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SEC's Role in Enforcing the Federal Securities Laws

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In a recent speech at the Securities Enforcement Forum, SEC Commissioner Luis Aguilar called for, among other things, increased enforcement activity against individuals, with more frequent use of Officer and Director bars, monitoring of recidivists through post-enforcement monitoring mechanisms such as access to phone and bank records and income tax returns, and passage of the SEC Penalties Act, which would allow the SEC to impose significantly harsher monetary penalties on individuals and institutions. We certainly understand the desire to rethink the SEC's enforcement priorities, particularly in light of recent criticism of the agency. But we are concerned that this speech reflects an unwarranted blurring of the line that should separate the role of criminal prosecutors from that of the SEC.

The SEC is an independent regulatory agency whose mission has long been understood to be protecting investors and fashioning appropriate remedial action in the public interest — through deterrence of future wrongdoing and improvement of business conduct. When violations of the federal securities laws reflect willful conduct warranting punishment for wrongdoers, prosecutors should — and do — play the central role in seeking criminal prosecution. The SEC, by contrast, is not charged with enforcing criminal laws and its enforcement attorneys are not prosecutors.

Notwithstanding those fundamental and widely recognized differences, the Commissioner's recent speech is replete with references and citations to criminal law, and the focus of the speech was not on remediation but rather on punishment. One illustration is his repeated references to Officer and Director bars as "sanctions." They are not sanctions; they are remedial measures. They are an evolution of the SEC's historical authority to impose securities industry bars in its role as regulator of broker/dealers, investment advisers and investment companies. The concept of the industry bar has always been that a person who engages in certain conduct should not, as a regulatory matter, be permitted to continue to associate with regulated firms and in such capacity deal with investors or advisory clients. Likewise, since obtaining the Officer and Director bar

power, the SEC has used it judiciously. The SEC has generally invoked this remedy only in cases in which it has concluded that investor protection warrants keeping people who have committed certain acts from serving in positions of responsibility in public companies, where they could repeat their misconduct. Although such a measure may feel punitive to the person receiving it, punishment has generally not been the animating idea behind the use of this remedy.

Similarly, the speech seemed aimed at promoting what we believe is a misunderstanding of the SEC's role in recovering investor losses. Both the plaintiff's securities bar, which brings class action lawsuits seeking financial recovery for injured shareholders, and federal prosecutors, who can seek restitution, are the most appropriate players to seek to make victims whole — and both possess tools devised for that purpose. The SEC was not historically tasked with that function, and its enforcement tools were thus not designed to empower the agency to recover investor losses *per se*.

Historically, the SEC has sought the equitable remedy of disgorgement to prevent wrongdoers from keeping ill-gotten gains. Even when the SEC's civil penalty authority was enacted, the statute did not tie the calculation of penalty amounts to investor losses, but rather to the wrongdoer's gains. That orientation was not changed by the creation of a "Fair Funds" mechanism in Sarbanes-Oxley, which simply established a new way to distribute disgorged funds and civil penalties, rather than depositing the money in the U.S. Treasury. There is a fundamental distinction between giving the SEC added flexibility in disposing of money collected in its regulatory function and altering the agency's mission to include pursuing recoveries for the benefit of private parties. Redefining the SEC's mission in that way would distort the enforcement function, and would make it challenging for Enforcement to adhere to the standard that for decades it generally lived up to extremely well — being "tough but fair."

The call for post-enforcement monitoring of recidivists would, if adopted, also take the SEC far afield from its proper domain. As a threshold matter, as the Commissioner recognized, the steps suggested raise significant privacy concerns. More fundamentally, those steps are properly imposed only on people who have committed crimes — and the Department of Justice and the courts already have mechanisms at their disposal to monitor convicted felons when appropriate.

To be sure, the SEC continues to face intense pressure and scrutiny from both the public and members of Congress to "get tough" with violators of the securities laws. We understand that. But in weighing these recommendations, we would remind all those who are concerned about the effectiveness of the SEC's enforcement program that there are many ways for the SEC to be viewed as a "tough cop" on the financial beat while also respecting its different role from federal prosecutors. For example, the SEC can, and should, be an innovative force by imposing

comprehensive remedies in cases of serious violations and incentivizing firms to ensure that their employees comply with the law through robust compliance policies, internal controls and rigorous training programs

The reality is that Chairman Schapiro and Enforcement Director Khuzami have brought an imaginative and energized approach to the enforcement program, and have been responsible for a steady flow of significant cases. Critics under-value the deterrent effect created simply when the SEC brings a case. Indeed, magnifying the SEC's ability to "punish" may not ultimately serve the SEC's goals. Seeking to impose harsher penalties inevitably results in more cases proceeding to trial, causing the SEC to expend additional resources and confront sometimes significant litigation risk on matters that could otherwise have been favorably resolved. The SEC needs to have the wisdom and courage to stand by its regulatory mission.