NEW SEC ENFORCEMENT REMEDIES

REMARKS OF
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

TWENTIETH ANNUAL SECURITIES REGULATION INSTITUTE

CORONADO, CALIFORNIA

JANUARY 20, 1993

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U.S. Securities and Exchange Commission
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Good morning. I am delighted to be able to participate in this conference.

I'm going to speak today about the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (the "Remedies Act") and some of the cases that the Commission has brought in the last two years pursuant to its new authorities. But before I get into that discussion, I'd like to spend a minute talking about the study on administrative process at the SEC that I've been working on for some time now.

As I suspect almost everyone in this audience knows, more than two years ago the Commission authorized the creation of a Task Force on Administrative Proceedings, which I have chaired. Initially, the Task Force had two purposes: first, to examine the Commission's administrative proceedings, and recommend procedures to make the adjudicatory process more efficient and effective; and second, to recommend changes to the Commission's Rules of Practice to ensure that the Rules reflect actual practices employed in the adjudicatory

process. In October 1990 these objectives were expanded to include writing any rules necessary to implement the Commission's new powers under the Remedies Act.

The expansion of the Task Force's mandate to include a study of the Remedies Act meant that there was a lot more work to be done than originally anticipated, and so our timetable for completion went a little astray. But I am entirely pleased with what we have accomplished, and am thrilled to be able to announce that our work is finally complete. The Task Force Report includes comprehensive revisions to the Commission's Rules of Practice, as well as a careful look back at how efficiently the Commission has handled its adjudicatory workload in the last decade. It sets the stage for adoption of rules governing the issuance of temporary sanctions, including temporary cease-and-desist orders, and the assessment of disgorgement and penalties against regulated entities.

The implementation of Task Force recommendations aimed at improving the timeliness of proceedings should result in dramatic

improvement in the adjudicatory program. The on-going success of the program, however, will depend upon this and future Commissions maintaining a high level of commitment to the endeavor. I wanted to mention the progress we are making in the adjudication program because all of the remedies and new authority in the world are meaningless if the Commission can't bring litigated enforcement proceedings to a conclusion within some reasonable time frame.

As I said, my panel assignment today is to discuss how the Commission is utilizing its new enforcement remedies. I arrived at the SEC - over four years ago now - just when the Commission was in the process of submitting its proposal for expanded enforcement powers to the Congress. So I shared in the reasons, both publically stated and privately held, that prompted the Commission to seek these new powers. I also recall some of the commentary, not all of it positive, that flourished in the period of Congressional consideration. The Commission's goals were no secret at the time: we said that we needed an expanded range of sanctions because we had to deal with a wide range of securities law violations, and because we were

convinced that the optimum level of deterrence could best be achieved by tailoring the remedy to the specific nature of the violation. From experience, we knew that disgorgement of ill-gotten gains did not, by itself, deter recidivists or discourage would-be violators from crimes that offered huge financial returns. We also knew that injunctions, while appropriate in many cases, were not the ideal solution for violators that lacked a high degree of scienter or were unlikely to be in a position to violate the law again. So we asked for, and received from Congress, the authority to apply to federal courts for the payment of civil money penalties, in addition to disgorgement, for any violation of the securities laws; the authority to order disgorgement and impose penalties in certain administrative proceedings; the authority to issue cease-and-desist orders; and an express right to seek in federal court, orders that bar certain individuals from serving as officers or directors of any reporting company.

We expressly asked Congress not to limit our fining authority to cases involving intentional or fraudulent misconduct. At the same

time, however, we advocated the adoption of a "tiered" fining approach, where the degree of scienter, and the extent of the harm, are taken into consideration in determining the amount of the fine. Within these tiers, the Commission has a lot of flexibility. In the least serious cases, maximum fines of $5,000 and $50,000 are available from natural persons and entities, respectively. In cases involving fraud, deceit, manipulation, or a deliberate or reckless disregard of a regulatory requirement, we may seek up to $50,000 against natural persons, and $250,000 against entities. In the most egregious cases, where scienter is coupled with substantial loss to investors, substantial gain to the violator, or a significant risk thereof, we may seek a maximum of $100,000 against natural persons and $500,000 against entities. If we elect to bring the case in federal court, the penalty can go up to the entire amount of the defendant's gross pecuniary gains. The Act instructs the Commission to consider the "public interest" in imposing a penalty, and recites six discretionary factors that the Commission may and does consider.

