BROADCAST TRANSCRIPT
Bingham Presents 2011: Enforcement After Dodd-Frank
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Jeffrey Manns: Good evening and welcome to Bingham Presents 2011: Enforcement After Dodd-Frank. We are broadcasting live from Bingham McCutchen LLP in New York and online at www.sechistorical.org, the virtual museum and archive on the history of the financial regulation. My name is Jeffrey Manns. I am the Associate Professor of Law at George Washington University and the moderator for today's program. The program is part of the Bingham Presents series, which is made possible through a partnership between Bingham McCutchen and the SEC Historical Society.

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The Bingham Presents series debuted in 2009 to provide insight into current issues in financial regulation of interest to the legal profession. The previous programs in the series include the New World of Financial Regulation, in 2009; and Harmonization of the Regulation of Investment Advisors and Brokers Dealers last year. All may be found online in the Bingham Presents section on www.sechistorical.org. The SEC Historical Society is grateful for the continuing generous sponsorship of Bingham McCutchen LLP for the series.

That brings us to today's program. We will be looking at enforcement issues after the passage of the Dodd-Frank Act. Joining with me today to discuss the Dodd-Frank's impact on the enforcement of financial legislation is an all-star panel. We have Eric Grossman, the Global Head of Legal Operations of Morgan Stanley on my far left; Susan Merrill, partner with Bingham McCutchen LLP and former Head of Enforcement for FINRA; David Meister, Director of Enforcement at the Commodity Futures Trading Commission; and Robert Khuzami, Director of Enforcement at the U.S. Securities and Exchange Commission.

Our discussion this afternoon will focus on the big picture of enforcement after the Dodd-Frank. How does the SEC and the CFTC deal with the expanded responsibilities and the greater challenges that larger mandate brings? We will look in enforcement funding, derivatives reform, whistleblowers and a broader role of private gatekeepers. Before we begin I have to give the necessary caveat that comes with all presentations which is that all views are the views of the individuals. They do not reflect Bingham McCutchen, the SEC Historical Society, the SEC, the CFTC or anyone else's employers. The SEC Historical Society selected me to be the moderator. Bingham and the Society worked together to bring together this distinguished panel of presenters. So I have said enough. And now is the time to pass the baton on to the folks you came to listen to.

So the first question to focus on today will be directed towards David and Rob. The Dodd-Frank Act has given the SEC/CFTC expanded responsibilities but has the act also given these agencies sufficient enforcement rules to take on these greater challenges? David, if you do the pleasure of starting us off I will greatly appreciate it.

David Meister: Thank you very much, Jeff, and thanks for inviting me. The question is whether or not the Dodd-Frank Act gives the CFTC, for my purposes, sufficient tools to enforce the Dodd-Frank Act in our new authority. And I think the answer to that question is a solid yes. The CFTC has been provided with a new section of the Commodities Exchange Act, Section 6(c)(1), which gives the CFTC new anti-manipulation and anti-fraud authority. It is broader authority than we have had in the past. For example, with respect to manipulation cases, we can now go after reckless conduct whereas before we were limited to going after intentional conduct. Our new authority also covers the swaps markets, which were previously beyond our jurisdiction. We also have broader fraud authority under our new statute. Section 6(c)(1) is modeled after Section 10b, which is obviously a broad, catch-all, fraud provision. It allows us to, I would say, be creative in our use of anti-fraud authority. We can cover fraud in the futures markets, the swaps markets and also in the cash commodity markets. The CFTC has already promulgated a rule pursuant to Section 6(c)(1). We modeled our rule off of Rule 10b-5 in the securities world which again is a very broad section. In addition to the new anti-fraud, anti-manipulation authority, we also have new disruptive trading authority under the Dodd-Frank Act. We have a provision that makes it a violation of the Commodities Exchange Act to provide the Commission with materially false information. We will have new swaps dealer and major swap participant business conduct rules, which include anti-fraud authority. So we have a number of new tools and we are pleased with that and we will use these tools in the most efficient way possible to enforce the Dodd-Frank Act.

Jeffrey Manns: Great. Rob?

Robert Khuzami: From our perspective, Dodd-Frank is more like the 25,000-mile service of your car, as opposed to a complete engine overhaul. This is because there are many provisions in the Dodd-Frank Act that are generally unrelated to enforcement – systemic risk regulation; the Consumer Financial Protection Bureau; the Volcker Rule; and supervision of payment, clearing and settlement activities, to name just a few examples. The Act does, of course, include some important investor protection provisions, such as the creation of a new whistleblower program, as well as a number of new or enhanced enforcement tools, like expanded aiding and abetting authority, penalties in administrative proceedings, nationwide service of process and collateral bars, which allow us to bar a registered person not just from one regulated industry but from all industries that we regulate. We pursued these legislative initiatives for a number of years, and we are thankful to have them now. A big impact of Dodd-Frank, from the SEC Enforcement perspective, will be on the great expansion of the number of registrants – hedge funds, private advisors, municipal advisors, nationally-recognized statistical rating organizations, and others who are now going to be registered and subject to inspection by our Office of Compliance, Inspections and Examinations. And that will translate, I suspect, into greater numbers of referrals to the Division of Enforcement, and likely a greater number of enforcement actions.

