Restructuring

Since I last testified in December, we have completed our restructuring process and now have achieved a flatter, more streamlined organizational structure that eliminated an entire layer of management. We reallocated a number of staff who were first level managers – some of our most experienced and dedicated attorneys – to the mission-critical work of conducting front-line investigations. Across the Division, we now have achieved staff-to-manager ratios that reduce unnecessary process and bureaucracy, while at the same time preserving the substantive consultation and collaboration that ensures timely case-building, quality control, effective investigative execution, and staff growth and development.

D. Investigative Process Streamlining

In addition, we have streamlined a number of our investigative processes and procedures. This streamlining includes permitting senior officers to approve the issuance of subpoenas for documents and testimony on a case-by-case basis without obtaining advance formal authorization from the Commission. The Commission's delegation of formal order authority to senior officers has increased our ability to act more swiftly in initiating investigations and uncovering evidence of wrongdoing. For example, in 2010

to date, we have opened 487 formal investigations through our delegated formal order authority, allowing us to investigate wrongdoing on a more timely basis and use subpoena authority where necessary to defeat dilatory tactics or address recalcitrant witnesses. In addition, we eliminated unnecessary internal approval processes for routine settlement negotiations, Wells notifications, and informal investigation openings, and we have shortened and simplified the administrative steps required before an Action Memo recommending an enforcement action is provided to the Commission.

E. Cooperation Tools

We also have developed formal agreements, similar to those used by criminal law enforcement authorities, to secure the cooperation of persons who are on the "inside" or otherwise aware of organizations or associations engaged in fraudulent activity. These agreements, the most important of which is our "cooperation agreement," require that cooperators provide truthful evidence and testimony concerning the organizers, leaders, and managers of wrongful activity in exchange for a potential reduction in sanctions. Cooperation agreements have the capacity to secure the availability of witnesses and information for the Division earlier in investigations so that our cases can be developed in a more timely and effective manner. This program has been operational for much of the last year and we are confident that it will allow us to build stronger cases than otherwise would be possible.

F. Training Initiatives

We are implementing a number of other initiatives designed to improve our processes and overall effectiveness. We have enhanced our training programs, and have

created a formal training unit to ensure that our staff is armed with the knowledge and expertise necessary to confront today's complex market and products.

V. New Initiatives to Identify Securities Fraud

While the Enforcement staff is dedicated to bringing programmatically significant cases, we are particularly focused on developing new initiatives to quickly spot emerging trends and risks. For example, in late 2009 and early 2010, Office of Compliance Inspections and Examinations ("OCIE") staff conducted a series of examinations of registered investment advisers to identify possible conflicts of interest at certain types of collateral pool managers working with various classes of structured products. The examinations focused on trading practices, disclosures, transactions between clients, and valuation practices. In advance of and during these exams, OCIE staff and Enforcement staff received specialized training in structured products from industry experts. Working closely with the Examination staff, the Enforcement staff is analyzing information and data learned through this initiative and will evaluate whether any investigations should result.

A key initiative of the Market Abuse Unit is the development and enhancement of the Commission's electronic Bluesheet System and the full integration of its capabilities into our investigative process. "Bluesheets" are the mechanism by which clearing firms report to the SEC and self-regulatory organizations individual trades in securities that they clear. Historically, the Division has not had the capacity to systematically search its bluesheet database on an aggregate basis to identify relationships between suspicious trading.

Using pattern and relational trading analysis across large volumes of bluesheet trading data involving multiple securities, the Market Abuse Unit is using offensive strategies for identifying possible relationships among traders who may be acting in a coordinated fashion – such as trading networks or rings of individuals who may be serially trading in concert or coordinating manipulative activity across various securities. This trader-oriented approach looks at traders across a wide range of equity and options securities and, through automated analysis, identifies securities common to those traders. By identifying traders who are common to multiple securities involved in market-moving events, we can isolate relationships indicative of the misuse of material non-public information.

In addition, the Market Abuse Unit is in the process of establishing the Division's Analysis and Detection Center that will be staffed by attorneys and specialists trained in conducting Automated Bluesheet Analysis. The purpose of the Analysis and Detection Center is to assist staff attorneys conducting investigations into complex trading schemes by analyzing trading strategies across all types of securities, identifying potentially abusive trading practices.

Our Asset Management Unit, focused on mutual funds, private funds, and investment advisers, has developed several initiatives targeting disclosure, performance and valuation by funds and their advisers. For example, the Unit has launched a Bond Fund Initiative that focuses on disclosure and valuation issues in mutual fund bond portfolios. Based on practices identified in an examination of a significant bond fund complex, the Unit has collaborated with other Divisions and Offices within the SEC to develop risk analytics that identify red flags for further investigation, such as

misrepresentations of leverage, outlier performance, and problematic valuations. In conjunction with the SEC's examination staff, the Unit also has developed a Problem Adviser Initiative – a risk-based approach to detecting problem investment advisers through on-going due diligence reviews of advisers' representations to investors related to their education, experience, and past performance. The Asset Management Unit also has established a Mutual Fund Fee Initiative to develop analytics, along with other SEC Divisions, for inquiries into the extent to which mutual fund advisers charge retail investors excessive fees. These analytics are expected to result in examinations and investigations of investment advisers and their boards of directors concerning duties under the Investment Company Act.