Now that the Commission has the powers it sought, how is it using them? I won't promise you that my numbers are absolutely correct - unfortunately, I fit into that category of persons who went to law school because of limited mathematical ability - but to date I believe that the Commission has sought civil penalties in approximately seventy cases filed in federal court in circumstances where no insider trading was alleged. That's seventy cases, sometimes involving multiple defendants and always involving serious securities laws violations, that formerly could be dealt with only through injunctions, and possibly where appropriate with follow-up administrative proceedings seeking suspensions from the industry. We have found ourselves in the position of having to waive collection of a substantial amount of penalties due to an inability to pay by many defendants, but in others, notably those involving regulated entities (the Salomon settlement is an example),[1] we have been successful in collecting large penalties for the Treasury in addition to establishing funds for the distribution of illegal profits to those harmed by the defendant's conduct. Interestingly, the Commission has requested

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[1] SEC v. Salomon, Inc. and Salomon Brothers, Inc., C.A. No. 92 Civ. No. 3691 (RPP) (S.D.N.Y., May 20, 1992).

monetary penalties in only six administrative cases, reflecting to some degree our preference for bringing the more serious cases in federal court.

We have instituted approximately seventy-four cease-and-desist actions - excluding sixty-some orders in the GSE case[2] - almost all of which have been settled by consent. Lastly, we have sought and received twenty officer and director bars against persons who, in our opinion, don't deserve any more chances, at least not when it comes to running a public company. It should go without saying that the conduct in these cases has been egregious, and, it should be noted, that it has not necessarily been a precondition for seeking an O&D bar that the defendant was an officer or director when he violated the law.

I'm not sure what conclusions, if any, you can draw from these numbers. I think it's difficult, when you look at statistics covering a relatively short period of time, to make any hard-and-fast conclusions about how effective your program has been, and whether you (as a

[2] In the Matter of the Distribution of Securities Issued by Certain Government Sponsored Enterprises, SEA Rel. Nos. 30192-30251, AP File No. 3-7646 (January 16, 1992).

regulator) are making the right choices about choice of forum, and sanctions, etc. The analysis is also made more complicated by the fact that every case that the staff brings up for Commission consideration is analyzed on the basis of its particular facts and circumstances. With each case, we ask whether we're in the right forum to argue these particular facts? Are the facts so technical that an administrative law judge is better equipped to deal with them? Is the district court's backlog so great that an administrative proceeding is the only alternative? Is the proposed respondent or defendant a recidivist? What combination of administrative remedies is most effective - a cease-and-desist order coupled with a fine? In sum, have we fashioned sufficiently meaningful corrective measures so that, hopefully, future compliance can be achieved? These are the questions that naturally result from a wider, more flexible arsenal of enforcement powers.

Because the Commission engages in this kind of analysis for every case, conclusions are somewhat hard to come by if you are on the outside looking in. For example, the fact that the Commission

decides to bring a case which involves fraud in the administrative forum, rather than in federal court, should not, I think, be interpreted by Commission-watchers as signaling a sea change in Commission policy. Rather, this can most correctly be interpreted as a reflection of the particular facts and circumstances of that case.

Having suggested to you that these are fact intensive inquiries, let me risk a few observations and generalizations about the Commission's actions to date.

The first - and most important, I think - is that the Commission has not strayed from its stated intent at the time of the Act's passage. We said then - and the cases bear this out - that we anticipated choosing the forum of a federal district court to bring cases involving more serious violations. We recognized that injunctions have more consequences for defendants than a cease-and-desist order, and that the collateral consequences typically associated with an injunction would almost always be warranted in cases involving a gross abuse of investor trust. We asked for cease-and-desist authority as a means to

address more technical violations, such as violations of the net capital and stock ownership rules. So it shouldn't come as a surprise that, while some of our cease-and-desist cases involve fraud, the vast majority do not. Instead, we have repeatedly used the cease-and-desist authority to address violations of sections 13 and 16 of the Exchange Act, and Section 5 of the Securities Act. Included among these more technical violations, are cases that we might not have brought at all, prior to the Remedies Act, when our only remedy was to pursue an injunction in federal court.

In my opinion the Commission's assessment of the importance of an injunction, and the distinctions we have made between the administrative and federal court forums based on this assessment, are not likely to change.

Second, if you look at the administrative orders issued to date, you see that a number of cease-and-desist proceedings are linked with the simultaneous settlement of broker-dealer or investment advisor proceedings. In all probability, many of these cases would

formerly have been addressed solely through a regulated-entity proceeding, leaving the Commission no immediate recourse in the event of further, future violations. Now, pursuant to the Remedies Act, the Commission can achieve the twin goals of an appropriate sanction and deterrence without resort to federal court. In the event a cease-and-desist order is violated, the Commission can apply to a federal court to impose civil penalties for each violation of the order. In fact, each day of a continuing failure to comply can be regarded as a separate violation of the order, thus making per diem fines a possibility.