And that brings me to the issue of funding, which is a continued challenge for the Commission. Increased funding was authorized under Dodd-Frank for the Commission, up to $2.5 billion by 2015, from the current roughly $1.1 billion, but that’s authorization, not appropriation. And, as I quickly learned in Washington, authorization without appropriation doesn't do much for you. We did not obtain independent funding, which was one of the legislative requests that we had pursued as well. So, it will be challenging from a resource point of view to be able to handle the additional responsibilities required of us under Dodd-Frank. It also puts a premium on expertise, which we have greatly enhanced as part of the Division's recent restructuring. We have recruited more staff with specialized expertise and experience. Enforcement now has on staff bond traders and risk managers, former Wall Street structurers, muni bond traders, forensic accountants and a whole slew of industry experts who are part of our specialized units, who participate in testimony and advise and counsel the staff in investigations. Very helpful, but all this new authority is going to put a premium on that kind of expertise as well.

Susan Merrill: Rob, one of the things that you mentioned as one of your new tools is getting to use the administrative proceedings where you can bring civil penalties against anyone, not just registrants. But I noticed that you didn't even use it against registrants, against broker-dealers in settled cases where you could have done it and instead brought federal injunctive actions even in the settled context. And those I am sure you know have enormous collateral consequences for the respondents. And even though waivers are routinely granted, the process can be quite burdensome. And I was wondering why you don't use it more for registrants and whether you will use it more now for non-registrants as Dodd-Frank lets you do?

Robert Khuzami: As a result of Dodd-Frank, we are now able to make a decision as to which form of proceeding to initiate – administrative or civil – without the concern that we cannot get complete relief in any single forum. We are no longer forced into district court in order to be able to obtain a penalty against a non-registered person. We can now make the decision based on what we think is the best forum, and that is based on a variety of considerations – such as some relief is available in the district court; it is not available in administrative proceedings; there are different rules with respect to discovery and deadlines; and other factors. While I cannot give you a hard and fast checklist of when we choose one forum versus another, I can say that we are now better able to make that decision without having to take into account the disparity or relief that is available.

Jeffrey Manns: Thank you, Rob. So let us move on to the next question in trying to look at the issue of benchmarks for success. Assuming that the SEC and CFTC do have the enforcement tools they need, what are going to be the benchmarks for successful enforcement in the wake of the Dodd-Frank Act and so ultimately how will the SEC and CFTC themselves be able to assure the public that they indeed are living up to the mandates? David, would you help us start us off with that?

David Meister: Sure. The way I answer that is to ask, what's our purpose? Our mission is to protect our market participants and investors and to rid the markets of fraud and manipulation and other abuses. And we have about a 175 people in the entire division of enforcement. So we are fairly small, but we cover the entire country. So with that number of people and that mission, the way I measure success is, what is the impact of the cases that we bring? Are we bringing cases that have national impact that will protect the most market participants in a particular case or the most investors in a particular case. Are we bringing cases that deliver a message broadly to influence market behavior. I don't think that you measure our success by the number of cases that we bring in any particular year, although this year we are setting a record in this regard. I think it is broader than that. I think you have to look at how well are we using the 175 people that we have? How strong is the message? How loud is the message?

Jeffrey Manns: Great. Rob, do you have any thoughts on this?

Robert Khuzami: In some sense, benchmarks don't change because of Dodd-Frank. There are a host of new rules that have or will be promulgated, and whether or not the rules achieve their purpose will depend on whether or not you see reduced occurrences of misconduct or manipulation or fraud, whether or not the rules achieve the correct cost-benefit balance, the impact of the rules on competitiveness, and whether the rules create opportunities for regulatory arbitrage between the U.S. markets and overseas markets. There are a lot of ways one can look at that. From Enforcement's perspective, I think the benchmarks are – is there a reduced incidence of fraud and wrongdoing? Is investor confidence in the market returning? Do we see fewer complaints? From our own internal workings, we have adopted in the last couple of years a number of metrics to measure our performance, both quantitatively and qualitatively. How quickly are we moving our cases, for example? Are we brining the right kind of cases? In that vein, we have created specialized units and other pockets of expertise in order to target the priority areas, with the goal of getting ahead of the curve so we are bringing cases earlier and sooner than before they are in the headlines and all the investor money is lost. A lot of these are admittedly soft metrics that may not be directly tied to Dodd-Frank and that can be influenced by a number of factors. But we keep a close eye on what the Division is doing and, hopefully, we are getting it right.

Jeffrey Manns: Great. Thanks, Rob.

Eric Grossman: Can I ask you a question?

