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News Release

"Enforcement Initiatives of the SEC: 1989"

Remarks of

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of the
Federal Bar Association

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The views expressed herein are those of Commissioner Schapiro and do not necessarily represent those of the Commission, other Commissioners or the staff.

I. Introduction

I'm very pleased to be here, for a number of reasons. First, since becoming a member of the Commission this past December, I have had the opportunity to work closely with many members of the Committee who "moonlight" at the SEC, and the experience has been a very positive one for me. The professionalism and expertise of the SEC staff is undoubtedly one of the principal reasons for the high esteem in which the agency is held, and is also one of the chief reasons I have so enjoyed my tenure thus far. Second, I have to say that the SEC is very fortunate in having an active bar association looking over its shoulder every once in a while. Although the securities bar and the SEC may find themselves on opposite sides of the fence at times, the dialogue between the bar and the Commission can be an invaluable tool to the Commission in terms of helping it define its goals and in some situations redefine its policies. So I thank you for the opportunity to be with you today.

When Steve Weiss invited me to speak this afternoon, he left the choice of topic to my discretion, so you might think the choice of selection would be an easy one. It actually left me in a bit of a quandary however, because of the wealth of subjects to choose from. We are quickly approaching the second anniversary of the October 19, 1987 market crash, so it would not be inappropriate to talk about market reforms that have been implemented since that time. Or one could talk about the six pieces of legislation we have proposed

that are currently pending on the Hill or recent Commission rulemaking proposals dealing with multijurisdictional offerings, or soft dollars, or arbitration, or penny stock fraud or new products such as index participations or stock baskets. These are all areas in which the Commission has been at work of late. After thinking about each of these things, I decided to focus my remarks this afternoon on two legislative proposals dealing with the Commission's enforcement authority. One of these proposals, the "International Securities Enforcement Cooperation Act of 1989," is scheduled to be marked up today by the Senate Banking Committee, and was favorably reported out of the House Committee on Energy and Commerce last week. It may go to the House floor as early as next week.

Before speaking on these proposals, however, I want to take a minute to comment on a suggestion made to me several weeks ago to the effect that the Commission has lacked focus and direction in the past several months, as the status of individual Commissioners became increasingly uncertain. In my opinion these uncertainties had no direct impact on the Commission's agenda. To the contrary, I think the Commission has tackled numerous complex policy issues in the last nine months, and has not faltered at all in its pursuit of securities law violators of every variety. As to the latter, I think the agency has been appropriately aggressive -- and has had great successes -- in its efforts, for example, to

curb the fraudulent practices of some penny stock promoters, and of course, most notably, in our handling of the Drexel investigation. From my viewpoint, I would have to say that the Commission has been a very activist one in the last nine months, despite the uncertain political climate. And I expect our activism to continue under the leadership of Richard Breeden.

The two legislative proposals about which I'm going to speak this afternoon are the "International Securities Enforcement Cooperation Act of 1989," and the "Securities Law Enforcement Remedies Act of 1989." Both proposals would significantly expand the enforcement capabilities of the SEC, and are an excellent indication I think, of the direction the Commission would like its enforcement initiatives to head as we go into the 1990s.

The International Securities Enforcement Cooperation Act of 1989 (I will call it the "International Enforcement Act" for the sake of brevity) is really the culmination of a decade's worth of initiatives on the part of the SEC -- initiatives aimed at bringing to justice securities violators who manipulate U.S. markets or defraud U.S. investors, but do business in the United States via foreign banks or foreign broker-dealers.

As I'm sure you're aware, the trend we have witnessed in the 1980s toward internationalization of the world's capital markets has carried with it an increasing incidence of

international securities fraud. As you no doubt know, it's become very popular among a certain group of securities professionals to do business via Swiss bank accounts or Cayman Island brokers. The problem this has created for the Commission has been an information gathering, evidence collection one -- namely, how is the Commission to obtain evidence relevant to violations of U.S. securities laws when the evidence we seek is located outside the United States? In the early 1980s the Commission addressed this problem in a unilateral manner, principally by seeking the production of evidence from abroad in civil actions brought in U.S. courts. This process was successful at times, but at other times not, and it became clear fairly quickly that we needed a new approach. The approach we eventually settled on, starting in 1982, involves negotiating bilateral memoranda of understanding, or MOUs, with foreign regulators.