Third, - and this is more by way of a prediction than an observation - I think the Commission will increasingly use its authority to order respondents in an administrative proceeding to take specific steps, determined by the Commission, to effect future compliance with whatever rules have been violated. The Remedies Act gave the Commission authority to order ancillary relief with respect to any security, any issuer, or any other person named in a cease-and-desist proceeding. We may set the terms and conditions of the relief, and a

time frame, which may be permanent, within which the Commission's directive must be carried out. As you know, the Commission gained experience with fashioning ancillary relief some time prior to the Remedies Act (the relief included in the Drexel settlement is the most prominent example that I have participated in), and I think we are comfortable with the analysis that goes into determining what the appropriate relief should be. The Act gives the Commission a great deal of latitude in determining the scope of the relief - in fact, it leaves the issue entirely to our discretion - and because of this, ancillary relief offers the Commission one of its best opportunities to craft a meaningful sanction. We have, for example, used this authority in proceedings against regulated entities to make sure that problems that, in our opinion are endemic to the way a business is being operated, do not recur. When we order a broker-dealer to hire an outside consultant to review its compliance and supervisory policies, for example, and implement the consultant's recommendations within a set time frame, we have achieved a far more significant sanction than simply ordering the violative conduct to stop. In those cases where we direct that a consultant be hired, we also typically require

an affidavit from the respondent attesting to the fact that the consultant's recommendations have in fact been implemented. In effect, we have gone past a generalized commandment to "obey the law," and have required in addition, proof, in the form of an affidavit, that the respondent has done what he or she promised to do.

To date, ancillary relief has most often been used, I believe, to effect remedial measures within regulated entities, and by their associated persons, but there is no reason to think that it won't be used, where appropriate, against other entities and individuals. As many of you know, this past summer the Commission imposed ancillary relief against Caterpillar Corporation, after finding that its management discussion and analysis ("MD&A") provided an inaccurate description of the importance of the operations of one of its subsidiaries.[3] The Commission ordered the corporation to implement and maintain procedures designed to ensure compliance in the future with the appropriate MD& A disclosure requirement, after noting that adequate procedures had not been in place during the period of the

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[3] In the Matter of Caterpillar, Inc., SEA Rel. No. 30532, AP File No. 3-7692 (March 31, 1992).

violation. Our ability to negotiate for this kind of relief in an administrative proceeding will, I think, be increasingly important and meaningful as we continue to use the administrative forum to deal most often with non-fraudulent, more technical violations of the securities laws.

Now, switching topics slightly, I want to say a few words about the manner in which I believe the Commission will propose to bring cases pursuant to its temporary cease-and-desist authority. Under the Remedies Act, the Commission may enter a temporary order requiring any respondent that is, or should be, registered as a regulated entity or associated person to cease-and-desist from a violation or threatened violation if the Commission finds that the violation is likely to result in the conversion of assets, or significant harm to investors or the public interest during the pendency of a proceeding seeking a permanent cease-and-desist order. The Commission envisions using this authority for emergency purposes only, in those cases where previously our only alternative was to seek a temporary restraining order from a federal district court.

The Task Force has proposed rules that deal with the mechanics of handling a Commission staff request for a temporary cease-and-desist order; a summary of these proposals is included in the materials that were distributed today. In drafting the rules, the Task Force tried to strike the right balance between procedures that are necessary to protect the integrity of the process, and those that are necessary to deal with the matter expeditiously. If you practice in front of the Commission, I would urge you, when these rules are noticed for comment, to let us know if you think we have struck the right balance.

Briefly, what we have proposed is that the staff present an application for a TCDO, together with a proposed order to show cause, a signed declaration of facts and memorandum of law, and a proposed order, after or simultaneously with, seeking Commission approval for the institution of proceedings. The Commission could waive filing of any of these documents, however. A hearing would be held unless, as provided by statute, the Commission determines to issue an ex parte order. Hearings would take place before the full

Commission, unless impracticable, and then before a panel of Commissioners, or even a single Commissioner.

I have never been convinced that the Commission needs authority to issue administrative temporary cease-and-desist orders. But as Baruch Spinoza said in 1677, nature abhors a vacuum and so do regulatory agencies. If the power is there, and the rules are written for the exercise of that power, you can count on the issuance of a temporary cease-and-desist order one day. Ex parte orders will probably become a reality too. In order to issue such an order, the Commission must determine that notice and a hearing prior to entry of the order are impracticable or contrary to the public interest. I imagine that the Commission might make this determination if it appeared that persons allegedly engaged in a fraud were in a position to cause substantial harm to investors by, for example, taking advantage of advance notice of a proceeding to sell out their positions in the public market.

In conclusion, let me just say that I hope many of you will take the time to look at - in fact to study - the Task Force Report, and share your comments with me.

Thank you.

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