Robert Khuzami: Sure.

Eric Grossman: My sense has been that over the years, securities and commodities misconduct has been sort of cyclical. You had a flurry of bad conducts in the early 2000s and then things seem to slow down. We are now two years out from the credit crisis. I know you are bringing lots of cases related to conduct prior to the crisis. What are you seeing now, maybe not post Dodd-Frank but just sort of post-credit crisis and then overlapping the post Dodd-Frank in terms of new misconduct for the lack of a better term?

Robert Khuzami: There are a number of credit crisis-related areas that we are focused on. We are focused on investment advisors and third party managers. Cycles come and go, crises come and go, but third party managers are here to stay and in all likelihood will continue to manage greater and greater amounts of investor funds. In the market abuse area, we are looking at market-based misconduct – not just insider trading, but some of the new market structure issues such as high frequency trading, algorithmic trading and direct market access arrangements, and a number of other exchange-related activities. In the FCPA area, we continue to get a large number of complaints alleging violations of the FCPA, and these make up a significant portion of the whistleblower complaints that we get. Municipal securities is an area that has caused us some concern because that market is not regulated in the same manner as the U.S. public company issuer market. Lots of people have invested in munis and with the strain on state and municipal resources and valuation issues and infrastructure needs that is an area that has concerned us. All of these areas are priorities for us, in part because we are seeing more evidence of misconduct there.

Jeffrey Manns: I had a question now for Eric and Susan. You got a chance to query the CFTC and SEC representatives. I would be curious - what is the industry perspective in terms of benchmarking successful enforcement? I hope that's not a paradoxical question.

Susan Merrill: I think that the numbers don't tell the whole story but they are irresistible. The press picks up on them, the Congress picks up on them, and they don't tell the story. I think what regulators need to do a better job of is setting out their expectations and sharing with the firms what they are learning, not just from the enforcement perspective but from the exam perspective, so that firms can internalize those lessons and hopefully it will result in fewer and fewer enforcement cases. Certainly no one wants to have a giant enforcement case with their name in the headline. But sometimes those message cases that David was talking about are the ones that really do change the game. They change the way things had worked in financial institutions for years and years and it's unfortunate that sometimes it has taken an enforcement investigation to make those changes. But if the SEC and the CFTC could share more of what they are finding along the way with a broader group, I think that might help in making those changes without having to have a giant enforcement case.

Eric Grossman: I would say in terms of effectiveness, I think, you won't really know until you know, so the judgment with respect to how the SEC enforcement division did prior to the credit crisis is informed by what we learned subsequently. Madoff and some of the other cases that have been brought in the wake of it, unfairly, are at least viewed as a report card for how Rob's predecessors did. So that's what I would say on effectiveness. I think that the challenge from our perspective is going to be that most financial services firms now, at least those that were not regulated by the Fed before, operate completely differently. So they are just in terms of the internal transparency with respect to our regulators in the old world. Goldman Sachs, Morgan Stanley, Lehman and others that are not around, Barclay, Bear Stearns, for the most part the relationship was principally with the SEC in terms of regulation. Now we have the Fed with us every single day. I hope you will see a significant decline in the number of cases brought against financial services firms and there will likely not to be as many "got you" moments because we are living with the regulators every day. That will be a good thing I think in terms of the view as to what Dodd-Frank and ultimately the credit crisis lead and hopefully these guys will get some credit for that as well, because I think the cases that they do bring therefore would be more important.

Jeffrey Manns: Well, thank you, Susan and Eric. Building on one of Eric's points, which is under-enforcement in the run-up to the financial crisis, is there an issue of chronic under-enforcement for the SEC and CFTC more generally? In other words, with marginally higher investments, will enforcement allow both agencies to pluck the low lying fruit? And either David or Robert if you would like to field that?

Robert Khuzami: Would additional investments in enforcement result in more cases of ….?

Jeffrey Manns: The analogy would be with the IRS, where many critics have said if the IRS simply had more funding, had more men, they would be easily be able to uncover large-scale tax fraud. Is your perspective that there are similar issues of under-enforcement, where there is fraud lurking on the financial sector and if you had judicial manpower, judicial time and resources, you would be able to uncover that?

Robert Khuzami: I think that's pretty clear. More importantly, not only would you find more fraud, but you would find it sooner, and as a consequence achieve more deterrence. The fact of the matter is the SEC's Enforcement Division is staffed with approximately 1,200 people. There are more than 30,000 broker-dealers, investment advisors, U.S. issuers, transfer agents and others that we are responsible for regulating, and that is in addition to the thousands of hedge funds and municipal advisors that have now come under SEC jurisdiction. Our capacity to effectively investigate that activity obviously is significantly challenged. We have approximately one SEC employee for every ten regulated entities, and that's the SEC overall, not the Enforcement division, whereas the banking regulators operate much more in a one-to-one ratio. Just the pure numbers suggest that there is much more that can be done. But, at the same time, that is not an excuse for not being smart and informed in how you deploy those resources – more expertise, earlier intervention, greater focus on priority areas, etc. We are trying to do more with less by investing in SEC's own infrastructure and operations as well as IT, so that Enforcement personnel can spend much less time on administrative duties and other burdens, and spend more of their time on investigations. I guess the answer is yes, but the obligation is for us to use those resources in a smart way.