The purpose of an MOU is to facilitate the exchange of information between securities regulators of different nations. This is an oversimplification, but briefly, an MOU works by allowing the Commission to make a direct request to a foreign regulatory authority for their cooperation and assistance in locating and obtaining evidence outside the territory of the United States. An MOU allows the Commission to avoid the problems of foreign secrecy and blocking statutes, and permits us to obtain the information we need without risk of causing an international incident. The

importance of MOUs to the Commission's enforcement program cannot be highlighted enough. Where an MOU does not exist between the SEC and a country whose cooperation we need, there can be inordinate delay, not to mention frustration, in our attempts to track down the evidence we need to bring a case or in fact, determine if a case exists. Fortunately, at the present time we have entered into approximately half a dozen agreements of this type -- including agreements with several nations having substantial capital markets of their own - and it appears that the approach has taken hold. Tomorrow, the membership of the International Organization of Securities Commissions ("IOSCO"), currently meeting in Venice, will consider an SEC sponsored resolution providing that signatories thereto will undertake to establish MOUs providing for the fullest possible assistance in securities matters.

The Commission has become more expert over the years at crafting MOUs to meet the particular needs of the agency. The earliest MOU, while precedent-setting in its nature, simply required the signatories to use their "best efforts" to obtain the information requested, and was limited in scope to alleged insider trading violations. The most recent MOUs we have signed take a significant step forward by providing that the signatories will, in appropriate cases, seek subpoena authority to obtain the information requested. In the case of the SEC, this necessitated a request to Congress

for new legislation, which would enable us to use Commission subpoena power to conduct investigations on behalf of foreign regulators, where the foreign regulator alleges activities that would constitute a violation of its own home country's securities laws. This authority was granted to us last year (in November 1988) as part of the "Insider Trading and Securities Fraud Enforcement Act of 1988."

Briefly, the legislation authorizes the Commission to proceed via a formal order of investigation just as it would if it were dealing with a violation of U.S. law. Accordingly, Commission staff retains control of the investigation in the U.S., and witnesses are accorded the same protections and remedies as they are granted in Commission initiated proceedings. Further, the Commission, in exercising its discretion regarding whether to provide the assistance requested, must consider whether the requesting authority has agreed to provide the Commission with reciprocal assistance. The Commission may turn down a request solely on the basis that reciprocity has not been provided.

The International Enforcement Act is intended to build upon, and help implement, this broader investigative authority given to the Commission last year. It has five principal provisions:

First, in response to concerns expressed by foreign regulators regarding the application of U.S. disclosure laws

to information in the Commission's possession, the Commission has requested an exemption from the disclosure provisions of the Freedom of Information Act for confidential documents received from foreign authorities. The legislation would not authorize the Commission to withhold information from Congress, or prevent defendants from obtaining the information through discovery.

Second, the legislation would provide the Commission with explicit rulemaking authority to provide nonpublic documents and other information to foreign and domestic authorities.

Third, the legislation would authorize the Commission to censure, revoke the registration of or impose employment restrictions upon, securities professionals registered in the United States, based upon the findings of a foreign court or foreign securities authority. (This provision of the legislation is a necessary adjunct to the Commission's authority to conduct investigations on behalf of foreign regulators; obviously, our efforts to assist foreign securities regulators in putting an end to illegal activities would be undercut substantially if the violator could continue to do business in the United States.)

Fourth, the legislation would permit the Commission to accept reimbursement from a foreign securities authority for expenses incurred by Commission members and employees in

carrying out investigations, or providing other assistance to the foreign authority. Needless to say, this is not an especially popular provision with foreign regulators.

Fifth, the legislation would authorize the Commission or a self-regulatory organization under its jurisdiction to prohibit a person who has been convicted of any felony from becoming a member of the SRO, or associating with a member, or to place conditions upon its membership or association.

Although the International Enforcement Act has engendered some negative comment1/, on the whole the response thus far from Congress and others has been positive. It looks like several other countries are going to follow our lead in adopting legislation that allows their regulatory authorities to use subpoena power to assist a Commission investigation. It's my understanding that the United Kingdom, France, the Netherlands and Hong Kong are in the process of considering legislation that would give their authorities these powers. In my opinion, the legislation would significantly increase the chances that the SEC would receive favorable reciprocal treatment from a foreign government or regulatory authority, and thus would have a substantial positive impact on our enforcement efforts.

The second piece of legislation I want to address today is the "Securities Law Enforcement Remedies Act of 1989." As

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1/See, e.g., "The SEC and Foreign Policy: The International Securities Enforcement Cooperation Act of 1988," Levine and Callcott, Securities Regulation Law Journal, vol. 17:115.

currently proposed, this legislation would allow the Commission greater latitude in fashioning remedies for securities law violations. One of the principal provisions of the legislation would authorize the Commission in administrative proceedings to impose monetary penalties, or the Commission could seek these penalties in a civil action. The legislation authorizes fines in an administrative proceeding up to $100,000 per violation by a natural person, and up to $500,000 per violation by a non-natural person. A court would have the additional flexibility to require payment of the gross amount illicitly gained.