Our Municipal Securities and Public Pensions Unit conducts investigations across a highly diverse market of approximately 50,000 state and local municipal securities issuers, as well as the $2 trillion public pension arena. Despite the size and complexity of this market, it is thinly regulated. Municipal securities are exempt from the registration requirements of the federal securities laws; they are, however, subject to the antifraud provisions of the federal securities laws. Under the Dodd-Frank Act's new provisions, municipal advisers are now subject to registration with the Commission. The Unit is actively involved in the Commission's efforts to develop new rules governing municipal advisers under authority granted by the Act. In addition, under a recent Memorandum of Understanding with the IRS, Unit staff participate in quarterly meetings with the IRS's tax-exempt bond group to facilitate cooperation and discussion of emerging trends.

Our Structured and New Products Unit is actively engaged in a number of initiatives to immerse Unit staff in various complex securities products. In addition to

mortgage and other asset-backed securities and related structured products, the Unit initiatives include a review of products such as reverse convertible notes, auto-callable notes, principal protected notes, and total return swaps. With respect to each securities product, Unit staff is engaged in a detailed assessment of the history of the product, various iterations of the product, institutions that market and/or sell the product, the nature of the investors in the product, and the product's potential risks to those investors. In addition, to build relationships with other regulators, the Unit formed a Coordination Working Group, which has helped to establish contacts with numerous Federal, state, and foreign regulators. The Unit also formed an Outreach Working Group, which is helping to establish contacts with market participants, including investors, industry groups, broker-dealers, rating agencies and audit firms.

Finally, our FCPA Unit is working closely with our law enforcement partners to pursue programmatically significant cases involving bribery and corruption by U.S. companies and corporate executives in their international operations. In addition, given that our FCPA investigations often are conducted in parallel with criminal investigations, the Unit is engaged in various outreach efforts with the criminal authorities. For example, the FCPA Unit recently conducted a multi-day FCPA training "boot camp" for our law enforcement colleagues, including DOJ and the FBI, to assimilate knowledge and identify best practices for investigations that often span the globe.

We believe that these Unit-based initiatives, among others, will expand our knowledge base and technical capacity to pursue cutting-edge investigations in the coming year and beyond.

VI. New Tools under the Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Act has increased our arsenal in several significant ways. We anticipate that a number of investor protection provisions in the Investor Protection and Securities Reform Act of 2010, contained within Title IX of the Act, will improve our ability to protect investors and deter wrongdoing by enhancing the Division's powers and effectiveness.

A. Whistleblower Program

Our Office of the Market Intelligence is taking a leading role in the development and implementation of our new Whistleblower Program. The whistleblower provisions of the Dodd-Frank Act enable us to provide substantial rewards to persons providing original information leading to certain successful securities enforcement actions. We expect our Whistleblower Program to generate significant tips from individuals with direct knowledge of serious securities law violations.

The Division currently is in the process of drafting the proposed rules applicable to the Whistleblower Program, including rules setting forth the procedures for whistleblowers to submit original information to the Commission and for the Commission to make awards to whistleblowers. We also have begun the process of staffing the Commission's Whistleblower Office. As we create the Program and the Office, we will be mindful of competing interests, including: (i) a desire to encourage whistleblowers to provide the Commission with high-quality tips regarding potential violations of the federal securities laws, and (ii) a need to avoid creating undue burdens

on the Commission and the constituencies that we protect and regulate that could result from groundless whistleblower submissions.

B. New Investor Protection Measures

Other investor protection measures established by the Dodd-Frank Act that we are in the process of utilizing include the following:

- ***Establishing nationwide service of process.*** The Act makes nationwide service of process available in SEC civil actions filed in federal court and provides a number of significant benefits, including requiring live witnesses to appear at trial. Nationwide service of process also will result in a significant savings in travel costs and staff time through the elimination of duplicative depositions.
- ***Secondary actors.*** The Act expanded and clarified the Commission's authority to enforce securities law violations by secondary actors, including providing the Commission with the ability to charge aiding and abetting violations under the Securities Act of 1933 and the Investment Company Act of 1940.
- ***Remedies.*** The Dodd–Frank Act also expanded and clarified the Commission's remedies, including the ability to seek civil penalties in cease-and-desist proceedings, the ability to seek penalties against aiders and abettors under the Investment Advisers Act of 1940, and the ability to impose collateral bars. For example, when we obtain a bar against a broker-dealer who misappropriates customer funds, the Commission now has to power to bar that individual simultaneously from engaging in similar conduct in another part of the securities industry, such as acting as an investment adviser.

- ***Coordination with Other Authorities.*** The new legislation includes a provision to enhance the ability of the SEC to share certain privileged information with other regulatory authorities by providing that sharing such information does not waive applicable privileges.

Also we are hopeful that the Act's provisions regarding the regulation of over the counter derivatives and the registration of hedge fund advisers, among others, will improve the Division of Enforcement's access to information about trades through uniform audit trails, greater transparency, and recordkeeping and reporting requirements.

VII. Conclusion

The Division of Enforcement's mission to protect investors and enhance the integrity of the financial markets through vigorous enforcement of the federal securities laws is critical. Although I have described for you some of our recent achievements and reforms, we are continuously assessing our progress and the way that we use our resources to best protect investors and the integrity of our financial markets. While the Dodd-Frank Act certainly will help address some of the practical challenges that we face in policing the securities markets, we recognize that there is more work to be done. One thing that has not changed since I last testified is my firm belief that the Division's extremely talented staff is the key to our ongoing success. With the dedicated professionals that I work with every day in the Division, and alongside my colleagues at the DOJ, the FBI, and other law enforcement authorities, I know that we will successfully

fulfill our shared mission of protecting the public against financial fraud and enhancing the integrity of our financial markets.

I thank you for the opportunity to appear before you today. I would be pleased to answer your questions.