Jeffrey Manns: Just on that point. With all of that to do why heavy focus on the FCPA for the SEC? The jurisdiction in the United States where all this potential climate make an impact, U.S. investors, trading activity in the United States. I forget how many bureaus but one of them is the FCPA, it's right up there with everything that's more domestic. I am just curious if you are allocating resources while the Department of Justice has concurrent jurisdiction in the FCPA space. Why the heavy focus?

Robert Khuzami: Because corruption is a significant problem and for many years the U.S. was a bit of a lone voice in this area. We have now seen a greater focus on corruption by regulators outside the United States. Also, these are U.S. issuers whose securities are registered in the U.S. and the activities in some or in many cases are known to the U.S. parent. I am happy to say that we are seeing greater and greater cooperation across the globe in this area and a lot more activity by foreign regulators in working to stop corruption. But it is a significant evil that has a big impact on the costs of goods and services that harms legitimate companies that are playing by the rules and losing business and losing competitive edges to those that break the rules. Congress opted to give the SEC jurisdiction in this area for those reasons and that's the reason why it's a focus of ours.

David Meister: Let me just… we are obviously not in the FCPA space but I think that Rob's last point is the right point and it applies to us as well. When Congress gives the agency certain authority, it expects the agency to enforce that authority and it is our obligation to do it the right way. It is very leveraged, this enforcement world. And I do think that small additional investments in the division of enforcement and in the CFTC at large can go a very long way, which I think is your point, Jeff, and I agree with it. In large part it is also about prioritizing your resources. I agree with Rob, we can always make the next case and we can always ask for more money. But the idea is to use the funds and the resources in the most intelligent way possible, and to set priorities and follow through with them.

Jeffrey Manns: Thank you very much for your comments, David. I was hoping you would announce a job program for law school graduates but allow us to not to wait on that but prioritizing it certainly makes sense. Let us shift gears a little bit. I will ask a question for Eric and Susan. Did the financial crisis expose the limits of traditional transparency and disclosure tools in regulating financial markets? Or is the problem really is too little disclosure of the type of information that market participants and regulators need?

Susan Merrill: I will kick it off. I think some of the financial disclosure cases certainly dealt with the traditional failures to disclose the types of information that prior cases have always dealt with. For example, the size of the losses due to sub-prime exposures. On the other hand, some part of the problem was just simply that senior management and boards of directors were not understanding the types of risks that the companies were taking, and there was nothing in the disclosure rules that would require the kind of detailed analysis that would get that information out to the public. Still to this day, I think there are issues underlying investor confidence in large financial institutions because people are not sure exactly what is being disclosed and what is still lurking out there. On the other hand, I think some of the financial institutions crisis cases have really stretched the traditional disclosure rules to get money back into the hands of some very sophisticated institutional investors who were absolutely playing the sub-prime market for yield. And in those cases I think it's a little less of a good use of resources. Certainly, disclosure cases where thousands of shareholders in public companies have been harmed from the traditional types of disclosure issues - I think those are fair game. But using those disclosure tools and stretching them to protect the big boys in Rule 144A kind of instance, I don't think is the best use of those resources. And in terms of whether it's the right type of disclosure. I think even some of the Supreme Court cases going back to Basic talk about the fact that there is something of an overload of information to people and that's not good either. The trick I think is to take the types of risk that investors need to know about and to try to get those out into the financial statements in a way that analysts can write about them, even if the traditional mom and pop investors don't understand them.

Eric Grossman: I would say is that the danger now in responding to the reality or the perception of a poor disclosure before is over disclosure. If you look at the size of Morgan Stanley's public filings, they have grown exponentially in size and complexity and I don't think anybody has the capacity to really read it and understand them completely. I think that is true of our peer firms and I think that will be true in the context of traded securities going forward as well, so it may be to the point where it becomes just noise. That is the risk to get to really what's important and I think the enforcement cases and frankly the day to day regulation and scrutiny that at least we and other issuers get from the SEC right now. We and every other financial institution get a comment letter every quarter on our public securities filings; it used to be a rotation. The result of that is someone pouring over our financial statements and all of our peers and then we had ten more pages to our Q and 30 more to our K to respond to well intended comments but that don't really get to what might be important from an investor. That then translates across the rest of the issuer community and then we have created a new problem that might be in some respects more troubling than the one that we are trying to solve.

Jeffrey Manns: Thank you Eric and Susan for your comments. So the next question will be focusing on the potential tension between the Dodd-Frank Act's focus on enlightening individual and corporate accountability. Is the greater emphasis on individual accountability going to reduce settlement incentives for companies and as a result consuming increasing amounts of agency resources?