The other key provision of the legislation would explicitly grant federal courts the authority to prohibit an individual from serving as an officer or director of a reporting company. It would also permit the Commission to impose this same sanction in an administrative proceeding brought pursuant to Section 15(c)(4) of the Exchange Act. The Commission has stated in testimony supporting the legislation that it anticipates employing this particular remedy "only in cases involving repeat violations of the securities laws or involving egregious conduct as a corporate official."2/

2/See Memorandum of the Securities and Exchange Commission in Support of the Securities Law Enforcement Remedies Act of 1989 (Attachment A to the Statement of David S. Ruder, Chairman, SEC, before the Subcommittee on Telecommunications and Finance (July 19, 1989)).

This legislation is currently being considered by Congressman Markey's Subcommittee on Telecommunications and Finance in the House, and by the Senate Banking Committee.

There has been some significant criticism of the proposal in its present form from members of the securities bar and industry professionals. Before addressing these criticisms I'd like to spend a minute discussing why the Commission chose to suggest this legislation to Congress, and why I personally support its enactment.

If you look at the remedies currently available to the Commission in its fight against financial fraud, you would come to the conclusion, I think, that the SEC's enforcement tools are indeed very powerful weapons. I think you could also conclude however that they are somewhat inflexible and perhaps have not kept pace with the evolving nature and scope of financial fraud. At one end of the spectrum the Commission may seek the imposition of an injunction and disgorgement, and if the violation found to have occurred involves insider trading or tipping, then the Commission may seek monetary penalties up to three times the profit gained or the loss avoided. If the defendant is a controlling person of an insider trader or tipper, then the Commission may recover from the control person a maximum of one million dollars or three times the trader's profit or loss. Obviously, these are very significant penalties.

At the other end of the spectrum the Commission has at its disposal those remedies that currently are available in an administrative proceeding. As you know, the Commission may censure or suspend a regulated person or entity, or it may revoke an individual's or firm's registration, or place limitations on its activities. These remedies all have an appropriate place in the Commission's enforcement program, but there are cases in which these remedies do not fit the misconduct.

Two examples come quickly to mind. The first involves those individuals who demonstrate a repeated, flagrant disregard for the securities laws. One, two, even three injunctions are simply not enough when they are not coupled with severe economic sanctions. It does not seem inappropriate to me to demand a monetary penalty from chronic violators of the securities law. To do so does not totally transform the goal of our remedies from remedial to punitive -- instead, it simply recognizes that no sanction can have a remedial effect if it is not harsh enough to persuade the violator that crime doesn't pay.

The second example concerns the Commission's ability to fashion an appropriate remedy when it finds that a broker-dealer has willfully violated the securities laws. As I mentioned a moment ago, the Commission could censure a firm or revoke its registration, but there is not a lot of middle ground for us to work with. A censure may be too weak, and

revocation of a firm's registration may be too harsh -- particularly in view of its effect upon the firm's customers and employees, and public shareholders. I think it is good public policy for the Commission to have a broader range of remedies available to it -- including money penalties -- so that we can avoid unwarranted consequences of imposing a sanction that is inappropriate in view of the violation.

As I alluded to a few moments ago, there have been a number of criticisms of this proposal.3/ Commenters have suggested that there is no limit to how much money the Commission could seek to obtain -- implying, I assume, that the Commission would purposefully allege more violations than were necessary, in order to increase the potential penalty. It has been suggested that the factors the Commission could consider in assessing a fine would give the Commission too much leeway, or alternatively, that defendants would be reluctant to settle cases in which the Commission seeks a penalty, because they could only do so if they admitted committing the violation. It has also been suggested that the Commission is being motivated by a desire to increase its sources of revenue. With regard to the Commission's authority to bar an individual from holding corporate office, there has been comment to the effect that only a

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3/See, e.g., "An Unwarranted Expansion of Authority," Levine and Thompson, Insights (July 1989).

corporation's shareholders, or perhaps a court, should be vested with this kind of authority.

No one should think that the Commission is not aware of the breadth of these new powers we are seeking. For that reason your comments are very instructive, and will no doubt help Congress to focus more clearly on the potential ramifications of the proposal. As I said at the outset of my remarks this afternoon, I personally believe that the more expertise we focus on a particular issue, the greater are our chances of coming up with the most appropriate solution. But, in terms of some of the criticism of this proposal, I would have to say that I think some of it is unfounded. It is true that the Commission will have a certain amount of leeway, or discretion, in determining whether to seek civil penalties or a bar from corporate officer status, but the discretion will not be unchecked. It will always be subject to the oversight provided by judicial review -- so there will be external controls -- and I don't think anyone should discount the internal control that the Commission imposes upon itself. Since joining the Commission this past December, I have seen just how forceful this discipline is, and I have a great deal of confidence in the Commission's ability to make the fine distinctions required by complex cases, and settle upon appropriately meaningful sanctions. That is really the whole point of this piece of legislation -- the Commission's authority will be increased, no doubt,

but the expanded authority should enable us to meet the twin goals of increased deterrence and appropriate sanctions.