Robert Khuzami: I do not see a tension as between any focus on corporate liability and on individual liability. In our Enforcement division, we focus on both – we are very focused on bringing cases against individuals when we think the circumstances warrant it. I think it is important to hold individuals personally responsible for misconduct, sometimes alone and sometimes in addition to bringing a case against the company. I do not see the tension that you are talking about. If what you are suggesting is that when we have an investigation against both a company and a individual, and we are coming down to settlement discussions, I would say that such a trade-off does not occur; we would never trade individual liability for corporate liability. I consider those decisions to be separate decisions. If we decide to bring an action against a company and the company wants to settle and we think that the settlement offer is sufficient, then we will settle, whether or not the individual also wants to settle the case.

Jeffrey Manns: May I redirect the questions for industry representatives, Eric and Susan, does it change the calculus on your end in terms of looking at the dual responsibility of looking at individuals and for the corporation?

Susan Merrill: Absolutely. Even if a law firm is not representing the individual, certainly the fact that the regulators have, I think it is very clear, a clear new focus on getting a head, getting a scalp in a case has complicated the whole equation. So, for example if the company knows that it's going to have to settle this case but it has a couple of individuals hanging out there, if it is a current employee, it's a nightmare. Even if it is a former employee, all the good work that you have done to negotiate the language that's going to be in the public document settling the case goes out the window, if the individual is sued on the same day in a complaint that lists in very graphic language all of the things that you spent months trying to negotiate out. So it does complicate things. I also think it complicates things for the regulators because there are certain cases certainly where individuals are culpable and they have to bring those cases. But in cases that are really more of an institutional problem, bringing a case against an individual complicates it for the regulators because individuals are nowhere near as ready to settle those cases as corporations are. And then resources that they thought they were going to be able to redeploy on to new cases continue to get spent on that same case. I am not sure how much more deterrence or message they are getting out of that, except for in the cases where it is truly an individual who has done the misconduct that is at issue and not an institutional problem.

Eric Grossman: It often comes down to a different sort of opinion. If the SEC or the CFTC takes a position that an individual has truly engaged in misconduct and the company has a different view of that, that's when it really becomes complicated. Because for the most part, most regulated entities, even if they believe they are right, will settle with their principal regulator and get it behind them. That is not a secret and there are a lot of motivations to do that. One of them is so that the franchise impact of that will be not as significant for the firm if they litigate with their principal regulators as well as other relationship issues. If you throw an individual in there and there is a difference of opinion and it is a current employee, it makes it very difficult. So my hope is that there are few of cases where we have a difference of opinion and in that there is a healthy recognition at the SEC and the CFTC that there are cases, not every case against a company had associated with it. I am not saying that they do recognize this but I think they do in many cases that there is a collective wrong and therefore they settle cases behind them. I think what we are seeing now is more disagreements about whether or not an individual was truly culpable or whether they were just part of a group engaged in a practice condoned and recognized with the business that the regulators now think was problematic in some way and that is where we are going to have. That is where it gets in the way and makes life more complicated for everybody.

Robert Khuzami: As a general matter, individuals commit wrongdoing; corporations don't. So as David said, first and foremost, that is where we start. There are circumstances where the actions of an employee of a corporation suggests a good faith basis for the conclusion that he or she did not engage in wrongdoing, or has a strong litigation defense that you would take into account. Certainly, we have done that; and, of course, we get heavily criticized when we have only a corporate disposition without charges against the individuals. But, to quote Michael Corleone: "This is the life we have chosen."

We are not out to "get a scalp," to quote Susan. We are trying to figure out whether or not the individual has engaged in wrongful behavior. I understand the corporate desire to settle the case and the discomfort that comes from settling the case but having the individuals continue to litigate. But with all due respect, the desire to put the problem behind them and the marketing that goes on with that is not really my primary concern. My primary concern is to do justice and make sure that the corporate resolution is not simply a way of inappropriately buying peace and protecting the individual, particularly as it applies to someone who may be highly ranked within the company, for which the company understandably will do all it can to protect the individual. It is hard to announce broad statements in this area. It all depends on the particulars of the case. But, at the end of the day, regardless of the consequences, pursuing individuals is the most important thing and if it means we are going to chew up more resources by having more trials, so be it. Frankly, my sense is that the more individuals you charge in in appropriate cases, the more deterrent impact it has, and the fewer cases you are going to have because there is no substitute for charging of individuals.

David Meister: Let me just comment on one thing that Susan said. Susan, you spoke about how you negotiated the language in a settlement document. Just so it is clear, at the CFTC, we don't negotiate the language in the factual parts of settlement documents. If we have gotten the facts wrong we are happy to hear from the counsel that we have gotten the facts wrong, so that we can accommodate those comments if we agree. But we don't negotiate that language.

Susan Merrill: So you don't use any adjectives or adverbs in your factual descriptions?

David Meister: We state the facts as we think are accurate and if we haven't gotten the facts correct then we will certainly correct them.

Susan Merrill: The facts are simple; it is always the adjectives and adverbs that are a problem.

Jeffrey Manns: I think we may have hit a thorny area where there is a slight difference of opinion between industry and regulators, surprisingly enough.

Eric Grossman: However, while we are on that topic, just to be clear, from an industry perspective we think cases should be brought against individuals as well. If individuals violate the law, the regulations, we think they ought to punished appropriately first and foremost. I think the disagreement is that we disagree about whether or not they in fact did so.

Jeffrey Manns: Thank you very much, Eric. Let us shift gears and focus on the SEC and CFTC perspective of the funding limits and the uncertainties. So the question I put to Rob would be, are funding limit uncertainties the biggest constraint on the SEC's enforcement abilities?

Robert Khuzami: it is very high on the goal list, if not the highest. If you think about it as a fraction, the numerator is the 3,700 people at the SEC and the denominator is the tens of thousands of regulated entities that we are responsible. Frankly, from an Enforcement perspective, it is not just regulated entities because the anti-fraud rules apply to all persons, not just those that are associated with regulated entities. It is the population in general that is involved in markets or financial products or securities that were responsible for it. Yes, we have a serious funding challenge, made more serious by Dodd-Frank, and we are going to continue to try and obtain additional funding and be as smart as we can with what we have got, because at the same time we owe that to the taxpayer.

Jeffrey Manns: That makes sense. David, you mentioned earlier that you can always use more money for enforcement but is funding as big an issue in the CFTC's perspective/

David Meister: Well, funding is certainly a big issue. Our Commission and our Chairman do everything they can to make sure that we are properly funded and I trust that they will continue that fight as we go forward.

Jeffrey Manns: There again, knowing that the representatives of the SEC and the CFTC may not be able to answer this question, I am curious about the self funding issue. So I will pose that to Eric and Susan. Since the SEC and the CFTC are net contributors to the Treasury, should they be able to keep more of what they kill, shall we say? From an industry perspective would that be beneficial or is it better to have constraints by Congress in terms of their spending?

Susan Merrill: I for one think that self funding should be pursued. There are models for it from other regulators, the Fed is self funded, FINRA is self funded. The new proposed SRO for investment advisors which was debated today on Capitol Hill, the model for that will have to be self funded. The problems with self funding that people worry about I think can be dealt with in some safeguards that can be built into the legislation. Obviously, you don't want to incentivise staff to be increasing fines so that they can get bigger bonuses and bigger salaries. But that is very easily dealt with, you can make sure that the fine money is segregated out, it cannot be budgeted for, it cannot be used for ordinary expenses. I had not seen that to be a problem in the self funded organization in which I worked. I never thought that there were people on the staff who were trying to up the penalties because they thought that FINRA needed more money, I think that is ridiculous. And also most of the funding in the self funded areas come from fees rather than penalties or fines at any rate. So, I do think it is something that could be pursued simply because as we heard today from both Rob and David, there is such a need for more funding. And the number and kind of entities over which Dodd-Frank granted jurisdiction are more complicated entities then the SEC for example has had to deal with before. They are going to need the expertise, not just staff who have just gotten out of law school or undergraduate school. There are people who really do have that expertise and I think self funding should be pursued.

Eric Grossman: I see the pros and cons of that. I don't think that it is ever going to happen, certainly not any time soon. That is just my sense. I think politically it is just going to be a challenge. In Washington right now I think they get a rather different view of that.

Robert Khuzami: Self funding or independent funding has, in my experience - except maybe at some state levels - nothing to do with penalties and fines that are assessed. Self funding or independent funding for the SEC has always been about using registration fees and transaction fees which the SEC currently charges and using that money to fund the SEC. No one has ever suggested that we should be getting a contingency fee based on the amount of penalties and fines that we levy. That, I think, is a bad idea. No one has seriously considered it. Dodd-Frank did make some changes to the SEC budget process. We are now deficit neutral, which means that the transaction fees that we assess for, which are the fees paid by the SROs, are now adjusted and match the appropriations. In addition Dodd-Frank provides that with respect to transaction fees paid by firms that register new securities, some of that money is going to get put in a reserve fund, which caps out at $100 million. Dodd-Frank also provides that our budget goes straight to Congress rather than to the White House, so that Congress can see the SEC's budget requests independent of any changes made by the White House. And two, this reserve fund is designed to deal with emergency situations where you have got to ramp up quickly, like the flash crash for example, when you need to bring on expertise or resources in order to quickly respond. You can use the fund to procure multi-year technology. Investments are one of the big casualties in the year-to-year appropriations processes. You buy a three-year document collection IT system but in a year or two your funding gets cut by 7%. It's the first place you cut because you don't want to cut your people, so you cut that contract that you signed the year before. That has made technology planning very difficult. Dodd-Frank did some good things for us but the independent funding is still something that we are interested in and we have to wait and see what happens.

Jeffrey Manns: Thank you, Rob. So let's have one last question related to funding which is, Rob, I believe you had mentioned earlier that the SEC has been able to continue to get top talent and so they have been able to expand the expertise over time. Part of that maybe because one can move between the private and the public sector rather seamlessly. One concern though maybe the sharper the divide between the public regulator's salary and the private sector, that could indeed ultimately affect restraint in engaging enforcement. Is that a concern that you have?

Robert Khuzami: So the question is, the more money that people make on the outside, the what?

Jeffrey Manns: The more money you can make on the outside, will that make it harder or easier in the future.

Robert Khuzami: There is a fair amount of commentary on the revolving door issue. I think that, on balance, it is a great advantage to the Commission to be able to bring on private sector expertise. Interesting commentary, of course, is: on day one you hear that you need more experts and fewer lawyers, and that you have got to be smarter and be able to understand the products and the transactions in the markets. So you bring people on, and then on day two, you are criticized for a revolving door and that people who come will leave and go back to work for law firms or the like. For me, specialization and expertise are key, and it has been the key initiative of the Enforcement Division in the last couple of years. In addition, the agency created a new Division of Risk, Strategy and Financial Innovation that is staffed with economists and academics who do data analysis and quantitative analysis and market research, and assist with a lot of the rulemaking and enforcement issues. As I said earlier, we have structurers and portfolio managers and folks who used to work at the credit rating agencies and up and down the line, valuation experts, forensic accountants who are assigned to specialized units or other parts of the division who help us. These people are critical to our investigations; they have timely and current knowledge. And so, the benefits far outweigh the cost, because overly restrictive probe missions on the circumstances of leaving the agency would impair that.

A recent GAO report analyzed our ethical restrictions and found that we have the same ethical restrictions that virtually all other agencies have. SEC employees are governed by a multitude of civil and criminal statutes and regulations and, for attorneys, professional conduct rules, in the performance of their duties. There is a criminal statute imposing a permanent ban concerning matters in which a former employee participated; a two year ban concerning matters under the former employee's official responsibility; a one year "cooling off" period for former senior employees; notifications by former employees seeking to represent someone during those periods so that the SEC can check to see whether or not the employee was ever involved in the case; ethical restrictions on client confidentiality by state bar associations; the list goes on and on. And so, there is a great deal of protection around the concern about the revolving door. While I understand, the benefits to the mission and the program and investors overall by bringing this kind of talent in far outweigh the concerns.

Jeffrey Manns: Thank you very much, Rob. Let us shift gears a bit again and talk about derivatives reform, one of the significant parts of the Dodd-Frank Act. The question for David would be, the SEC and the CFTC have joint responsibilities for overseeing the derivatives industry. What are the challenges you envision for coordination between the agencies, both in overseeing the derivatives markets as well as monitoring expanded growth of clearing houses and exchanges?

David Meister: Well, we work in parallel with the SEC's Enforcement Division all the time. Since I have been at the CFTC, and I think well before that, the relationship has been a very good one. We swim in parallel, we swim in our own lanes. We share information quite well. Sometimes we are making cases together and sometimes we are just sharing information. And we obviously share space in the derivatives world now and particularly after Dodd-Frank. I am thinking, for example, of the instrument called mixed swaps in the Dodd-Frank Act. I expect that we will just map on our current good relationship and continue to work the way we have always worked. Right now there are teams of lawyers and professional people from the CFTC and the SEC working together promulgating joint rules pursuant to the Dodd-Frank Act. Those teams meet all the time. I think we are doing a fabulous job and we will continue that effort once the rules are final, to enforce them. I see no issue there.

Jeffrey Manns: Great. Thank you, David. Rob, do you have any comments on that?

Robert Khuzami: There are lots of harmonization efforts going on, lots of coordination and I think that will continue.

Jeffrey Manns: Great.

Eric Grossman: Sometimes, I just say, we hope that is all true in the industry.

David Meister: Let me just add one other point, and I will speak for Rob. Both of us see a need to make efficient use of our resources. I don't want to make a case redundant of their case, and I don't think they want to make a case as redundant of ours. We share that philosophy; that's one of the reasons that this works well.

Susan Merrill: There are going to be issues though. I think when you have something like a credit default swap that is cut up in terms of jurisdiction, depending on whether it is single name or whether it is on a index and you have the same trader or people within the same trading unit, trading both of those products and there is a problem, are you going to coordinate the enforcement investigation or are both agencies going to do the same investigation? How much can you cede turf to the other in a case where Dodd-Frank has really laid out who is responsible for what particular part of this product?

David Meister: I don't think it is a question of ceding turf, I think it is a question of being smart and efficient about how we want to investigate that case. And from our side we will be as smart and as efficient as possible. I understand what you are saying but again I am not interested in being redundant of them and they are not interested in being redundant of us.

Robert Khuzami: There are pooled investigation cases now wherein we have a combination of FX derivatives and securities-based instruments and in those cases if one dominates the other, then one of the agencies or the other typically will take that case. If both are involved, one is clearly in the lead. There will not be any confusion as to whose phone call you have to answer.

Jeffrey Manns: Well, thank you, Rob and David, for your comments about derivatives. One other issue of enforcement is getting information. An innovation under the Dodd-Frank Act was authorized in financial awards to whistleblowers. Are you concerned that whistleblower incentives don't look too well and that the agencies will be inundated with low quality information? Do the agencies have to follow up on all the whistleblower allegations?

Robert Khuzami: That was a concern that was expressed during the rulemaking comment process. This rule evoked a great deal of interest. But we read every comment letter and met every conceivable interest group and spent a great deal of time trying to balance the admittedly legitimate concerns of both the whistleblower bar and the corporate community, particularly as it relates to the issue of whether the rules should require whistleblowers to report internally first before they come to the SEC. On the issue of the quantity, lots of folks expressed that concern, but we have not seen that in practice. The program has been in place since July of last year, although the rules only became effective last month. We have not seen a deluge of whistleblower complaints. As a preliminary matter, the need to handle a high volume of tips and complaints is not new and long pre-dated Dodd-Frank. We receive tens of thousands of tips and complaints every year, which requires skill and expertise to separate the wheat from the chaff. We are now positioned, as a result of our restructuring which created a new Office of Market Intelligence, to analyze information provided to us by the public and turn it into a structured format so that it can be manipulated and analyzed, with much better tracking and auditing procedures. The whistleblower submissions have come – and this maybe as a result of the plaintiff's bar being involved given the financial rewards – accompanied by underlying supporting documents, and the quality has gone up, and I haven't seen the deluge that has been feared.

Jeffrey Manns: Thank you, Rob. I will just shift gears to focus on the industry perspective, we don't have a plaintiff's bar representative here but we can get Eric to proceed, if you would like. And I am curious what you think of the bounty approach?

Robert Khuzami: Eric can play the plaintiff's bar… (Laughter)

Eric Grossman: I do that all the time.

Jeffrey Manns: So the question is this, do you think a bounty approach is better than creating broader private enforcements such as implementing a key time provision?

Eric Grossman: And you addressed me to like pick my poison.

Jeffrey Manns: Pick your poison, it is exactly that.

Eric Grossman: I frankly didn't think that there was anything wrong with the system of fraud in Dodd-Frank. I thought there were significant avenues for internal reporting when we have a hotline. We have an anonymous hotline, we get emails, we get letters both before and after the whistleblower provisions. We responded to anonymous tips and complaints that were made at the SEC and those we are investigating. We got phone calls, I thought that there were more than adequate avenues for people who felt like they knew of a wrongdoing to report that to both the SEC, the CFTC, the Attorney General, the Department of Justice, anybody they wanted. So all I think that has happened on the back of this, that's really meaningful is that the much more tangible attachment of economic reward to the whistle-blowing. I am happy to hear Rob say that the stats don't bear this out, that they have been deluged with complaints. My sense is we have been on the receiving end of some inquiries that were the product of whistle-blowing but I am just guessing, I don't know. I do think that it is unfortunate that even if there are just a handful of cases where people don't come to us but rather go to them first for the money. I think that is a better result for corporate America personally.

Susan Merrill: I think the SEC tried to do what it could to balance that issue that you are talking about in the final rules, by saying that they would take into account whether the person had reported internally. Given what the Dodd-Frank Act told the SEC they had to do, I think they did as good a job as they could on that. I am not going to try to play a plaintiff's lawyer here or on television but I think that private litigation, more private litigation is really not the answer. The social cost of that, of going back to pre-1995's Securities Litigation Reform Act, will be far, far greater than handing out a few million dollars to some whistleblowers. And really the studies have shown that those types of cases are settled by companies, not really on a merits basis, it is mostly on the types of resources that companies have to expend on them. I don't think that it serves the greater good either. So as far as the bounty is concerned I agree with Eric, you have to kind of pick your poison but I think in general the whistleblower's statute and the rules that the SEC has come up with do a pretty good job of balancing those interests.

Jeffrey Manns: Great, thank you Eric and Susan for your comments. Unfortunately our hour has come to a quick close. So we are almost out of time. But I do want to take the time to thank each of our distinguished panelists for coming and talking with us. Susan, Eric, Rob and David, thank you very much for taking part in this discussion of Enforcement after Dodd-Frank. On behalf of the SEC Historical Society, I would like to again thank Bingham McCutchen for being our gracious hosts as well as offering us generous support to make this program possible.

An audio of today's program will soon be available in the virtual museum and archive of the SEC Historical Society and a transcript will be ready soon. Thank you again to our audiences both here in the office of Bingham in New York and online at www.sechistorical.org. Good evening.